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23 October 2019

Review of the initial investment framework

Policy on co-financing

Summary

This document provides background information on the GCF Policy on Co-financing and presents the policy for the Board's consideration and adoption. The document explains how the principles that underpin the policy relate to the GCF funding proposal assessment process. The proposed Policy on Co-financing, set out in annex II to this document, (i) establishes the objectives for co-financing in GCF-funded activities; (ii) defines co-financing and related terms that apply to GCF-funded activities; and (iii) sets out guiding principles, approaches for co-financing in GCF-funded activities and reporting obligations, including provisions for monitoring and evaluating co-financing. The policy is not intended to impose any conditions or restrictions on GCF funding allocation, but rather to improve consistency and alignment with the mandate and financing modalities of the GCF.

I. Introduction

1. The Board, by decision B.07/06, adopted the initial GCF investment framework, as contained in annex XIV to the decision (annex XIV to document GCF/B.07/11). When adopting the initial investment framework, the Board decided (decision B.07/06, para. (e)) to keep the framework under review and to take action as necessary, in particular with respect to the criterion on needs of the recipient countries in the investment guidelines. By decision B.09/05, the Board further developed the initial investment framework by adopting initial activity-specific sub criteria and indicative assessment factors.

2. In decision B.17/10, the Board requested the Secretariat to develop a proposal for the Board's consideration to address, inter alia, a policy on co-financing.

3. At the nineteenth, twentieth, twenty-first and twenty-third meetings of the Board, the Secretariat presented a policy document on co-financing as part of a policy package including draft papers for a policy on concessionality and a methodological approach for calculation of agreed full and agreed incremental costs.

4. This paper provides background information on the GCF Policy on Co-financing and considers briefly its interlinkages in the context of the review of the initial investment framework of GCF. It presents a draft Policy on Co-financing for the Board's consideration and articulates briefly how its adoption and implementation are likely to impact investment by GCF.

5. The GCF Policy on Co-financing sets out the objectives, definitions, principles, scope and methodology to determine, account for, track and report on co-financing as well as additional resources invested alongside GCF resources. The proposed Policy on Co-financing has been developed considering, where appropriate, the experience and lessons learned of similar policies from other climate finance delivery channels, particularly the Global Environment Facility (GEF)[1] and the Climate Investment Funds (CIF)[2] with regard to co-financing. This policy is not intended to impose any conditions or restrictions on GCF funding allocation, but rather to improve its consistency and alignment with GCF's mandate and financing modalities.

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[1] The GEF *Operational Guidelines for the Application of the Incremental Cost Principle* proposes a five-step process to quantitatively and qualitatively demonstrate incremental costs and simplify the negotiation process. Through these steps, the transparency of the determination of incremental costs of a project during the preparation and implementation periods can be enhanced by determining the environmental problem (corresponding to the climate change problem, in the case of GCF) and the business as usual scenario without GEF support; identifying the global environmental benefits, links with GEF strategic programmes and priorities of the focal areas; developing the result framework of the intervention; providing the incremental reasoning and GEF role; and negotiating the role of co-financing. The GEF policy on co-financing is applicable to its secretariat and all GEF partner agencies as well as to all projects and programmes financed with resources of the GEF Trust Fund. The GEF policy sets out mandatory requirements for co-Financing throughout the GEF project and programme cycles, as well as for portfolio monitoring and reporting by the GEF secretariat. Co-financing is required for all GEF-financed full-Sized projects (i.e. GEF project financing exceeding USD 2 million) and medium-sized projects and programmes (GEF project financing of up to USD 2 million). Co-financing is encouraged for all "enabling activities", which refers to projects for the preparation of a plan, strategy or report to fulfil commitments under a Convention. In the case of the GEF policy, during the concept stage, project identification forms and programme framework documents are required to be submitted for work programme entry or approval by the GEF Chief Executive Officer. Agencies provide indicative information regarding the expected amounts, sources and types of co-financing, and the subset of such co-financing that meets the definition of investment mobilized. At the Chief Executive Officer endorsement/approval stage, agencies provide confirmed information regarding the expected amounts, sources and types of co-financing and investment mobilized, with appropriate supporting evidence. Finally, during project implementation and at project completion, agencies provide information on the actual amounts, sources and types of co-financing and investment mobilized in their midterm reviews and terminal evaluations.

