Recommendations for Further Accrediting National, Regional and Private Sector Entities (Progress Report)

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I. Introduction

1. This document suggests that the Board considers policy options that could help to streamline the Fund's existing accreditation process, in particular those for regulated financial entities in developing countries.

2. In its recent decision 7/CP.20, paragraph 9, the Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change requests the Board of the Fund to:

> *"… accelerate the operationalization of the private sector facility by aiming to ensure that private sector entities and public entities with relevant experience in working with the private sector are accredited in 2015".*

3. In addition, decision 7/CP.20, paragraph 10, emphasizes the role that non-public entities can play in providing financial resources.

4. The Board mandated the Secretariat, in consultation with the Accreditation Panel (AP), in its decision B.09/07, paragraph (h), to provide recommendations for the fast-tracking of national, regional and private sector entities, in addition to those falling under decision B.08/03, paragraph (k), so as to better meet the objectives of the aforementioned decision by the COP.

5. Following guidance received from the Board, the Secretariat reviewed potential opportunities to complement the Fund's existing accreditation and due diligence procedures. In addition, it identified well-established regulated financial entities as promising partners through which to channel the Fund's resources efficiently to climate-smart public and private investments.

6. Financial entities are subject to the scrutiny of local authorities, rating agencies and, in some instances, the authority of stock exchange listings. Such third-party oversight bodies already verify a significant subset of the fiduciary standards that are required in the Fund's accreditation process. These bodies could, therefore, be considered to conduct due diligence, for example, on the fiduciary competencies of financial entities that seek accreditation.

7. As a first step, the Secretariat suggests a pilot phase in order to streamline the assessment of the fiduciary standards required by the Fund's accreditation process with well-established regulated financial entities that could operate at scale.

II. Previous Board decisions and guidance on accreditation

8. Decision B.07/02 established the Fund's accreditation framework, as well as the fiduciary principles and standards and environmental and social safeguards against which entities, including subnational, national, regional, international, and public and private entities, are assessed.

9. The standards reviewed in the accreditation process include the following:

(a) Initial fiduciary principles and standards, which include:

- (i) Basic fiduciary standards (key administrative and financial capabilities and transparency and accountability);
- (ii) Specialized fiduciary standard for project management;

(iii) Specialized fiduciary standard for grant award and/or funding allocation mechanisms; and

(iv) Specialized fiduciary standard for on-lending and/or blending;

(b) Interim environmental and social safeguards; and

(c) Gender policy.[1]

10. The standards were set as one of several mechanisms allowing the Fund to ensure that its funding is used in a transparent, accountable and effective manner that mitigates the risk of fiduciary mismanagement or inadvertent environmental or social harm.

11. Decision B.07/02, paragraph (k) (ii), requested the Secretariat to elaborate on the elements of a work programme on complementarity and coherence of accreditation systems and processes of other relevant funds, as well as relevant private sector associations.

12. The Fund's accreditation framework states that the Fund would continuously aspire to increase efficiency in the processing of accreditation requests (Annex I of the decision B.08/02, paragraph (c)). The existing procedures aim at reaching a balance between the information required from an entity seeking accreditation and the efficiency of the process, while ensuring that the accreditation process remains robust.

13. Furthermore, decision B.08/03, paragraph (k), requested the Secretariat to identify other entities applying fiduciary and environmental and social principles or standards found to be comparable with the Fund's fiduciary standards and environmental and social standards, and to propose to the Board that the eligibility to apply under the fast-track accreditation process be extended to those entities.

14. Decision B.08/05, paragraphs (c) and (d), invited institutions with a track record of engaging with the private sector, particularly those in areas relevant to the Fund's objectives, to apply for accreditation, and requested the Secretariat, in consultation with the Accreditation Panel, to provide recommendations on their potential accreditation or fast-tracking for decision by the Board.

15. Decision B.09/09, paragraph (c), requested the Secretariat to achieve a diverse balance in accredited private entities, including subnational, national, regional and international intermediaries that have a significant on-the-ground presence in developing countries.

