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Review of the initial modalities for the Private Sector Facility

Summary

This document presents information and analysis for Board consideration to undertake the review of the initial modalities of the Private Sector Facility.

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I. Introduction

1.1 Background

1. Through decision B.22/02, the Board adopted the document GCF/B.22/09/Add.01 "Updated work plan of the Board for 2019" and decided to consider the "Review of the initial modalities for the Private Sector Facility" (PSF) (hereinafter referred to as "the review"). Decision B.22/02 framed the review in the context of previous private sector related Board mandates, which provide a series of inputs and sources of relevant information for the Board's consideration of this agenda item, namely:

(a) The private sector strategy;

(b) Modalities to support activities to enable domestic and international private sector actors to engage in GCF activities in least developed countries (LDCs) and small island developing states (SIDS);

(c) Review of the micro, small and medium-sized enterprises (MSME) pilot programme and terms of reference for the request for proposals for the remainder of the allocation for the programme;

(d) Review of the mobilizing funds at scale (MFS) pilot programme to address adaptation and mitigation;

(e) Recommendations by the Private Sector Advisory Group (PSAG) on mobilization of private sector finance to progress the GCF forestry-related results areas; and

(f) PSAG recommendations on engaging the private sector, including local actors, in adaptation action at the national, regional and international levels.[1]

2. Decision B.22/02 constitutes a re-endorsement of a previous provision pertaining to decision B.07/08, which provides for the review. At its seventh meeting, the Board decided "to undertake a review of the initial modalities for the operation of the Fund's mitigation and adaptation windows and the PSF, no later than three years after the initial resource mobilization of the Fund" (decision B.07/08, paragraph (d)).

3. Decision B.04/08 contained several relevant provisions for the review:

(a) The PSF will initially focus on grants and concessional lending and will also draw on a broad range of other financial instruments and modalities to achieve its objectives;

(b) The PSAG will make recommendations to the Board on GCF-wide engagement with the private sector and its modalities; and

(c) The PSF, in accordance with the no-objection procedures and in order to ensure consistency with national climate strategies and plans and a country-driven approach:

(i) Will commence its operations through accredited national, regional and international implementing entities and intermediaries; and

(ii) May, over time, work directly with private sector adaptation and mitigation actors at the national, regional and international levels, subject to consideration by the Board of a phased approach.

[1] Although this review of the initial modalities for the PSF will include consideration of matters related to engaging the private sector in adaptation, this specific item related to PSAG mandate will not be fully considered in the scope of this document, but will be more comprehensively considered together with other adaptation matters under B.23 provisional agenda item 17 related to support for adaptation and steps to enhance climate rationale.

4. Section 1.2 below presents a summary of the specific provisions associated with these five mandates that inform the review.

1.2 Board mandates relevant for the various inputs to the review

5. Relevant Board mandates for informing the review are as follows:

(a) **For consideration of a private sector strategy**: The PSAG reported to the Board at its seventeenth meeting that it will support the PSF in the development of a strategic road map 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. Subsequently, at the nineteenth meeting of the Board, the Board took note of the PSAG recommendations on the development of a private sector outreach plan and, through decision B.19/17, requested the Secretariat to incorporate the plan into the strategic road map of the Secretariat for leveraging, mobilizing and engaging domestic and international private sector actors, as appropriate;

(b) **For modalities to strengthen private sector engagement in SIDS/LDCs**: paragraph 43 of the Governing Instrument for the GCF makes provision for the PSF to "support activities to enable private sector involvement in LDCs and SIDS". At B.19, the Board considered the PSAG recommendations on the development of modalities to support activities enabling private sector involvement in LDCs and SIDS. On that basis, the Board requested the Secretariat to develop modalities, based on the recommendations from the PSAG, to support activities to enable domestic and international private sector actors to engage in GCF activities in LDCs and SIDS (decision B.19/18, paragraph (b) and decision B.20/03, paragraph (b)(vi));

(c) **For the reviews of MFS and of MSME pilot programmes**: the two requests for proposals were established by the Board at its tenth meeting, with an allocation of USD 500 million for MFS and USD 200 million for the MSME pilot programmes over the initial resource mobilization period. In decision B.10/11, paragraph (i), the Board decided to review the implementation and scale of the initial phase of these pilot programmes, two years from the date on which the requests for proposals were made; and

(d) **For PSAG recommendations on the mobilization of private sector finance to progress the GCF forestry-related results areas**: in decision B.12/07, paragraph (f); decision B.14/01, paragraph (a); decision B.BM-2017/02; and decision B.17/01, paragraph (b)(xxi), the Board invited PSAG to make recommendations on the mobilization of private sector finance to progress the GCF forestry-related results areas.

1.3 Secretariat approach

6. In response to decision B.22/02, this document presents an overarching framework for the review of the PSF and its initial operational modalities. The review is informed by five policy documents covering the issues noted above. The five documents (as well as a supplementary sixth addendum, which summarizes technical notes), are presented to the Board for its consideration in addenda to this document. Finally, a single decision text is proposed. The analysis presented in the overarching document includes a review of the development of the PSF, including its operationalization and achievements to date; the lessons learned through its efforts to engage the private sector; and, a summary of a proposed, new private sector strategy. It also reviews key challenges that have made it difficult for the GCF to engage the private

sector. Finally, it contains a summary of the private sector strategy which constitutes a fundamental input to the Review.

II. Background on the development of the Private Sector Facility

2.1 Operationalization of the Private Sector Facility

7. Since the establishment of the GCF's independent Secretariat, significant efforts have been undertaken to ensure full operationalization of the PSF. The foundational directives that support the operationalization of the PSF are based on several decisions adopted by the Board and related to the structure of the Fund and the Secretariat, building on provisions contained in the Governing Instrument and the guidance from the Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC). Among the key decisions that support this operationalization are decision B.04/08 and its specific provisions relevant to the PSF, decision B.04/09 on the structure and organization and decision B.07/07, as well as additional recommendations provided by PSAG on enhancing the structure of the PSF.

8. The provisions from the Governing Instrument and guidance from the COP have provided the PSF with its distinct features, namely, direct access modality, high risk appetite, climate impact focus, market-making ability, as well as the unique investment approach to balance countries as represented by their national designated authorities (NDAs) and private sector perspectives, with the view to support country efforts in achieving paradigm shift toward low greenhouse gas emission and climate resilient development.

