



**GREEN
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Recommendations of the Private Sector Advisory Group on opportunities to engage the private sector in adaptation

Summary

This document contains the recommendations of the Private Sector Advisory Group to the Board on opportunities to engage the private sector in adaptation. The recommendations are presented in response to a request from the Board to scale up solutions to enhance the volume and impacts of adaptation programmes and investments, and include:

- (i) Reiteration for support to readiness and project preparation activities in order to close information asymmetries and mitigate risk perceptions;
- (ii) Knowledge generation and transfer, including support for the utilization of climate data and projections to enable decision-making;
- (iii) Risk transfer products, such as insurance, to cover the residual costs of risk;
- (iv) Blended finance and public–private partnership structures to address market failures and incentivize private sector participation; and
- (v) Gap analysis to determine areas where efforts should be focused, in order to support the development of funding proposals that target gap areas.

I. Introduction

1. The Board, in decision B.15/03, paragraph (i)(ii) and decision B.17/06, paragraph (d)(ii), requested the Private Sector Advisory Group (PSAG) to provide recommendations on “opportunities to engage the private sector, including local actors, in adaptation action at the national, regional and international levels”.
2. This document can also inform the forthcoming Secretariat’s report to the Board on the approach and scope for providing support to adaptation activities as requested by the Board in decision B.17/10, para. (c)(ii).
3. The PSAG held meetings from 6 to 7 December 2017 in Copenhagen, Denmark, and from 1 to 2 March 2018 in Songdo, Republic of Korea, to discuss requests from the Board and provide intellectual leadership to key private sector and climate change issues. Initial data and content from GCF-commissioned research by the World Resources Institute was also reviewed by the PSAG members, which helped to initiate the discussion.
4. This paper provides an overview of the PSAG discussions on the challenges, barriers and opportunities to engage the private sector in adaptation action as background information, followed by specific recommendations to the Board in response to this mandate.

II. Private Sector Advisory Group discussions

5. During the meetings held in December 2017 and March 2018, the PSAG discussed a broad range of aspects relating to private sector engagement in climate adaptation finance, including guidance and scope for ways in which GCF can provide support towards a deepening of such engagement.

2.1 Background and context

6. Adaptation is an “adjustment in natural or human systems in response to actual or expected climatic stimuli or their effects, which moderates harm or exploits beneficial opportunities”.¹ In the Paris Agreement, the global goal on adaptation was established as a process to enhance adaptive capacity, strengthen resilience and reduce vulnerability to climate change. In the context of increasing the resilience of communities and regions, and of reducing risk and vulnerabilities, climate finance has been paramount to supporting international as well as local efforts in assessing market vulnerabilities and delivering investments.
7. Adaptation finance through public flows has been deemed insufficient to satisfy adaptation needs globally, particularly in developing countries. For example, the United Nations Framework Convention on Climate Change (UNFCCC) estimates the additional investment and financial flows needed for adaptation worldwide to be around USD 60–182 billion by 2030, of which USD 8–130 billion may be required for adapting infrastructure. The UNFCCC also estimates that an additional USD 52–62 billion would be needed for agriculture, water, health, ecosystem protection and coastal-zone protection, most of which would be used in developing countries.² As such, private sector engagement in adaptation finance has become relevant to closing the existing gap.

¹ Intergovernmental Panel on Climate Change. 2001. *Climate Change 2001: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Third Assessment Report of the Intergovernmental Panel on Climate Change*. Annex B: Glossary of Terms. J McCarthy, OF Canziani, NA Leary, DJ Dokken and KS White (eds.). Cambridge, United Kingdom, and New York: Cambridge University Press. Available at <<http://www.ipcc.ch/ipccreports/tar/wg2/index.php?idp=689>>.

² UNFCCC. 2007. *Investment and Financial Flows to Address Climate Change*. Available at <<http://www.un.org/ga/president/62/ThematicDebates/gpicc/iffacc.pdf>>.

8. However, there are currently very limited robust and well-defined business models or products to promote adaptation activities in the private sector, with possible exceptions of insurance, the built and physical environment, corporate industry, the agriculture sector and supply chain. Yet even these are not widely used or available in countries or groups most vulnerable to climate change. The members of the PSAG are confident that investments with high adaptation potential could be generated and implemented for various sectors using a wider range of financial instruments.

9. Hence, rather than immediately assuming that adaptation is purely a social goods problem, there is potential for further development in private sector driven markets for adaptation. Nevertheless, the negative impacts of climate change bear costs for the overall economy, especially for developing countries that are particularly vulnerable to the adverse effects of climate change. It is recognized that adaptation investments can avoid new additional costs in relation to the adverse effects of climate change.

10. Similar to the progress in scaling up energy efficiency and renewable energy in climate change mitigation, private sector investments in adaptation are slowly growing, as risks, vulnerabilities and the business case for adaptation finance are better understood.