III. Working with financial entities in developing countries to promote public and private investments, including by small and medium-sized enterprises

16. Experience of various countries in development analysis during the last few decades has shown that financial entities are crucial for economic growth in developing countries. In the modern financial system, intermediaries mobilize savings, promote investments and allow risks to be diversified resulting in a more efficient allocation of resources. There is empirical evidence to support the notion that financial intermediaries play a critical role in promoting economic development in developing countries.

17. Generally, financial intermediaries appear to lower the costs involved in researching potential investments, exerting corporate control, managing risk and mobilizing savings. Studies suggest that, by providing these services to the economy, financial intermediaries influence savings and allocation of funding decisions in ways that may alter growth rates in the long run. The economies of countries with 'better' financial intermediaries – those that are better at

[1] Decision B.09/11.

acquiring information, exerting corporate control, managing risk and mobilizing savings – would grow faster than those with less developed financial systems.

18. For example, a study of over 50 countries for three decades found that factors relating to financial sector development might account for up to 1 per cent of economic growth, or up to 20 per cent of the growth difference between the slowest and the fastest growing economies.[2]

19. In addition financial intermediaries are an important partner in providing financial support to small and medium-sized enterprises (SMEs), which play an instrumental, but often under-recognized, role in economic growth. They are a fundamental part of the economic fabric of developing countries and are central drivers in furthering growth, innovation and prosperity.

20. SMEs, however, are strongly restricted in their ability to access the capital that they require in order to grow and expand, with nearly half of the SMEs in developing countries rating access to finance as a major constraint. In a survey of 71 entities, access to and cost of finance ranked amongst the highest constraining features to business.[3]

IV. Potential areas for streamlining and fast-tracking

21. Against this background, the financial sector of developing countries appears to be a promising partner to channel the Fund's resources efficiently to climate-smart public and private investments. The financial sector serves to channel savings, provide credit, and smoothen out cyclical cash flows. In so doing, it enables the local public and private sector to invest in productive capital assets and infrastructure.

22. Regulated financial entities can be either public or private. The Fund may want to consider actively engaging these types of regulated entities in the fight against climate change within a context of sustainable development.

23. The Fund could envisage expanding the scope of entities eligible for fast-tracking by recognizing the competencies and legitimacy of national and regional financial sector regulators and global credit rating agencies**.** This is in line with the core guiding principles of the Fund's accreditation process, including the aim of using a dynamic process that is reliable, credible and flexible.[4] It also is in line with the Fund's guiding principle of country ownership, in that it recognizes and relies on the competencies and legitimacy of local regulators.[5] As a first step, it is recommended that a pilot phase be set up to streamline the fiduciary information required during accreditation from well-established regulated financial entities that can operate at scale.

24. The Fund is unique in its business model; it has a broad mandate that spans several areas of impact across a diverse range of sectors and regions, and applies various financial instruments. It does so by working with and through a diverse set of accredited entities. Each entity is expected to bring forth subject matter expertise that could help the Fund to catalyse climate financing at scale, so as to promote a paradigm shift towards low-emission and climate-resilient development pathways. That expertise could take the form of regional, financial and/or technical expertise. The Fund's ability to deliver on its mandate in a timely fashion depends on its ability to efficiently accredit this diverse set of entities with an accreditation-seeking entity transaction cost that is neither prohibitive, nor dissuasive to entities working with the Fund, and simultaneously respect the financial rigour and transparency requirements contained within the Governing Instrument.

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[2] Department for International Development. 2004. *The Importance of Financial Sector Development for Growth and Poverty Reduction*.
[3] Thorsten Beck. 2007. *Financing Constraints of SMEs in Developing Countries: Evidence, Determinants and Solutions.*
[4] Document GCF/B.07/11, Annex I, Paragraph 2 (c).
[5] Document GCF/B.04/05.