2.2 Achievements to date

9. The PSF's interventions span several GCF priority areas: investments, policy development, strategy formulation and other corporate-wide activities.

10. On investment, as of 30 April 2019, 23 private sector projects have been approved for GCF resources amounting to USD 2,074 million and mobilizing an additional USD 6,006 million. The associated mitigation portfolio is expected to reduce 1.1 gigaton of CO_2 equivalent, while the adaptation portfolio is expecting to reach 29 million beneficiaries. Of this portfolio, eight (8) projects[2] representing a total project value of 816 million USD are under implementation with USD 334 million disbursed so far, accounting for 62 per cent of the Fund's disbursed amount. Disbursed loans for these projects have also started to generate reflows of payments and interests. Figure 1 below presents the status of the PSF portfolio as of 30 April 2019. Figure 2 presents the portfolio breakdown per geography, theme and by access modality.

[2] Excluded is FP026 a joint proposal by two AEs. Only part of the project entered under implementation with USD 2.4 million disbursed so far, while the implementation of the second part is pending finalization of legal procedures between the GCF and the AE responsible for this part. This project will be added to the list of projects under implementation, once the implementation of both parts starts.

Figure 1: Status of the Private Sector Facility portfolio

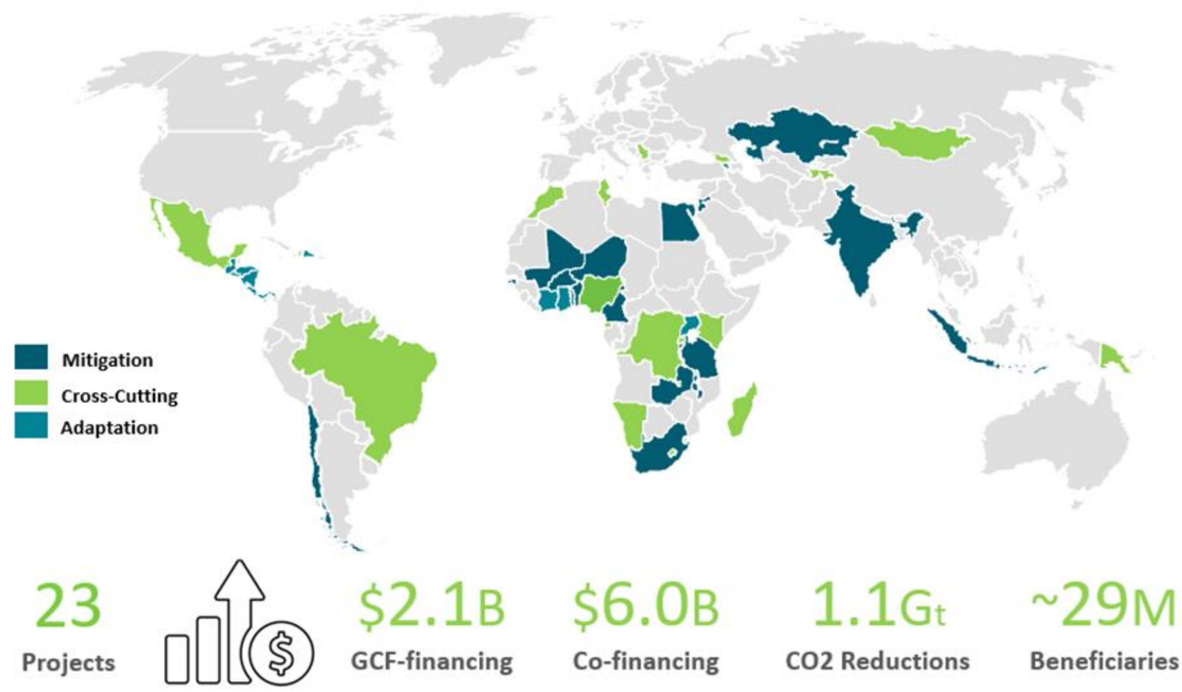
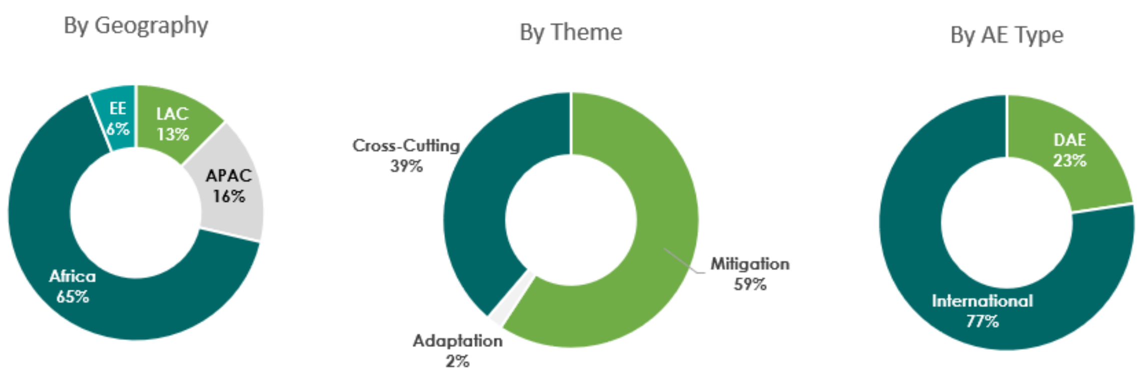