[2] Co-financing is not formally required at the CIF; however, in concessional lending operations, the aspiration has been for proposals to achieve a 1:44:1 ratio. Even in the absence of formal co-financing requirements, the CIF operational policies put strong emphasis on "facilitating the mobilization of co-financing. The CIF aims to leverage financing not only from the multilateral development banks themselves, but also from other development actors, including United Nations agencies and bilateral development agencies, and the private sector, thereby demonstrating the potential of scaled-up, blended development financing".

6. Public and/or private co-financing is highly valued in all GCF funding proposals as a means to maximize the opportunity for strategic partnerships to achieve the highest possible impact and ambition in accordance with the GCF mandate. The Policy on Co-financing is useful to maximize the impact expected from GCF resources.

7. An appropriate level of co-financing by the accredited entity (AE) plays a critical role in aligning interest and maximizing the opportunities for partnerships by bringing more resources alongside GCF financing while also promoting joint learning.

8. Co-financing may play a role in strengthening country ownership by supporting more effectively the engagement of national and/or regional actors in implementing the climate actions.

9. Private sector co-financing is also likely to support greater impact in terms of climate change mitigation and adaptation, including through knowledge transfer and the consideration of best practice in climate finance.

10. GCF currently requires AEs, in their funding proposals, to report on ”Co-financing, Mobilized and Leveraging long-term investments” (section E.6.2 of the funding proposal template) and ”Expected volume of finance to be leveraged by the proposed project/programmes and because of the Fund’s financing, disaggregated by public and private sources” (section E.6.5 of the funding proposal template). The responses to these requests currently form the ex-ante estimation of co-finance and leveraged finance.

11. As part of the criterion ”Efficiency and Effectiveness” in the GCF investment framework, the following indicative assessment factors are included (considered): (i) expected volume of finance to be leveraged by the proposed project/programmes, disaggregated by public and private sources; (ii) co-financing ratio; and (iii) potential to catalyse private and public sector investment, assessed in the context of performance on performance industry best practices.

12. However, the lack of a clear definition of what constitutes co-finance, mobilized or leveraged finance has led to inconsistencies in estimations of relevant amounts across funding proposals. The Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee has developed proposed methodologies for calculating amounts of mobilized finance from the private sector. These methodologies are tailored per instrument (guarantees, syndicated loans and shares in collective investment vehicles, credit lines and direct investment). The methodologies are described by OECD as “ongoing work” and characterized by “causality assumptions and attribution techniques that balance accuracy with practicality”.[3]

13. Against the background of the increased focus on mobilizing finance in the context of blended finance and climate finance, nine leading global multilateral development banks in 2017 developed a methodology to capture private investment mobilization. The methodology includes the need to provide details of a proven causal link, backed by evidence (e.g. mandate letters, fees linked to financial commitment or other validated or auditable evidence of the active and direct role of an MDB leading to commitment by other private financiers).

14. In addition, in decision B.17/04 on the operational framework on complementarity and coherence, the Board noted that co-financing is important regarding fund-to-fund arrangements to maximize impact and at the activity level for greater complementarity with main multilateral funds in the climate finance sector.

15. While there is some project co-financing between GCF and other climate funds, experience has shown that financing of most projects between GCF and other funds is done in

[3] See for instance OECD. 2017. *Private Finance for Climate Action: Estimating the Effects of Public Interventions*. p.3 Available at <http://www.oecd.org/env/researchcollaborative/WEB%20private-finance-for-climate-action-policy-perspectives.pdf>.

parallel. This builds on the natural strengths and mandates of each institution. The ability to capture such complementarity would allow the GCF to report back to the Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) the scope of complementarity and coherence of its investments with other climate funds.

16. This document provides definitions and presents guiding principles to calculate, track and report co-finance, thereby providing clarity for both countries and AEs as they prepare funding proposals. This policy is not intended to impose any conditions or restrictions on GCF funding on the basis of co-financing, but rather to improve consistency and alignment with the mandate of the GCF.

