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Concessionality: potential approaches for further guidance

Summary

This document outlines the current understanding of concessionality, examining current definitions and previous Board discussions and decisions on concessionality. The document further summarizes the key issues associated with concessionality to be considered by the GCF, as it continues to develop further guidance for accredited entities and national designated authorities.

I. Introduction

1. The Board of the GCF (“The Board”) requested the Secretariat, through its decision B.17/10, to prepare, under the guidance of the Co-Chairs, a proposal to be discussed at B.19 for “options for further guidance on concessionality, building on related work.”

II. Objective

2. As the GCF gains operational experience in assessing and considering funding proposals, this additional guidance on concessionality seeks to achieve the following objectives:

- (a) Ensure consistency in the application of policies regarding concessionality and the selection of the GCF financial instruments. This can facilitate the work of national designated authorities (NDAs) and accredited entities (AEs) in developing funding proposals by having clearer guidance on the criteria to be used in linking the GCF financial instruments and their terms and condition to specific activities in funding proposals;
- (b) Facilitate the assessment of funding proposals with respect to principles and performance parameters previously agreed by the Board, such as maximizing leverage of GCF funding and avoiding crowding out private sector investments; and
- (c) More generally, facilitate the work of the Secretariat and the Independent Technical Advisory Panel in assessing funding proposals particularly with respect to the efficiency and effectiveness investment criterion, which underpins the review of the level of concessionality requested in funding proposals.

3. This document is divided into five sections:

- (a) Review of prior decisions related to concessionality;
- (b) Review of prior Board discussions and other related work on concessionality;
- (c) Key issues to be considered by the GCF in developing further guidance on concessionality;
- (d) Potential approaches on concessionality for the GCF; and
- (e) Recommended approach.

III. Review of prior decisions and Board discussions related to concessionality

3.1 Definition of concessionality

4. There is not a unique definition of concessionality but this term has traditionally been used in the context of lending to governments, particularly as part of the definition of external debt accounting. The International Monetary Fund (IMF) defines concessional lending as “loans that are extended on terms substantially more generous than market loans. The concessionality is achieved either through interest rates below those available on the market or by grace periods, or a combination of these. Concessional loans typically have long grace periods”.¹

¹ IMF, 2003, *External Debt Statistics: Guide for Compilers and Users – Appendix III, Glossary*, IMF, Washington DC.

5. The practice of the IMF and other international bodies such as the multi-lateral development banks (MDBs) and the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) is to more formally define concessionality in terms of the grant equivalency or the grant portion of the concessional loan. The grant equivalence is calculated by measuring the difference, in present value terms, between the loan disbursed and the repayments made, including interest charges and other fees.² In the case of DAC members, the agreed minimum grant equivalence threshold to define a loan as concessional is 25 percent.³

3.2 Concessionality and the UNFCCC and the GCF Governing Instrument

6. The United Nations Framework Convention on Climate Change (UNFCCC) in its Article 11 defines a financial mechanism to provide “financial resources on a grant or concessional basis”. The GCF Governing Instrument states in paragraph 54 that the GCF “will provide financing in the form of grants and concessional lending, and through other modalities...” The UNFCCC Standing Committee on Finance prepares a biennial assessment and overview of climate finance flows that includes reporting of concessional funds that generally follows the OECD DAC methodology.

3.3 GCF board decisions on concessionality

7. The approach to concessionality in the GCF is underpinned by several key Board decisions:⁴

- (a) **Decision B.05/07** defined the principles and factors to be taken into account to establish the terms and conditions of the GCF financial instruments for both public and private sector operations. These principles and factors include:
 - (i) Grant elements should be *tailored* to incremental cost or the risk premium required to make the investment viable, or to cover specific activities such as technical assistance;
 - (ii) Seeking the *right level* of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment and avoid crowding out commercial financing;
 - (iii) Levels of indebtedness capacity of the recipient should be taken into account so as not to encourage excessive indebtedness;
 - (iv) Structure terms on a case-by-case basis to address specific barriers;
 - (v) Leveraging of other financing, seeking to maximize leverage in the case of private financing;

² For a more detailed discussion of the evolution of the concept of concessionality, see for example Simon Scott (2017): *The grant element method of measuring the concessionality of loan and debt relief*. Working Paper No. 339. OECD: Paris

³ These thresholds, as well as other parameters, will change starting with the DAC report on official flows in 2019. The new thresholds will be different for less developed, lower middle income, and upper middle income recipient countries.