11. In a number of cases, private sector enterprises could already be acting in line with the concept of adaptation without directly using that term. For example, when responding to circumstances that cause greater business disruption and operational risk in water access activities, companies are indeed adapting to climate change. Moreover, adaptation is also a process that encompasses several activities and cannot therefore be confined to one single sector. While complex in nature, this could be an opportunity for GCF to act as a leader in working with private sector entities (such as the insurance and corporate sectors), as well as other stakeholders (such as civil society organizations and local governments), to continuously optimize and adjust their business models and operations to act on the increasing impacts and uncertainties caused by climate change. In this context, it is important to support new models alongside sustained awareness campaigns that are needed to address scarce resources and limited knowledge of adaptation, respectively.

2.2 Key existing barriers

12. PSAG members identified several key existing barriers to engaging the private sector in adaptation action:

- (i) **Underdeveloped or non-existent markets:** this includes difficulties in identifying adaptation projects, their climate impact and commercial potential. PSAG members have highlighted the need for a flexible approach to foster markets in adaptation. As the adaptation space is still at an early stage, it is important to create incentives to allow local private sector participation. Members also discussed the need to develop the concept of 'loss-cost avoidance' (i.e. actions needed now to avoid costlier damage in the future). In addition, programmes such as the Readiness and Preparatory Support Programme, technology transfer, grants for knowledge-sharing and project preparation can be supportive to market creation, regulatory support and, ultimately, pipeline development;
- (ii) **Liquidity and macroeconomic challenges:** PSAG members also highlighted a lack of longer-term investment modalities and products needed to finance adaptation projects that are often characterized by long-term economic pay-back profiles and/or delayed benefits. Specific challenges in this context include capturing positive societal externalities generated by private investment in

adaptation, as well as ensuring sufficient scope for adequate monetization of adaptation benefits; and

- (iii) **Information asymmetries:** another key set of barriers discussed by PSAG members pertains to incomplete or asymmetric information on climate change impacts, including inadequate access to climate data models and projections, or difficulties in turning vulnerability assessments into action. These can prevent informed decision-making. PSAG members also observed that this information gap can often translate into an increased perceived risk profile being attached to adaptation compared to other investment opportunities undertaken by the private sector. Awareness activities to close this gap can therefore help both the private and the public sector to understand adaptation, which will reduce the risk perception from private actors. This will ultimately result in the development of favourable public policies and a strengthening of the regulatory framework that enables adaptation projects.

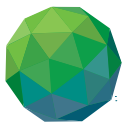
III. Recommendations of the Private Sector Advisory Group

13. The following recommendations are made to the Board by the PSAG in relation to opportunities to engage the private sector in adaptation action:

- (a) **Consider focusing on risk transfer instruments, which includes insurance as a financing modality:** risk transfer instruments may be rolled out and tested more broadly to enhance the engagement of the private sector in adaptation activities. GCF can consider supporting insurance-based products and structures that address 'residual' climate-induced risk, where physical adaptation measures may not be feasible and/or make financial sense. This could include insurance-based risk management and transfer solutions, such as parametric (index-based) insurance, extending into innovative financing structures that also tap into capital markets, including resilience bonds and dedicated green/blue bonds. Attention should be paid to opportunities that allow: (a) aggregation/bundling (geographical and financial); (b) expansion of access to data and other information to standardize and facilitate access to climate risk information; and (c) harmonization of legal and regulatory frameworks as a way of reducing costs for insurance solutions. The cost of insurance needs to be placed in the context of the level of adaptation investments that may be averted, as opposed to purely viewing it in terms of the premium paid;
- (b) **Facilitate blended finance and public-private partnerships (PPP):** blended finance has been used with success in leveraging finance for climate change mitigation. GCF should facilitate an increase in blended finance and PPPs to support engagement with the private sector in adaptation action. By using public finance to alter the risk/return profile of adaptation projects and investments, current barriers to private sector adaptation finance could be removed. Blended finance is also important to guide behavioural change and address financial and non-financial barriers in the same project or investment. There is also an opportunity to address adaptation finance in PPP structures, for example in long-term concessions that are managed by the private sector, such as energy distribution, water and sanitation, or solid waste management, among other services and technology solutions that support the day-to-day needs of the population. Lastly, there is growing urgency in private adaptation finance to understand the opportunity cost of action and non-action, in particular as it pertains to the avoidance of infrastructural lock-in and maladaptation;
- (c) **Support a broader enabling framework:** as emphasized in the recommendations of the PSAG on the development of modalities to support activities enabling private sector involvement in the least developed countries and small island developing States