25. The Fund has taken initial steps to address this need. Its existing fast-track accreditation approaches focus thus far on entities accredited by the Global Environment Facility (GEF), the Adaptation Fund (AF) and the Directorate-General for Development and Cooperation – Europe Aid of the European Commission (EU DEVCO). The accreditation process is also "fit for purpose", i.e. it takes into account the scale and type (e.g. financial instrument) of funding that the entity intends to access, as well as the nature of its intended activities. This approach ensures that the assessment of the entity's conformity with the fiduciary standards – and relevant capacities related to the Fund's environmental and social standards in the accreditation process – is commensurate with the level of fiduciary and non-financial (e.g. environmental and social) risks to which the Fund will be exposed through the activities of the entities.

26. However, despite these initial steps, there is a growing backlog of entities in the accreditation process. As at 31 May 2015, the Fund had a total of 95 entities having been issued accounts for the Online Accreditation System (OAS)[6] – the web-based portal through which applicants submit their applications for accreditation. Of these, a total of 55 have submitted their application, including seven entities accredited at the ninth meeting of the Board[7] and 13 entities recommended to the Board for accreditation at its tenth meeting.[8] The number of entities interested in applying is growing substantially. If the Fund is aiming to provide a smooth application assessment process, it should further streamline the accreditation process by making good use of credible third party experts.

27. The Fund is looking at potential approaches to streamline the accreditation process with respect to national, regional and private sector entities by recognizing the subject matter expertise of auditors, national and regional regulators, credit rating agencies, and listing authorities that already assess and provide oversight over such areas as those listed in Table 1. Relying on external expert reviews could potentially reduce the amount of documentation required for submission without undermining the Fund's standards, and could potentially decrease the overall time required for the institutional assessment and completeness check and assessment by the Secretariat (Stage I of the accreditation process) and the accreditation review by the AP (Stage II [Step 1]).

Table 1: Initial list of accreditation items for which local financial regulators, auditors and credit rating agencies that could be used, in a limited manner, as proxies for some of the Fund's standards

Accreditation items that could potentially be eligible for fast-tracking
• Basic fiduciary standards related to key administrative and financial capacities; except for procurement, which would not be included • Specialized fiduciary standard for on-lending and/or blending (for loans, equity and guarantees - so long as they demonstrate an adequate track record in the instrument for which they are applying). The specialized fiduciary standards for project management and for grant award and/or funding allocation mechanisms would not be eligible for fast tracking

28. The reliance on external expert review could potentially bring benefits to the Fund as such institutions conduct dynamic and regular reviews and assessments of different entities operating in developing countries. Firstly, relying on their expertise could potentially make the Fund's process more efficient. Secondly, it could potentially make the process more effective. The Fund's accreditation process foresees a review of an entity's accreditation status every five years. However, by recognizing the existing supervision of local regulators and credit rating agencies, the Fund could be in a position to reconsider the accreditation status if an entity's compliance under the regulatory licence is in default or if the entity is downgraded by the credit

[6] The OAS is available at <https://accreditation.gcfund.org>.
[7] Document GCF/B.09/07.
[8] Document GCF/B.10/03 to be considered by the Board.

rating agency. The third advantage of relying on national/regional regulatory bodies and credit rating agencies is that it would provide a level playing field to national, regional and private entities active in financing climate-sensitive projects but not accredited by the GEF, the AF or EU DEVCO. Currently, such entities are at a disadvantage in terms of applying for accreditation to the Fund as the process is significantly more onerous for them.

V. Qualifying for fast-tracking

29. There are a number of suggested elements for consideration for additional entities eligible for fast-tracking, including the need to be regulated, publicly listed and in possession of a credit rating. Each country has a central regulatory authority which is responsible for the supervision of its financial sector. Financial intermediaries that obtain a licence are obliged to comply with the applicable laws and regulations and remain under the surveillance of the respective authority. An investment grade rating by a reputable credit rating agency follows an analysis of the company's governance, structure, liquidity risk and financial management. Furthermore, companies listed on a stock exchange are reviewed by the listing authority before an initial public offering is issued.

