GREEN CLIMATE FUND

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# Review of the initial modalities of the Private Sector Facility – Addendum I

## Consideration of the private sector strategy

**Summary**

This paper presents the private sector strategy for Board consideration and approval.

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# I. Introduction and context setting

1. In accordance with the Governing Instrument for the GCF, the Private Sector Facility (PSF) is an integral part of the initial structure of GCF that enables it to directly and indirectly finance private sector mitigation and adaptation activities at national, regional and international levels. The Governing Instrument provides for the operation of the facility to be consistent with a country-driven approach and to promote the participation of private sector actors in developing countries, particularly local actors, including micro, small and medium-sized enterprises and local financial intermediaries. The mandate of the PSF also includes an additional provision to support activities to enable private sector involvement in small island developing States and least developed countries.

2. Through decisions B.06/04, B.09/09 and B.07/08, the Board further developed the necessary arrangements, including the access modalities, to operationalize the PSF. Since the establishment of the independent Secretariat of the GCF, the PSF has been working according to the initial modalities for its operation. This distinctive feature, integral to the architecture of GCF, is fully operational and effective, thereby ensuring GCF can play a decisive role in mobilizing private sector resources to support climate change actions in developing countries.

3. The Board established the Private Sector Advisory Group (PSAG) to make recommendations to the Board on the GCF-wide engagement with the private sector and modalities to that end (decision B.05/13, paragraphs (h)-(m)). As part of its work programme, PSAG reported to the Board at its seventeenth meeting that it "will support the PSF in the mapping of private sector players and the development of a strategic roadmap for GCF engagement with the private sector, institutional investors and areas of uniqueness, complementarity, and collaboration in the climate finance space with the ultimate goal of developing a business plan".

4. Subsequently, at the Board's nineteenth meeting and responding to a mandate specified in the initial Strategic Plan of the GCF, PSAG provided its recommendations on the development of a private sector outreach plan. In decision B.19/17, the Board, having considered document GCF/B.19/30 titled "PSAG recommendations on the development of a private sector outreach plan", among other things, requested the Secretariat to incorporate the recommendations from the PSAG into the strategic roadmap of the Secretariat for leveraging, mobilizing and engaging domestic and international private sector actors, the communications strategy of GCF, and other relevant policies, processes and programmes, as appropriate.

5. In response to the above provisions, the PSF has undertaken the development of a private sector strategy with the overall purpose of ensuring a more proactive engagement of private sector entities towards the achievement of its mandate. The current private sector strategy has been designed in a manner to maximize synergies with ongoing efforts to implement the revised Readiness and Preparatory Support Programme Strategy for 2019–2021. It has further been informed by ongoing Board deliberations on the revision of the initial Strategic Plan and potential programming directions in the context of the replenishment process. The implementation of the strategy will enable PSF to:

(a) Become a risk-inclined and impact-oriented premier institution in the climate finance space; and

(b) Accelerate the flow of private and institutional funding from international, regional and local sources toward the development of projects and programmes to support both mitigation and adaptation activities in developing countries, thereby enabling domestic and international private sector engagement.

## II. Core elements of the private sector strategy

6. The private sector strategy was developed by matching countries' needs and priorities (demand) with private sector players' interests and opportunities in financing these needs (supply). In addition, the formulation of the strategy considers the current challenges faced by the PSF, as well as unique areas that will make the PSF offering unique, additional and most impactful. The intersection of these demands and supply are summarized below, and the strategy is a bridge that creates a balanced private sector strategy.

7. The table is summarized below and focuses on the needs of national designated authorities and the private sector. These needs have been expressed by national stakeholders (national designated authorities (NDAs)), outlined on the left side of the table, and private sector actors, outlined on the right side.

**Table 1: Summary of national designated authority and private sector perspectives on needs**

| Countries needs as expressed by national stakeholders (NDAs) | Needs expressed by private sector actors |
|---|---|
| › Private sector needs **enhanced access** to credit (tenor, rates, currency, speed);<br>› GCF to help intermediate between international **private sources and domestic capital markets;**<br>› NDAs need substantive support in identifying private business opportunities, including through NDC conversion and in adaptation;<br>› Help to build stronger **local financial institution**s focused on climate finance;<br>› Better **targeting of readiness** to support project development and origination; and more rapid deployment of readiness;<br>› Interested in **flexible country-led approaches** to encourage replication; want predictability from programmatic platforms;<br>› Improve PSF awareness of national circumstances/policies; consideration of these in project origination, selection;<br>› **DMA and PSF to work closely together** to deploy country-driven programmes across public and private and develop toolkits;<br>› **Better articulation** between PSF, local private sector & FIs are wanted, including for MSMEs and bottom of the pyramid;<br>› Welcome **South-South knowledge-sharing platform** in engaging the private sector;<br>› GCF policy and **selection criteria should support more risk** taking from GCF and AEs: focus on higher impact projects; | › **Foreign exchange risk** support and hedging; and GCF to offer **longer tenor debt** in **local currency** at reasonable rates;<br>› **Guarantees, price off-taker support** and other credit enhancements;<br>› Support financial intermediaries that channel financing **to climate-focused SMEs;**<br>› Unavailability of **climate investment platforms suitable** for institutional investors;<br>› Support **vehicles aimed at mobilizing local capital market**s for climate investments;<br>› **Early stage equity** such as accelerators and incubators, venture and seed to build out investable project pipelines**;**<br>› Capacity-building for governments to build **appropriate climate policy** and private sector conducive environments;<br>› AEs need to **improve channeling function** as private sector players have found large DFI AEs as unsupportive of non-AE generated private sector projects;<br>› Expert **private sector focused staff at GCF** who understand the private sector who can provide speed, efficiency and accountability with processing and reviewing deals at GCF;<br>› **Clear pathway to capital** with commitment from GCF (e.g. product-specific RFPs);<br>› Proactive market-making to address gaps in the climate finance architecture; |