⁴ The italics in this paragraph are introduced to highlight key words in the Board decisions and they present the key components of those decisions relevant to this document, they are not the full text of the decisions. The italics are not part of the decision text.

- (vi) The grant element of concessional finance will be *tailored* to provide the appropriate incentive to facilitate the implementation of mitigation and adaptation activities;
 - (vii) Concessional forms of finance will be designed to minimize market distortions and potential disincentives to private investment;
 - (viii) The expertise and capacity of financial intermediaries and implementing entities should be taken into account; and
 - (ix) The risk sharing between public and private investment, when relevant.
- (b) **Decision B.07/05** established the initial financial risk management framework of the GCF including:
- (i) The subsidy element provided through grants and/or concessional lending will be the *minimum amount* necessary to make the project or programme *viable* and help achieve the GCF paradigm shift objective; and
 - (ii) The average concessionality level of outgoing loans will be less than the average concessionality level of incoming contributions with a sufficient margin to cover credit risk.
- (c) **Decision B.07.06** mandating that funding received and extended by the GCF be accounted for in grant-equivalent terms based on a standard methodology to be developed by the GCF based on best international practices.
- (d) **Decision B.09/05** elaborated further the GCF investment framework including defining the efficiency and effectiveness criterion which includes as indicative assessment factors:
- (i) Proposed financial structure (funding amount, financial instrument, tenor and term) is *adequate and reasonable* in order to achieve the proposal's objectives, including addressing existing bottlenecks and/or barriers; and
 - (ii) The subsidy element provided through grants and/or concessional lending will be the *minimum amount necessary* to make the project or programme *viable* and help achieve the GCF paradigm shift objective.

3.4 Board discussions on concessionality and the GCF financial instruments

8. Further to decision B.09/04, that established the terms and conditions of the GCF financial instruments, the Board held at its tenth meeting a series of discussions focused on the criteria to be used for providing grants, low, and high concessional loans to the public sector. These discussions were based on two documents prepared by the Secretariat (GCF/B.10/06 and GCF/B.10/Inf.10) that reviewed the practices of other institutions in this area and proposed options for the GCF. The options analyzed sought to provide rules-based criteria to decide the type of financial instrument (and thus, the level of concessionality) available for a funding proposal based on country (e.g., income level or grade of vulnerability to climate change) or project (e.g., level of income generation and financial sustainability) characteristics. The Board at that time did not take a decision with respect to this matter.

IV. Key issues to be considered by the GCF in developing further guidance on concessionality

4.1 Linkages to other GCF initiatives and tools

9. Adequate implementation of existing decisions on concessionality may in fact require further guidance on certain concepts that are mentioned in the Board decisions on this topic such as “incremental cost”, “grant element”, making projects “viable”, and “risk premium”.