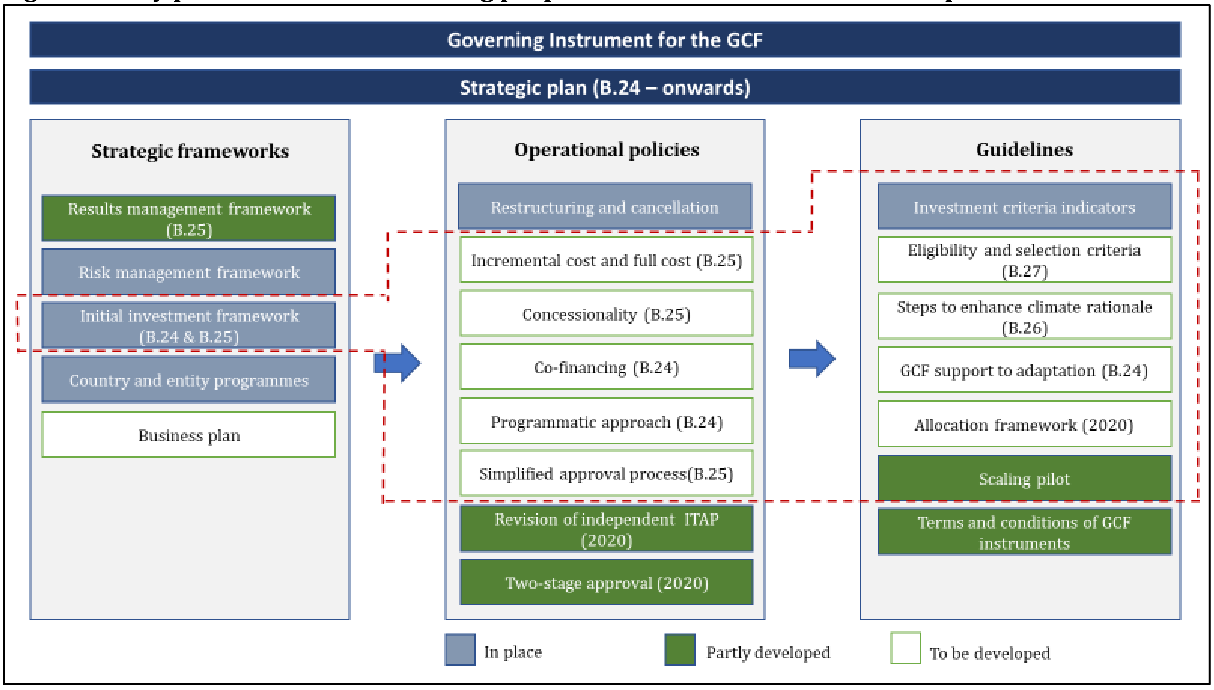
II. Interlinkages between policies

17. The Board's 2019 work plan called for a review of the Fund's initial investment framework. In that context, the Board will consider a set of investment guidelines and policies. An understanding of the interrelations of these policies and guidelines and how they are applied to GCF-funded activities is necessary in order to address the policy gaps related to the GCF funding proposal approval process.

18. Clarifying matters related to co-financing will provide additional transparency to national designated authorities (NDAs), AEs and other stakeholders regarding the principles behind the assessment of GCF funding proposals and will clarify definitions and reporting obligations. As noted above, these clarifications are not intended to impose additional conditions or restrictions on GCF funding, but rather aim to improve consistency and alignment with the mission of the GCF.

19. Figure 1 below presents an overview of key policies related to funding proposals in the context of the 2019 Board workplan. The boxes outlined by a dashed red line are items that relate to the initial investment framework. The figure shows that the interlinkages exist at a number of levels, including between and across the three different categories: strategic frameworks, operational policies and guidelines.