| **Countries needs as expressed by national stakeholders (NDAs)** | **Needs expressed by private sector actors** |
|---|---|
| › **Simplify processes** and **decision-making** to better suit local private sector, MSMEs and bottom of the pyramid activities; and<br>› **Greater transparency on criteria for financial terms** (e.g. when is concessionality considered?) could help private sector proponents determine whether GCF is a viable source. | › **Flexibility to adapt accreditation criteria** to diverse governance structures;<br>› Allow the **private sector to co-invest or partner with the GCF** without becoming an AE; and<br>› **Improve transparency** of GCF access and decision-making processes on accreditation and project cycle. |

*Abbreviations:* AEs = accredited entities, DFI = development finance institution, DMA = Division of Mitigation and Adaptation, FIs = financial institutions, MSMEs = micro, small and medium-sized enterprises, NDA = national designated authority, NDC = nationally determined contribution, PSF = Private Sector Facility, RFPs = requests for proposal, SMEs = small and medium-sized enterprises.

8. As such, the driving force underpinning this strategy is that GCF and its PSF is to focus on achieving a paradigm shift by acting proactively as a risk-inclined and impact-oriented keystone or premier institution in the climate finance space. Reconciling all the insights and feedback from all stakeholders led to the identification of seven initial scenarios or pillars that could underpin the development of a unique and differentiated private sector strategy:

(a) Taking more risk to achieve more climate impact in line with the strategic priorities of the fund;

(b) Building local financial institutions and local capital markets that support delivery of climate finance;

(c) Building and capitalizing a high impact pipeline;

(d) Supporting country markets and expertise;

(e) Improving micro, small and medium-sized enterprise (MSME)/"bottom of pyramid" modalities;

(f) Being a market maker for implementation; and

(g) Applying flexibility and providing clarity for private sector proponents.

9. The focus of the strategy is built on three scenarios or pillars (a, b and c), as the areas that will have the highest impact for a strong and a transformative pipeline. These are elaborated below. It is believed that these three pillars or scenarios will distinguish GCF from other players in the climate finance architecture. In addition, the paper also outlines a clear outreach plan (elaborated in section III) that is needed to support the strategy, as well as how the strategy and the Secretariat are addressing challenges and lessons learned during operations (IV). Finally, section V presents an outline of the impact the implementation of the strategy could have on the GCF portfolio as well as resource implications.

10. As such, the first three scenarios have been prioritized together with the Secretariat based on reflections on consultations from stakeholders, analysis grounded on key GCF principles and the need to ensure both countries' and the private sector's perspectives while considering complementarity with a wider climate finance architecture. The following three prioritized scenarios are more encompassing, therefore, the remaining four could be implemented under their scope:

(a) Becoming more risk inclined for high impact projects;

(b) Strengthening climate oriented local financial systems, markets and institutions; and

(c) Acting as a market maker for climate actions.

11. The following tables summarize key considerations for each scenario and what they mean, clearly describing not only the examples but also the Board's considerations.

12. **Pillar I: GCF should take more risks to achieve a transformational impact.** There are four key activities that support the risk inclined approach, and these include: (1) considering offering local currency to support mostly non-foreign dominated intervention; (2) increasing investments in direct equity in strategic direct equities and investment funds for a total maximum of, for example, 350-500 million in the 3-4 year time horizon; and (3) the development of venture style incubators and accelerators in partnership with credible players- and existing players including the lab, foundations interested in this space, and others. Summarized below are further details on this modality, its potential impact on the portfolio and resources required. It also shows that it can be implemented under the current modality with limited overall impact.