- (a) **Incremental costs:** In response to the Board’s request at its seventeenth meeting, another document to be issued for B.19 on incremental cost calculation methodology discusses this issue in further detail. Tailoring the level of concessionality to incremental costs could imply focusing the higher concessionality instruments of the GCF to support the more readily measurable incremental costs related to climate change while using lower concessionality instruments for activities whose costs only partially arise from incremental activities to address climate change. This is also consistent with the GCF Governing Instrument paragraph 54 that states “Financing will be tailored to cover the identifiable additional costs of the investment necessary to make the project viable.” While this approach would be consistent with ensuring maximum focus of GCF resources on climate change, it could also lead to certain potentially undesirable outcomes such as making activities with high level of co-benefits and sustainable development potential, but only partially related to mitigation and adaptation to climate change, ineligible for highly concessional loans or grants;
- (b) **Grant element calculation:** Agreeing on the appropriate level of concessionality of funding provided by the GCF requires having a tool to calculate such concessionality for a broad range of financial instruments. The Secretariat has developed such a tool to support portfolio management processes, including the reporting of GCF resources in grant equivalence terms. The methodology to calculate grant equivalency for loans to the public sector is generally well established and has been used for some time in international debt statistics as reported by the IMF. This is not the case for other types of instruments as well as for private sector transactions so the GCF methodology in these areas may have to be reviewed periodically to incorporate additional analytical enhancements;
- (c) **Co-financing:** Previous discussions at the Board have indicated interest in eventually defining a policy regarding the expected levels of co-financing from AEs and other co-financiers in GCF projects that would take into account country- and region-specific factors such as depth of financial markets. Funded activity agreements currently include provisions requiring AEs to show the delivery of evidence of the status and amount of co-financing disbursed and applied to the implementation of projects as to ensure adequate reporting and monitoring of co-financing resources. Such guidance could be tied to the level of concessionality of GCF resources with respect to those of other co-financiers with a view to increase the leverage of GCF funding. The terms of the co-financing resources are also critical to measure the grant equivalence of the entire financing, not just the GCF resources.
- (d) **“Viability” and funding proposals economic and financial analysis:** The concept of assessing the viability of proposed projects requires linking it to an economic and financial analysis. AEs submit economic and financial analyses of projects as part of the funding proposal package. Decision B.09/05, when describing the efficiency and effectiveness investment criterion, lists “expected economic and financial internal rate of return” and “financial viability in the long run” as activity-specific sub-criteria. The decision further lists as indicative assessment factor, “Economic and financial rate of return with and without the GCF support (i.e., hurdle rate of return or other appropriate/relevant thresholds”. The Secretariat assesses the economic and financial analyses as carried out by the AEs using their own methodology to ensure consistency

with generally accepted practices. At this point, there is not an agreed GCF standard on some of these parameters such as the discount or hurdle rates that ought to be used in these analyses.

- (e) **Risk premium:** This concept refers to the minimum expected rate of financial return that a project should have for it to be viable given the risk involved. A higher degree of concessional funding may be required to ensure such minimum level of financial return is achieved. Identifying risk premia for private sector projects and revenue-generating investments can be done by analyzing the historical cost of debt and equity of similar projects. In the case of public sector projects, particularly if they do not generate revenues, this is more difficult and may require, for example, assessing the country's level of financial risk. Ongoing work as part of the GCF risk management framework may provide additional guidance on this area.

4.2 Rules-based methodology versus framework to be applied on a case-by-case basis

10. Prior discussions on concessionality, particularly at the tenth Board meeting, sought to provide a rules-based approach for public sector operations based on country and project characteristics. While this approach would be easy to communicate and would provide a clear ex-ante eligibility criteria for concessional funding, it may not capture some of the broader concerns that some Board members expressed regarding consistency with the overall approach of the Climate Convention and the Conference of the Parties. On the other hand, a framework to be applied on a case-by-case basis may require additional guidance and further technical work, particularly for non-revenue generating projects⁵. For example, linking the level of concessionality to the viability of projects would require considering matters such as *the concept of viability and financial and economic analysis*. Financial analysis uses actual flows of money in assessing project viability and its use for revenue-generating projects is relatively straightforward: incorporating the reflows necessary to repay a concessional loan to assess whether or not the project would be viable can be easily done. In the case of non-revenue generating projects, financial analysis and calculation of financial internal rates of returns are generally not performed, instead relying on an analysis of financial sustainability that only considers operating costs and that assumes that the capital investment was made through a grant or through a loan whose repayment is not made out of project resources. Additionally, there is a need to provide further guidance in defining the concept of "revenue generation" in GCF projects. Such revenue may be generated but not flow back to the AE or to government agencies but stay, for example, with community groups. Or in other cases, the revenue generated may not be sufficient to repay concessional loans. Economic analysis considers costs and benefits to the country (and in the case of climate change, to the world) more broadly and linking concessionality to this type of analysis would be more difficult not only because economic analysis does not use actual flows of money but shadow prices that measure the opportunity cost to society. Results of both economic and financial analysis are very sensitive to underlying assumptions, which could be helped by a common set of standards.⁶

⁵ The review of practices of other funds that the Secretariat prepared as part of document GCF/B.10/06 highlighted the fact that concessionality is tied to financial analysis in the case of revenue-generating projects as in the case, for example, of the Clean Technology Fund.

⁶ For a complete treatment of financial and economic analysis see, for example, *Financial Management and Analysis of Projects*. Manila: Asian Development Bank, July 2005; and *Guidelines for the Economic Analysis of Projects*. Manila: Asian Development Bank, 2017.



