GREEN CLIMATE FUND

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GCF/B.33/11

6 July 2022

Review of the financial terms and conditions of the Green Climate Fund financial instruments

Summary

This document contains the outcome of the second review of the financial terms and conditions of GCF's financial instruments that was undertaken in accordance with decision B.BM-2019/08. By regularly reviewing the financial terms and conditions of GCF's financial instruments, the Fund will be able to better demonstrate clarity and consistency in the application of terms and conditions in GCF financial instruments used in projects that are approved by the Board including the reporting procedures and appetite for providing concessionality.

In summary, the review puts forward for the decision of the Board two main recommendations that requests the Secretariat to: (i) undertake further work on local currency and guarantees; and (ii) in consultation with the Investment Committee (IC), to take account of the findings and recommendations from the review related to concessionality in the context of developing a policy on concessionality.

Where appropriate, the review also proposes that recommendations which can be taken up by the Secretariat per the mandate granted by the Board is undertaken accordingly.

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I. Introduction

1. The Board, in decision B.09/04, adopted the financial terms and conditions for the financial instruments of GCF. Board decision B.09/04 outlined the options for the financial terms and conditions to be adopted by the Board for grants and non-grant instruments to be initially provided by the Fund and also stipulated that the terms would be structured on case-by-case basis to address specific barriers wherein the Fund will apply due diligence to assess the risk of the investment.

2. In decision B.12/15, the Board requested the Investment Committee (IC) to provide the draft terms of reference (TOR) for the annual review of the financial terms and conditions for consideration by the Board at its fifteenth meeting. The TOR for the review of the financial terms and conditions of the GCF financial instruments was adopted by the Board in decision B.15/05.

3. In decision B.17/08, the Board decided that, pending the conclusion of the review of the financial terms and conditions, the financial terms and conditions to decision B.09/04 should be applied in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.

4. In 2017, the Secretariat conducted the first review of the terms and conditions of GCF's financial instruments under the oversight of the IC. Following the review, the Board via B.BM-2019/08, approved the revised TOR for future reviews and requested the Secretariat to conduct a biennial review of the financial terms and conditions of the GCF financial instruments, as set out in annex I to the decision. The B.BM-2019/08 decision, also decided that Board approval for subsequent changes to the revised TOR for the review of the financial terms and conditions of the GCF financial instruments will only be necessary in the case that such changes are considered material by the Secretariat and the IC.

5. Under the revised TOR, the scope of the review included an internal component, which considered the current financial terms and conditions as they relate to the projects and programmes approved by the Board, and an external component, which reviewed the current practices with respect to the terms and conditions of financial instruments used by other institutions with policy mandates related to those of GCF, covering different national circumstances in developing countries.

6. The scope of the review considered all the financial terms and conditions (i.e. interest rate, commitment fee, service fee, other fees if applicable, and tenor and grace period of the financial instrument) and, where relevant, recommended appropriate changes for the consideration of the Board. The review also considered whether the project/programme is public or private, the theme (mitigation, adaptation or cross-cutting), the total project/programme size category (micro, small, medium or large), and the different national circumstances of the recipients.

7. Following the approval of the revised TOR for the review of GCF's financial instruments in decision B.BM-2019/08, Climate Finance Advisors, BLLC (CFA) was selected to undertake the review of the financial terms and conditions of the Green Climate Fund. The full report is in annex III of this document.

II. Policy rationale and analysis of policy proposal

8. As per the revised TOR for the review of GCF's financial instruments approved by the Board in decision B.BM-2019/08, the review analyzed, and outlined findings and recommendations in relation to three areas: (1) the degree to which there has been compliance with existing policies on financial terms and conditions in GCF operations; (2) assessment of whether existing GCF policies related to financial terms and conditions are fit for purpose; and

(3) proposed additions or adjustments on how policies related to financial terms and conditions could be improved. Some of the recommendations of the review touched on additional policy guidance that could be provided, particularly in relation to concessionality, while other recommendations covered ways the GCF could evolve the operationalization of its instruments, including in relation to local currency financing and guarantees among other things.

9. Based on the consultant's report, the recommendations can be divided into four parts: (i) recommendations relating to local currency, (ii) recommendations relating to guarantee, (iii) recommendations to be passed on to the concessionality paper, and (iv) other recommendations. These recommendations including the way forward are attached in annex II of this document.

10. Further work in the area of local currency financing is required as currently, the GCF does not directly provide local currency financing and a more in-depth study is required to understand the implications, regulatory framework, and risks associated with the local currency financing. The review notes that local currency lending can support local capital market development and boost resilience by alleviating vulnerability to foreign currency risks. As such, the Secretariat under the oversight of the IC and with the support of an external consultant, can consider the demand of the local currency financing along with the needs of the recipients, and the accredited entities to formulate appropriate strategies to address these gaps. The study could explore different options for local currency financing and following IC consideration, present the outcome of the review for GCF Board consideration, as necessary. A deeper analysis and appreciation of the overall workings of local currency financing in the context of GCF's operations and mandate is essential to fully understand additional potential requirements that may be imposed or required by the Board and subsequent implications that may arise in order to minimize risks to the Fund. Comparative studies must be conducted as well on how to execute local currency financing and implement at the project level in a cost-efficient manner to ensure beneficiaries receive the maximum possible benefits. The local currency financing work is also envisioned under the Updated Strategic Plan for the Green Climate Fund: 2020-2023 approved by the Board via decision B.27/06.