**Table 2: Pillar I – Becoming more risk inclined for high impact projects**

| Options | Application | Examples | Board's role in each consideration |
|---|---|---|---|
| Private Sector Facility to offer local currency finance to de-risk high impact climate investments in developing countries | • For all transaction sizes<br>• Ensure concessional credit lines are available in local currency for micro, small and medium-sized enterprises, local developers of transformational climate, cooperatives and farmers so they can access climate-compatible technologies | • Different approaches could be considered, such as partnering with an organization like the Currency Exchange Fund to implement hedging solutions or piloting other innovative local currency financing mechanisms | • Require Board consideration<br>• Could be structured with limitation under current business model<br>• More efficient application requires Board consideration and business model enhancement |
| Take direct equity positions to support innovative business models | • Early-stage equity funds<br>• Investing in demonstration concepts<br>• Invest alongside local incubators pari-passu with foundations and other risk inclined investors | • May wish to consider piloting in under-resourced results areas in adaptation<br>• May need to strengthen readiness for concept development | • Could be structured under current business model<br>• More efficient application requires Board consideration and business model enhancement |
| Develop and support venture style development finance | • Competitive innovation funding: seed support, on a competitive basis in partnership with | • A risk-based provisioning approach for guarantees would allow the tool to be | • Could be structured under current business model |

| Options | Application | Examples | Board's role in each consideration |
|---|---|---|---|
| | other funders, for promising teams and concepts to reach scale quickly | more efficiently used as a complement to loans and equity | • More efficient application requires Board consideration and business model enhancement |

13. **Pillar II: Supporting climate oriented local financial systems, markets and institutions**. This pillar focuses on the role of PSF in building credible local financial institutions, including green banks that can effectively deliver climate finance, and for PSF also to support the bundling of portfolios that can be packaged to be sold to institutional investors interested in the developing country climate portfolios. In addition, it involves building a network of XacBank-like banks who can effectively deliver and implement quickly. This can be implemented easily under the current modality, but it is key to also support the accreditation of a strong network of XacBank-like banks.

**Table 3: Pillar II – Supporting climate-oriented local financial systems, markets and institutions**

| Options | Application | Considerations | Prerequisites |
|---|---|---|---|
| Include financial system reform of the entire climate finance delivery mechanisms (institutional and policy) to be included in the country programmes | • Provide support to countries willing to undertake financial and climate finance delivery system reform in design and review of GCF country programmes | • To be implemented in the context of the review or any future iterations of country programmes | • None. Immediately applicable and consistent with current business model |
| Develop flexible, targeted programming for national climate banks | • Bottom up and iterative: seek to replicate successful experiences like XacBank through South-South cooperation and readiness support<br>• Systemic: support requests from national designated authorities/ accredited entities to promote the establishment of platforms for the greening of financial systems<br>• Specific: help countries implement specific policies, e.g. (TCFD) Task Force on Climate Risk | • Maximize the opportunity to partner with local financial intermediaries and engage micro, small and medium-sized enterprises in domestic climate actions<br>• Cooperative dialogue and knowledge-sharing platforms could be included to increase capacity building impacts | • None. Immediately applicable<br>• Consistent with current business model |

| Options | Application | Considerations | Prerequisites |
|---|---|---|---|
| | Financial Disclosures recommendations | | |
| Underwrite securities in markets where applicable (e.g., frontier and emerging markets) | • Underwrite securitization of Financial Institutions climate portfolios. Green bonds (e.g., for infrastructure projects), and asset backed securities | | • Could be structured under current business model<br>• More efficient application requires Board consideration and business model enhancement |

6. **Pillar III: Acting as a market maker for climate actions**. As outlined below, this pillar can be within the current business model and has been further enhanced by a re-alignment of the project cycle approach and further focuses on ensuring that the readiness and country programmes properly reflect the role of the private sector, and align the country needs to focus readiness to support policy reform that lead to sectoral transformations, and finally, aligning the accredited entities (AEs) to support country programmes that are well developed with strong transformational climate agendas.

**Table 4: Pillar III – Acting as a market maker for climate actions**

| Options | Application | Considerations | Pre-requisites |
|---|---|---|---|
| Strengthen private sector role in the country programmes | • Support NDAs to better involve the private sector in country program processes and consider their role in implementing their priorities<br>• Support countries' efforts to improve enabling environments for climate investment<br>• Encourage NDAs to consider readiness/PPF resources for private sector project development | • Secretariat-wide efforts to strengthen the country programme processes that comprehensively target both public and private sectors at the national level | • None. Immediately applicable<br>• Consistent with current business model |
| Develop flexible and targeted programmes that yield critical private sector transformation | • Bottom up/iterative: seek to replicate successful experiences from other countries<br>• Systemic: support requests from NDAs/AEs to promote the establishment of platforms for overall sector transformation | • Cooperative dialogue and knowledge-sharing platforms could be included to increase capacity-building impact | • None. Immediately applicable<br>• Consistent with current business model |

| Options | Application | Considerations | Pre-requisites |
|---|---|---|---|
| | • Specific: targeted RFPs to identify projects in support of common priorities and challenges across multiple countries | | |
| Align all private sector actors and AEs around national priorities | • Targeted national RFPs to identify projects that support specific-sector policy<br>• Competitive selection of "best fit" AE partners that can support implementation<br>• Sourcing partnership solutions (e.g. CTCN on climate technology related priorities) | • Consideration could be given to outsourcing RFP management to private firms | • Require Board consideration |

*Abbreviations:* AEs = accredited entities, CTCN = Climate Technology Centre and Network, NDAs = national designated authorities, PPF = Project Preparation Facility, RFP = request for proposal.