(document GCF/B.19/31 titled “PSAG recommendations on the development of modalities to support activities enabling private sector involvement in LDCs and SIDs”), it is important to foster processes for the modernization of local, regulatory and financial institutions in order to support the enabling environment that will underpin further investments. GCF intervention should go beyond engaging the private sector in individual adaptation projects and look towards support for a wider set of components that contribute to an improved enabling environment that will ultimately create a competitive and efficient market for successful private sector adaptation projects. These activities can include capacity-building and knowledge transfer for stakeholders, policy dialogue, and regulatory framework assistance;

- (d) **Support the conception, production and dissemination of consistent and relevant climate data and projections:** GCF should provide support that will improve access to and use of climate data, analysis and projections, which in turn will help to improve private sector decision-making in relation to adaptation finance by providing more certainty for economic agents and investors. This can also help by developing new products and markets to support adaptation projects and strengthen the climate rationale of funding proposals. Existing GCF activities, such as readiness support for national adaptation plans (NAPs), can be used as a delivery mechanism, alongside dedicated technical assistance and project preparation grants;
- (e) **Involve the private sector in the development and implementation of national adaptation plans:** GCF, at the request of countries, could support private sector involvement in readiness activities and country programming and support national-level communication campaigns for the solutions that it decides to fund (e.g. insurance for smallholder farmers). This can be done through dedicated private sector participation in country dialogues and in country programming. Smooth cooperation between the public and private sectors should be promoted and strong alignment between relevant NAPs and GCF private sector adaptation projects needs to be ensured, with a view to understanding and then supporting end-users’ needs;
- (f) **Identify and partner with existing financial intermediaries that are expanding their businesses:** GCF should identify and partner with existing GCF accredited entities and financial intermediaries (including local financial intermediaries) that are expanding dedicated pro-adaptation products (e.g. water efficiency credit lines) and explore partnership opportunities with them in order to support transformational change and the sustainability of such activities;
- (g) **Request the Secretariat to undertake deeper analysis of the business models of private sector concept notes and funding proposals related to adaptation:** GCF should undertake further analysis of the business models (e.g. financing modalities, products) of the concept notes already received under previously issued private sector requests for proposals (e.g. micro-, small-, and medium-sized enterprises, and mobilizing funds at scale), as well as private sector adaptation projects in the existing pipelines. This analysis can provide information as to the composition of adaptation projects, the areas covered and the instruments used. It can inform the identification of gaps either in areas to be developed or in products/instruments to be used, which can further guide future private sector engagement; and
- (h) **Focus efforts on developing funding proposals that target specific gaps in private sector adaptation investment:** efforts could be focused wholly or partially on a particular area of adaptation, targeting developing countries that are particularly vulnerable to the adverse effects of climate change, as those countries face a number of common and diverse challenges in relation to climate change adaptation, such as water stress, sea level rise and exposure to extreme weather events (e.g. hurricanes, flooding). Particular focus can be provided to underserved areas with high vulnerabilities and high



potential for private sector participation. A potential modality for this could be through a dedicated Request for Proposals, e.g. to be launched at B.23.

Annex I: Draft decision for the Board

The Board, having considered document GCF/B.20/12 titled “Recommendations of the Private Sector Advisory Group on opportunities to engage the private sector in adaptation”:

- (a) *Welcomes* the discussions and recommendations from the Private Sector Advisory Group, and asserts its support for the role of the private sector in climate adaptation amongst others through dedicated efforts to involve the private sector in Readiness Support Programmes and to generate further adaptation funding proposals, cognizant of the fact that viable business models are limited;
 - (b) *Requests* the Secretariat to further explore the role of risk transfer mechanisms to be considered at B.23 and encourage the development of risk-transfer insurance-based funding proposals;
 - (c) *Requests* the Secretariat to further consider opportunities for private sector cooperation to enhance climate data origination and utilization, in particular in Readiness Support Programmes and in co-operation with focal points and NDAs;
 - (d) *Requests* the Secretariat to more vigorously incorporate private sector in the support to the development and implementation of National Adaptation Plans and Processes, including in country dialogues and programming, in co-operation with focal points, NDAs, and other relevant stakeholders;
 - (e) *Requests* the Secretariat to undertake further analysis, based on the recommendations from the Private Sector Advisory Group, of the business models of private sector concept notes and funding proposals related to adaptation, including those received under previously issued RfPs, as well as private sector adaptation funding proposals in the pipeline, to be considered at B.23;
 - (f) *Also requests* the Secretariat to identify existing GCF accredited entities, partners and financial intermediaries (including local financial intermediaries) that could potentially expand dedicated pro-adaptation products; and
 - (g) *Encourages* the Secretariat to focus efforts in developing funding proposals with AEs that target specific gaps in private sector adaptation finance, and to consider a dedicated Request for Proposals for private sector adaptation investment, to be launched at B.23, subject to Board approval.
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