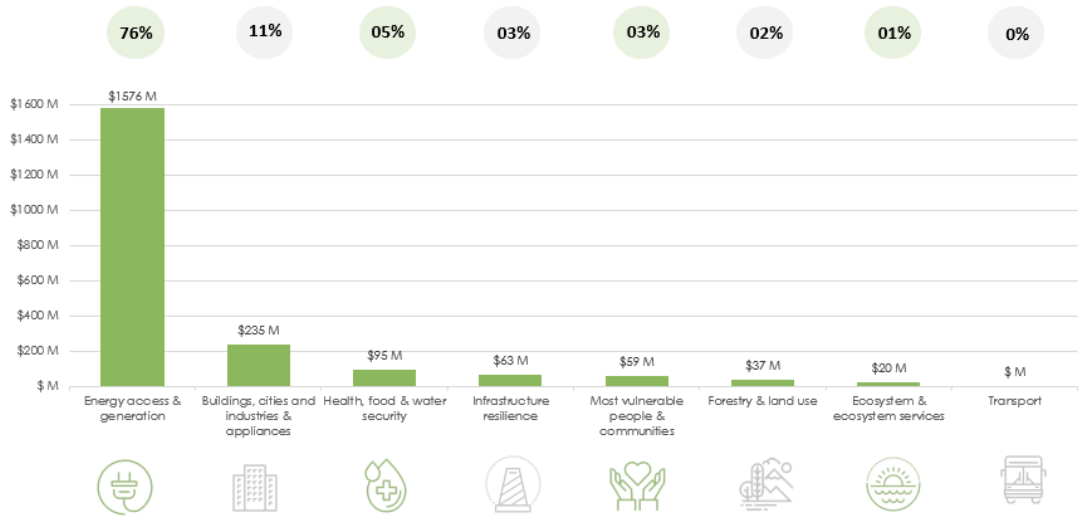
Figure 2: Private Sector Facility portfolio breakdown by geography, theme, and accredited entity type



Abbreviations: AE = accredited entity, AP = Asia-Pacific, DAE = direct access entity, EE = Eastern Europe, LAC = Latin America and the Caribbean.

11. An analysis of the PSF's interventions in relation to the eight results areas of GCF (see figure 3) indicates a predominance of projects in the energy-related results area, including emissions reduced from energy access and generation, followed by emissions reduced by energy efficiency measures. This highlights a need to diversify and expand the PSF portfolio to the other results areas that have high climate impact and paradigm shift potential, such as forestry and transport, while seeking to maximize opportunities to increase private sector investment in adaptation where relevant and opportune.

Figure 3: GCF private sector investment by results areas



12. On the strategy formulation side, following the establishment of the PSF and in collaboration with PSAG, several efforts have been undertaken with the goal of supporting the GCF initial strategic plan. These include making recommendations to:

(a) Support mobilizing private sector funds at scale and recommending instruments to mobilize private sector resources;

(b) Support the engagement of the private sector in SIDS and LDCs, as well as on adaptation and GCF-related forestry activities;

(c) Engage local private sector actors, including small and medium-sized enterprises;

(d) Develop the GCF's risk appetite;

(e) Analyze barriers to crowding-in and maximize the engagement of the private sector; and

(f) Develop a private sector strategy, including a private sector outreach plan.

13. In connection with paragraph 12(f) above and in preparation for the Board's consideration of the initial modalities for the PSF, the PSF team undertook preparatory work to outline the technical specifications and requirements for the proposed modalities for the Board's consideration as part of the private sector strategy. These modalities include: (1) mobilizing private sector finance for adaptation via targeted endowments at country level; (2) piloting local currency funding, paying particular attention to LDCs and SIDS;(3) supporting climate-focused centres of excellence; (4) promoting private sector co-investment solutions; and (5) piloting a direct investment approach.

14. The PSF team has been collaborating with the Division of Country Programming to strengthen upstream engagement with NDAs, accredited entities (AEs) and relevant stakeholders. A stronger upstream engagement and readiness approach to support the engagement of private sector actors in developing countries is considered as part of the

implementation of the revised Readiness strategy for 2019–2021. This includes continued support to countries' demand for green finance readiness initiatives and the incorporation of other sectors and areas under the scope of the GCF Readiness and Preparatory Support Programme.

15. On the investments side, while focusing on increasing the number of projects under implementation through significant efforts to accelerate disbursements for approved projects, a greater emphasis has been recently placed on the delivery of high-quality proposals in accordance with the financial planning priorities (MFS, MSME, simplified approval process, etc.), as well as on building a strong pipeline for the post-replenishment period.

16. Finally, since 2018, the PSF has been leading GCF efforts to organize an annual Private Investment for Climate Conference.

III. Experience of working with the private sector

17. Two-thirds of the PSF's investments have been provided through international channels and the remaining third through the direct access modality. In general, PSF engagement with the private sector has been achieved indirectly, through national, regional and international multilateral accredited development finance institutions. Such collaboration has enabled PSF to fulfil elements of its mandate, aiming at financing private sector mitigation and adaptation activities at the national, regional and international levels. These interventions have enabled the de-risking of private sector investments in climate actions and have enabled their investments with GCF. Furthermore, PSF participation in these interventions has allowed it to address several cases where there were issues pertaining to the affordability of climate-related solutions and the high capital upfront costs generally associated with these options. It has also enabled GCF to incentivize the governments of several countries to undertake positive policy reforms that support further private sector investments in climate actions or the penetration of solutions, including technologies that support climate actions.

18. PSF value propositions for the private sector are presented in figure 4 below.

Figure 4: PSF value propositions across various sectors and product lines

19. To date, experience of engaging private sector actors directly has been very limited because private sector actors are under-represented in the portfolio of the AEs (generally limited to some players of the financial sector). Several Board mandates and PSAG recommendations specifically direct the PSF to explore opportunities to foster GCF's efforts and implement a targeted approach to support the following:

(a) MSME engagement in climate actions;

(b) Private sector engagement in SIDS and LDCs;

(c) Private sector engagement in adaptation, with particular respect to Africa; and

(d) Mobilizing private sector resources at scale through the MFS pilot programme.

20. The experiences have also identified some limitations in these areas.

(a) Regarding MSME, efforts to launch a first request for proposals targeting the engagement of MSMEs in climate actions have achieved some success, with Board approval of three projects under this scheme (one of them lapsed at the post-approval stage). An initial review of this modality is presented in addendum IV of this document. Lessons learned from these experiences informed the revision of the terms of reference for the launch of the second phase of this pilot programme, post replenishment, for the remainder of the allocated resources. A draft version of the terms of reference is provided in addendum IV for Board consideration.

