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Policy on concessionality

Summary

This document proposes a policy on concessionality that presents key principles around the concept of concessionality and elaborates various approaches for determining concessionality in private sector projects, public sector projects with reflows as well as public sector projects with no reflows. By illustrating the requirements for implementation, it sets clarity and consistency in the project approval process including the reporting procedures. The paper also provides actions taken as per review of the financial terms and conditions by the Investment Committee.

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I. Introduction

1. The Governing Instrument for the GCF, paragraph 54, states "The Fund will provide financing in the form of grants and concessional lending, and through other modalities, instruments or facilities as may be approved by the Board."

2. By decision B.05/07, the Board adopted guiding principles and factors for determining terms and conditions of grants and concessional loans. It also took note of criteria and indicative parameters for the terms and conditions, which include consideration of the contribution to the result areas of GCF, viability of implementation, and efficient and catalytic use of resources.

3. The Board, by decision B.07/06, adopted initial GCF investment framework, as contained in annex XIV to the decision. When adopting the initial investment framework, the Board decided 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 (decision B.07/06, paragraph (e)). By decision B.09/05, the Board further developed the initial investment framework by adopting initial activity-specific subcriteria and indicative assessment factors.

4. By decision B.17/10, paragraph (c), the Board requested the Secretariat to develop a proposal for its consideration at its nineteenth meeting, taking into account best practices from other multilateral funds and other approaches, to address, among other issues, "options for further guidance on concessionality, building on related work". In decision B.17/08, the Board instructed the Secretariat to ensure that the financial terms and conditions proposed in concept notes and funding proposals for concessional loan products meet the principle of minimum amount of concessionality, among others, and apply the financial terms and conditions set out in decision B.09/04 in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.

5. At its nineteenth meeting, the Board considered document GCF/B.19/12/Rev01, titled "Concessionality: potential approaches for further guidance". In decision B.19/06, paragraph (d), the Board requested the Secretariat to develop an integrated approach to resolve interrelated policy matters for consideration at its twentieth meeting, including "policies on the review of the financial terms and conditions of GCF instruments and concessionality, incremental costs, full costs, and co-financing". Also in the same meeting, a Grant Equivalent Calculator (GEC) was reported to the Board that has been approved by the Risk Management Committee (RMC) to support portfolio management processes, including the reporting of GCF resources in grant equivalence terms.

6. In decision B.27/06, the Board adopted the Updated Strategic Plan (USP) for the Green Climate Fund: 2020-2023. The document sets strategic priorities for 2020-2023, which included an action to urgently close remaining investment policy gaps in line with the 2020-2023 Board workplan through the ongoing consideration of how to strengthen the eligibility criteria of the GCF, as part of the process to simplify and clarify project and programme eligibility and selection criteria and update the policies and procedures of the GCF, including policies on the review of the financial terms and conditions of GCF instruments and concessionality.

7. The following paper addresses these mandates by the Board and provides guidance on the concessionality through explanation of guiding principles and implementation measures such as requirements for concessionality, application and reporting measures.

II. Policy rationale

8. As per Board decision B.07/06, concessionality in GCF is widely understood as **"funding with below-market terms and conditions"** where the minimum amount of concessional

funding needed can be up to and including the full cost of the project or programme. Concessionality can also be defined as a measure of the level of benefit provided to a borrower when compared with financing available at full market rates. Concessionality aims at lowering the cost of borrowing or minimizing the risk in a transaction for the borrower.

9. GCF offers concessionality in order to facilitate a high-impact climate action that would otherwise not take place. In many countries, a paradigm shift towards low-emission and climate-resilient development pathways may not be achieved through existing market financing. Although reducing greenhouse gas emissions and increasing climate resilience have economic benefits for the public, these benefits are often under-priced in public and private investment decisions, leading to suboptimal outcomes. To circumvent these market shortcomings, GCF provides concessional financing to align the financial incentives with the economic benefits, leading to low-emission and climate-resilient investments.

10. This policy underscores the key principles to support concessionality for GCF funding proposals in order to achieve the following objectives:

(a) To provide guidance to ensure consistency and a systematic approach in the application of principles underpinning concessionality and the selection of GCF financial instruments. This guidance can facilitate the work of national designated authorities (NDAs) and accredited entities (AEs) in developing funding proposals by having a clearer description of the criteria to be used in linking the GCF financial instruments and their terms and conditions to specific activities in funding proposals;

(b) To facilitate the assessment of funding proposals with respect to principles and performance parameters agreed by the Board in decision B.05/07, such as maximizing the mobilization effect of GCF funding and avoiding crowding out private sector investments; and

(c) To facilitate the work of the Secretariat and the independent Technical Advisory Panel (iTAP) in assessing funding proposals, particularly with respect to the investment criteria, which underpins the review of the level of concessionality requested in funding proposals.

11. The paper does not intend to pose any conditionality in approval of funding proposals. On the contrary, it strives to provide consistent and systematic approach on the selection of the most appropriate financial instrument and the relevant level of concessionality. Such consistency during the approval and implementation process will also ease project development, review and reporting.

12. Without the policy in place, there is a possibility of lack of consistency in the application of the financial terms and conditions. In addition, having a policy on concessionality will allow for AEs to be clearer on what to expect when preparing projects for GCF consideration.