30. A regulator (the United Kingdom's Prudential Regulation Authority and Central Bank of Nigeria), a listing authority (United Kingdom Listing Authority), and a credit rating agency (Standard & Poor's Financial Services LLC) were surveyed in an initial attempt to make observations regarding overlaps with the Fund's fiduciary standards on the below listed items (see the Annex):

(a) General management and administrative capacities;

(b) Control frameworks;

(c) Governance and organizational arrangements;

(d) Management plans;

(e) Financial resource management;

(f) Investment management policies;

(g) Financial risk management, including asset liability;

(h) Transparency in channelling funds;

(i) Public access to information; and

(j) Due diligence policies and procedures.

31. Based on the findings made in relation to overlap in fiduciary due diligence requested by the Fund and that carried out by local regulators, rating agencies and listing authorities, the establishment of a set of requirements for fast-tracking some of the information, documents and due diligence currently required in the Fund's accreditation process could then be proposed. The proposal could envisage using multiple filters to help to ensure that an entity has the ability to meet some select fiduciary standards. These common criteria should not distinguish between entities based on their public, private, national or regional status, and thus guarantee equal access to fast-tracking for all qualifying entities.

32. One potential approach could be that national and regional entities that meet the following listed requirements could be eligible for fast-tracking. For the online accreditation application form, they could potentially not need to submit information on the basic fiduciary standards in sections 4.1 (key administrative and financial capabilities); except for procurement (item 4.1.5), for which they would need to submit information. In addition, depending on the

financial instruments for which they have been assessed to have an adequate track record,[9] it could be envisaged that they would not be required to submit information on the specialized fiduciary standard for on-lending and/or blending under section 5.3 for loans, equity, and/or guarantees (subject to evidence of a relevant track record in such instrument(s)) if:

(a) They are able to present three consecutive years of audited financial statements by an internationally recognized accountancy firm of good reputation or one of its subsidiaries or affiliates;

(b) The entity is regulated as a fully licensed onshore financial entity – for the instrument they seek to apply – by a central bank (or an equivalent). The fast-tracked entity should provide evidence from the local regulator that it and its licence remain in good standing with the regulator. Such certification should be renewed annually;

(c) The entity submits evidence of an adequate track record in the instrument for which they are applying (e.g. loans, equity and/or guarantees);

(d) It is listed on a stock exchange (in the case of private entities); and

(e) **Option 1**:

The entity's local currency rating is investment grade (BBB- or above) by one of the three global credit rating agencies (Standard & Poor's Rating Services Inc., Moody's Investor Service or Fitch); or

Option 2:

The entity is one of the country's top three fully licensed and regulated entities – for the relevant instrument – by asset size and is rated at the same level as the country's sovereign rating, awarded by one of the three global credit rating agencies.

The relative advantages and disadvantages of the aforementioned credit rating options are outlined in Table 2.

Table 2: Comparison between option 1 and option 2

Options	Advantages	Disadvantages
Option 1 **Investment grade**	**More conservative** approach as this approach will include investment-graded entities where the one-year average default rate is *c.* 0.50 per cent.	**Limited to entities in mid- to high-income countries.** Many entities in the least developed countries (LDCs) and small island developing States (SIDS), and Africa will not qualify for fast-tracking. Mitigant: the Secretariat will continue to work on identifying additional potential approaches for further accrediting entities in LDCs, SIDS and Africa
Option 2 **Rated at the same level as sovereign ratings and Top 3 leading entities by asset size in each country**	**More inclusive** approach as this approach will include national champions in a greater number of countries than Option 1	**Higher risk** as this approach could include CCC/C rated entities where the one year average default rate stands at 26.38 per cent. Mitigant: the Secretariat in cooperation with the Risk Committee could be requested to look into ways of mitigating this risk by setting limits on the amounts and type of investments that can be deployed by non-investment grade entities that have been fast-tracked

[9] See <http://www.gcfund.org/fileadmin/00_customer/documents/Accreditation/Accreditation_Application_form_Version_1.0_finalwith_examples_of_supporting_documents__May_2015_.pdf>.

33. Entities that meet all of the above conditions would have to submit proof of meeting the conditions at the time of submitting the application form, in lieu of providing information and documents required under sections 4.1 (except for item 4.1.5) and 5.3 of the online accreditation application form.

