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# PSAG recommendations on the development of modalities to support activities enabling private sector involvement in LDCs and SIDS


## Summary

This document contains the recommendations of the Private Sector Advisory Group to the Board on the development of modalities to support activities enabling private sector involvement in least developed countries and small islands developing states. The recommendations are made in response to a request from the Board, and can be summarised as follows:

(i) Creating an enabling environment;

(ii) Demand aggregation;

(iii) Market activation;

(iv) Innovative financing structures and modalities;

(v) Modalities for working with the private sector; and

(vi) Targeted Request for Proposals.

# I. Introduction

1. Paragraphs 43 and 44 of the Green Climate Fund's (GCF) Governing Instrument state the Private Sector Facility (PSF) will promote the participation of private sector actors in developing countries, in particular local actors, including small- and medium-sized enterprises and local financial intermediaries. The PSF will also support activities to enable private sector involvement in Least Developed Countries (LDCs) and Small Island Developing States (SIDS) . The Board will develop the necessary arrangements, including access modalities, to operationalize the facility.

2. At its fourth meeting, the Board, through decision B.04/08, paragraph (c), decided that in line with the Governing Instrument, the Private Sector Facility will promote the participation of private sector actors in developing countries, in particular local actors, including small and medium-sized enterprises and local financial intermediaries.

3. In United Nations Framework Convention on Climate Change (UNFCCC) decision 10/CP.22, paragraph 11, the Conference of the Parties to the UNFCCC encouraged the Board to implement the aforementioned decision B.04/08.

4. The Board has requested the Private Sector Advisory Group (PSAG) to provide recommendations on the development of modalities to support activities enabling private sector involvement in theLDCs and SIDS (decision B.15/03, para. (d) and B.17/06, para (d)(i)).

5. The Board further decided to co-opt a Board representative from the LDCs and another from the SIDS to assist the PSAG to develop its recommendations referenced in the paragraph above.

6. The members of the PSAG, Board representatives from the LDCs and SIDS and a CSO representative held a meeting from 6 to 7 December 2017 in Copenhagen, Denmark to further discuss the issued Board requests on this matter. The background paper prepared by the Secretariat for this discussion can be found here.

# II. PSAG discussions

## 2.1 Background and context

7. Some of the overlapping private sector challenges faced by both LDCs and SIDS include:

(a) Distance from existing external mature markets, distribution etc.;

(b) Lack of reliable/cheap internal logistical/distribution chains;

(c) Difficulty in developing indigenous business and technical talent (and of attracting and retaining talent from elsewhere);

(d) First-mover / investor challenges of working in new, small, isolated markets;

(e) Policy/regulatory/financial environment (knowledge and institutional) gaps and blockages;

(f) Lack of local market/customer knowledge by both local and foreign investors; and

(g) Lack of consumer (and political) awareness of climate change technologies/ approaches.

8. During the meeting, the PSAG discussed a range of topics to support activities enabling private sector involvement in the LDCs and SIDS.

(a) Creating an enabling environment;

(b) Aggregation of demand from LDC/SIDS countries;

(c) Technical assistance facilities focused on market activation, education and enterprise development, and local currency funding;

(d) Innovative investment structures and modalities;

(e) Modalities for working with the private sector; and

(f) Targeted Request for Proposals (RfPs).

### 2.1.1 Creating an enabling environment

9. The PSAG considered the importance of creating processes of local political, regulatory, and financial institutions modernization to build enabling environments in LDCs and SIDS to encourage private sector engagement. It commented that political risk and foreign exchange risks are issues for the private sector that delay or hinder investment opportunities. In order to encourage private sector participation in the LDCs and SIDS, it is important that countries demonstrate their commitment to mitigate political risks through clear, durable and supportive policies and legislation that actively promotes long-term private sector investment. At the same time, members also noted the need to take close account of the current regulatory context and market structure in individual LDC/SIDS countries, such as in terms of depth of regulatory frameworks, levels of ownership fragmentation in the economy and accessibility of financing for smaller enterprises, which make up the bulk of most LDCs and SIDS.