III. Analysis of policy proposal

3.1. Policy proposal

13. This paper outlines guiding principles on concessionality that are consistent with the financial terms and conditions of GCF and with the GCF investment criteria for public and private sector operations. It recognizes the best practices in private sector operations and public sector funding proposals adopted by the Board in decision B.05/07 and elaborates tailored approaches for determining concessionality as relevant to private sector projects, public sector projects with reflows as well as public sector projects with no reflows. Lastly, the reporting on concessionality should be done on a grant equivalency basis using the GEC tool in addition to the reporting on a nominal basis.

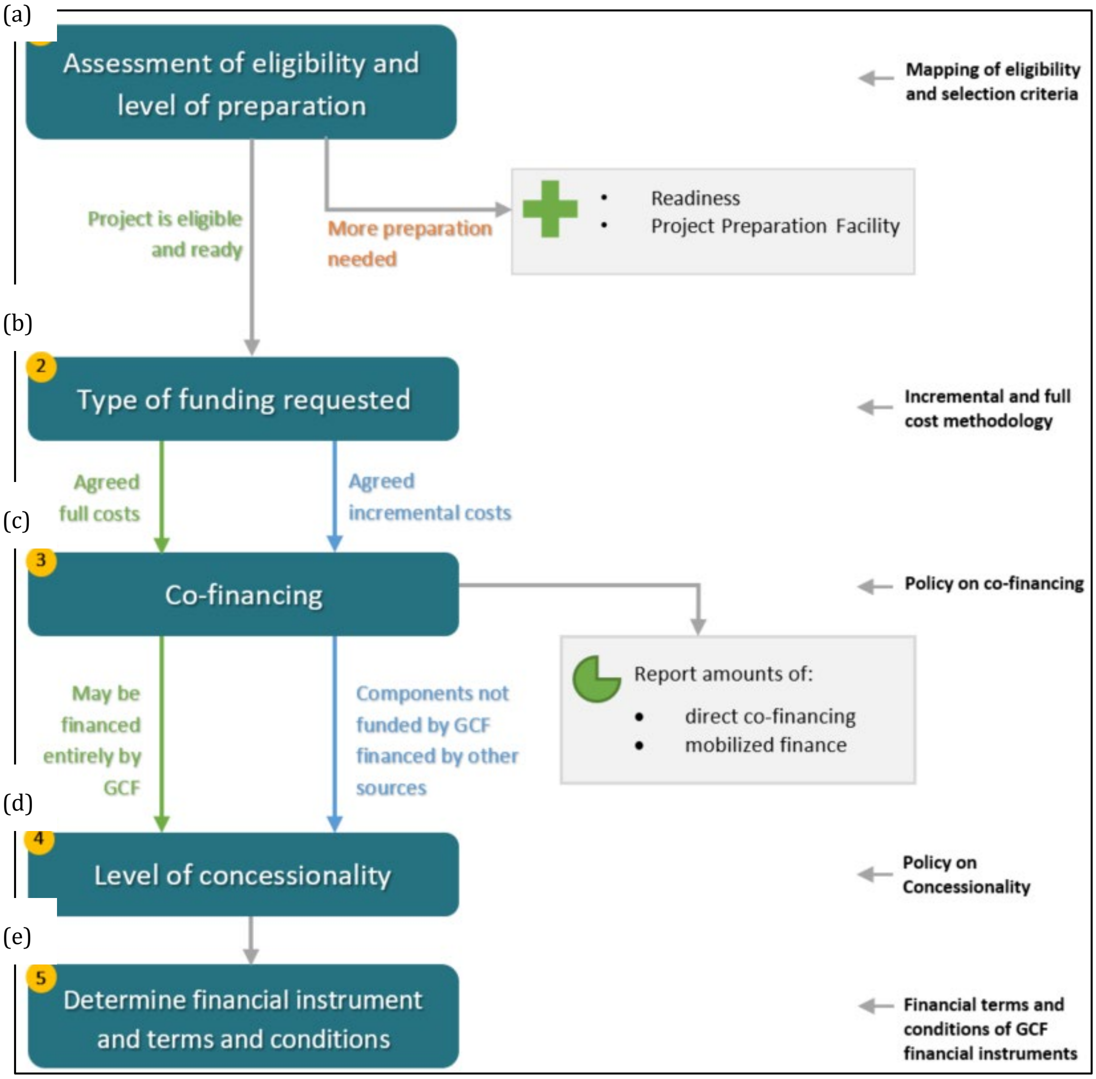
14. It is also proposed that the application of guidance on concessionality will be able to respond appropriately to the various stages in the project approval process:

(a) At origination and design stages, through the determination of the best applicable instruments (e.g. grant, loan, equity, guarantee);

(b) At financial due diligence and financing structure stage, through the definition of the terms and conditions underpinning the instruments (e.g. low- or high-concessional loans); and

(c) At reporting on concessionality in quantifiable format of grant equivalency basis that has been agreed by the RMC.

Figure 1: Policy approach for the funding proposal approval process



15. The proposed policy in this paper is considered within the project approval process as in Figure 1. The alignment of policies on incremental costs and full costs, concessionality, and co-financing along with GCF financial terms and conditions is important to determine the overall financial structure of proposed projects/programmes.