34. These requirements for fast-tracking complement one another in order to provide multiple layers of filtering regarding an entity's ability to meet fiduciary standards. These common criteria do not distinguish entities on the basis of public, private, national or regional status, and thus guarantee equal access to fast-tracking for all qualifying entities.

35. Applicant entities accredited under this approach would have to provide evidence of continuing to meet such conditions annually and a failure to meet those conditions would result in the potential revocation of their accreditation.

36. Such an approach would be considered as the first step towards a more efficient accreditation process. Additional fast-tracking approaches will be studied to especially benefit entities operating in the least developed countries, small island developing States and African States.

37. The Annex contains a brief survey of some of the fiduciary standards overseen by a local regulator, a credit rating agency and a listing authority.

VI. Other considerations and conclusions

38. The Fund has already addressed some of the lessons learned since launching its OAS. The suggested approach presented in this document reflect these lessons. For a more streamlined assessment process, it is important to minimize duplication of assessment, rely on existing ecosystems, and recognize the competences and legitimacy of local, national, regional and international subject matter experts. This would allow for a more effective and efficient accreditation process.

39. Thus, the Board may wish to consider the proposed approaches to further streamline the accreditation process and:

(a) Adopt the conditions suggested in paragraph 32 above as pre-request for the fast-track accreditation of national, regional and private sector entities; or

(b) Request the Secretariat to further develop this approach by presenting more examples of how the assessment of other institutions in selected countries cover the Fund's fiduciary standards.

40. Furthermore, regional, national and private sector entities can operate through various subsidiaries and affiliates. Regional organizations often have local offices that are established as an independent legal entity under specific local regulatory requirements. In order to further streamline the accreditation processes, it could be considered that an accredited entity's subsidiaries and affiliates should be able to submit funding proposals and be authorized to channel the Fund's resources. The responsibilities of the accredited entity, described in the accreditation master agreement, would be passed on to its affiliates and subsidiaries, and the accredited entity would accept full and irrevocable joint liability for its affiliates or subsidiaries in compliance with the Fund's standards.

41. It could also be considered that any approach eventually approved by the Board could be initially applied as a pilot phase in order to test it for its efficacy and effectiveness. For example, the pilot phase could be limited in time or number of entities that would be fast-tracked. A progress report could be prepared at the end of the pilot period, underlying the lessons learned in terms of benefits, drawbacks and possible barriers in application of the approach.

Annex: Examples of fiduciary oversight by a local financial regulator, credit rating agency and listing authority

1. Table 1 contains some of the Prudential Regulation Authority's regulatory requirements, which apply to financial institutions in the United Kingdom of Great Britain and Northern Ireland. Overlap with the Fund's basic fiduciary standards and part of the specialized fiduciary standards (in particular, on-lending and blending) is observable.

Table 1: Prudential Regulation Authority (PRA) regulation assessment

PRA regulation[a]	Requirements under regulation
Identifying the risks to safety and soundness	
Potential impact	Assesses the significance of a firm to the stability of the United Kingdom's financial system. This 'potential impact' reflects a firm's potential to adversely affect the stability of the system by failing, coming under stress, or the way it conducts its business
External context	Consideration of system-wide risks, such as low interest rates, excessive credit growth or international imbalances, and sectorial risks, such as in commercial real estate, including sectorial analysis
Business risk	Examines the threats to the viability of a firm's business model, and the ways in which a firm could create adverse effects for other participants in the system by the way it conducts its business. Assessment of where and how a firm creates revenue, the risks it takes in doing so, and how it funds itself
Safeguarding safety and soundness	
Management and governance	Composition of the board and senior management, its responsibilities and competences, including the track record of the firm's past misconduct
Structures	Clear structures of accountability and delegation of responsibilities for individuals and committees, including checks and balances to prevent dominance by an individual
Competence	Staff members have appropriate expertise and experience, and (in the case of non-executive directors) devote sufficient time to their roles in order to fulfil their obligations to a high standard
Supervision	Persons must be approved by the PRA, qualified and able to undertake the supervision of the firm's activities
Risk management and control	Robust frameworks for risk management and financial and operational control are required, commensurate with the nature, scale and complexity of the business. Competent and, where appropriate, independent control functions should oversee these frameworks
Capital	Existing appropriate capital resources, in terms of both quantity and quality, consistent with banks' safety and soundness, and taking into account the risks to which they are exposed, including provisions on quality, location and level of capital
Liquidity	Banks must ensure that they have an appropriate degree of resilience to liquidity stresses (e.g. liquid assets and maturity mismatch)
Supervision	PRA conducts its own risk assessments of the banks. In doing so, it requests that the banks submit sufficient data of appropriate quality so as to inform the PRA's judgement about key risks