(b) The PSF has been more successful in engaging the domestic and international private sector in climate actions in SIDS and LDCs. The status of GCF engagement in LDCs and SIDS is presented in addendum II, titled "modalities to support activities to enable domestic and international private sector actors to engage in GCF activities in LDCs and SIDS". GCF interventions in these countries have occurred primarily in the context of multi-country programmes targeting mitigation in energy-related results areas. More efforts are needed and the recommendations from PSAG, as contained in addendum II, will contribute to increasing such efforts, including diversifying the portfolio and increasing adaptation interventions; and

(c) Engaging the private sector in adaptation measures has also proven to be challenging, although some successful examples can be reported. An overall limitation on engaging the private sector in adaptation has also had an impact on achieving the mandate to pay particular attention to private sector engagement in adaptation in Africa. Although there are a few examples that could be showcased, inherent challenges hampering such interventions include:

    (i) Access to adaptation finance and local markets, owing to the high upfront costs of many adaptation interventions and limited market capabilities;

    (ii) Limited range of financial instruments, considering the need for longer tenors and flexible repayment schedules in relevant sectors, including agriculture;

    (iii) Affordability and technology, in transferring innovative technologies to vulnerable borrowers with little access to credit;

    (iv) Knowledge and education needed to assess risks and opportunities of investing in adaptation projects;

    (v) Region and country specific capacity constraints, including local financial institutions' lack of capacity, as well as the fragmented local private sector; and

    (vi) Policy and regulatory characteristic of the overall fragile enabling frameworks, calling for the need for appropriate strategic and regulatory frameworks and consistent policy support and incentive systems to promote local private sector investment in adaptation.

21. To address some of these limitations, PSAG has provided specific recommendations on engaging the private sector in adaptation action,[3] which include:

(a) Focus on risk transfer instruments, which includes insurance as a financing modality;

(b) Facilitate blended finance and public-private partnerships;

(c) Support the conception, production and dissemination of consistent and relevant climate data and projections;

(d) Involve the private sector in the development of national adaptation plans; and

(e) Partner with financial intermediaries in expanding their businesses (e.g. microfinance).

22. In line with Board decisions, a dedicated request for proposals aiming at mobilizing resources at scale was launched by the PSF. Addendum III presents an initial review of this programme, highlighting lessons learned, for the Secretariat to ensure the successful implementation of the programme.

23. The main reason for the limitations is that the original GCF business model does not adequately accommodate the specific business practices of the private sector, suggesting the need for potential adjustment and enhancement of the original GCF business model, thus better accommodating the specific business practices of the private sector. For example, the accreditation process by itself is deemed time and resource intensive and not consistent with the private sector's high reliance on efficient and swift processes.

24. Overall, the experience of the PSF in engaging the private sector has proven to be limited in terms of achieving the scale of desirable impact, including a partial success of the PSF in mobilizing resources from both domestic and international private sector actors to support paradigm shifting climate actions in developing countries. This explains, in part, the relatively low co-financing and mobilization ratio of PSF projects, in the light of the existing potential. Recommendations by the Board, as well as by PSAG, relating to the accreditation of private sector entities have led to some evident improvement (though marginal), with an increased number of accredited entities from the private sector. However, the result is not significant enough to successfully support PSF mobilization efforts as intended in the original objective.

25. The analysis above suggests a need for additional considerations, including business model enhancement to support domestic and international private sector engagement in climate actions in developing countries. Key challenges and strategic issues, as well as opportunities deriving from these experiences, are presented in the following section.

IV. Key challenges and strategic issues

26. Several challenges have been experienced by the GCF in the implementation of the initial modalities for the PSF. They can be summarized in the following categories: business model and practices; financial instruments and modalities; operational modalities; and policy context.

4.1 Business model and practices

27. The main strategic issue is the challenge of operationalizing and reconciling specific features of the GCF business model and practices with those generally used by private sector actors in areas such as approach to origination of programmes and projects, the central role of

[3] Private sector engagement in adaptation is addressed in the B.23 provisional agenda item 17 "Support to adaptation and steps to enhance climate rationale".

the NDA, the responsibilities of the AEs, the accreditation process and the requirement for a non-objection letter.

28. **Origination of programmes and projects**: one of the differences between the approach used by the GCF for programme and project origination and practices in the private sector arises in deal origination. While the origination approach of the GCF requires a strong alignment with countries' climate needs and priorities, private sector deal origination is often driven by market knowledge, trends and opportunities.

29. Considering that the GCF business model relies on partners – both countries and AEs – any challenges faced by partners in engaging the private sector in climate actions in developing countries will hinder GCF ability to interact with the private sector.

30. **Engaging the private sector as part of the central role of the NDAs**: overall many countries' NDAs have a limited understanding of the role of the private sector in supporting climate actions in developing countries. This has been reflected by the limited private sector engagement in the implementation of country readiness programmes and in the formulation and implementation plan of country programmes. Similar observation is made in relation to the limited number of nominations of private sector direct access entities for accreditation.

31. **Responsibilities of AEs and domestic private sector actors**: there is a lack of awareness of climate business opportunities, knowledge, time and capacity to deal with complex proposals and approval processes, as well as an absence of attractive climate business opportunities. Direct access AEs generally demonstrate low capacity to engage the local private sector. Most AEs have been perceived as not comprehensively fulfilling their envisaged role. In fact, they seem trapped in a race to submit projects and chase NOLs, or they have found themselves competing with the market. There is a perception that AEs are not focused on high impact, but rather they are more supportive of innovative approaches, financial structuring that would not necessarily lead to high climate impact. Finally, the risks of crowding-out should be addressed, as many domestic private sector actors tend to see the GCF as a source of "cheaper-than-market" finance, often competing with development finance institutions, rather than a financier of riskier investments.

32. The uniqueness of the GCF business model, when compared with private sector business approaches, includes the requirement for accreditation and for the non-objection letter.

33. **Accreditation process.** Specific issues relating to the GCF accreditation process include not only its requirement, but also the time it currently takes and its complexity. General strategic issues relating to accreditation include: (1) time sensitivity and predictability; (2) value for money; (3) the need to ensure nominated entities are able to successfully meet international standards implicit to GCF requirements for accreditation (legal, fiduciary, organizational, financial) and demonstrate the ability (financial and technical capacity, strategic fit and expertise) to support the country to implement its climate priority plan effectively; (4) the need to perform integrity and financial due diligence.

34. **Requirement for a non-objection letter.** This requirement is fundamental to demonstrate country ownership, which is a core principle of the GCF and to which all actors, including the private sector, must adhere. However, in the case of global programmes, or large multi-country programmes, private sector entities have found it complex to collect all the non-objection letters from all the governments interested in participating in the programme. These raise the question of understanding how best country ownership can be ensured in GCF, and PSF projects in particular. The Independent Evaluation Unit's ongoing evaluation on country ownership might provide a better understanding of the experience so far, regarding non-objection letter process.