(a) <u>Assessment of eligibility and level of preparation</u>: First, the funding proposal's eligibility for GCF financing needs to be determined. Especially, the climate impact potential at the level of preparation must be determined prior to requesting what type of funding to request. If it is not ready, it should be returned to the country and entity for further preparation and/or support from Project Preparation Facility (PPF) and Readiness;

(b) Type of funding requested: Next, the estimation of agreed full costs and agreed incremental costs due to climate change is relevant for the concessionality policy, consistent with paragraph 54 of the Governing Instrument, which states "Financing will be tailored to cover the identifiable additional costs of the investment necessary to make the project viable." The calculation methodology for estimating incremental costs and full costs helps determine which part of the project is eligible to be funded by GCF and which may be better suited for co-financing or whether the project may be financed entirely by GCF;

(c) Co-financing: The co-financing policy explains how costs funded by other parties are to be classified and reported. The concessionality policy is linked to the co-financing policy because GCF concessional financing may be blended or applied in parallel with concessional or market-rate financing from other parties, affecting the overall concessionality and financial sustainability of the project. Changes to the way co-financing is defined, monitored and reported could have an impact on the need for GCF concessional financing; and

(d) Finally, the concessionality guidance and its associated tools determine the appropriate financial instruments and terms of GCF financing to ensure efficiency and effectiveness. The principles used to determine levels of concessionality have a direct impact on the financial terms and conditions of the GCF financial instruments, as they are the tools by which these principles will be made operational. The review of terms and conditions of the GCF financial instruments as presented in document GCF/B.21/05/Add.1 produced several recommendations (see annex III for more information).

16. Any concessionality policy should be tailored to fit within the programme framework of specific initiatives for direct access entities, such as enhanced direct access and the simplified approval process, so as not to undermine their effectiveness.

3.2. Policy impact

17. When the policy on concessionality is in place, some of the anticipated impacts and benefits within the project approval process are:

(a) Add flexibility in the choice of instruments and terms in projects; and

(b) Facilitate Secretariat and the iTAP in the assessment of funding proposals.

18. More importantly, the policy on concessionality will facilitate the work of NDAs and AEs in developing funding proposals with a clear description of the principles for determining concessionality and linking financial terms and conditions to specific proposed activities.

19. Through these benefits, the policy will lead to time and cost savings for the NDAs and AEs. Furthermore the GCF will be able to determine the most appropriate form of financial instrument required to deliver climate impact through an efficient and effective utilization of GCF funding.

IV. Linkages to other policies

20. As aforementioned, this paper is part of a series of policies within the initial investment framework. It has close linkages to:

(a) Policy on incremental cost and full cost methodologies (to be tabled at B.29);

(b) Policy on co-financing (decision B.24/14); and

(c) Financial terms and conditions (document GCF/B.21/05/Add.01).

21. The process of implementation of the concessionality policy will require coherence with related policies on incremental and full cost calculation methodology, co-financing, the financial terms and conditions of the GCF financial instruments and the risk management framework, among others.

V. Implementation arrangements and operational impact

22. The Secretariat proposes a phased approach in the implementation of the policy on concessionality. The first phase of the approach will focus on learning and capacity-building for GCF stakeholders (i.e. AEs, NDAs, Direct access entities (DAEs), focal points, etc that are involved in developing funding proposals) and the subsequent phases include a review and evaluation.

23. The implementation of this approach would require the Secretariat to adjust the existing funding proposal templates to signal to AEs which information is needed to undertake the assessments described above. Owing to the multiple integrated and interrelated policies that are currently under consideration, it is proposed that all modifications to the template occur simultaneously as per the current practice of funding proposal updates.

24. In addition to changes in the templates, the Secretariat, as part of its support to NDAs/focal points and dialogue with AEs, would carry out a series of training sessions to ensure that proposals are consistent with the new principles discussed above.

25. The Secretariat intends to report on its experience with assessing projects following the report on progress of implementation according to concessionality principles as part of the periodic review of financial terms and conditions of GCF. A detailed description of what each of the proposed phase would entail is indicated below.

5.1. First phase

26. The Secretariat is already implementing many of the principles in relation to the assessment of funding proposals. In this phase of the implementation of the policy, there will be a focus on learning and capacity-building that will support the implementation of the policy on concessionality among NDAs and AEs - in particular, DAEs. For background information and a basis to improve the implementation of this policy, the Secretariat will review a sample of projects from the approved portfolio and the information used to assess concessionality in each one, including economic and financial analyses and other materials submitted by AEs.

27. During this phase, the Secretariat will also seek to apply the principles more systematically and in a measurable way to funding proposals. The primary focus of this application will not only be to increase clarity in the application of concessionality principles outlined here in funding proposals, but to also be able to learn from any issues or challenges in applying concessionality principles in the GCF context. GCF will also continue to build from the minimum standards of the AEs in assessing concessionality for funding decisions. As part of this learning process, the Secretariat will document any problems that arise from interlinked issues of concessionality.

28. The Secretariat will undertake parallel activities to discuss these concessionality principles with AEs and learn about their challenges in assessing the need for concessionality. The Secretariat will survey the tools and methods used by AEs, including the applicable standards for economic and financial analysis. As needed, the Secretariat will engage in activities to build capacity among AEs to conduct these assessments. These activities will be

conducted through the Readiness and Preparatory Support Programme, regional structured dialogues and strategic partnerships.

5.2. Subsequent phases

29. As per decision B.24/04 when the policy is reviewed, it will include lessons learned and recommended policy improvements. It also will examine any gaps in data or capacity to apply the methodology and propose a strategy for closing these gaps keeping in mind of the linkages between concessionality and other policy issues, such as incremental cost, full cost and co-financing. The results of this review will be aligned to the next review of the financial terms and conditions of GCF.