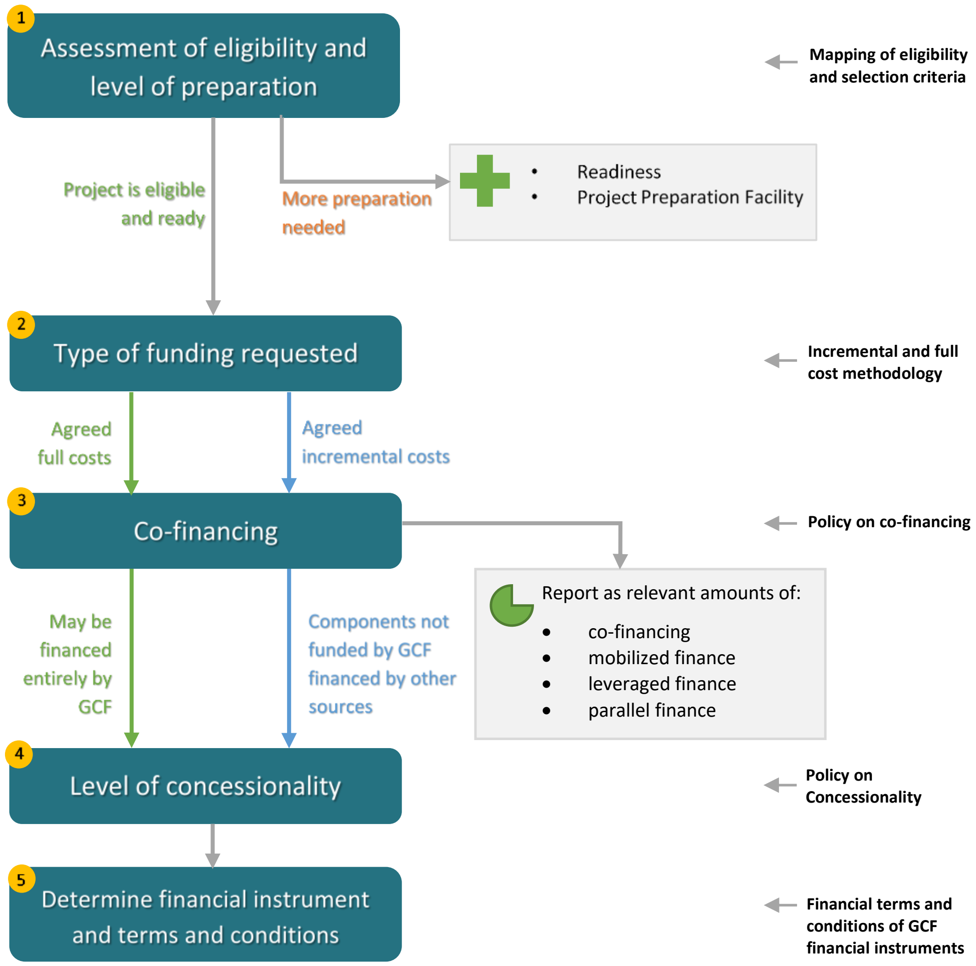
Figure 1: Key policies related to funding proposals and the 2019 Board Workplan



Abbreviation: TAP = Technical Advisory Panel

20. Recognizing the interlinkages among the policies and guidelines, figure 2 presents an illustration of some interlinkages and how they may be applied to the funding proposal approval process, bearing in mind that the application to programmes or individual funding proposals may differ.

Figure 2: Integrated policy approach for the funding proposal approval process



Notes

(1) Is the funding proposal eligible for GCF financing, and is it eligible and prepared to begin the approval process? If not, it may be returned to the country and entity for further preparation and/or support from the Project Preparation Facility and/or the Readiness and Preparatory Support Programme. The mapping of eligibility and selection criteria will enumerate elements related to project or programme eligibility and selection criteria that have been included in guidance from the Conference of the Parties, the Governing Instrument for the GCF and relevant Board decisions.

(2) What type of funding is requested from GCF: agreed full costs or agreed incremental costs? Is this choice supported by the information provided? The incremental and full cost methodology will outline guiding principles and a methodological approach to estimating incremental costs and full costs.

(3) What type of co-financing is needed? Agreed full costs would be entirely eligible for GCF funds, while financing from other sources would be needed to finance components not covered by agreed incremental costs. The Policy on Co-Financing (annex II to this document) presents the general principles and approaches to determine and monitor co-financing applicable to all GCF-funded activities.

(4) What level of concessionality should be applied to support the funding proposal? The Policy on Concessionality will provide guidance to ensure consistency and a systematic approach in the application of principles underpinning concessionality as it pertains to the selection of the GCF financial instruments, the terms and conditions to be applied, reporting on concessionality as well as the supportive evidence needed for concessionality to be applied.

(5) Following agreement on the appropriate level of concessionality, concessional terms will be applied through the Financial Terms and Conditions of GCF Financial Instruments (decision B.09/04 and decision B.17/08).