4.2 Financial instruments and modalities

35. There are a wide variety of financial instruments made available by the GCF. However, they have been used unevenly, those mostly used 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 and points to the need to increase a relevant use of equity instruments and guarantees. Over time, considerations could be given to other types of innovative instruments more tailored to the private sector and climate change, which are needed to complement the set of instruments currently available.

4.3 Operational modalities

36. Understanding GCF's procedures and the role of its PSF has proven difficult, resulting in a significant number of constraints at several levels in guiding the private sector to strategically leverage GCF's 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 the GCF makes it difficult to reach community organizations, MSMEs and "bottom of the pyramid" organizations. An additional issue is the current limitation of an NDA demand driven approach to Readiness, which limits the opportunity to provide targeted funding for private sector project development. With particular respect, the focus on project origination and idea development, prior to accessing the PPF, or the submission of a concept note, is problematic. 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.

4.4 Policy context

37. The policy environment, which is characterized by weak policy frameworks, low capacity of local financial institutions and a lack of broad (deep or liquid) capital markets in many developing countries, is also affected by rapidly changing technology, highlighting the necessity to stay "ahead of the curve". The international climate policy context suggests that the private sector is able to anticipate policy changes that will affect their businesses. However, there is considerable pressure on the private sector to act on climate change, given that the magnitude of the required resources is on the order of trillions of USD – significantly larger than the USD 100 billion per year mobilization pledged under the Paris Agreement.

V. Considerations to deal with challenges and strategic issues

38. This section offers some reflections for the Board's consideration on possible ways to deal with the strategic issues.

39. Although the GCF business model, which is consistent with the Governing Instrument for the GCF, is relevant for the overall operation of the GCF, this review has identified that the current business model largely explains the results achieved by the PSF during the initial replenishment period, including the fact that the current PSF portfolio is skewed towards mitigation. Moreover, it is implicated in the challenge of moving private sector action towards non-energy related mitigation results areas, as well as the overall underrepresentation of adaptation in the PSF portfolio (particularly in Africa). That being said, the overall challenges of engaging the private sector in adaptation and non-energy related areas are broader and may be

explained by other factors including the underdevelopment of the market for adaptation, other market barriers, limited interest of the private sector in investing in many adaptation-related sectors, high upfront cost of investment and affordability issues. However, it is also apparent that the GCF portfolio characteristics mirror the portfolio characteristics of the accredited multilateral and regional development banks that usually serve as intermediaries between the GCF and the private sector actors, which results in many private sector actors being unwilling to undertake the GCF accreditation process.

40. One of the direct consequences of the constraints posed by the GCF business model and operational modalities is that a limitation is imposed on the PSF, namely that it needs to maximize its potential to support the GCF achieving its mandate. There is also a perceived restriction in the application of the GCF stated high risk appetite. These constraints have resulted in:

(a) A limit on the potential to unlock private finance and make it work for adaptation, including in Africa and the non-energy related sector, including forest-related activities;

(b) A limit in the capacity of PSF to engage with the domestic private sector, including MSMEs;

(c) Uncertainty that the GCF interventions will really work for the most vulnerable populations;

(d) Lack of access to local financial market and institutions (MSMEs), in particular in SIDS and LDCs, and direct private sector actors;

(e) Difficulties in reaching smaller actors at the national and local level; and

(f) The heavy focus of GCF intervention on hard currency debt instruments, mostly in USD/EUR, which can erode GCF-offered concessionality.

41. Solutions to address these challenges include better and strategic utilization of current instruments to support the private sector in adaptation, and continuing to deploy targeted technical assistance and capacity-building to support private sector engagement in climate actions in least developed and frontier markets, while strengthening origination and encouraging the proactive seeking of business opportunities. However, consideration of new modalities to complement existing PSF modalities will likely maximize the PSF potential.

VI. Strategy for the Private Sector

42. The private sector strategy was developed through a rigorous process that included a mapping of climate finance demand by countries and supply from private sector actors, as well as extensive consultations with stakeholders. This work enabled the PSF to identify both potential gaps in the area of private sector finance and niches where the GCF could play a unique, but essential role in the climate finance landscape.

43. The resulting private sector strategy defines a broader vision for the PSF that would make it distinctive in the GCF structure and within the overall climate finance architecture. It lays out a systematic and coherent approach aimed at (1) strengthening the capacity of private sector entities and ensuring their pro-active engagement in high impact climate change activities; (2) catalyzing the mobilization of private sector resources at scale; and (3) enhancing the private sector role in supporting climate change adaptation measures. It does this while ensuring that both country ownership and private sector approaches are reinforced.

44. The private sector strategy suggests that further enhancement of the business model of the GCF would better enable the PSF to maximize private sector impact.

45. The private sector strategy will enable the GCF to offer targeted and flexible investment modalities, which are intended to better support priority areas including climate actions in SIDS and LDCs, adaptation in developing countries (particularly in Africa), and sectors of high-impact potential beyond renewable energy and energy efficiency that attract private sector investments. Specifically, it proposes consideration of new modalities tailored to the needs of the private sector to complement the initial modalities of the PSF. The adoption of some of these modalities involve reforms from the Board that can improve GCF's impact and engagement with the private sector. These reforms can improve GCF-wide impact and engagement with the private sector.

46. Furthermore, the private sector strategy is underpinned by three pillars, namely:

(a) De-risk high-impact climate investments in developing countries;

(b) Increase access to MSMEs and local financial intermediaries in developing countries; and

(c) Mobilize resources from institutional investors for climate change interventions in developing countries.

47. The first pillar of the strategy would involve taking on more project risk to achieve more impact. To strengthen the risk-taking inclination of the GCF to achieve greater impact, the PSF would ensure that its private sector investments are focused only on high impact innovative projects that can demonstrate full alignment with the GCF's mandate and investment criteria.

48. This would be achieved through a formal and systematic early screening process to distinguish projects that could "crowd-out" from those that would "crowd in", including through the development of a crowding out test, in partnership with AEs. A more risk inclined approach for projects to live up to the stated risk appetite could then be supported by effective use of the diverse GCF financial instruments deployed throughout new risk-mitigating modalities, including : (1) local currency financing, (2) direct equity positions, including in venture style development finance, to support innovative business models and (3) direct investment approaches.