30. The assessment and improvement of the concessionality policy could become an iterative process repeated at regular intervals in coordination with reviews of the financial terms and conditions of GCF as directed by the Board. At an agreed interval, an independent evaluation of the policy can be undertaken.

VI. Monitoring and review

31. As noted in Section V, the Secretariat will monitor the implementation of the concessionality policy on an ongoing basis, synchronizing with the regular reviews of the financial terms and conditions of the GCF. This will be done with a view to advising the Board of any issues arising in relation to implementation of the policy and potential changes needed. There will also be an opportunity to more formally review the concessionality policy in the third year of each replenishment cycle, as part of the overall policy review cycle, should this be needed based on issues identified through ongoing monitoring.

VII. Recommendation to the Board

32. The Secretariat recommends that the Board takes note of the Policy on Concessionality presented in Annex I, which is based on the information presented above, which will be subject to further consultation prior to its presentation for Board consideration and approval.

Annex I: Policy on concessionality

I. Objective

1. This policy builds upon the initial guidance adopted by the Board in decision B.05/07, with the objective of outlining guiding principles to underpin the determination of the level of concessionality for funding proposals, consistent with the GCF investment criteria for public and private sector operations. It also sets out how concessionality will be reported post-project approval through the application of a Grant Equivalency Calculator (GEC) additional to nominal basis.

II. Scope

2. This policy shall apply to all funding proposals submitted to the Secretariat after the date on which a modified funding proposal template is made available that includes the information requirements as set out in the policy, except for proposals which are in Stage 4 to Stage 7 of the project/programme activity cycle on that date. It will also not apply to funding proposals submitted under the following requests for proposals and pilot schemes: Enhancing Direct Access Pilot Programme, Simplified Approval Process Pilot Scheme and the REDD plus Results-Based Payments Pilot Programme.

III. Guiding principles

3. Concessionality can be extended to interventions of both the public and the private sector in several ways:

(a) As a non-reimbursable grant, i.e. 100 per cent concessionality, typically for services such as capacity building and technical assistance where there is no direct repayment mechanism; or for operations where a non-repayable capex or opex grant is necessary due to International Monetary Fund (IMF) restrictions on lending based on sovereign affordability constraints;

(b) As minimum concessionality, typically to reflow-generating private sector clients or established sub-sovereign clients with revenue generating operations (e.g. utilities). Reflows are the resources that are paid back as capital and interest. Terms can vary and include below-market rates, as well as longer tenors and grace periods:

    (1) In funding proposals using debt structures, a concessional loan can have different seniorities (senior, pari passu, subordinated) and may have a heavily discounted interest rate with generally longer tenors and grace periods before first repayment, as well as facilitation of more flexible terms; and

    (2) In equity, concessionality can be extended as first loss shares in junior positions in tiered funds or can be the “anchor” portion of the fund that de-risks the investment and thus catalyses further equity participation, with preferred equity returns for the private sector to move the flow of financing to climate finance sectors.

4. GCF, in cooperation with the accredited entities (AEs), will always seek the right level of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment, and will avoid crowding out commercial financing.

5. As adopted by the Board in decision B.05/07, the following principles are recognized as best practice in private sector operations and public sector funding proposals with the potential to generate reflows, i.e. the ability to repay the capital and interest received:

(a) Extend the **minimum level of concessionality needed** for the project or programme to make it viable, thus avoiding any market disruptions by **crowding out** private sector investors in the climate sector or otherwise distorting broader markets, and avoiding undue gains to co-financers;

(b) Ensure that GCF intervention is mostly a catalyst for further co-financing, **crowding in** *other* investors, co-financiers or financial institutions; this is the case of acting as "anchor" capital in equity structures or in providing risk mitigation;

(c) Ensure the **sustainability of the intervention**, whichever the financing instrument used. This includes dedicated capacity-building and knowledge transfer in full concessionality instruments; or ensure 'graduation' or movement towards partial or full commercial viability, in the case of concessional loans;

(d) Structure the concessional product in such a way that it dedicates GCF resources to mitigation and adaptation measures that **address the root cause of market failures or find opportunities to create welfare** and work towards the removal of barriers to pro-climate investments, thereby bringing market transformation towards low-emission and climate resiliency. This entails that certain instruments may be better suited than others to target specific barriers, for example support to alignment in policy and regulation may be best targeted through grants for policy dialogue, while project-related financial barriers such as lack of available finance may be best targeted through concessional debt or equity; and

(e) Ensure that the GCF concessional tranche is central to **upholding high standards** in the development of funding proposals throughout the entire cycle.

6. The above principles will be implemented by the GCF in the assessment of funding proposals in the context of the review of the investment criteria, under the effectiveness and efficiency sub-criteria or paradigm-shift subcriteria on knowledge learning and the creation of an enabling environment. For example, some of the above can be assessed in the various sub criteria indicators under the effectiveness and efficiency criteria of the investment framework. Others can be assessed under the paradigm shift potential of the investment framework, under the scaling for sub criteria indicators on knowledge learning, and the creation of an enabling environment.