III. Current and future actions by the Secretariat

21. In the context of the GCF's mandate to advance complementarity and coherence, the Secretariat has been considering the work of international institutions in this area. Specifically, GCF is collaborating with OECD and other multilateral and bilateral institutions to achieve alignment on definitions and methodologies, to make sure that official co-financing metrics and statistics on private climate finance mobilized through public interventions are robust and consistent, eliminating the risk of double counting. So far, data collection through the OECD Common Reporting Standard is operational for five financial instruments: guarantees; syndicated loans; shares in collective investment vehicles (investment funds); direct investment in companies; and credit lines. Methodological work is ongoing to cover two additional financial instruments/arrangements: project finance structures (public–private partnerships) and standard loans and grants in "simple" co-financing arrangements with private investors (e.g. matching grants).

22. The GCF Policy on Co-financing reflects the fact that negotiations are still ongoing with multilateral development banks and financial institutions to seek alignment with the OECD methodology. Therefore, in this policy GCF seeks to align definitions and present a simplified approach that can be applied as soon as possible upon its approval.

23. Ensuring that all GCF AEs, in particular direct access entities, are aware of the requirements of the GCF Policy on Co-financing, in particular direct access entities, will require additional consultations and the provision of capacity-building in some cases, to ensure that information on scope, metrics and reporting are fully understood and applied across the entire GCF portfolio. This effort would be in recognition of the need for additional capacity-building to strengthen the skills and knowledge of direct access entities to apply the proposed policy.

24. Over the past four years, the Secretariat has been able to provide to OECD each year the necessary GCF financial data including co-financing amounts in support of the work by OECD to track development and climate finance flows, thereby complying with the OECD standards and methodologies. Upon the approval of the GCF Policy on Co-financing, the Secretariat will put in place systems to systematically collect from AEs the additional relevant data required and to report to OECD on mobilized finance[4] (publicly mobilized private finance) from GCF projects/programmes.

25. In the implementation of the Policy on Co-financing, the Secretariat will carry out the following actions:

(a) Review all new funding proposals to ensure consistency with the requirements of this policy;

(b) Avoid imposing a minimum threshold and/or specific co-financing sources in specific project or funding proposal assessment processes, cognizant that, while always desirable, co-financing may not always be achievable and further noting the provisions of the Governing Instrument for the GCF regarding the provision of full cost finance;

(c) Provide relevant documentation, including operational guidelines to support AEs, NDAs/focal points, in the calculation and reporting of co-finance and mobilized private finance ex-ante and ex-post of a project or programme;

[4] The term "mobilized finance" used in this background document as well as in the Policy on Co-financing contained in annex II is consistent with the terminology used by OECD. A demonstrable causal link between the public and private investment underpin the methodologies of the OECD Research Collaborative on Tracking Finance for Climate Action, available at <https://www.oecd.org/env/researchcollaborative/>.

(d) In addition to paragraph 26(c) above, continue to collaborate with OECD as well as work on capacity-building with a view to introduce an instrument-based methodology as soon possible and reach full alignment with OECD and other bilateral and multilateral institutions;

(e) Maintain a project and programme database to record all co-financing data during all the stages of the GCF project cycle;

(f) Monitor, evaluate and report to the Board, including on the progress achieved in improving the levels of co-financing and mobilized private finance over time at both the project and the portfolio level; and

Support focal points/NDAs, AEs and all relevant stakeholders for consistent implementation of the GCF Policy on Co-financing.

IV. Recommended action by the Board

26. It is recommended that the Board adopt the draft decision set out in annex I to this document.

Annex I: Draft decision by the Board

The Board, having considered document GCF/B.24/04 titled "Review of the initial investment framework: Policy on Co-financing":

(a) *Adopts* the Policy on Co-financing as set out in annex II;

(b) *Decides* that the Policy on Co-financing will apply to funding proposals approved at the twenty-sixth meeting of the Board and thereafter;

(c) *Requests* the Secretariat to design and implement a capacity-building programme, as part of the Readiness and Preparatory Support Programme, to support direct access accredited entities in the implementation of the Policy on Co-financing, including its reporting and evaluation requirements;

(d) *Also requests* the Secretariat to update the templates for concept notes and funding proposals to reflect the Policy on Co-financing by the twenty-fifth meeting of the Board, in keeping with the Secretariat's current practice of updating templates no more than once per year;