4.3 Concessionality in private sector projects

11. The application of the approach approved in decision B.09/04 for the private sector, a case-by-case approach, continues to benefit from the fact that most private sector projects have identifiable cash flows that facilitate the use of financial analysis. Board discussions, however, have highlighted the fact that further clarity may be needed particularly with respect to the implementation of prior decisions regarding the need to ensure that the level of concessionality minimizes market distortions and avoids disincentives to private investments that would otherwise take place even in the absence of the GCF financing. The concept of concessionality in private sector operations has important differences with respect to the public sector. In fact, using the traditional definition of concessional loans for the public sector (i.e., loans at below market rates), provision of concessional funding to the private sector could generate market distortions and crowd out other sources of funding. Therefore, provision of concessional funding to the private sector has traditionally been tied to addressing specific market failures and developing new markets using some of the criteria presented in Box 1. This linkage between market failures and concessional finance also applies to public sector operations as reflected on the discussion below on global public goods.

Box 1: Concessionality in Private Sector Operations – Historical Perspective

The concept of concessionality as initially developed by organizations such as the OECD-DAC was associated with public sector transactions where an explicit grant element is meant to flow to the country receiving the financing as part of foreign aid resources. In principle, the provision of a concessional loan to a private sector entity would in fact constitute a subsidy to the private sector that would distort markets and could prevent the development of sustainable private markets. Two issues are important when discussing concessionality in private sector operations:

Criteria used to provide concessional finance to the private sector: Guidance on this area comes mainly from MDBs and bilateral agencies that generally provide concessional finance to the private sector in limited circumstances when social benefits exceed private benefits and other criteria are met such as: (i) long-term financial sustainability is ensured in the absence of continued concessional funding; (ii) the project includes measures to “crowd-in” additional sources of funding and avoid the “crowding-out” of other private investments; (iii) avoidance of market distortions.⁷

Measurement of grant equivalency: Until now, most MDBs and bilateral agencies have not reported in grant equivalency terms its loans to the private sector. In fact, using the OECD-DAC methodology to measure grant equivalency for loans to the public sector would probably result in most of these private sector loans having in fact a *negative* grant element. The OECD-DAC is currently developing methodologies to measure the concessionality of private sector transactions.⁸ While the final approach will not be finalized until 2019, initial discussions center around using different types of discount rates to reflect the different types of risk profiles of private sector projects.

4.4 Emerging approaches to concessionality in private sector operations: blended finance

12. The role of concessional finance as a trigger to mobilize private sector financing is being increasingly recognized. For example, most of the multi-lateral development banks have coalesced around a set of principles on crowding-in private sector finance (*Hamburg Principles*)⁹

⁷ For a detailed discussion of the approach used by multilateral development banks and bilateral agencies, see *DFI Guidance for Using Investment Concessional Finance in Private Sector Operations*. Private Sector Development Institutions Roundtable. 2013.

⁸ A full description of the ongoing changes to the OECD-DAC methodology to measure concessionality is presented in <http://www.oecd.org/dac/financing-sustainable-development/modernisation-dac-statistical-system.htm>

⁹ These principles were prepared by the MDBs in April 2017 in preparation for the G20 meetings in Hamburg, Germany.

that highlights the role of combining concessional and private capital (blended finance) as a critical mechanism to promote investments where the economic and social benefits and other positive externalities are substantially larger than the commercial returns accruing to the private investors. Effective use of blended finance requires that this financing be made available in the context of other measures that are also part of the Principles: ensuring the primacy of country ownership; creating an investment-friendly environment; expanding and standardizing available financial instruments; prioritizing commercial financing; and ensuring that internal incentives within MDBs are conducive to crowding-in private sector resources. Approaches to blended finance are being further developed through a working group of development finance institutions centred around five key principles:¹⁰

- (a) Ensure additionality of blended finance and avoid crowding out the private sector;
- (b) Catalyze private sector investments (crowding-in) using the minimum concessionality necessary to induce the required investment;
- (c) Ensure commercial sustainability of the investment;
- (d) Concessional finance should supplement and be consistent with measures addressing the root causes of market failures and barriers; and
- (e) Private sector operations should seek to promote adherence to high standards of conduct in their clients, including in the areas of Corporate Governance, Environmental Impact, Social Inclusion, Transparency, Integrity, and Disclosure.