IV. Implementation and other requirements

4.1. Requirements for funding proposals

7. When assessing a funding proposal, the GCF shall consider the following to determine its financial structure:

(a) The cost of the project, including an assessment of whether the costs are reasonable;

(b) Current market rates and conditions, including average costs and returns for similar investments in the country and/or region;

(c) An analysis of barriers and risk to the investment;

(d) The cost to hedging local currencies, or the cost of currency swaps, if such foreign exchange risk management options are sought by clients;

(e) In case of financial intermediation between the underlying project and GCF, AEs and EEs should analyse the counterparty risk and pricing mechanism at each level and target financial terms AEs and EEs aim to provide to final beneficiaries;

(f) The cost and funding needs that should be financed by GCF;

(g) Overall viability of the underlying climate project(s);

(h) The instruments GCF should use to finance its portion of the costs;

(i) Comparison between GCF concessionality and that of co-financing, particularly that of the AE, based on pricing, tenor, grace period, seniority, fees, estimated returns and grant equivalency; and

(j) The grant equivalency in case of non-grant transactions.

8. In addition to the above, and in support of existing GCF policies and consistent with GCF's mandate and recognised principles in blended finance, the following will also be assessed by the Secretariat, in consultation with the proposing AE, to support the choice of financial instrument to be used and the pricing and conditions applied:

(a) Whether concessionality is utilized to benefit the appropriate beneficiaries and ensure a reasonable return for investors, to align economic incentives during the lifespan of the project, but not to unduly enrich investors;

(b) The existence and availability of other climate finance products and the elements or areas they address;in addition to their availability for the project in question

(c) Whether the project would occur without concessional resources, thus ensuring GCF additionality, including consideration of country circumstances in relation to the project as proposed in the Nodalis Conseil review of the financial terms and conditions (document GCF/B.21/05/Add.01);

(d) Evidence (e.g. market studies; technical, risk or financial assessments) to inform decisions on the size and type of concessionality alongside the objective of that concessionality, that is, to remove barriers related to affordability;

(e) A financial analysis that calculates the internal rates of return with and without GCF concessionality and estimates whether a project generates sufficient reflows to be sustainable;

(f) Sensitivity analyses using different models, rates and conditions to test different stress scenarios;

(g) Assessments of the primary due diligence of the accredited or executing entity;

(h) The capacity of the borrower to repay;

(i) An economic analysis that estimates both the financial and non-financial benefits of the project (e.g. reduced greenhouse gas emissions) ;

(j) An assessment of risk to ensure that concessionality is not captured by intermediaries, beyond the applicable risk margins where the intermediaries are bearing the counterparty risks, but that it is shared between GCF and co-financiers as appropriate and extended to the end-beneficiaries of a given transaction;

(k) An assessment to ensure that the assistance provided does not distort the market; and

(l) An economic analysis that estimates both the financial and non-financial benefits of the project (e.g. reduced greenhouse gas emissions), especially for projects without reflows.

9. Fees paid to any AE that participates in the programme as a subproject AE will follow the principles set out in the GCF policy on fees for accredited entities.

10. This approach recognizes the need for flexibility to determine concessionality on the basis of market conditions for private sector projects (including the nature of counterparty risks in a given transaction),, while also recognising that sub-sovereign, revenue-generating projects which are majority publicly owned have characteristics similar to private sector projects.

Therefore, their concessionality can be based on market conditions (including financial and economic analysis):

(a) Concessionality for **private sector projects** will be determined on a case-by-case basis according to the needs of the project, consistent with the guiding principles outlined in section III and the guidelines for implementation outlined in section IV and decisions B.09/04 and B.17/08;

(b) Concessionality for **public sector projects (e.g. sub-sovereign) with reflows** (i.e. resources that are paid back as capital and interest) will be determined according to the needs of the project, consistent with the guiding principles outlined in section III and the guidelines for implementation outlined in section IV and decisions B.09/04 and B.17/08; and

(c) Concessionality for **public sector projects with no reflows** (e.g. grants) will be determined by the current financial terms and conditions of the Fund.

4.2 Application of concessionality

11. As a starting point, AEs are expected to use the initial investment framework and the existing terms and conditions of the GCF financial instruments to conduct an initial assessment on the degree of concessionality. After the project has gone through the incremental and full cost calculation process, and the amount that the GCF will finance is known or being negotiated, then an assessment will be undertaken by the Secretariat, in consultation with the proposing AE, with the aim to agree on:

(a) The most appropriate financial instrument for the proposal that is being presented for approval to the GCF (e.g., grant, reimbursable grant, concessional loan, equity, guarantee). The GCF's initial Investment Framework states that only revenue-generating activities that are intrinsically sound from a financial point of view will be supported through loans by the Fund.

(b) The financial and economic analysis of activities proposed in the project, as well as strategic considerations, to help determine the most suitable instrument for GCF funding. These analyses are provided in the funding proposal package. These analyses could include consideration of country circumstances in relation to the project; (GCF/B.21/05/Add.01)

(c) The grant equivalency (in non-grant structures), derived using the Grant Equivalency calculator (GEC). This can be done both for the GCF component as well as for the entire financing package; and

(d) The terms and conditions to be applied (e.g. interest rates, tenors, grace periods, seniority, fees, investment ratios).