### 2.1.2 Aggregation of demand and dealflow from LDC/SIDS countries

10. The PSAG discussed known need for aggregating overall LDCs and SIDS demand in relation to climate finance businesses and projects, in terms of project sites, technology/equipment (e.g. solar panels, LED lights), financing (e.g. borrowing, insurance) and other relevant aspects. Purchase of aggregated “climate solutions” reduces prices (through enhanced bargaining power) and transaction costs, and establish alignment of purchasing and investment strategies on a regional or collective basis. It also noted the need for coordination and consolidation of such aggregated demand requirements into Nationally Determined Contributions (NDCs) and National Adaptation Plans (NAPs), as well as in terms of their implications for achieving relevant Sustainable Development Goals (SDGs). PSAG members further noted mechanisms or platforms for collective procurement or sourcing of finance for investments and Micro-, Small- and Medium-sized Enterprises(MSMEs) working on mitigation and adaptation should be supported., Bulk procurement in particular is prohibitive for smaller and/or more remote markets. Lowering costs through better procurement options provides a quicker pathway to scale for domestic private sector actors and increases involvement of local financial institutions (including microfinance and insurance).

### 2.1.3 Support mechanisms focused on market activation, education and enterprise development, and local currency funding

11. Given the pre-commercial context of most LDCs and many SIDS, the PSAG discussed the need for broad support mechanisms (in addition to enabling environment reforms) focused on market activation and reform which could be included in individual LDC-SIDS requests to the readiness programme of the GCF. Support should focus on the building blocks of functional markets currently missing in most LDCs and many SIDS, especially on building: awareness and demand for mitigation and adaptation goods and services; skilled local workforces and entrepreneurs; availability of affordable and appropriate technologies that match local needs (see previous section); and a local financial sector that understands and has the tools to

structure and finance climate investments. The PSAG also highlighted a need for technical assistance facilities around enterprise development to facilitate greater volumes of local currency funding, with particular focus on benefits that would accrue from this to MSMEs.

#### 2.1.4 Innovative investment structures and modalities

12. The PSAG discussed the development and use of new and innovative financing structures with applicability to LDCs and SIDS. One example highlighted was a debt restructuring/swap for marine conservation and climate adaptation undertaken by Seychelles, under which national foreign currency debt can be reduced and restructured into a local currency fund, conditional upon demonstrated progress on policy reform, supporting private climate finance investments. Seychelles is also leading the issuance of an innovative Blue Bond to finance a transition to sustainable fisheries.

13. Another example highlighted by PSAG was the on-lending through green banks and other local financial institutions in LDCs/SIDS for the purpose of financing specific and high-priority climate finance projects and interventions in these countries. Of particular note in this context is the fact that most LDC/SIDS countries' economies are characterized by a prevalence of micro-/small-sized businesses, which have specific needs in terms of access to capital and associated technical knowhow and capacity-building.

14. The discussion also brought out the importance of looking at utilising public-private insurance structures to help transfer and share climate-induced risks facing LDCs and SIDS, thereby enhancing their long-term resilience. Private lenders are ready to equalize some risks - in Grenada, for example, interest payments are deferred if a hurricane of certain level hits the island. However, applying risk-transfer solutions goes beyond insuring against loss: frequent challenges in LDCs and SIDS refer to political risk and foreign exchange risks, for which appropriate risk sharing/allocation solutions such as guarantees should also be incorporated, particularly in the mitigation space where offtaker risk is a significant concern, particularly in LDCs. These mechanisms are well-understood and could immediately be deployable to existing lenders in the climate space to ramp up their ability to engage in riskier and less developed markets such as LDCs and SIDS.

#### 2.1.5 Modalities for working with the private sector

15. The PSAG identified accreditation as one of the key barriers for private sector engagement with the GCF: processes are long and timelines as well as outcomes – at least for outsiders - come across as unpredictable. This is incompatible with the needs of private sector investors and financial institutions, who typically receive, and therefore expect, decisions within a matter of weeks. In this context, members observed that GCF having three Board meetings per year represents a major obstacle for many private sector investors and financial institutions, who typically have investment committee meetings on a much more frequent basis. As a consequence of its longer and less predictable processes, the GCF risks ending up missing out on potentially valuable long-term client relationships, which could adversely impact the deliverability of solutions and support for LDCs and SIDS countries. Ideas suggested in the discussion to overcome these barriers included a fast-track option for specific types of private sector entities specialized in SIDS / LDC markets or issues and generally much faster GCF procedures for all entities, in the first place.

#### 2.1.6 Requests for Proposals

16. Members commented on the potential value of issuing RfPs specifically targeting LDCs and SIDS, but noted that it would be valuable to first review the concept notes already

submitted to the earlier RfPs, which may provide important insights into what the private sector is potentially interested in financing in relation to LDCs and SIDS, and which may provide projects that can quickly be incorporated into GCF's project pipeline.