11. Similarly, expanding on the existing use of guarantee instruments in a more effective manner and exploring the feasibility of a credit rating for the Fund can also be encouraged in light of the low uptake of guarantee instruments as can be seen in the GCF project portfolio. As noted in the review, the Fund can utilize full and partial guarantees to reduce or transfer risk in order to mobilize investors and reduce the cost of capital. Leveraging international experience and best practices with regards to guarantees and credit rating is also crucial as this has the potential to scale up projects. In this regard, the Secretariat can, under the oversight of the IC and support of an external consultant where appropriate, undertake the review with the purpose of ensuring more efficient use of the guarantee instrument.

12. The scope of review relating to local currency financing and guarantees can be found in section III of this document where more granular information will be outlined in the TOR following the Board mandate to proceed with the additional work relating to local currency financing and guarantees.

13. On the recommendations relating to concessionality, this document proposes that consistent with the approach undertaken in the first review of the financial terms and conditions, concessionality related recommendations could benefit from being considered holistically as part of the development of a policy on concessionality as mandated by the Board under Decision B.19/06.

14. In line with the above, the proposed decision in Annex I sets out:

(a) A request for the Secretariat, under the guidance of the IC, to consider relevant recommendations from the review as part of ongoing work to develop a policy on concessionality.

(b) A mandate for the Secretariat to prepare, for consideration by the IC, needs and options for GCF to provide local currency financing;

(c) A mandate for the Secretariat to prepare, for consideration by the IC, an analysis of options for the efficient use of existing financial instruments by the GCF;

(d) A request for the Secretariat to review the financial terms and conditions of the GCF financial instruments.

III. Scope of the review

15. The review will: (i) examine the demand of the local currency financing, (ii) explore the complementarity of current GCF financial instruments with the proposed local currency and guarantee instrument, (iii) assess its impact on the GCF business model, and (iv) provide the recommendation for more efficient usage of the guarantee by GCF. The review will also examine the current practices used by other institutions with mandates comparable to those of GCF, including the terms and conditions of the local currency financial instruments and guarantee instruments.

16. The review should also include an analysis of various structures in which local currency financing can be deployed by GCF, considering GCF's policy frameworks, its operational maturity as well as the needs of countries and AEs. In addition, the review will include a possible hedging mechanism for local currency financing to minimize the effects of currency fluctuations on GCF, including a detailed cost-benefit analysis.

17. Under the guidance from the IC, the deliverables from the review should, inter-alia, include a written report(s) covering the following:

(a) A clear set of recommendations distinguishing between the immediate and longer-term recommendations for both local currency financing and guarantee;

(b) The principles to set the terms and conditions for the local currency and guarantee financing within the GCF context;

(c) An analysis of the risks associated and mitigating measures for local currency financing and guarantee instrument;

(d) Provide concrete recommendations such as if a pilot program would be advisable for GCF; and

(e) Recommendations on possible hedging mechanisms for local currency financing, including options for implementation strategies.

IV. Implementation arrangements and impact assessment

18. An analysis of matters relating to local currency financing, as well as optimization of the GCF financial instruments such as guarantees and underlying credit rating, as captured in the draft decision, requires specialist expertise to complement the in-house expertise and resources of the Secretariat. Accordingly, the Secretariat proposes to engage external consultants to help inform and advance internal discussions already undertaken in the area.

19. The Secretariat, under the guidance of the IC, will engage external support as necessary and as such will liaise with the Budget Committee on securing the necessary financial support of USD 200,000 for this work.

20. The Secretariat will present the initial findings of the review for the consideration and guidance of the IC. The final report once endorsed by the IC should be shared with the Board along with the suggested way forward from the IC. The Secretariat, under the guidance of the IC,

will provide the report to the Board. This report would identify/recommend any further action required by the Board.

21. As a dedicated paper on further guidance on concessionality is currently under consideration by the IC, concessionality-related recommendations will be illustrated in the context of key findings from the review in Annex II of this document whilst relevant recommendations would be considered in depth in the Concessionality Paper.

22. The impacts for the GCF of pursuing any of the options identified, including resourcing implications, will be further elaborated as part of the mandated analysis.

V. Policy linkages

23. The following documents are also relevant to the financial terms and conditions of the GCF financial instruments:

(a) "Business Model Framework: Terms and Criteria for Grants and Concessional Loans" (document GCF/B.05/07);

(b) "Investment Framework" (document GCF/B.07/06);

(c) "Level of Concessional Terms for the Public Sector" (document GCF/B.10/06);

(d) "Concessionality: potential approaches for further guidance"(GCF/B.19/12/Rev.01); and

(e) "Risk Management Framework" (document GCF/B.23/23).

VI. Research and consultation

24. Based on the revised terms of reference adopted by the Board in decision B.21/05, GCF engaged the consulting firm, Climate Finance Advisors, Benefit LLC (CFA), to support the review. Consultations were held face to face and virtually, where appropriate, with focused groups through structured interviews. The CFA team engaged various stakeholders including the Secretariat and representatives of accredited entities.

25. The review from the consultant is attached as annex III to this document. The scope of the review covered funding proposals approved by the Board up to and including the twenty-first meeting of the Board.

VII. Recommended action by the Board

26. Under the guidance of the IC, the Secretariat will continue to review the financial terms and conditions of the GCF financial instruments as set out in annex I to decision B.BM-2019/08 based on the terms of reference to be agreed with the IC.