12. The application measures are outlined in Table 1 below.

Table 1: Concessionality - How it is applied

Terms and conditions		**How to determine**
Choice of financial instrument	- Grant (including reimbursable grant) - Non-grant: loan, guarantee, equity	- Financial analysis - Cash-flow analysis - Economic analysis - Strategic context - Grant equivalency calculator (GEC)
Establishment of conditions	- Interest rate - Tenor - Grace period	- Qualitative and quantitative analysis - Market overview

	- Local currency - Others	- Technical, risk or financial assessment - Grant equivalency calculator (GEC)
Reporting	- Intensity/equivalency of concessionality - Other qualitative / descriptive	- Grant equivalency calculator (GEC)

4.3 Reporting measures

4.3.1 Information requirements on AEs

13. As per decision B.07/06 of the initial Investment Framework and reiterated in decision B.24/02 of an updated policy for contributions, funding received and extended by the Fund "will be accounted for in grant-equivalent terms based on a standard methodology."

14. When the AEs/NDAs are developing funding proposals, they shall take the grant-equivalency into consideration in calculation of the concessional funding.

4.3.2 Reporting obligations of the Secretariat

15. Following the above mandates, the Secretariat reports concessionality in quantifiable format of grant equivalency basis that has been approved by the Risk Management Committee and presented to the Board since B.19.

16. The grant equivalence is calculated by measuring the difference, in present value terms, between the disbursements of funds and reflows from investments, including interest charges and other fees.

V. Implementation arrangements

17. The Secretariat shall amend the funding proposal templates to signal to AEs which information is needed to undertake the assessments described in this policy.

18. The Secretariat will also elaborate tools for assessing projects as adopted by the Board and a robust programme of capacity-building among AEs and NDAs where necessary.

VI. Monitoring and review

19. The Secretariat will monitor the implementation of this policy on an ongoing basis and in conjunction with periodic reviews of the financial terms and conditions of the GCF. The Secretariat will notify the Board of issues arising in relation to the implementation policy as they are identified, and any potential amendments needed.

20. The policy may also be reviewed as part of the overall policy review to be conducted in the third year of GCF's replenishment cycle and alongside other policies related to the Investment Framework, including the policy on incremental cost and full cost methodologies and co-financing, to examine linkages and coherence between policies.

Annex II: Consultations

1. Since B.19 the policy on concessionality document has been circulated to both Board members and AEs to receive feedback and comments that have helped to shape the paper over time. As per guidance by the Co-Chairs in 2020, the document has also been under review by the Investment Committee (IC) since B.26.

2. The table below summarizes major comments and feedback received from the Board and IC members that have been incorporated and reflected in the current document.

BM	Comments and feedback	Action taken and proposal
B.9		The Board, through decision B.09/04, adopted two types of concessional loans: high concessionality and low concessionality. The Board furthermore decided to consider a proposal at its tenth meeting regarding the **cases in which the high-level concessional terms and the low-level concessional terms would apply**
B.10	Main comments from discussions at the meeting include: – Some Board members sought clarity on the **definition of vulnerability**. A number of Board members felt that, instead of referring to income levels, the definition should correspond to existing definitions in the context of the UNFCCC. – Some Board members saw **criteria relating to income and sovereign indebtedness as useful** and felt that it should be taken into account, whilst others did not support this approach. One Board member saw it as pre-judging the ability of countries to promote the paradigm shift through access to the Fund. – Another Board member stressed that there should be **no further categorization of developing countries in the Fund as this would contradict the UNFCCC.** – One Board member saw it as equally important to **consider countries' access to finance**. Another Board member stated that the Fund should take into account country capacities and existing debt structures. – Many Board members backed an approach to determine the level of	The Secretariat prepared document GCF/B.10/06, "Levels of Concessional Terms for the Public Sector", which provided an analysis of best practices for the determination of the level of concessionality for public-sector projects in other institutions. It outlined three options for the cases in which various levels of concessionality will apply for the public sector: 1. **Project based**, which based levels of concessionality on project characteristics, such as the revenue generation and economic viability; 2. **Project and income level based**, which based levels of concessionality both project characteristics and country income levels, with higher concessionality going to lower income countries; and 3. **Project, income level and vulnerability based**, which based levels of concessionality on project characteristics, country income levels and the degree to which the project targets vulnerable communities, with higher concessionality going to those that do target vulnerable communities. Following further discussions by Board members and owing to a **lack of consensus** it was agreed that the RMC, with the support of the Secretariat, would present a revised decision to the Board at its twelfth meeting. –

	concessionality on a **case-by-case basis**. Many Board members backed the **project-based approach** in determining the level of concessionality.	
B.17		After the issue was deferred a few times, in decision B.17/10, paragraph (c), the Board requested the Secretariat, under the guidance of the Co-Chairs, to develop a proposal… to address, among other issues, "**options for further guidance on concessionality, building on related work.**" Also in decision B.17/08, the Board instructed the Secretariat to ensure that the financial terms and conditions proposed in concept notes and funding proposals for concessional loan products **meet the principle of minimum amount of concessionality**, among others, and apply the financial terms and conditions set out in decision B.09/04 in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.
B.19	Main comments from discussions at the meeting and from a call for inputs on B.19 agenda items include: - Level of concessional finance offered by GCF should be calculated based on the **specific characteristics and requirements of each project, not the overall characteristics or income level** of the country concerned. Any country classification that is done should be in line with the Governing Instrument and not simply based on income levels. - Rules-based approach: o A rules-based approach **may not be consistent with the UNFCCC** and in order to maximize the transformational impact of a project, it would be necessary in certain cases to increase, rather than reduce, the level of concessionality offered; o If a purely rules-based approach were used, entities co-financing GCF projects could use GCF concessional finance as a way to **minimize**	Secretariat published a draft document GCF/B.19/12/Rev.01 titled "Options for further guidance on concessionality, building on related work", which **proposed 3 options**: 1. Revisit options discussed as B.10 to increase the range of projects falling under a **rules-based approach;** 2. **Redefine the "efficiency and effectiveness**" investment criterion to more explicitly consider concessionality in a broader context; or 3. **Implement concurrently** both options 1 and 2. However, the Board could not agree on concessionality document and urged on the need for a technical and practical approach regarding financial terms and conditions, investment criteria indicators, and a grant equivalent calculator. Board also requested the Secretariat through decision B.19/06, paragraph (d) to **develop an integrated approach** to resolve interrelated policy matters for consideration at its twentieth meeting including "policies on the review of the