4.5 Leverage of other sources of funding

13. Decision B.05/07 highlights the need to leverage additional sources of funding in selecting terms and conditions of GCF instruments. Maximizing leverage of funding may in some cases require the GCF to adjust the level of its concessional resources to enable the AEs and other co-financiers to increase their level of financing taking into account their own constraints as well as the capacity of the country to accept non-concessional funds. This is also in addition to an approach that considers adjusting the level of concessional resources to maximize the climate impacts of projects. This may lead to the GCF providing resources in concessional terms different from those of other co-financiers. For example, in public sector operations, a country close to its debt limit may seek GCF grant resources to be combined with loan resources from other co-financiers in order to address a financing gap which may not be filled by additional lending. In such cases, explicit rules may need to be applied for blending resources in projects. In the case of the private sector, the concept of “maximizing leverage” that is part of decision B.05/07 is tied to some of the need to crowd-in other sources of private sector funding as discussed in box 1 above.

4.6 Country characteristics

14. In the case of public sector projects, avoiding excessive indebtedness may imply limiting GCF support to grant instruments for countries with high levels of debt. This could be done by including in funding proposals an assessment of the impact on the requested GCF resources on the country’s debt management capacity if the funding were to be provided in non-grant terms. Alternatively, the GCF could use other existing methodologies such as the joint World Bank – IMF Debt Sustainability Framework for low-income countries that classifies low income

¹⁰ DFI Working Group on Blended Concessional Finance for Private Sector Projects. Summary Report. October 2017.

countries based on their risk of debt distress. In addition to debt levels, the GCF may consider tying concessionality to other country characteristics considering their special needs and levels of vulnerability with respect to climate change risks as could be the case with least developed countries (LDCs) and small islands developing States (SIDS). This approach is taken, for example, by some of the concessional lending windows of the MDBs, that consider country characteristics such as status as small economies or other criteria to differentiate terms and conditions of financial instruments.

4.7 Role of concessionality in supporting global public goods and other positive externalities

15. Many GCF-supported projects and programmes are expected to generate positive externalities (i.e., some of the project benefits accrue to parties not involved in the project). In such situations, financial and economic analyses that only consider the costs and direct benefits to the project and use non-concessional financing may lead to discarding initiatives with large global benefits. Individual firms and countries may be unwilling to borrow at market rates to undertake projects where a large part of its benefits accrue to others. As a decrease in greenhouse gas emissions represent a global public good, all mitigation projects generate this type of positive externality. Global public goods and other positive externalities can also arise from adaptation projects as would be the case, for example, in a national project to increase soil resilience to climate change that leads to the rehabilitation of degraded soil that positively impacts the salinity of a river basin shared by several countries. The provision of concessional funding is increasingly being used to facilitate the financing of global public goods¹¹ and it is one of roles of the Global Environment Facility that uses concessional funding to support projects with global environmental benefits. The GCF may consider assessing funding proposal's global public good characteristics as one of the criteria to determine the adequacy of the requested financial instrument.

4.8 Unit of analysis of concessionality

16. As indicated above, the analysis of the concessionality of a funding proposal should encompass the entire set of activities and all sources of funding, including those in which the GCF is not expected to participate directly. However, the unit of analysis must be each one of the components or set of activities of the project/programme reflecting the fact that each one may require different levels of concessionality for them to become viable. For example, a renewable energy project may be composed of the building of a private generation plant supported by a power purchase agreement and the retrofitting of existing transmission and distribution lines owned by a public utility.

V. Potential approaches on concessionality for the GCF

Option 1: As a starting point, revisit some of the options discussed at B.10 to increase the range of projects falling under a rules-based approach

17. There are several advantages in maximizing the use of a rules-based approach to concessionality including increasing the level of certainty to NDAs and AEs about the terms and

¹¹ For a discussion on ongoing reform processes in development banks to mobilize concessional finance for global public goods, see *Providing global public goods – What role for development banks*. London: Overseas Development Institute (2017)

conditions that can be expected from the GCF and, more generally and reducing transactions costs for all GCF stakeholders with respect to assessing the appropriateness of the request funding in a case-by-case basis. Unlike the approach taken by other funds and financial organizations, this rules-based approach would not be meant to assign all types of funding proposals into a level of concessionality. Instead it would define a “positive” list of project characteristics that would define eligibility for certain types of financial instruments without requiring further justification. This would facilitate the assessment of the funding proposals with respect to the “Efficiency and Effectiveness” investment criterion, with the understanding that the rest of criteria would have to be assessed as per current procedures. Table 1 presents an example of how this positive list could be defined.