(e) *Further requests* the Secretariat to recommend for the Board's consideration the modality for the review of the Policy on Co-financing as part of the overall GCF policy review and update, ensuring consistency with other relevant policies and building upon lessons learned and implementation challenges identified in the application of this policy;

(f) *Requests* the Secretariat to report mobilized private finance, as defined in the Policy on Co-financing, to the Organisation for Economic Co-operation and Development beginning with calendar year 2021; and

(g) *Also requests* the Secretariat to continue to work on the collaboration with the Organisation for Economic Co-operation and Development as well as on capacity-building with a view to introduce an instrument-based methodology to report mobilized private finance as soon possible and reach full alignment with the Organisation for Economic Co-operation and Development and other bilateral and multilateral institutions.

Annex II: Policy on Co-financing

I. Purpose

1. This Policy on Co-financing (the Policy) sets out key principles and approaches to determine and monitor public and private co-financing applicable to all GCF-funded activities.

2. The Policy provides guidance on determining, reporting and monitoring co-financing (as defined in section IV below) in GCF-funded activities, consistent with paragraphs 54 and 57 of the Governing Instrument for the GCF.

3. The Policy also contains provisions to support GCF in accounting for and reporting on the mobilization of private finance to maximize the impact of GCF interventions in developing countries while assisting entities and countries in understanding, defining and applying the concept of co-financing in the specific context of the mandate of GCF.

4. The Secretariat will support focal points, national designated authorities, accredited entities (AEs) and other relevant stakeholders for the successful implementation of this Policy.

II. Objective

5. The objective of the Policy is to clarify definitions and key principles for the GCF, working with its partners, to attain adequate levels of co-financing as a means to:

(a) Achieve the highest possible impact and ambition expected from the GCF and strengthen climate action through both public sector and private sector contributions to the projects and programmes in accordance with the objectives and guiding principles of the GCF;

(b) Strengthen country ownership and provide for the necessary resources for the long-term sustainability of climate actions in developing countries;

(c) Increase accountability by improving transparency and consistency of reporting of the amounts of co-financing; and

(d) Improve complementarity with other climate funds.

III. Definitions

6. The following terms, as defined, apply to the GCF Policy on Co-financing:

(a) "**Co-financing**" means the financial resources required, whether Public Finance or Private Finance, in addition to the GCF Proceeds, to implement the Funded Activity for which a Funding Proposal has been submitted;

(b) "**Expected Co-financing**" refers to the amount of Co-financing that is identified in the Funding Proposal submitted to the Board for adoption and included in the funded activity agreement that is expected to be necessary for the implementation of the Funded Activity;

(c) "**Funded Activity**" means the project or programme described in the Funding Proposal;

(d) "**Funding Proposal**" means, prior to Board approval, the Funding Proposal submitted to the GCF by the Secretariat, and, after Board approval, the Funding Proposal as approved by the Board, including any modification thereto made in accordance with the policies, rules and procedures of the GCF;

(e) "**GCF Proceeds**" means the amount of financial resources requested by the AE from the GCF in the Funding Proposal or, if different, the amount approved by the Board in respect of a particular Funded Activity;

(f) "**Leveraged Finance**" means private investment resulting from the contribution associated with GCF involvement in an investment, including private investment provided, regardless of whether or not the GCF was actively and/or directly involved in raising such financing or soliciting investors, and includes investment made as a result of the intervention of additional investors after the first project is completed;

(g) "**Mobilized Finance**" means private climate finance mobilized through public interventions;

(h) **"Parallel Finance"** means the financial resources that flow alongside GCF Proceeds to a project, but which are not required for the implementation of the Funded Activity, and which are earmarked for other outcomes and may be consistent with general mitigation and adaptation measures;

(i) **"Private Finance"** means all financial resources that are provided for the implementation of a Funded Activity from entities that are more than 50 per cent owned and/or controlled by private shareholders;

(j) **"Public Finance"** means all financial resources, other than the GCF Proceeds, that are provided for the implementation of a Funded Activity from the public sector or entities that are more than 50 per cent owned and/or controlled by the public sector; and

(k) "**Realized Co-financing**" means the amount of Co-financing actually provided to the Funded Activity during its implementation.