7. In order to support issues related to the lack of access for private sector players, the strategy outlines strong recommendations in opening up a small window or direct approach while considering changes to the current project-specific accreditation framework to support category B as well as medium-sized projects. The project specific approach does not currently solve the access issues of the private sector, and it does not address the needs of the private sector players.

**Table 5: Recommendation: consider reforms that can improve impact and engagement with the private sector**

| Options | Application | Considerations | Prerequisites |
|---|---|---|---|
| Pilot a direct investment approach to PSF | • The Secretariat put in place necessary conditions to undertake full due diligence for these investments<br>• Establish "sidecar" vehicles to allow other investors to partner with, rather than fund through, the GCF | • Clarify the provision in the Governing Instrument for the GCF, decision B.04/08, paragraph (l)(ii), stating that the PSF may, over time, work directly with private sector adaptation and mitigation actors and adopt modalities consistent with this provision | • Require Board consideration and business model enhancement<br>• The Board could decide to approve such a modality for limited capital (up to USD 500 million) |
| Reform project and programme activity cycle | • To assess and address potential implications of proposed recommendations and requirements to implement them | • Crowding out test may require review following the adoption of the GCF policy on concessionality | • |

| Options | Application | Considerations | Prerequisites |
|---|---|---|---|
| | • Transparent selection and assessment criteria for new modalities (e.g. institutions and projects for piloting direct investment, results of tests for crowding out risk) to be presented by the Secretariat prior to Board consideration<br>• Appropriate and private sector responsive notification procedure benchmarked against best practice that NDAs can choose instead of NOL (to be clarified after the evaluation of country ownership by IEU) | | |
| Reform accreditation | • Project-specific assessment approach for proponents that win RFPs<br>• Strategic accreditation through competitive processes<br>• Ideally, private sector accreditation should be rethought to allow for a separate private sector-appropriate track, in particular for direct access | • Adoption of project-specific assessment approach with specifications that will enable participation of private sector actors (ESS category B; no limit to project size but possible to GCF funded amount, etc.) | • Require Board consideration and business model enhancement<br>• Decision to be consistent with the decision on PSAA |

*Abbreviations:* ESS = environmental and social safeguards, IEU = Independent Evaluation Unit, NDAs = national designated authorities, NOL = no-objection letter, PSAA = project-specific assessment approach, PSF = Private Sector Facility, RFP = request for proposal.

# III. Private sector outreach plan

14. This section presents an overview of the outreach plan, which articulates how the Secretariat intends to implement, as part of the private sector strategy, the PSAG recommendations to promote the participation of private sector actors in climate actions in developing countries, with the views to unlock private capital towards achieving the GCF mandate.

15. The PSAG recommendations include the following : (i) communicate short and predictable GCF timelines; (ii) undertake regional and country-level outreach, including through structured dialogues and missions; (iii) address the specific needs and interests of private sector partners within GCF communications; (iv) use existing networks and communication channels; (v) leverage an annual meeting or conference of the GCF for outreach; and (vi) communicate around targeted requests for proposal (RFPs) to yield a greater volume of high-quality climate projects with interested private sector partners.

16. PSF is proposing to implement these recommendations through the following channels.

## Readiness and Preparatory Support Programme and country engagement

17. The Readiness and Preparatory Support Programme (Readiness Programme) constitutes an important channel to implement the private sector outreach plan. The 2019-2021 revised strategy offers several entry points that can be leveraged. PSF will support Secretariat-wide efforts to:

(a) Update the Readiness Programme Guidebook with improved guidance for NDAs and delivery partners with respect to private sector climate investments;

(b) Develop a manual and training materials to guide NDAs on approaches to engage with domestic private sectors and increase their understanding of the importance of the climate change agenda. The manual will capture lessons learned on engagement of the private sector with readiness and incorporate these into training modules;

(c) Share successful experiences on the relevance of integrating domestic private sectors in climate change governance structures and on ways to more meaningfully involve the private sector in national consultations;

(d) Support a comprehensive approach in integrating the private sector in the formulation and implementation of country programmes;

(e) Provide tailored support relevant for private sector direct access entities (DAEs) to further their understanding of GCF and its access modalities, including, but not limited to, the use of the wide range of available GCF financial instruments; GCF principles around concessionality; the scoping, designing and financial structuring of climate change projects, etc.; and

(f) Facilitate knowledge sharing activities, including NDA dialogues, DAE workshops and programming conferences to increase the understanding of NDAs/focal points about the potential of the private sector to support mitigation and adaptation activities.