18. Funding proposals meeting the characteristics in the first column of the table could request the instrument in the second column of the table without the need to provide additional justification for the type of instrument selected. The Efficiency and Effectiveness investment criteria would still need to be assessed for other aspects, including the appropriateness of the total amount of GCF funding requested. Projects falling outside those categories would continue to be assessed on a case-by-case basis in a manner consistent with existing Board decisions as well as funding proposals that fall into these categories but that request an instrument with an even higher concessionality level. This approach would focus GCF efforts on assessing the requested public sector financial instrument in a smaller sub-set of funding proposals.

19. Additionally, the indicative positive list of financing would be adjusted based on the evolution of the GCF portfolio to also include criteria related to project characteristic. For example, if mitigation projects are over-represented in the portfolio, any mitigation project would be eligible only for low concessional loans. Other instruments for the public sector – equity and guarantees - would continue to be considered on a case by case basis until such time as the GCF gains sufficient experience with these instruments to define rules-based criteria for them.

20. Private sector projects would continue to be assessed on a case-by-case basis but the funding proposal template would be adjusted to ensure that AEs provide a more detailed justification for the financial terms and conditions requested including:

- (a) Market analysis of the proposed project sector identifying the obstacles to private sector investment requiring GCF intervention and the steps taken to minimize market distortions; and
- (b) Strategy to ensure not only long-term sustainability of the proposed project but also the creation of new private markets that would contribute to replicate and scale-up the proposed project.

Table 1: Indicative* Positive List of Financing Instrument for Public Sector Projects

Funding Proposal Characteristics	Maximum ¹² Concessionality Instrument not requiring further justification
Non-revenue generating project/programme in Least Developed Countries (LDCs) and Small Island Developing States (SIDS)	Grant ¹³
Revenue generating project/programme located in LDC or SIDS	High Concessional Loan
Revenue generating project/programme not located in an LDC or SIDS	Low Concessional Loan

* Could be refined further based on the full list of issues noted in section C.

¹² These would be “maximum” parameters, emphasizing the fact that lower concessionality parameters may be agreed based on specific project characteristics.

¹³ Grants may also be used to crowd in private sector finance, where suitable. Recent decision like the Hamburg principles for crowding in private sector finance can be considered where possible.

Option 2: Redefine the “Efficiency and Effectiveness” investment criterion to more explicitly consider concessionality in a broader context

21. This approach would require developing additional guidance to assess this criterion taking into account the following principles, which would be common for public and private sector projects:

- (a) Analysis of individual components: The assessment of this criterion for a particular funding proposal would be the aggregate results of assessing each one of its components. This would facilitate accounting for the fact that a single project/programme may have different elements requiring different financial instruments.
- (b) Financial and economic analysis methodology that explicitly includes an assessment of the activity's risk premium and positive externalities: This methodology, which could be based on the ones already being used by several multi-lateral development banks, would allow the AEs to measure and present the necessary level of concessionality to make the activity viable and, in the case of positive externalities as those arising in global public goods, the gap that there may be between the benefits accruing to the project and those externalities. This methodology would encompass:
 - (i) For revenue-generating projects, establish a financial analysis methodology, including parameters such as the discount rate to be used in the analysis and the criteria to define the “incremental” activities related to climate change;
 - (ii) For non-revenue generating projects, the type of financial sustainability that would replace the standard financial analysis and how this would be incorporated into the assessment of concessionality;
 - (iii) For all projects, a methodology for economic analysis with emphasis on approaches to estimate climate change benefits; and
 - (iv) Approaches to estimate financial and economic rates of return and risk premia that would support a specific level of concessionality from the GCF.
- (c) Co-financing, leverage, and country characteristics: These three aspects would be assessed at the funding proposal level (not individual activity).