	their own concessional rates and financial risk; and ○ A **rules-based approach helps in cost efficiency and predictability**, so it is encouraged to go towards rules-based approach as far as possible. GCF should build on existing work such as the "Hamburg principles" and the DFI Working Group on blended concessional finance. GCF should abide by those widely recognized principles, with regard to its private sector operations. - **Financial risks should not be shifted from GCF onto developing countries** and said that the purpose of GCF, in line with previous climate negotiations, was to provide developing countries with funding for mitigation and adaptation projects that did not necessarily need to be repaid. - Purpose of concessionality: (a) to **make investments possible** that would otherwise not be and therefore, concessionality should be set at the minimum amount versus (b) to **maximize the use of GCF funds.**	financial terms and conditions of GCF instruments and concessionality, incremental costs, full costs, and co-financing.
B.20	Main comments from these consultations include: The **'three key variables' listed in the paper (the proposal's strengths in delivering climate impact, paradigm shift potential, and potential for reflows) should not determine concessionality**, as impact and paradigm shift potential more closely relate to existing GCF investment criteria, i.e. whether a proposal warrants GCF support, whereas other factors should determine the terms of that support. The variables are problematic, particularly in the case of private sector projects where they risk introducing market distortions; **Link the degree of concessionality to that necessary to overcome market failures and other barriers**, lack of data and knowledge, perceptions of risk, capacity and political economy barriers; as well as affordability	Prior to publication, through Board consultations, the Secretariat received comments on topics such as key variables, examination of the grant equivalence of overall proposal, grant equivalents of different transactions structures, and the need to consider Nodalis report. The proposal stated that GCF will base the degree of concessionality on the nature of each funding proposal, as a function of **three key variables:** the proposal's strengths in delivering **climate impact, paradigm shift potential, and potential for reflows**. It would be applied in the following ways: ○ **Private sector =** case-by-case based on the **needs of the project** and the **three variables;** ○ **Public sector with reflows =** case-by-case based on the **needs of the project** and the

	questions, e.g. related to a country's access to capital markets, that otherwise make the project unviable; The concessionality level does not consider the mobilisation effect of the instruments nor the grant equivalent and its size compared to alternative transaction structures. If the **GCF can leverage private sector financing with a small grant**, this might be more efficient than a large concessional loan. As a consequence, some Board members felt that the GCF restricts the use of potentially highly efficient and catalytic grants to a very small number of projects; and The term **reflows needs to be defined.** If economic viability of a project is given, any initial investments will be somehow repaid (either by revenues (e.g. in RE), reduced spending (e.g. in EE) or in a reduced risk exposure (e.g. in adaptation). If such a wide definition of reflows would be applied, some Board members struggled identifying any projects with no reflows in the ex-ante perspective.	**three variables** within the boundaries of the financial terms and conditions; and ○ **Public sector without reflows =** determined by current **financial terms and conditions.** Taking these comments into consideration, the Secretariat **removed 3 options and proposed only on guiding principles and implementation phases.** A draft document GCF/B.20/19 titled "Interrelated policy matters on incremental cost and full cost, concessionality, and co-financing" was published containing a combined decision text. The document noted on the linkages between incremental cost and full cost, concessionality and co-financing and set out principles and definitions of concessionality in Annex III. The item was included in the B.20 meeting agenda, but it was **not opened during the Board meeting.**
B.21	Main comments from these consultations include: Re finding in Annex III relating to approved private sector projects that **those with high impact potential and transformational change potential** (and high potential for reflows) **generally see greater grant equivalence** in their funding: The **implication of this finding is not clear** (including whether it is simply an observation of past practice or a suggestion of expected future practice); Annex III also links high potential for reflows with a high score for efficiency and effectiveness; however, this is not our interpretation of efficiency and effectiveness – indeed all the **private sector proposals have high potential for reflows from loans or equity** as these are the main instruments, **but this does not mean they should therefore be financed on highly concessional terms;** Grant equivalence should not only be provided for reporting purposes and only once a project is approved. The **grant equivalent needs to be provided in**	In preparation for B.21, guidance from Co-Chairs was to separate the 3 papers and present separate decision text. Through Board consultations, the Secretariat received comments on the concessionality level and best practices and other approaches. Taking these comments into consideration, the Secretariat proposed a draft document GCF/B.21/24 titled "Options for further guidance on concessionality", which proposed options similar to B.20 but without the three key variables: ○ **Private sector =** case-by-case based on the **needs of the project;** ○ **Public sector with reflows =** case-by-case based on the **needs of the project** within the boundaries of the financial terms and conditions; and ○ **Public sector without reflows =** determined by current **financial terms and conditions.**