27. It is recommended that the Board adopt the draft decision presented in annex I to this document.

Annex I: Draft decision of the Board

The Board, having considered document GCF/B.33/11 titled "Review of the financial terms and conditions of the Green Climate Fund financial instruments":

(a) *Takes note* of the review of the financial terms and conditions of the Green Climate Fund (GCF) financial instruments led by the Investment Committee (IC) as contained in document GCF/B.33/11;

(b) *Requests* the Secretariat to take up the recommendations from the review of the financial terms and conditions relating to Concessionality, in the context of ongoing work to develop the policy on Concessionality as mandated under Decision B.19/06;

(c) *Also requests* the Secretariat, to develop a local currency financing pilot programme, including an analysis of the requirements for operationalization and impact assessment of a programme, with a view for the IC to review and make a recommendation to the Board no later than B.36;

(d) *Further requests* the Secretariat to present an approach in which the GCF can more efficiently deploy its current financial instruments, with a view for the IC to review and make a recommendation to the Board for consideration no later than B.36;

(e) *Requests* the Secretariat to review the financial terms and conditions of the Green Climate Fund financial instruments in accordance with the terms of reference set out in annex I to decision B.BM-2019/08, as may be amended pursuant to decision B.BM-2019/08, with a view for the IC to review and make a recommendation to the Board for consideration no later than B.37; and every four years thereafter prior to commencement of the new replenishment programming period;

(f) *Approves* an additional administrative budget for the Secretariat in the amount of USD 200,000 to conduct the further reviews and analyses referred to in paragraphs (c), (d) and (e) above. This approval is in addition to the 2022 administrative budget for the Green Climate Fund Secretariat as approved via decision B.30/07, it being understood that amounts not utilized in 2022 shall be carried forward into the administrative budget for the Secretariat for 2023.

Annex II: Summary of findings and recommendations – Review of financial terms and conditions of the GCF financial instruments

I. Recommendations related to local currency financing

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
3. Policy Improvements and Additional Improvements	To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 of the Report	The GCF currently does not have a treasury function that would allow currency conversions or issuing local currency bonds. In addition, current terms and conditions and policies are silent on the issue of foreign exchange risk, costs of currency swaps, and the potential structuring of mechanisms or products to offer local currency, in particular in frontier markets.	<u>Recommendation no 13.</u> GCF could benefit from a more formalized policy approach that targets local currency lending, its benefits to the operations and goals of the Fund, current barriers, and risk.	Agree – Board may like to give the IC the mandate to explore getting a local currency lending. It will be better to start with a pilot program with few currencies, which can then be extended based on lessons learned. This approach should be guided by a clear principle / policy explaining when the facility is used for projects (e.g. GCF takes local currency risk only when hedging is too expensive). The experience so far is that hedging is quite expensive. For projects in markets where hedging is possible, a partnership with TCX and/or some other similar institution providing hedging services should be explored.
		The absence of a local currency financing platform for GCF projects means that the concessionality provided by the GCF is either used up to cover the costs of currency swaps or is eroded by foreign exchange fluctuations and risk.	<u>Recommendation no 14</u>. In order to operationalize additional instruments, GCF could structure a local currency lending platform as a revolving fund, with an initial part capitalization from contributors in the form of a grant and additional revenue generated from service fees. This is a structure similar to TCX but could be targeted to frontier markets not covered by current instruments	Agree – The Secretariat is already exploring the partnership with the TCX. The Secretariat should learn from TCX's global experience to provide local currency solutions in emerging markets. TCX has an experience of hedging transactions for multilateral and development finance institutions, as well as commercial banks and have expressed interest of collaboration with GCF.

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
			due to risk considerations. GCF can pilot a part-subsidization of a local currency platform with interested MDBs and NDBs in order to issue green bonds in local currency, which will strengthen the domestic capital markets in the countries of operation of the GCF.	PSF is also working on structuring local de-risking/credit enhancement/guarantee platforms that help crowding in capital form LFIs/local capital markets, which is denominated in local currency (thereby indirectly mobilizing domestic savings). This approach has been discussed in the PSF strategic document.

II. Recommendations related to guarantee

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
3. Policy Improvements and Additional Improvements	To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 of the Report	For callable guarantees, the GCF currently needs to provision 100% of the guarantee it offers, and the entire amount needs to be disbursed to the Accredited Entity. This is different from commercial guarantees issued by A-rated institutions, which do not require this level of provisioning.	Recommendation no 11. To move forward in including a more comprehensive range of financial instruments, the GCF could seek to obtain a corporate credit rating by a rating agency. This would enable the Fund to implement guarantees (and other instruments) more efficiently. A rating would be backed by the GCF portfolio, its available cash, and a forecast of payments of contributions and commitments to fund projects. When this is done, a range of full and partial guarantees can be deployed. In the relevant section of this review, we provide tentative costs and fees for guarantees.	Agree – Board may like to give the IC the mandate to explore the feasibility of the GCF obtaining a credit rating.

3. Policy Improvements and Additional Improvements	To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 of the Report	There are additional ways in which the GCF can structure and offer guarantee products, while the process of obtaining a credit rating is ongoing.	Recommendation no 12.
			In the short term, GCF can look at structuring guarantees in a number of ways that do not require a corporate credit rating, such as:
			• Revolving funds;
			• Guarantee (insurance) products:
			    ○ Guarantees to PPAs
			    ○ Guarantees for Contracts for Difference
				Agree –
				Guarantee is one of the GCF financial instrument. The current policies do not restrict GCF from providing the guarantees in the manner recommended.