## Secretariat-wide upstream engagement and business origination missions

16. To raise awareness among stakeholders and to engage with domestic private sector actors, PSF needs to tailor its approaches to the private sector according to the specific needs and the potential of different stakeholders, such as MSMEs or national development banks. Local private sector actors should be supported in furthering their understanding of climate change and the need to build their projects on countries’ climate priorities, needs, strategies and plans.

## GCF communications pertaining to the private sector

17. The GCF communications strategy should provide visibility to success stories demonstrating on-the-ground impacts of private sector projects. In April 2019, PSF supported a GCF communications project to develop, in the margins of a business development mission to Mongolia, a video, as well as graphics and written materials on GCF investments in the country. Such contents were later published on the GCF website and other media outlets to showcase how GCF works with private sector actors in developing countries. These materials provide powerful impetus to the private sector in Mongolia and other developing countries to continue to take the lead in the promotion of climate focused businesses. To strengthen awareness on the role and opportunity to engage the private sector in climate actions in developing countries, the PSF will continue to participate in similar communication related projects in the margins of major GCF events to showcase successful GCF investments implemented with private sector partners.

### GCF Private Investment for Climate Conference

18. In 2018, PSF led the organization of the inaugural Private Investment for Climate Conference, which attracted more than 700 guests from over 100 countries, representing a mix of institutional investors, specialized climate firms, project developers and high-level country representatives. Preparation for the 2019 conference is currently underway and is headed by a cross-divisional team. This event will continue to serve as a platform for business origination, while also familiarizing private sector actors with the purpose and distinctive characteristic of GCF as well as with PSF and its success stories.

### Other communications channels

18. **Communication around publication of RFPs.** Prior to the issuance of RFPs and in order to ensure they are clear, relevant and appropriate, communications activities will be undertaken to promote exchanges with the private sector on expectations and requirements. This approach has proven useful for the mobilizing funds at scale RFP with the publication of an advertisement through multiple channels, including on the GCF website, international media such as *The Economist*, and regional and national media strategically selected by the Secretariat to reach the widest audience.

19. **Other publication materials.** In addition to the efforts mentioned above, PSF has also produced a dedicated brochure that explains the way in which GCF engages the private sector, as well as examples of the first few projects. The brochure has been designed to address the needs and demands of the private sector and includes information on GCF access modalities and investment criteria. To ensure it reaches a wide range of audiences, it is presented in plain language accessible to a general audience and has been made available in French and Spanish. The Secretariat has been distributing the brochure during missions and conferences. The PSF brochure will be updated in 2020 to reflect the latest progress made.

## IV. Strategic challenges, lessons learned and proposed resolutions

20. The main strategic issues that arose from the experience of PSF engaging private sector actors using the initial modalities of the PSF are presented below.

### Challenge 1: origination of programmes and projects

21. There are distinct differences between the GCF programme and project origination approach and private sector practices related to deal origination. While the GCF origination approach requires a strong alignment with countries' climate priorities and desire for maximizing climate impact, private sector deal origination is normally driven by market knowledge, trends and opportunities, with a view of aligning various incentives including the incentives of profits. As PSF continues efforts to engage the private sector actors in GCF-related activities, following the GCF business model, it is clear that this difference has been demonstrated by the limited AE focus on countries' climate priorities and needs.

22. **Mitigants: the origination of programmes and projects** requires a strong approach to origination grounded on countries' priorities and the need to enhance understanding of private sector actors on the importance to support the climate change agenda. The need to increase outreach and continue to build long-lasting capacity in areas related to climate investments. Strategic use of readiness support, the Project Preparation Facility (PPF) and public sector policy instruments (generally in the form of technical assistance included in GCF-funded activities) to support private sector engagement in GCF activities.

**Challenge 2: engaging the private sector as part of the central role of the NDA**

23. An analysis undertaken in the context of the formulation of the private sector strategy suggests that overall, many NDAs have a limited understanding of the role of the private sector in supporting climate actions in developing countries.

24. **Mitigant: engaging the private sector as part of the central role of the NDA.** It is key that GCF and its PSF take an active and focused role in marshalling AEs to support the implementation of countries' priorities. Furthermore, there is a need to target the use of readiness resources for the meaningful involvement of the private sector, including dedicated activities that will help in the mapping of actors that are relevant for addressing climate change, which helps private sector entities understand the risks posed by climate change to their businesses, identify opportunities to contribute to the solutions, develop pipelines that are aligned with country priorities and needs, and support policy and investment frameworks that will support their mobilization, among others; and further guidance to include the private sector in the development of country programmes.