Option 3: Implement concurrently both Options 1 and 2

22. Implementing option 1 by itself would still leave the need for further guidance for funding proposals falling outside the positive list. Therefore, the additional guidance presented in option 2 would still be needed. Over time, it would be expected that, at least for public sector projects, the number of funding proposals falling under rules-based criteria for concessionality would increase.

23. Implementation of either of these options would require additional guidance on technical methodologies. Irrespective of the option chosen, additional technical work will be required to provide GCF stakeholders with clear guidance on several areas, including:

- (a) Methodologies, assumptions and parameter values (e.g., discount rates, minimum hurdle rates) for economic and financial analyses as to more clearly define the concepts of financial and economic viability;
- (b) Definition of revenue generation in GCF projects and how it applies to economic and financial analyses depending on the level of revenue generated and whether or it accrues to project beneficiaries, project proponents, AEs or the GCF; and

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- (c) Approaches to assess country levels of indebtedness.

VI. Recommended approach

24. Prior Board discussions suggest that the transformational nature and the mandate of the GCF may not be amenable to a purely rules-based approach to determining the terms and conditions of the Fund's financial instruments. On the other hand, correct implementation of prior Board decisions regarding concessionality requires further definition by the GCF of key concepts mentioned in those decisions (e.g., financial and economic analysis methodologies) as well as further guidance to AEs and NDAs on the approach that the Secretariat and the Board is expected to follow in assessing funding proposals. This would not only ensure the correct application of Board decisions but would also reduce transaction costs and reduce uncertainties for all Fund stakeholders. On this basis, the Fund may consider approving the draft decision presented in annex I.

Annex I: Draft decision of the Board

The Board, having considered document GCF/B.19/12/Rev.01 titled “Concessionality: potential approaches for further guidance”:

- (a) *Requests* the Secretariat to develop additional guidance to assess the appropriateness of the financial instruments requested by accredited entities in funding proposals submitted to GCF and to submit such guidance for the Board’s consideration at its twenty-first meeting;
- (b) *Decides* that for public sector funding proposals, the additional guidance should include a set of project/programme characteristics that would make such projects/programmes eligible for specific financial instruments without further detailed justification for the requested financial instrument (“expedited eligibility”), taking into account the following characteristics:
 - (i) Whether the proposed activities would be revenue generating;
 - (ii) The level of country vulnerability to the adverse effects of climate change risks, with a focus on the least developed countries, small island developing States and African States; and
 - (iii) The size of the proposed project/programme;
- (c) *Decides* that the additional guidance referred to in paragraph (a) should be applicable for all types of funding proposals, including public sector funding proposals that are not addressed by the expedited eligibility category referred to in paragraph (b), and private sector funding proposals, and should reflect the following principles:
 - (i) It is applicable at the individual component level to reflect that a single funding proposal may have multiple components requiring different financial instruments and different levels of concessionality; and
 - (ii) It establishes financial and economic analysis methodologies that can be used by accredited entities to assess a funding proposal’s risk premium and positive externalities to:
 - a. Allow accredited entities to identify and request the minimum level of concessionality required to make the relevant funding proposal viable; and
 - b. Identify the economic benefits that will accrue as a result of the relevant project/programme;
- (d) *Agrees* that the methodologies to be established pursuant to paragraph (c)(ii) should:
 - (i) For revenue-generating projects/programmes, set out the parameters for applying the methodologies, such as the discount rate to be used in the analysis and the criteria to define the “incremental” activities related to climate change;
 - (ii) For non-revenue generating projects, set out the type of financial sustainability analysis that should be undertaken in place of the standard financial analysis referred to in paragraph (d)(i) and identify how this would be used to assess concessionality;
 - (iii) For all projects/programmes:
 - a. Include guidance on how to estimate climate change benefits; and

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- b. Identify approaches to estimate financial and economic rates of return and risk premia that would support a specific level of concessionality from GCF;
 - (e) *Decides* that with respect to private sector funding proposals, the additional guidance should also include a set of additional principles and guidelines on the use of blended concessional finance, consistent with international best practice; and
 - (f) *Requests* the Secretariat to make the necessary amendments to the funding proposal template to ensure accredited entities present all relevant information necessary for the Secretariat to assess whether a funding proposal is compliant with relevant Board decisions regarding terms and conditions of GCF financial instruments, including decisions B.05/07, B.07/05 and B.09/05.
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