III. Recommendations to be passed on to the Concessionality paper

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
1. Consistency and Compliance	To review those policies that may directly or indirectly be significant to aid the interpretation and application of the terms and conditions of the GCF financial instruments; and to assess the degree of compliance in the application of T&C in GCF operations. This analysis also informs further considerations on internal consistency in the application of terms and conditions, and ultimately their consistency vis-à-vis the mandate of the GCF. This review is presented in Part 2.1 of the Report under "*Consistency and compliance*".	The application of the financial terms and conditions is compliant with existing policies; however, this is mainly due to the broad nature of the guidance and principles. The table for low and high concessionality for loans for the public sector provides values to determine terms and conditions in the high and low concessionality brackets. However, there is no guidance as to when to use high or low concessionality parameters.	Recommendation no 1. Within the context of existing terms and conditions, the Secretariat and the Board should provide further guidance for the use and interpretation of the given parameters, in order to ensure clarity and predictability in the process of setting and negotiating terms and conditions, concessionality levels, and the choice of instrument.	Partially Agree, Further guidance will help. Please read it along with the comments under recommendation no. 4. This can be considered in the Concessionality paper scheduled to be presented to the Board in 2021.
		The application of fees has varied depending on the project. In some cases, waiving of the fees or merging the service fee with the interest rates has been necessary in order to align GCF and entity pricing, and lower the costs of borrowing for a GCF client (the AE, the end beneficiary).	Recommendation no 2. In order to increase transparency and speed of negotiations, the GCF could issue guidelines on the application of all fees (service fees, commitment fees) in order to simplify the process of negotiating the fees for both GCF and AEs, as well as for clarity on the costing structure itself. Service fees and interest rates could be merged to simplify the cost structure of the loan and to offer better comparability with public sector terms and conditions provided by other institutions.	Partially agree- The current policy provides the fixed rate of service fees. However, for the commitment fees a cap (i.e. up to 0.5% for high Concessionality and 0.75% for low Concessionality). In the Secretariat's view, nothing further needs to be done in this area. The service fees charge was envisaged to partially recover administrative cost the loan portfolio, which is a good practice. Hence, we don't recommend combining the service fees and interest rate.

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
		Decision B.17/08 offered flexibility in the application of the terms and conditions. The interpretation of this decision is unclear.	Recommendation no 3. In addition to the flexibility granted in the negotiations of fees and tenors, flexibility could also be extended for other conditions, such as in grace periods, interest rates or seniority position. Accompanying guidelines would also be useful to speed negotiations and clear doubts in the application of terms and conditions, as well as on the choice of the most appropriate instrument for each given proposal.	Agree. Within a grant equivalent, if the flexibility regarding Grace period, interest etc. is provided then it will assist GCF in aligning its financial terms with other co-financers including the AE's. This will also ease the processing for the AE and the borrower.
		The dataset and the graphs show clear patterns in the distribution of concessionality levels by project characteristics, geographical distribution, and by the 'vulnerability' of the country (i.e., in the SIDS and LDC group).	Recommendation no 4. The GCF could strengthen the use of financial terms and conditions by adopting: - a rules-based approach, on the basis of guidelines that would make explicit a pattern that is already present but currently implicit; [or] - a principles-based approach, with a focus on minimum concessionality, as defined by the economics of the proposal.	Partially agree - Given the diversity of the GCF intervention, the principle-based approach, which is defined by the economics of the projects, is suitable for the Fund at this stage particularly for the PSF operations.
		There is no approved definition within the Fund of a public or private sector proposal.	Recommendation no 5. Provide guidance on the definition of private / public (e.g., whether this is based on ownership of implementing AE; ownership of end-beneficiary; sovereign guarantee requirements; or on project components).	Agree – this will be helpful. Thought it's not clear if FT&C is the right place to define it.

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
2. Relevance	To assess whether existing GCF policies related to financial terms and conditions are 'fit for purpose' or relevant to achieve the goals of the Fund. Given this goal, we provide additional benchmarks that could be introduced to enhance the clarity and transparency in the determination of terms and conditions in GCF proposals. We also explore the linkages between relevance and the application of the grant element as an expression of the level of concessionality as well as the linkages between concessionality and pricing. This assessment is presented in Part 2.2 of the Report under "*Relevance*".	The overall framework nature of the T&C means that proposals are ultimately structured on a case-by-case basis. This is important in order to deploy the most appropriate T&C and structure the most appropriate concessionality and pricing. The GCF has principles on how to do this, but no specific guidelines.	<u>Recommendation no 6</u>. Complement the application of the existing T&C policy with data from a comprehensive dataset that includes context-specific benchmarks. This analysis will guarantee that proposals receive the most appropriate concessionality level for their specific characteristics.	Agree, further guidance will help. This recommendation could be passed on to the Concessionality paper scheduled to be presented to the Board in 2021.
		The GCF uses the GEC to determine the grant equivalency of the GCF contribution in each proposal. The grant equivalent is widely used in climate and development finance. At present, there are no guidelines on interpreting the GEC or attributing value to the percentage derived from the calculations (i.e., the "grant element").	<u>Recommendation no 7</u>. Issue guidelines for the interpretation and wider use of the grant equivalent, in particular on the values and meaning of the grant element itself in GCF operations. This could entail the creation of a positive list of typical project characteristics that one would see, for example, in the 0-32% grant equivalency range; in the 33-65% low concessionality range; in the 66-99% high concessionality range; and in 100% concessionality.	Agree- This recommendation could be passed on to the Concessionality paper scheduled to be presented to the Board in 2021.