# III. PSAG recommendations

## 3.1 Key recommendations

17. **Creating strong enabling policy, planning, regulatory and financial environments.** Within the context of country ownership and in line with country-specific demands, the PSAG recommends the GCF provide support for the development of policy, regulatory and financial institutions frameworks conducive to improving the ease of doing business and scaling up of private sector climate financing in LDCs/SIDS, including through such measures as awareness building vis-à-vis LDC/ SIDS governments and regulatory authorities. This could be implemented through the use of the Fund's Readiness Programme or via project-specific TAFs. Where feasible, this engagement should be structured into relevant GCF outreach and country engagement activities, such as in connection with country missions or regional Structured Dialogue events. Given that one of the most pressing financial needs for local businesses is access to capital in local currencies, training of local financial institutions in climate-related finance is fundamental to creating self-sustaining progress.

18. **Demand and dealflow aggregation**. It has long been recognized that small purchases and deal sizes are significant barriers to accessing finance for nascent and/or small markets, such as those in LDCs and SIDS. GCF should work with relevant partners to develop support mechanisms to both aggregate or bundle smaller-scale climate projects (such as minigrids), and aggregate purchasing of small-scale solutions at lower effective prices (such as small solar units, agricultural technologies, etc.). This might be at local, national or regional or other collective level (cross-border, industry-wide), and anchored on solid and existing demand requirements within these markets.

19. **Market activation**. Within the context of country ownership and in line with specific country demand, GCF is encouraged to establish, including through its Readiness Programme, Technical Assistance Facilities (TAF) and other support tools and processes, to activate markets in LDCs and SIDS. Given the pre-commercial and often non-existent status of markets for many climate goods and services in LDCs and SIDS, there are often only few businesses within the climate goods and services space. Given the complexity of market systems, individual interventions will be inadequate to create self-sustaining growth of climate businesses. Recalling GCF's objective to create self-sustaining and inclusive markets for climate goods and services, the PSAG recommends supporting best practice LDC market activation processes in each country, comprised of a suite of longer term interventions focused on awareness, knowledge and trust building amongst key market actors. Such recommendations include:

(a) Support local private sector capacity through Technical and Vocational Education and Training (TVET) institutions and business incubators;

(b) Support financial sector literacy and interest in climate business and investment through training in climate finance for local business, including microfinance;

(c) Support local industry's voice by encourage industry bodies and associations to work with governments and consumers to design locally appropriate policy and regulatory environments;

(d) Support market data collection and publication to facilitate both market intelligence for financial markets and also policies and regulations appropriate to local conditions;

(e) Support demand growth through:

(i) Support to civil society to build awareness, trust and skills amongst poor and marginalized communities around new/unknown business, technologies and services; and

(ii) Awareness / communications campaigns on climate technologies, services and business.

20. **Innovative financing structures and modalities.**

(a) GCF should engage with relevant partners (AEs, countries and other stakeholders) to develop and structure innovative projects with high impact potential for LDCs/SIDS. This could build on showcase projects, or build on existing GCF modalities for intervention, e.g. targeted on-lending through local financial institutions. Projects should be tailored to the distinctive issues and barriers facing LDCs/SIDS (individually and, where relevant, collectively) and involve significant paradigm shift potential;

(b) PSAG encourages GCF to analyze the use of risk-transfer instruments to address climate-induced risks as an area of particular relevance. The GCF is invited to partner with specialized institutions in this area, for the development of risk sharing structures that can specifically address climate-induced risk exposure of LDCs/SIDS. Specifically, support for guarantee funds is recommended, which are well-understood tools that have been vastly underutilized to date; and

(c) The above outlined efforts by GCF should translate into targeting LDC/SIDS countries to develop at least one Funding Proposal involving an innovative financing structure or modality to be presented to the Board for approval.

(d) PSAG recommends the GCF to analyze the engagement with Green Banks already in place, or those to be created under a proposal by an AE, as well as other dedicated local green financing entities to act as counterparties to the GCF for generating projects and programs or for aggregating demand for LDCs and SIDS.

21. **Modalities for working with the private sector.** It is suggested to have an increased interaction between PSAG and the GCF accreditation panel/committee to better understand the barriers and challenges of accreditation of private sector entities. Furthermore, the PSF should present and promote "GCF Private Sector Showcases", where accreditation and project approval occurred in a reasonable timeframe, as a way of potentially attracting new private sector partners.

22. **Targeted Requests for Proposals.** The Mobilizing Funds at Scale RfP has been "oversubscribed" with about 350 proposals, requiring a multiple of the Board approved envelope of USD 500 million. This ready pipeline of potential private sector GCF projects should be carefully anlyzed, including its relevance for GCF strategic priority areas, such as LDCs/SIDS and adaptation.