	advance of any investment decision in order to ensure an efficient use of GCF funds; The **terms of GCF support should not be determined only after the amount that the GCF will finance is known** – ideally the two (amount and terms) need to be considered together since overall grant equivalence rates can also be affected by the relative size of the GCF contribution; and Other comments were **reiterated from B.20.**	The item was included in the B.21 meeting agenda, but it was **not opened during the Board meeting.**
B.22		While an updated document was being drafted by the Secretariat, the item was dropped from the final agenda because of other impending items. There was no Board consultation, and the item was ultimately **not included in the meeting agenda.**
B.23	Main comments from Board consultation include: - Through B.23 Board consultations, the Secretariat received comments on the need to include findings of the Nodalis report and the use of grant equivalence; and - Reiteration of the use of the grant equivalence during the initial assessment of concessionality in relation to co-finance and to the terms and conditions, and then also reported.	Guidance was given from Co-Chairs **to integrate the papers under review of investment framework with one combined decision text** from incremental and full cost, co-financing and concessionality. The draft Concessionality Policy proposed the following: ○ **Private sector = case-by-case** based on the needs of the project; ○ **Public sector with reflows = case-by-case** based on the needs of the project within the boundaries of the financial terms and conditions; and ○ **Public sector without reflows =** determined by current **financial terms and conditions** Taking these comments into consideration, the Secretariat revised to share with the CC teams for clearance.
B.26	Main comments from the IC members include: Clarification on exemptions from applicability of this policy. While understanding that there should be no additional burdens on, for example, mobilizing funds at scale or SAP projects, it is key that for example SAP projects also adhere to the concessionality policy.	In preparation for B.26, the Co-Chairs have agreed that the paper shall be reviewed by the Investment Committee members prior to wider Board consultation. The comments have been incorporated into the document and updated accordingly.

	Further clarification on the graduation concept (what criteria are applied), on the principle thatany project should be analyzed on its own merit to determine the level or type of concessionality, without modifying any conditions in the middle of an operation or if the project has several stages. Clarification on application to public sector projects. - Incorporation of key recommendations from the Nodalis report in the current version.	

Annex III: Selected recommendations from Nodalis Conseil report (GCF/B.21/05/Add.01)

1. As concessionality has close linkage to the financial terms and conditions as well, findings from the review of financial terms and conditions conducted by the Investment Committee (IC) have been an integral part of the document.

2. Previous studies conducted by Nodalis Conseil on behalf of the Secretariat as part of the review of the financial terms and conditions of the GCF's financial instruments (document GCF/B.21/05/Add.01) made a number of recommendations that could inform a concessionality approach. The table below summarizes those recommendations and explains how the Secretariat has dealt with these proposals:

Recommendation (selected for concessionality)	Action taken
There needs to be a clear methodology to assess and measure the level of concessionality.	This is provided through this paper, which further defines tools and evidence (for example, through economic and financial analyses) to derive pricing and conditions for lending, through the primary due diligence of AEs and the secondary due diligence by the Secretariat. In addition, both at design phase and at the reporting phase, the grant equivalent calculator can support calculations of equivalency across instruments.
Provide more guidance to AEs to enhance process predictability for all types of project (e.g. impact indicators).	This is addressed through the approval of the investment criteria indicators in decision B.22/15.
GCF resources would provide more overall leverage to public-sector projects if loan instruments were more frequently used.	More flexibility in conditions and rate setting is introduced here, whereby public-sector projects with a cash-flow and ability to repay (reflow generation) can be assessed on a case-by-case basis. In certain cases, a small grant may be more efficient than a loan in enabling GCF to leverage private sector financing.
Use of macro-characteristics and vulnerability.	This is an issue for discussion by the Board.
Seek to transfer concessionality equitably and efficiently in country-wide renewable energy or energy efficiency programmes that lower the cost of such investments in a given country and usually come in support of a national programme.	This is provided for in the principles of ensuring the trade-off between minimum concessionality and the right level of incentive to make that project viable.

Recommendation (selected for concessionality)	Action taken
Differentiation of the level of scrutiny required on concessionality between pilots, scale-up and one-off funding proposals.	This can be explored further. However, justifications need to account for sustainability and viability of a funding proposal first vis-à-vis climate impacts to be achieved.
The IFC has been at the forefront of setting up an independent "Concessionality Committee" that functions very much like a Credit Committee. The GCF could incentivize adopting such internal concessionality review mechanisms either through the GCF approval process, in the AMA or through its Terms and Conditions.	Each AE working with non-grant instruments has a dedicated committee where terms and conditions of loans and of co-finance operations are determined. This is part of the AE primary due diligence. The Secretariat also has an Operations Committee, which reviews the financial terms and conditions of funding proposals, among other responsibilities.
Definition and communication of a set of criteria to assist AEs in choosing the level of concessionality granted to a project or programme proposal.	As above, GCF works alongside the AE when determining concessionality and its application, including terms and conditions and pricing. Each AE working with non-grant instrument has a dedicated committee where terms and conditions of loans and of co-finance operations are determined. This is part of the AE primary due diligence. The Secretariat also has an Operations Committee, which reviews the financial terms and conditions of funding proposals, among other responsibilities.