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
		Currently, GCF can calculate the grant element using different discount rates, but only reports using a rate of 5%. This can limit the possibility of comparing the concessionality deployed across instruments.	Recommendation no 8. Strengthen a "GEC 2.0" with the following: - Issue accompanying guidelines to the existing technical GEC manual, to explain and offers ranges of discount rates that are determined by instrument type and project characteristics; - Provide internal guidance for Secretariat staff to use more appropriate discount rates to calculate the GE; - Provide guidance on how to use benchmarks and reference points to interpret GEC calculations.	Agree- The current GEC can use different discount rates however GCF is currently using 5% as standard discount rate for the GE calculation. Using different rates will provide better GE figures but it makes the system somewhat complex and may require some subjectivity in determining the discount rates.

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
		The concessionality given to an AE is sometimes passed on to the end-beneficiary, although there have been instances when the concessionality is retained for specific purposes. The T&Cs are silent on this issue.	Recommendation no 9. T&C could be more explicit in defining the instances when the concessionality obtained by an AE can be retained for a specific purpose, e.g. to buy currency swaps in order to offer local currency on-lending.	Partially Agree - Due to the non-availability of the local currency window from the GCF, in some instances AE's have borrowed in USD and lent in the local currency. When the local currency loans are used by the AE, they use the hedging instrument to pay back to the GCF in USD. This can be explored in more detail under the local currency loans. An AE buying a swap / currency hedging product does not mean Concessionality is not passed on to the end beneficiaries. The GCF interest (in local currency, after hedging) is concessional compared to the AE's interest rate. In such cases the Concessionality could be seen as the difference in local currency rates of GCF's funding and AE's funding. One cannot calculate Concessionality by comparing interest rates on different currencies.
		There are established benchmarks and indicators for loan pricing. Yet, climate impacts, riskier investments, and savings from resource efficiency measures will inform any cost/benefit and risk/return trade-off. In these cases, concessionality is required in order to adjust the pricing towards a level that is accessible to the borrower. Concessionality can support a movement from market distortion to market re-alignment.	Recommendation no 10. In the pricing table given in the report, quantitative benchmarks can be complemented by qualitative considerations, in particular with emphasis on the links between a pricing strategy and its alignment with the GCF corporate strategy.	Agree – this goes back to the principles set for GCF investment, i.e. minimum Concessionality should be provided. In order to achieve the minimum Concessionality, one need to also ensure that both the qualitative and quantitative considerations are taken into account.

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
3. Policy Improvements and Additional Improvements	To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 of the Report	Currently, the T&C are silent on the trade-off between concessionality and the cost of hedging.	Recommendation no 15. Terms and conditions could make it explicit that there is a trade-off between concessionality and the cost of hedging, with the possibility for the AE to utilize the concessionality to cover the costs of hedging or to buy a currency swap. Typically, the more developed the capital markets, the lower the costs of hedging (which may imply that a lower concessionality may be needed); the less developed the capital markets, the higher the likelihood that some products are not available, or too risky, and therefore more expensive, which may justify a higher level of concessionality.	Agree This is related to the recommendation no. 9. Among others, a local currency hedging cost depends on the maturity of the local capital market and liquidity of the local currency vis-à-vis GCF holding currency.

IV. Other recommendations

	Objective per Terms of Reference	Findings	Recommendations	Proposed Way Forward
3. Policy Improvements and Additional Improvements	To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 of the Report	The GCF can provide equity, but there are no specific terms and conditions determining volume, rates, or scope. Going forward, GCF can look into other instruments not currently provided for by the T&C. They could further support the reach of the GCF into all developing countries.	Recommendation no 16. Equity can be included in the full framework of financial terms and conditions through a dedicated equity strategy that provides for the application of typologies of equity (start-up, growth, etc.) and a range of terms and conditions that can be taken into consideration. In the longer-term, GCF can include other 'innovative' financial instruments such as bond issuance and crowdfunding.	Partially Agree - this requires more work, including aligning it with the private sector strategy. The terms and conditions for equity investments are very difficult to define. Equity investments warrant flexibility, yet prudent, in order to be effective.
	To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 of the Report	The frequency of review is currently determined to take place every two years.	Recommendation no 17. We recommend that the next review is conducted in three years, so as to allow sufficient time for the recommendations made in this review to be operationalized (in 2020) and for changes and results to be observed.	Agree.

Annex III: CFA Review of Financial Terms and Conditions of the GCF Financial Instruments

The CFA Review of Financial Terms and Conditions of the GCF Financial Instruments is contained below.

Review of the Financial Terms and Conditions of Green Climate Fund (GCF) Financial Instruments

(Final)

Prepared for the Green Climate Fund

By Climate Finance Advisors, BLLC

CONFIDENTIAL

FOR THE USE OF THE GREEN CLIMATE FUND ONLY

Climate Finance Advisors, Benefit LLC
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ABER	Burkina Rural Electrification Agency
ADB	Asian Development Bank
AE	Accredited Entity
AfDB	African Development Bank
AGF	African Guarantee Fund
AMA	Accreditation Master Agreement
B.	Board Meeting of the GCF (e.g., B.1)
CA	Concessional Assistance
OCR	Ordinary Capital Resources
CCAP	Center for Clean Air Policy
CFA	Climate Finance Advisors
CfD	Contract for difference
CTF	Clean Technology Fund
DAE	Direct access entity
DBSA	Development Bank of South Africa
DFI	Development Finance Institutions
DMA	Division of Mitigation and Adaptation
EBRD	European Bank for Reconstruction and Development
ESI	Energy Savings Insurance
FAA	Funded Activity Agreement
FP	Funding Proposal
FX	Foreign Exchange
GCF	Green Climate Fund
GDP	Gross Domestic Product
GEC	Grant Equivalency Calculator
GNI	Gross National Income
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association