IV. Principles

7. There is no minimum amount of Co-financing required for a Funded Activity, and no specific sources of Co-financing that must be complied with.

8. Whenever possible, Funded Activities should seek to incorporate appropriate levels of Co-financing to maximize the impact of GCF Proceeds, as determined on a case-by-case basis, cognizant that while desirable to demonstrate alignment of interests between the GCF and AEs, and country ownership by developing countries, Co-financing may not always be achievable or realistic.

9. While maximizing Co-financing is desirable, GCF will avoid using Co-financing metrics as stand-alone targets since maximizing climate mitigation and adaptation results does not necessarily equate with minimizing or optimizing spending on climate mitigation and adaptation. Co-financing ratios as well as expected levels of Mobilized Finance or Leveraged Finance should therefore not become stand-alone targets, as this may disincentivize GCF from financing projects/programmes with strong impact potential and high paradigm shift potential.

10. Co-financing should be assessed in a comprehensive manner in conjunction with other indicators included in the investment framework.

11. Where GCF funding is covering the whole or part of the incremental costs of a Funded Activity, other costs should be co-financed by other sources.

V. Reporting and other requirements

5.1 Accredited entities

12. AEs shall include in each Funding Proposal the amount of the Expected Co-financing, if any, required for the implementation of the relevant Funded Activity. Such estimates must be supplemented by evidence and justified by appropriate explanations and methodologies, particularly in the case of estimated Mobilized Finance.

13. AEs shall monitor and report on the delivery of Co-financing to the relevant Funded Activity in accordance with the provisions of the relevant legal agreements between the AE and the GCF, including the accreditation master agreement and funded activity agreement.

14. Amounts of Co-financing should also be monitored and reported on by AEs cumulatively, separately for Public Finance and Private Finance.

15. Upon completion of a Funded Activity, the AE shall report on Realized Co-financing by including in the relevant reports required by GCF under the relevant legal agreements an assessment of the extent to which the Expected Co-financing was actually provided by the relevant co-financier for the implementation of the Funded Activity. Such reports shall also include information on any financial resources provided for the implementation of the Funded Activity that were not identified in the Funding Proposal.

16. Where relevant, the AE should also report on Mobilized Finance in the context of the Funded Activity as part of its annual performance report to the GCF, based on demonstrable causal links in light of known financing sources.

17. AEs should also report, to the extent possible, on Parallel Finance at the completion of the relevant Funded Activity in the final annual performance report (or project completion report).

18. To the extent possible, AEs should report on Leveraged Finance at the completion of the relevant Funded Activity in the final annual performance report (or project completion report) on the basis of demonstrable causal links.

19. All reporting shall be done in absolute numerical terms without converting loans to their grant equivalent.

5.2 Secretariat

20. The Secretariat will monitor overall Co-financing at the Funded Activity, and portfolio, level, including in relation to the levels of Public Finance, Private Finance, Mobilized Finance, Parallel Finance and Leveraged Finance as reported by AEs.

21. The Secretariat will report on such Co-financing, to the extent available and based on the information provided by AEs, through the annual portfolio review or other such reports as the Fund may request from time to time. In particular, to the extent available, the reporting shall include information on:

(a) The total amount of Co-financing, Mobilized Finance and Leveraged Finance at the individual Funded Activity level, distinguishing Public Finance and Private Finance; and

(b) The total amount of Co-financing, Mobilized Finance and Leveraged Finance at the GCF portfolio level, distinguishing Public Finance and Private Finance.

22. In reporting Leveraged Finance, the Secretariat will endeavour to the extent possible to complement information provided by AEs with any other reliable publicly available information.

23. The Secretariat shall develop guidelines that will include, among other things, an instrument-based methodology to report mobilized private finance aligned with the requirements of the Organisation for Economic Co-operation and Development and other bilateral and multilateral institutions to measure Mobilized Finance (private sector mobilized

finance); guidance and methodologies on, among others, reporting Leveraged Finance on project completion; guidance relating to the treatment of in-kind contributions and tax exemptions; and guidance to measure and report Parallel Finance.

VI. Effectiveness

24. This Policy shall apply to all Funding Proposals approved by the Board starting from the twenty-sixth-meeting of the Board.