**Challenge 3: responsibilities of AEs and domestic private sector actors.**

25. The role of AEs is central to GCF operations. They are entrusted with the fiduciary, legal, technical and operational responsibilities to manage and oversee the GCF funded activities that benefit the GCF country partners. So far and in general, the majority of AEs have been perceived as not comprehensively fulfilling their envisaged role. Instead they seem trapped in a race to submit projects and chase no-objection letters (NOLs), or they have found themselves competing with the market. There is a perception that AEs are not necessarily focused on high impact, but rather they are more supportive of innovative approaches and financial structures that would not necessarily result in high climate impact. Finally, the risks of crowding out should be addressed, as many domestic private actors tend to see GCF as a source of "cheaper-than-market" finance, often competing with development finance institutions (DFIs), rather than a financier of riskier investments that might otherwise not be funded.

26. **Mitigants and remedies: engaging the private sector as part of the central role of the NDA** requires marshalling AEs to support the implementation of countries' priorities. Furthermore, there is a need to target the use of readiness resources for the meaningful involvement of the private sector, including dedicated activities that will help in the mapping of actors that are relevant for addressing climate change, which helps private sector entities understand the risks posed by climate change to their businesses, identify opportunities to contribute to the solutions, develop pipelines that are aligned with country priorities and needs, and support policy and investment frameworks that will support their mobilization, among others; and further guidance to include the private sector in the development of country programmes.

**Challenge 4: accreditation process.**

27. Specific issues related to the GCF accreditation process include not only its requirement, but also the time it currently takes and its complexity. General strategic issues related to accreditation also include: (i) time sensitivity and predictability; (ii) value for money; (iii) need to ensure the right entities are nominated; (iv) the limit of the accreditation framework, including the limited capacity to perform integrity and financial due diligence on private sector entities, which is absent in the current process.

28. **Mitigant and remedies: accreditation process.** The consideration of a pilot for the direct investment modality as well as the project-specific assessment approach could provide further flexibility in engaging directly with the private sector, as well as the need to reconsider

accreditation in ways that support its strategic fit for private sector entities. There is also a need to address issues related to the underrepresentation of DAEs and in particular the lack of private sector DAEs, especially from GCF priority countries, least developed countries, small island developing States and Africa. In addition, there is also a critical need for support at country level in the identification and nomination of the right and most suitable domestic private sector entities that can successfully meet international standards related to the GCF requirements for accreditation (legal, fiduciary, organizational, financial) and demonstrate the ability (financial and technical capacity, strategic fit and expertise) to support the country effectively in implementing its climate priority plan.

**Challenge 5: requirement for an NOL.**

29. The requirement for an NOL is fundamental to demonstrate country ownership, which is a core principle of GCF to which all actors, including the private sector, must adhere to. However, in the case of global programmes supporting global climate change benefits, it becomes challenging to collect all the NOLs from all the governments interested in participating in the programme. Hence, the question is to understand how best country ownership can be realized in GCF projects and in PSF projects in particular. The upcoming Independent Evaluation Unit evaluation on country ownership might provide a better understanding of the experience so far with the NOL process.

30. **Mitigant and remedy requirement for an NOL**. There is a need to better understand how best country ownership can be realized in GCF projects and in PSF projects in particular. The upcoming Independent Evaluation Unit evaluation on country ownership might provide a better understanding of the experience so far with the NOL process.

**Challenge 6: other strategic non-business model challenges.**

31. Other strategic non-business model challenges are related to financial instruments and modalities in use by GCF, operational modalities, and the overall policy context in which PSF work is being undertaken. These include:

(a) **Financial instruments and modalities:** although GCF has a diversified set of financial instruments available for use, those most in use have been grants and loans. While equity instruments have been used marginally, and guarantees even less, the usefulness of these instruments in mobilizing resources is very significant;

(b) **Operational modalities:** issues in this area reflect the complexity of GCF and the limitations of its access modalities. Understanding GCF procedures and the role of its PSF has proven difficult, resulting in a significant degree of difficulties at several levels in guiding the private sector in tapping strategically into GCF resources, particularly for paradigm shifting and innovative investments. In addition, the limit of GCF concessionality in reaching large segments of private sector actors operating in developing countries is an issue that needs to be addressed. The current structure of GCF makes it difficult to reach community organizations, MSMEs and “bottom of the pyramid” organizations;

(c) **Policy context, the overall characteristic of weaker policy frameworks, the lower capacity of local financial institutions and lack of broad (deep or liquid) capital markets in many developing countries:** the policy environment is also affected by rapidly changing technology, rising to the challenge of staying “ahead of the curve”. The international climate policy context also provides a signal to sectors that are able to anticipate policy changes that will affect their business. Lastly, there is pressure on private sectors to act for the climate, considering the orders of magnitude of resources needed larger than USD 100 billion per year pledged in the Paris Agreement.

32. **Mitigants for the other non-business model strategic issues** include:

(a) **Financial instruments and modalities:** There is a need to increase a relevant use of equity instruments and guarantees. Overtime considerations could be given to other types of innovative instruments more tailored to the private sector and climate change and needed to complement the set of instruments currently available;

(b) **Operational modalities:** Support during early stages is essential to build the capacity of local financial systems and the real economy sectors. Finally, there seems to be a need to improve the attractiveness of the PPF, which is an important modality but is reported to be challenging; and

(c) **Policy context** needs to be strengthened by policy instruments.