IDB	Inter-American Development Bank
IEU	Independent Evaluation Unit
IFC	International Finance Corporation
IMF	International Monetary Fund
INV	Investment
IRR	Internal Rate of Return
LCCC	Low Carbon Contracts Company
LCL	Local Currency Lending
LDC	Least Developed Countries
MDB	Multinational Development Bank
NABARD	National Bank for Agriculture and Rural Development
NAP	National Adaptation Plans
NDC	Nationally Determined Contribution
OMRC	Office of Risk Management and Compliance
PBL	Policy-Based Blended Loans
PFI	Partner Financial Institution
PPA	Power purchase agreement
PSF	Private Sector Facility
PV	Present Value
RMCs	Regional Member Countries
ROI	Return on Investment
SAP	Simplified Approval Process
SCLC	Synthetic Local Currency Loan product
SIDS	Small Island Developing States
SME	Small Medium Enterprise
T&C	Terms and conditions
TCCL	Tata Cleantech Capital
TCX	Currency Exchange Fund
UNFCCC	United Nations Framework Convention for Climate Change
WACC	Weighted average cost of capital

2 EXECUTIVE SUMMARY

The GCF was established to make a significant contribution to climate action in order to support developing countries' efforts to reach the targets set by the international community. In its draft Strategic Plan 2020-2023, the Fund stressed its role to "drive a rapid paradigm shift towards low-emission, climate-resilient development pathways in line with the goals of the UNFCCC and Paris Agreement, and based on its comparative advantages" (GCF/B.24/Inf.01)[1]. The pledging conference that took place in Paris in October 2019 also demonstrated the continued will of governments to promote climate action through the GCF, with pledges reaching USD 9.8 billion.

Furthermore, the version for consultation of the Strategic Plan, published online and for Board information at the time of the twenty-fourth meeting of the GCF Board (B.24) in November 2019, and again in preparation for B.25, proposes key actions for the GCF. Those are related to the financial instruments of the Fund and the application of terms and conditions in GCF proposals, such as:

- Examine how GCF risk and concessional finance can encourage more private sector investment in adaptation and resilience.
- Diversify the use of GCF financial instruments by maintaining a relatively stable proportion of grant financing, while shifting from concessional lending towards greater use of risk mitigation instruments such as equity and guarantees to unlock innovation and potential for financing at scale.
- Demonstrate, through investment practices, that the risk appetite of the GCF differs from other investors to increase investments in which GCF takes calculated risks (such as first-loss positions or participation in higher-risk tranches) to demonstrate the viability of potentially paradigm-shifting interventions.

In this context, this **Review of the Financial Terms and Conditions of the GCF Financial Instruments** has been commissioned to contribute to the GCF's efforts to review and assess the range of available instruments to fulfill the above objectives. This **Review** has been carried out by Climate Finance Advisors BLLC jointly with the Center for Clean Air Policy (CCAP) (the Project Team) from September to January 2020.

The aims of the assignment have been:

1) To review those policies that may directly or indirectly be significant to aid the interpretation and application of the terms and conditions of the GCF financial instruments; and to assess the degree of compliance in the application of T&C in GCF operations. This analysis also informs further considerations on internal consistency in the application of terms and conditions, and ultimately

[1] https://www.greenclimate.fund/documents/20182/1908411/GCF_B.24_Inf.01_-_The_Strategic_Plan_for_the_GCF 2020_2023.pdf/ef612592-bc92-43a2-dc2a-af412e4cc7ff

their consistency vis-à-vis the mandate of the GCF. This review is presented in Part 2.1 below under "*Consistency and compliance*."

2) To assess whether existing GCF policies related to financial terms and conditions are '*fit for purpose'* or relevant to achieve the goals of the Fund. Given this goal, we provide additional benchmarks that could be introduced to enhance the clarity and transparency in the determination of terms and conditions in GCF proposals. We also explore the linkages between relevance and the application of the grant element as an expression of the level of concessionality as well as the linkages between concessionality and pricing. This assessment is presented in Part 2.2 below.
3) To propose additions and adjustments to the financial terms and conditions, to include guarantee instruments, local currency lending, scaling up equity, and, going forward, additional innovative instruments. These proposals are presented in Part 2.3 below.

Prior to this review, in 2017, the firm Nodalis Conseil conducted the first review of terms and conditions of the Fund's financial instruments, as mandated by Decision B.BM- 2019/08. The review was finalized in September 2017 and analyzed the Fund's portfolio between B.9 and B.17. At the time that the review was completed, no proposals under the Simplified Approval Process (SAP) had yet been approved by the Board. A list of findings from the first review is included in Annex 7.

2.1 CONSISTENCY AND COMPLIANCE

We initially conducted a desk review to determine how the GCF's current terms and conditions are considered over the different stages of the GCF approval process. We focused on a broader set of policies, including the Fund's Risk Management Framework and the Investment Framework.

Decision B17/08, which introduced a level of flexibility in the determination of terms and conditions for public sector proposals, informed our observations. According to this decision, the financial terms and conditions set out in annex II to decision B.09/04 should be applied "in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein."

To verify the degree of compliance of the FP and SAP approved in the period between B.17 and B.23 with the given T&C parameters, we constructed a dataset including terms and conditions and the grant element of public and private sector proposals and calculated the weighted average of the grant element of those proposals with multiple instruments. We have used the grant element as a proxy for concessionality, in alignment with best practices currently within both climate finance and development finance. The grant element is used to express the element of "gift" as a percentage of total. To understand the distribution of concessionality in the GCF portfolio, we plotted proposals according to their overall terms and conditions, as summarized graphically by the grant equivalency expressed in percentage terms (i.e., the 'grant element').