49. The second pillar is to support the strengthening of climate compatible national financial systems. This pillar looks to enable local financial markets and institutions to finance the transformation towards a low carbon economy and climate resilient future. Under this pillar, the GCF would support necessary adjustments including enabling policies for the private sector and readiness options on financial system reform, with a view to establishing an ecosystem to support more climate compatible portfolios and products. This rests on strategic use of readiness resources, the Project Preparation Facility (PPF), and the use of public sector climate policy lending instruments. In the long run, it is expected that such interventions would improve local capital markets for green securities, making it crucial to have a Board-approved policy on underwriting issuance of securities to be followed by a credit rating and development of readiness offering for financial institutions to securitize climate portfolios.

50. The third pillar calls for the PSF to act as a market maker for implementation. This pillar envisions the GCF to stimulate sectoral transformation at the national and regional levels, primarily through enabling the development of supporting financial policies; supporting financial mechanisms for private transformation; and developing a pipeline of robust, high impact projects and programmes. This will require the strengthening of AE partnerships along with the development of appropriate incentives with respect to countries' priorities. Specific interventions would include strengthening the private sector role in "economy-wide climate finance" country programs and the development of flexible, opt-in standardized programs for sector transformation. Finally, such an approach will require an effort to marshal private sector and AEs around national priorities. It is expected that these interventions complemented by an

enabling environment created through country programmes and policy cooperation will allow private sector participation in pursuing high impact sectoral and cross-sectoral opportunities.

51. These three pillars of the private sector strategy will require consideration of reforms that can improve impact and engagement with the private sector. As part of these reforms, it is also proposed that the current accreditation framework be reviewed to allow strategic and project-based assessment approach (current Board deliberation on PSAA). The existing AE-driven pipeline makes it difficult to select "ideal" projects that have high impact and paradigm shifting potential, hence hindering PSF capability to proactively invest in innovative climate projects. Both the direct investment and the project-specific assessment approach will enable the PSF to focus on entities' ability to implement the proposed project, thereby reducing the transaction costs for project proponents and broaden access to the GCF. Hence, a direct investment modality consistent with the Governing Instrument is also proposed for Board consideration.

52. While this overview paper has discussed a number of solutions to address challenges experienced, maximizing the potential of the PSF will likely take a more creative use of existing modalities and the adoption of new modalities tailored to private sector needs. The existing and new modalities reviewed in this paper and considered more in-depth in addendum I include:

(a) Use of targeted RFPs in identified areas where private sector intervention is likely to be the most efficient in driving impact and paradigm shift and where the GCF's limited minimum concessional resources are needed;

(b) Establishing endowment funds to support adaptation for the most vulnerable populations and communities at the bottom of pyramid (BoP) in developing countries, particularly in LDCs, SIDS and Africa;

(c) The GCF support for the climate-focused centres of excellence to support innovation of climate business ideas and financial structures and modalities that present high impact to address climate change in developing countries; and

(d) The GCF can offer local currency instruments, which is also considered in the review of financial terms and conditions of the financial instruments of the GCF.

53. The adoption of these four modalities of this first category will unlock the potential of the PSF to deploy, in a more balanced way, the diverse financial instruments at its disposal. They could be implemented, potentially, in the form of funding proposals submitted by accredited entities and structured in the form of special purpose vehicles. However, their implementation will face some limitations under current mandates. Their implementation at full potential will be made possible with the adoption of the remaining two modalities in the second category.

54. These two are subject to Board consideration and approval. Furthermore, they offer innovative additions to the GCF's current business model and address current GCF policy limitations, while promoting the diversification in the use of GCF's financial instruments and modalities.

(a) The first is a consideration of a co-investment platform that will enable other investors to co-invest alongside with GCF funded activities.

(b) The second requires ensuring the implementation of the project specific assessment approach (PSAA) works for the private sector and to set a portfolio target and limit for piloting the direct investment modality in specific areas. Consideration of this latter modality should be undertaken in synergy with the review of the accreditation framework by the Board. The implementation of these two modalities should be considered in synergy with other policies, including the review of the financial terms and conditions of the GCF financial instruments and the policy on concessionality. climate

55. The private sector strategy, while confirming the relevance of several elements of the GCF initial architecture and business model, suggests that further enhancement of the GCF business model would help to maximize the impact of the PSF and advocate for the consideration of the proposed modalities relevant for the private sector to complement the initial modalities of the PSF.

VII. Considerations for the evolution of the modalities for the Private Sector Facility

56. During the initial phase of the operationalization of the PSF as well as the adoption of the initial modalities of the PSF, the Board recognized that the structure of the GCF, including that of the PSF, is evolving. Implementation of the initial modalities has proven that even if the overall architecture of the GCF, as well as its business model, serve the purpose of the specific instrument it represents as an operating entity of the financial mechanism of the UNFCCC, with the mandate to serve the Paris Agreement, some enhancements to the business model can further support aspects of the GCF model aiming at further engaging the private sector. To that end, all the inputs to this review of the initial modalities of the PSF, including recommendations from PSAG, suggest that there should be additional flexible modalities to complement the initial modalities of the PSF. The application of some of these modalities is also relevant for more effective public sector climate change intervention and as such will have an overall impact on the GCF. Figure 6 below presents an illustration of how the proposed new modalities could enhance the GCF business model and tables 1–4 present considerations that might be needed from the Board to ensure their operationalization.