# V. Resource implications and impact on the GCF portfolio

33. This section presents a brief overview of the resource implications and the anticipated portfolio impact of the proposed new modalities.

34. Over the course of the initial resource mobilization period, the PSF has evolved into a mature investment team with seasoned climate finance specialists having a strong investment track record across different product lines (project finance, financial institutions and funds) and financial instruments (debt and equity).

35. The full resource implications of the proposed new modalities will have to be looked at more accurately during the Secretariat workplan development for the implementation of these modalities. However, it is clear that some of the modalities need to be supported through additional investment professionals and support staff. Preliminary estimates suggest that a potential increase of 25 per cent of current PSF staff capacity per year would be required over the next three years to complete the wealth of specialized expertise and talents needed to support the effective operationalization of these modalities. Additional human resource capacity will be needed across the entire project cycle, in particular for the appraisal, monitoring and evaluation functions, in addition to the dedicated rosters of experts to be mobilized. Overall, an increase of 6 per cent of total GCF human resource capacity over the same period would be expected for the operationalization of these modalities to enable their effective implementation.

36. For example, with respect to the direct investment approach, the established practice across institutions is to have a roster of independent experts to undertake specific need-based tasks, depending on the nature of transactions. These may include independent engineering firms which do technical due-diligence, or firms specializing in integrity due diligence as well as independent legal firms for documentation and legal due diligence. Further, it is proposed to implement the direct investment modality, initially in partnership with one to two co-financing partners that have a strong local presence and climate investment track record.

37. The extent to which the implementation of the private sector strategy will impact the private sector portfolio over the course of the replenishment period is illustrated in table 6. It is anticipated that a more risk-inclined and impact-oriented approach will significantly support the origination of transformative climate projects, by enabling (a) direct equity investments; (b) investments in ventures of incubation and acceleration facilities; (c) local currency /guarantee investments through climate investment vehicles; (d) the provision of risk capital for local currency; (e) fund investments; as well as (f) investments in green banks and (g) investments in local financial institutions.

**Table 6: Impact of proposed modalities on private sector portfolio of GCF from 2020 to 2023**

| Initiatives | Year 2020 | Year 2021 | Year 2022 | Year 2023 |
|---|---|---|---|---|
| **# of direct equity investments** | › 1+ proposal to be initiated | › 1+ proposal to be initiated | › 2+ proposal to be initiated | › 3+ proposal to be initiated |
| **# of ventures of incubation and acceleration facilities** [a] | › 5-7 regional incubation facilities to be established<br>› 1 global accelerator facility to be established | › 2-3 additional incubation facilities to be established<br>› 2 additional global acceleration facilities to be established<br>› 1 global growth fund to be presented to the board | | › Potential up scaling of the initiative |
| **# Local currency/guarantee investments through climate investment vehicles** | › 2 proposals to be initiated, which may need PPF support (1 Africa & 1 Asia focused) | › A least 2 proposals to be approved and at least 1 vehicle to be operationalized | | › 1 additional vehicle to be operationalized |
| **# Risk capital available for local currency** | › 2+ proposals (ESS category B or C, project size less or equal to medium) | › 2+ proposals (ESS category B or C, project size less or equal to medium) | › 2+ proposals (ESS category B or C, project size less or equal to medium) | › 2+ proposals (ESS category B or C, project size less or equal to medium) |
| **# of Fund investments** | › 3+ (at least 1 adaptation or innovation fund) | › 3+ (at least 1 adaptation or innovation fund) | › 3+ (at least 1 adaptation or innovation fund) | › 3+ (at least 1 adaptation or innovation fund) |
| **# of green bank investments** [b] | › 2 proposals to be initiated, which may need PPF support.<br>› 2 readiness projects initiated to support countries transition to green financial system.<br>› Develop standardized Green Finance Readiness offering and proactively market it through PSF and DCP | › 3+ green bank proposals initiated, 1-2 may need PPF support.<br>› Develop a more standardized GCF green banking PPF offering. Implemented green bank PPF and funding proposal in 2020, marketed and replicated in other countries.<br>› 3-5 green finance readiness approved to support countries transition to green financial system. | › 4+ green bank proposals initiated, 1-2 may need PPF support.<br>› Work with Green Bank Design Network to develop pipeline of countries interested in green banking | › 2 proposals to be initiated, which may need PPF support.<br>› 2 readiness projects initiated to support countries transition to green financial system.<br>› Develop standardized green finance readiness offering and proactively market it through PSF and DCP |
| **#Local FIs investments** [c] | › 3 proposals to be initiated; 1 may need PPF support<br>› Encourage direct investment and local currency financing to enable higher impact funding proposals<br>› Build network of FIs, encourage accreditation where feasible | | › 4-5 proposals to be initiated; 1-2 may need PPF support<br>› Build capacity of local financial institutions through replicable funding proposals and technical assistance grants<br>› Deploy direct investment and local currency financing | |

*Abbreviations:* DCP = Division of Country Programming, ESS = environmental and social safeguards, FI = financial institution, PPF = Project Preparation Facility, PSF = Private Sector Facility.