We also plotted the proposals based on the value of GCF total financing as a percentage of total financing, as well as across sectors (private, public), area (mitigation, adaptation, cross-cutting), regional distribution, LDCs, and SIDS. The graphs from this analysis are presented in chapter 4 (4.4.2), from which we draw patterns and observations about GCF investments.

Based on the qualitative analysis of the policies as well as on data analysis from graphs, we observe that the Secretariat and AEs comply with GCF policies that are related to the terms and conditions of the Fund. This is mainly due to the fact that the Fund's policies and guidance are generic, so conditions can be interpreted to fit the broad guidance provided for by GCF principles, factors, and concepts such as "appropriate" or "the right level." Within this framework, it appears that the level of concessionality, the choice of financial instruments, and the T&C themselves, are set on a case-by-case basis, particularly whether a proposal receives high or low concessionality.[2] [3] We also observe several recurring patterns which could lead and support the drawing of specific rules.

The following table summarizes our findings and recommendations based on our analysis. The details of these findings are also further analyzed in the relevant sections of this report.

Table 1: Summary of Findings and Recommendations: consistency and compliance

Findings	Recommendations
The application of the financial terms and conditions is compliant with existing policies; however, this is mainly due to the broad nature of the guidance and principles. The table for low and high concessionality for loans for the public sector provides values to determine terms and conditions in the high and low concessionality brackets. However, there is no guidance as to when to use high or low concessionality parameters.	Within the context of existing terms and conditions, the Secretariat and the Board should provide further guidance for the use and interpretation of the given parameters, in order to ensure clarity and predictability in the process of setting and negotiating terms and conditions, concessionality levels, and the choice of instrument.
The application of fees has varied depending on the project. In some cases, waiving of the fees or merging the service fee with the interest rates has been	In order to increase transparency and speed of negotiations, the GCF could issue guidelines on the application of all fees (service fees, commitment fees) in order to simplify the process of negotiating the fees for both GCF and AEs, as well as for clarity on the costing

[2] Decision B.09/04

[3] Decision B.17/08

Findings	Recommendations
necessary in order to align GCF and entity pricing, and lower the costs of borrowing for a GCF client (the AE, the end beneficiary).	structure itself. Service fees and interest rates could be merged in order to simplify the cost structure of the loan and to offer better comparability with public sector terms and conditions provided by other institutions.
Decision B.17/08 offered flexibility in the application of the terms and conditions. The interpretation of this decision is unclear.	In addition to the flexibility granted in the negotiations of fees and tenors, flexibility could also be extended for other conditions, such as in grace periods, interest rates or seniority position.
The dataset and the graphs show clear patterns in the distribution of concessionality levels by project characteristics, geographical distribution, and by the 'vulnerability' of the country (i.e., in the SIDS and LDC group). Our work concluded that both a rule-based ***or*** principle-based approach can work technically and financially.	The GCF could strengthen the use of financial terms and conditions by adopting: - a rules-based approach, on the basis of guidelines that would make explicit a pattern that is already present but currently implicit; ***[or]*** - a principles-based approach, with a focus on minimum concessionality, as defined by the economics of the proposal.
There is no approved definition within the Fund of a public or private sector proposal.	Provide guidance on a working definition of private / public (e.g., whether this is based on ownership of implementing AE; ownership of end-beneficiary; sovereign guarantee requirements; or on project components)

2.2 RELEVANCE AND FIT-FOR-PURPOSE NATURE OF THE T&C

To assess whether existing GCF policies related to financial terms and conditions are 'fit for purpose' and relevant to achieve the goals of the Fund, we included additional macro (related to the context of the proposal) and micro (related to the proposal) indicators. We then conducted a more detailed analysis of the underlying financial and economic contexts that can impact the choice of instruments and specific terms and conditions, such as on pricing or on the interpretation and use of the grant element.

On this basis, we recommend further guidance on context-specific benchmarks. This is consistent with practices at other institutions that offer rule-based approaches based on negotiations with clients. Hurdle rates, profitability ratios, financial and economic analyses are important decision criteria − particularly in the private sector − that can facilitate negotiations with clients, create additional transparency and ultimately lower the transaction costs of engaging with the GCF.

In this section, we consider the various approaches to concessionality and present a way to enhance the grant equivalency calculation (the GEC) and the ensuing utilization of the "grant element" in considerations of the application of terms and conditions and concessionality levels. This includes, for instance, the recommendations to draft interpretation and utilization guidelines for the grant element as well as an optimization of the GEC calculator model.

The following table summarizes our findings and recommendations with regard to whether current T&Cs are relevant and fit-for-purpose.

Table 2: Summary of Findings and Recommendations: relevance

Findings	Recommendations
The overall framework nature of the T&C means that proposals are ultimately structured on a case-by-case basis. This is important in order to deploy the most appropriate T&C and structure the most appropriate concessionality and pricing. The GCF has principles on how to do this, but no specific guidelines.	Complement the application of the existing T&C policy with data from a comprehensive dataset that includes context-specific benchmarks. This analysis will guarantee that proposals receive the most appropriate concessionality level for their specific characteristics.