VIII. Recommendations

57. The Secretariat proposes that the Board approve the draft decision contained in annex I.

Figure 6: New PSF Modalities for GCF business model enhancement

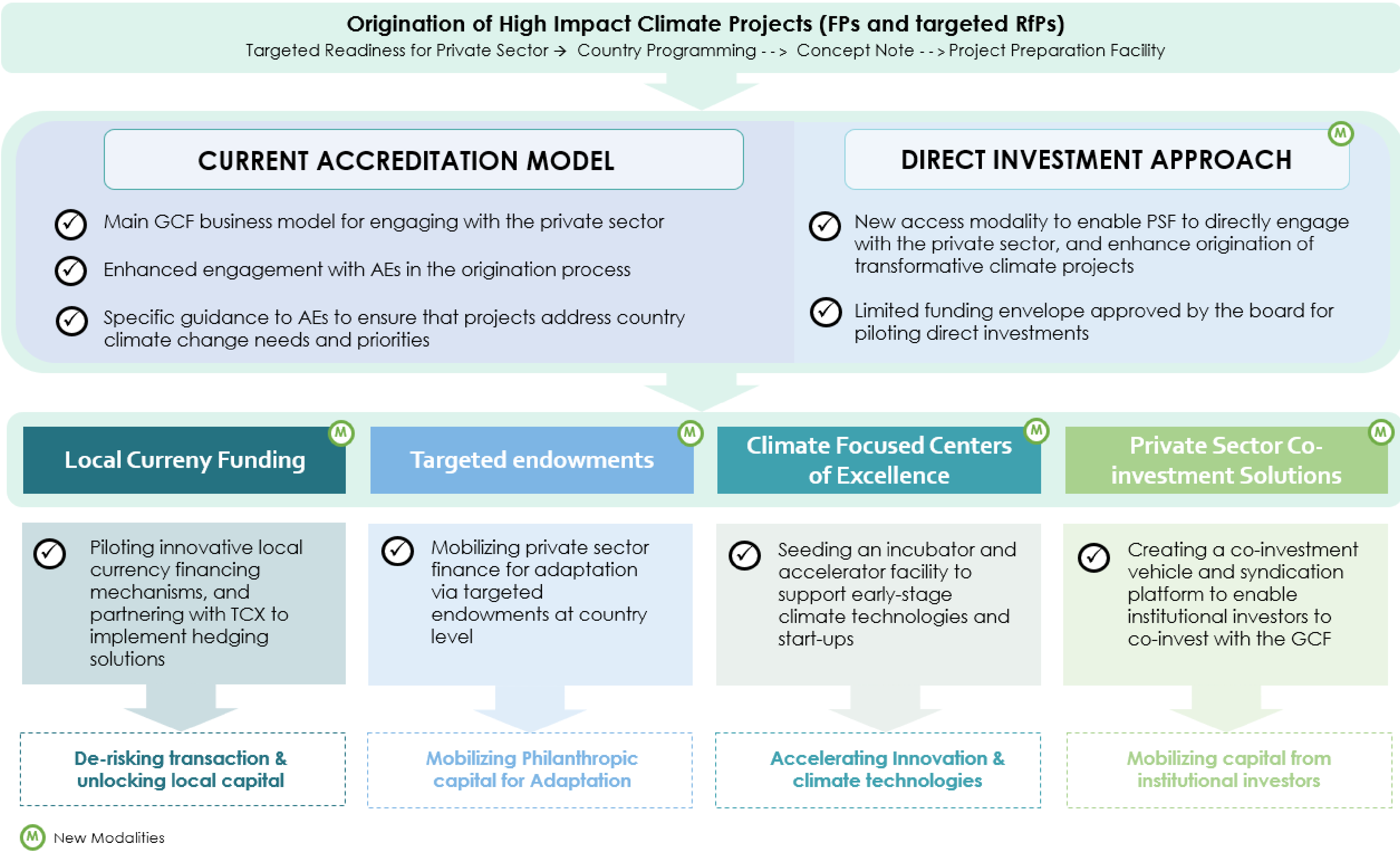


Table 1: Suggested modalities for the Private Sector Facility – Category 1: Modalities to be implemented immediately within existing Board mandates

Modalities	Proposed approach
Strategic use of readiness support, PPF and public sector "climate policy" lending instruments	***Readiness:*** • Support the implementation of the objectives of the 2019-2021 revised strategy relating to the private sector • Include in the dedicated readiness support to strengthen the capacity of NDAs with regard to the private sector and their role in climate actions • Map private sector actors and the legal and regulatory support needed by the country to engage the private sector; design targeted climate policies and frameworks lending support to relevant public sector institutions in partnership with key accredited entities • Design a road map on how to engage the private sector over the short, medium and long term and a comprehensive public sector strategy to support that ***PPF:*** Ensure that PPF continues to provide support to entities operating in LDCs and SIDS ***Public sector climate policy lending instruments:*** Support the development of tailored climate policy programmes for ambitious climate action, including a transparent and predictable regulatory approach and appropriate structural design to provide incentives to private sector to invest in climate actions
Better utilization of current instruments to support the private sector in adaptation in LDCs and SIDS	Targeted requests for proposals and review of previous high-quality concept notes submitted through earlier requests but which remained unimplemented, to identify prominent concepts that present high potential for adaptation in SIDS and LDCs
Prioritize strong institutions for accreditation that can support private sector projects in LDCs and SIDS	• Dedicated outreach to increase understanding of the GCF by private sector actors in SIDS and LDCs • Support enhanced institutional capacity of organizations from LDCs to address the accreditation barrier
Green finance readiness programme consistent with the Readiness and Preparatory Support Programme: Strategy for 2019–2021	• Readiness can provide grants to countries interested in greening their local financial institutions with experienced delivery partners already undertaking similar work or through identified national delivery partners with experience and capacity to implement the tailored green finance readiness interventions • At the request of NDAs, support the understanding, adoption and implementation of green finance principles and/or regulations • Replicate successful initiatives through south–south collaboration and development of national or regional green finance institutions, among others • Facilitate matching of NDAs/delivery partners which could be international institutions with sustainable finance initiatives or national/regional players

Abbreviations: LDCs = least developed counties, NDA = national designated authority, PPF = Project Preparation Facility, SIDS = small island developing States.