[a] Deal flow of up to 300+ start-ups are expected to be originated through the facility by the end of each year.

[b] Green banks require readiness and PPF support, so 2020 is likely to be dedicated to preparatory work to increase pipeline in upcoming years. GCF anticipates working proactively with various partners, such as, for example, the Green Bank Design Network, to develop pipeline of countries interested in green banking. Additionally, it plans to partner with the Network for Greening the Financial System and International Financial Institution Sustainable Banking Network to develop pipeline for green finance readiness program

[c] The FI team mapped key FIs in developing countries and shall encourage funding proposal submission through accredited entities or accreditation. The projections are based on an assumption that a direct investment approach is introduced.

# Annex I: Private sector strategy

## I. Vision and approach

1. The private sector strategy presents a broader vision to define the distinctive features of the Private Sector Facility (PSF) of GCF, not only in the GCF structure, but also within the overall climate finance architecture. It provides a systematic and coherent approach for the GCF to maximize its ability to engage private sector actors in climate actions in developing countries in a differentiated way, prioritizing projects that have the highest climate impact in order to support a faster transition to low carbon and climate resilient pathways. The strategy development approach is built on analyses, feedback and insights from the national designated authorities representing the countries and their needs to support their national climate change priorities (demand) and private sector actor funding interests in engaging in climate change (or supply of finance). The strategy identifies areas of uniqueness, complementarity and collaboration in the climate finance space and assesses some of the challenges (internal and external) that have posed limitations during the initial resource mobilization period. The strategy will be applied in conjunction with the proposed Strategic Plan for the GCF and programming directions for the first replenishment period.

## II. Objectives

2. The private sector strategy has been developed with the objectives to:

(a) Strengthen the capacity for private sector investments in climate change activities;

(b) Catalyse private sector resources through mobilization at scale for climate change interventions in developing countries; and

(c) Enhance the private sector role in supporting climate change adaptation measures.

## III. Case for the strategy

3. The private sector strategy is instrumental to GCF to consistently and coherently pursue its efforts to engage private sector actors in climate actions in developing countries. By implementing the strategy, PSF will support the removal of current barriers hampering the most impactful investments of significant private capital into climate actions in developing countries. Specifically, the strategy will address: barriers to private sector investment in adaptation and mitigation activities; support for formulation of key policy reforms that will support the flow of finance; affordability of technologies and solutions using flexible financial instruments; a lack of awareness, insufficient capacity and market failures to mobilize private capital and expertise at scale in accordance with national plans and priorities. The strategy is supporting the active participation of national, regional and international private sector actors in climate actions in developing countries. The strategy is necessary to tap into the enormous potential of the private sector and unlock opportunities in developing countries for investment and technological innovation that will underpin low emission and climate-resilient development, providing finance for mitigation and adaptation.

## IV. Strategic directions

4. The strategy is comprised of three pillars completed by a recommendation to undertake the reforms that will enable GCF to implement the strategy and improve impact and engagement with the private sector. The three pillars of the strategy derived from the analysis undertaken are:

(a) Becoming more risk inclined for projects, initiatives and programmes with high climate impact and paradigm shift potential;

(b) Supporting climate-oriented local financial systems, green banks, markets and institutions; and;

(c) Acting as a market maker for climate actions, transformation in sectors and regions with imperative needs to address climate change (least developed countries, small island developing States, non-energy-related high-impact sectors, adaptation with a particular focus on Africa, etc.).

## V. Specific modalities

5. Below is a summary list of the modalities recommended for the development of the strategy:

(a) Strategic use of readiness support, the Project Preparation Facility and public sector "climate policy" lending instruments, including consideration of a green finance readiness programme;

(b) Reform of accreditation to make it strategic and fit for the private sector;

(c) Piloting local currency funding;

(d) Climate-focused centres of excellence (incubation and acceleration of early-stage climate technologies and start-ups);

(e) A private sector co-investment platform; and

(f) Piloting a direct investment modality.

## VI. Outreach plan

6. PSF will support the implementation of the private sector strategy by implementing the recommendations of the private sector advisory group for a private sector outreach plan. These recommendations will be implemented through the following channels:

(a) The Readiness and Preparatory Support Programme and country engagement;

(b) Secretariat-wide upstream engagement and business origination missions;

(c) GCF communications pertaining to the private sector;

(d) The GCF Private Investment for Climate Conference; and

(e) Other communications channels, including communication around publication of requests for proposal and other publication materials, including the PSF brochure, short videos on results achieved.