[a] Bank of England, Prudential Regulation Authority. 2014. *Prudential Regulation Authority's Approach to Banking Supervision*.
Available at: <http://www.bankofengland.co.uk/publications/Documents/praapproach/bankingappr1406.pdf>.

2. Furthermore, an analysis of the rules and regulations of a central regulating authority, namely the Central Bank of Nigeria, suggests that regulatory requirements are stringent both in developed and developing countries. This central regulating authority conducts oversight of the financial sector in Nigeria, and the *Code of Corporate Governance for Banks and discount houses in Nigeria* is the minimum governance standard with which banks and discount houses in Nigeria should comply. The code relates to the majority of the Fund's basic fiduciary standards (such as risk management, conflict of interest, audit, etc.[1]). Furthermore, the *Revised Guidelines for Finance Companies in Nigeria* underline the rules and procedures for financial services companies and cover the following information as outlined in Table 2.

Table 2: Information assessed under the Central Bank of Nigeria's Revised Guidelines for Finance Companies

Regulatory requirements	Licensing requirements
	Prudential requirements
	Risk management policies
	Supervisory and compliance regulation
	Governance requirements
	Know your customer and anti-money laundering measures

3. Table 3 presents information on the methodology for assessing banks by credit rating agency Standard & Poor's. Overlaps with some of the Fund's fiduciary standards are observable.[2]

Table 3: Standard & Poor's (S&P) methodology for rating banks

Standard & Poor's rating component	Information assessed
Business position	
Business stability	As part of its assessment, S&P looks into the stability or fragility of the bank's franchise, favourable contractual terms such as credit-related termination events, triggers and an exit strategy
Management and corporate strategy	Management's ability to execute operational plans, the bank's strategic direction, management's risk appetite, etc.
Capital and earnings	
Regulatory compliance	Whether the bank meets the minimum requirements of local regulators
Quality of capital and earnings	Whether the bank commands additional high-quality earnings and additional financial flexibility, economic capital in reserves, etc., including significant tax, and legal and regulatory constraints in the bank
Risk position	
Growth and changes in expose	Whether management has the capacity to manage the risks associated with growth and future prospects
Risk concentrations and risk diversification	Concentration of exposure to individual debtors, industries, sectors, etc.
Complexity of risk profile	The transparency of underlying risk positions, risk management or earnings generation is also assessed

[1] *Code of Corporate Governance for Banks and Discount Houses in Nigeria*, May 2014.
[2] Information on Standard & Poor's rating methodology and assumptions for banks is available at: <http://img.en25.com/Web/StandardandPoors/BanksRatingMethodology_Final110911.pdf>.

4. Table 4 presents items reviewed by the United Kingdom Listing Authority when assessing an initial public offering. Overlaps with some of the Fund's fiduciary standards are observable.

Table 4: Analysis of the United Kingdom Listing Authority's (UKLA's) initial public offering (IPO) assessment process

UKLA checks before issuing an IPO	Information assessed
Business due diligence	• Business strategy • Potential growth
Financial due diligence	• Audited and interim financial statements • Capital structure • Breakdown of historical financials • Detailed review of budgets • Meetings with auditors • Budget versus actual financial statements • Accounting policies and accounting management • Financial control systems • Working capital requirements • Debt covenants
Legal due diligence	• Litigation • Compliance with laws and regulations • Title to principle assets • Corporate structure • Environmental issues • Intellectual property

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