Table 2: Suggested modalities for the Private Sector Facility – Category 2: Modalities to be piloted, with limitations, by the Secretariat within existing Board mandates

Modalities	Proposed approach	Specific comments
Mobilizing private sector finance for adaptation via targeted endowments at the country level	• GCF and other philanthropic investors contribute initial corpus, which will be invested in an investment portfolio that is aligned with the climate goals and respect environment, social and governance standards • Countries set up national adaptation funds to finance adaptation projects in the country in coherence with the national priorities	This modality will be implemented with special attention given to LDCs, SIDS and African States
Piloting local currency funding	The modality should focus on projects and programmes with high climate impact and paradigm shift potential by enabling GCF to: • Hedge against potential currency fluctuations by transferring the foreign exchange risk to TCX • Increase availability of capital from local banks/Financial institutions towards climate projects	This modality will be implemented with special attention given to LDCs, SIDS and African States
Climate-focused centres of excellence (incubation and acceleration of early-stage climate technologies and start-ups)	• Source early-stage start-ups and climate technologies from developing countries, with a specific focus on LDCs, SIDS and African States • Focus on start-ups that present a high climate impact and paradigm shift potential	This modality will be implemented with special attention to LDCs, SIDS and African States. Furthermore, the scope of this proposal is wider than the modality previously mandated by the Board to present a technology related request for proposals (B.18/03). While this modality will support the effective operationalization of the previous mandate, it also presents a wider scope beyond technology only focus centres of excellence, to include all relevant climate centers of excellence able to advance ideas, products and structures with high climate impact and paradigm shift potential
Private sector co-investment platform	• The investment vehicle will be seeded by the GCF and other institutional investors • GCF participation will be structured to de-risk institutional investors using innovative blended finance instruments	

Modalities	Proposed approach	Specific comments
	• The vehicle will primarily invest in projects or sub-projects of programmes approved by the GCF Board • The target is to mobilize at least 4–5 times the capital seeded by GCF	

Abbreviations: B.13 = thirteenth meeting of the Board, LDCs = least developed counties, SIDS = small island developing States.

Table 3: Suggested modalities for the Private Sector Facility – Category 3: Modality requiring Board consideration and business model enhancement

Modality	Proposed approach	Specific comments
Direct investment approach	• The Secretariat would lend funds directly to innovative on-the-ground projects and programmes that present high climate impact and high paradigm shift potential • Participating private sector entities should disclose ex ante information to clearly demonstrate that the submitted funding proposals are contributing to shift financial flows towards low greenhouse gas emissions and climate-resilient sustainable development • The Private Sector Facility investment teams would undertake fiduciary and non-fiduciary duties in-house	The decision on this modality needs to be considered in synergy with the current Board consideration of the project-specific assessment approach for consistency

Table 4: Suggested modalities for the Private Sector Facility – Category 4: Modality that requires further work from the Secretariat

Modality	Proposed approach	Specific comments
Options for insurance and capitalizing climate disaster risk funding mechanisms	• Identify and track climate risk via a public database • Create a private sector risk-sharing facility with insurance and reinsurance, based upon the identified risks	Any future decision of the Board on this matter would need to be consistent with the most recent decisions on financial instruments and terms and conditions associated to them

Annex I: Draft decision of the Board

The Board, having considered document GCF/B.23/12 titled "Review of the Initial modalities for the Private Sector Facility":

(a) *Takes note* of document GCF/B.23/12 and the addenda thereto;

(b) *Recalls* paragraph 43 of the Governing Instrument for the GCF that 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. The facility will also support activities to enable private sector involvement in small island developing States and least developed countries;

(c) *Also recalls* decision B.04/08, in which the Board decided that that the Private Sector Facility, in accordance with non-objection procedures and in order to ensure consistency with national climate strategies and plans and a country-driven approach may over time work directly with private sector adaptation and mitigation actors at the national, regional and international levels;

(d) *Approves* the GCF private sector strategy presented in the annex III of this decision;

(e) *Agrees* that the Private Sector Facility will support an increased risk threshold for projects, initiatives and programmes with high climate impact and paradigm shift potential;

(f) *Also agrees* that the Private Sector Facility will support climate-oriented local financial systems, green banks, markets and institutions;

(g) *Further agrees* that the Private Sector Facility will act as a market maker for climate actions, transformation in sectors and regions with imperative needs to address climate change;

(h) *Underscores* the importance of the Readiness and Preparatory Support Programme and Project Preparation Facility in supporting an increase in local private sector proposals, in particular from the least developed countries and small island developing States;

(i) *Approves* the direct investment modality as provided in annex II;

(j) *Approves* the recommendations to facilitate and increase private sector activities in least developed countries and small island developing States of this decision;

(k) *Requests* the Secretariat to implement the strategy and its modalities and to report to the Board on the progress of the implementation of these modalities via regular reporting on the activities of the Secretariat;

(l) *Also requests* the Secretariat to present to the Board the implementation challenges and budgetary information for the strategy and its modalities for the Board's consideration at the earliest opportunity;

(m) *Further requests* the Secretariat to implement the modalities in annex II, listed under the category "Modalities to be implemented immediately within existing Board mandates", and to report to the Board on the progress of the implementation of these modalities via regular reporting on the activities of the Secretariat;

(n) *Notes* the findings of the Secretariat in the reviews of the micro, small and medium-sized enterprises and mobilizing funds at scale pilot programmes;

(o) *Requests* the Secretariat to also submit an updated version of the terms of reference for the second phase of the micro, small and medium-sized enterprises pilot for consideration by the Board at its twenty-fifth meeting;

(p) *Also requests* the Secretariat to integrate the lessons learned from the implementation of the micro, small and medium-sized enterprises and mobilizing funds at scale pilot programmes and to present a progress report on the state of implementation of these programmes for consideration by the Board at its twenty-fifth meeting;

(q) *Welcomes* the recommendations from the Private Sector Advisory Group on the mobilization of private sector finance to progress the GCF forestry-related results areas;

(r) *Requests* the Secretariat to take full account of the Private Sector Advisory Group's recommendations in the implementation of the private sector strategy; and

(s) *Also requests* the Secretariat to continue developing options for insurance and capitalizing climate disaster risk funding mechanisms.

Annex II: List of proposed modalities

Categories of modalities	List of modalities
Modalities to be implemented immediately within existing Board mandates	Strategic use of readiness support, PPF and public sector policy instruments relevant for climate change
	Better utilization of current instruments to support private sector in adaptation in LDCs and SIDS
	Prioritize strong private sector institutions (local, regional and international) in accreditation that can support private sector projects in LDCs and SIDS
	Green finance readiness program consistent with Readiness Strategy for 2019 to 2021
Modalities to be piloted with limitation by the Secretariat within existing Board mandates	Mobilizing private sector finance for adaptation via targeted endowments at country level
	Piloting local currency funding
	Climate-focused centres of excellence (Incubation and acceleration of early-stage climate technologies and start-ups)
	Private sector co-investment solutions
Modalities requiring Board consideration and business model enhancement	Direct investment approach
Modality that will require further work from the Secretariat	Options for insurance and capitalizing climate disaster risk funding mechanisms

Annex III: 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.

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