Findings	**Recommendations**
The GCF uses the GEC to determine the grant equivalency of the GCF contribution in each proposal. The grant equivalent is widely used in climate and development finance. At present, there are no guidelines on interpreting the GEC or attributing value to the percentage derived from the calculations (i.e., the “grant element”).	Issue guidelines for the interpretation and wider use of the grant equivalent, in particular on the values and meaning of the grant element itself in GCF operations. This could entail the creation of a positive list of typical project characteristics that one would see, for example, in the 0-32% grant equivalency range; in the 33-65% low concessionality range; in the 66-99% high concessionality range; and in 100% concessionality.
Currently, GCF can calculate the grant element using different discount rates, but only reports using a rate of 5%. This can limit the possibility of comparing the concessionality deployed across instruments.	Strengthen a "GEC 2.0" with the following: - Issue accompanying guidelines to the existing technical GEC manual, to explain and offers ranges of discount rates that are determined by instrument type and project characteristics; - Provide internal guidance for Secretariat staff to use more appropriate discount rates to calculate the GE; - Provide guidance on how to use benchmarks and reference points to interpret GEC calculations.
The concessionality given to an AE is sometimes passed on to the end-beneficiary, although there have been instances when the concessionality is retained for specific purposes. The T&Cs are silent on this issue.	T&C could be more explicit in defining the instances when the concessionality obtained by an AE can be retained for a specific purpose, e.g. to buy currency swaps in order to offer local currency on-lending. There may be cases where ‘capturing be more explicit in inclusions / exclus
There are established benchmarks and indicators for loan pricing. Yet, climate impacts, riskier investments, and savings from resource efficiency measures will inform any cost/benefit and risk/return trade-off. In these cases, concessionality is	In the pricing table given in the report, quantitative benchmarks can be complemented by qualitative considerations, in particular with emphasis on the links between a pricing strategy and its alignment with the GCF corporate strategy.

Findings	Recommendations
required in order to adjust the pricing towards a level that is accessible to the borrower. Concessionality can support a movement from market distortion to market re-alignment.	

2.3 POLICY IMPROVEMENTS AND ADDITIONAL INSTRUMENTS

The draft Strategic Plan 2020-2023, published ahead of B.24, offers high-level direction for the realization of the Fund's paradigm shift toward low-carbon and climate-resilient development. This Plan sets the strategic goal of using risk mitigation and risk transfer instruments more, to complement the most widely used instruments currently (grants, concessional finance), as a means to achieve the Fund's objectives. Specifically:

- Full and partial guarantees can be useful instruments to either reduce or transfer risk in order to mobilize investors and reduce the cost of capital. Despite these potential benefits, guarantees have rarely been used by the GCF. Guarantees do not in themselves provide liquidity to a project but may stimulate liquidity injection by other investors or contributors, who may feel that the lowered risk profile (that is derived by having an underlying guarantee) makes the proposal more investable.
- Local currency lending can support local capital market development and boost resilience by alleviating vulnerability to foreign currency risks. Platforms to mitigate or absorb risks and costs from currency fluctuations ensure that concessionality reaches the end-beneficiaries, who may otherwise be harmed by a local currency devaluation. The utilization of local currency lending has so far been limited in GCF proposals.
- Equity, which is provided for in the founding GCF Instrument, is under-utilized. Equity investments offer the potential to catalyze private sector investment further. In blended finance, equity can also be the necessary 'bridge' between the supply of resources and demand.
- Other 'innovative' financing structures that could be developed in the medium term include: supporting the issuance of green bonds (e.g., in local currency platforms); co-financing directly in crowdfunding and impact-investment platforms; and securitization.

The following table summarizes our findings and recommendations with respect to policy improvements and additional instruments.

Table 3: Summary of Findings and Recommendations: policy improvements and instruments

Findings	Recommendations
For callable guarantees, the GCF currently needs to provision 100% of the guarantee it offers, and the entire amount needs to be provisioned and disbursed to the Accredited Entity. This is different from commercial guarantees issued by A-rated institutions, which do not require this level of provisioning. **This would enable the Fund to implement guarantees, local currency lending and bond** issuance efficiently**. A rating would be backed by the GCF portfolio, its available cash, and a forecast of payments of contributions into the Trust Fund. In the relevant section of this review, we provide tentative costs and fees for guarantees.**	To move forward in including a more comprehensive range of financial instruments, the GCF could seek to obtain a corporate credit rating by a rating agency.

There are additional ways in which the GCF can structure and offer guarantee products, while the process of obtaining a credit rating is ongoing.	In the short term, GCF can look at structuring guarantees in a number of ways that do not require a corporate credit rating, such as:
	• Revolving funds;
	• Guarantee (insurance) products:
	  ○ Guarantees to PPAs
	  ○ Guarantees for Contracts for Difference

The GCF currently does not have a treasury function that would allow currency conversions or issuing local currency bonds. Current terms and conditions and policies are silent on the issue of foreign exchange risk, costs of currency swaps, and the potential structuring of mechanisms or products to offer local currency, in particular in frontier markets.	GCF could benefit from a more formalized approach that targets local currency lending, such as for example a dedicated Policy for Local Currency Lending. The policy can include the analysis (e.g. a SWOT analysis) of the potential benefits to local currency modalities for the operations and goals of the Fund.

Findings	Recommendations
The absence of a local currency financing platform for GCF projects means that the concessionality provided by the GCF is either used up to cover the costs of currency swaps or is eroded by foreign exchange fluctuations and risk.	In order to operationalize additional instruments, GCF could structure a local currency lending platform as a revolving fund, with an initial part capitalization from contributors in the form of a grant and additional revenue generated from service fees. This is a structure similar to TCX but could be targeted to frontier markets not covered by current instruments due to risk considerations. GCF can pilot a part-subsidization of a local currency platform with interested MDBs and NDBs in order to issue green bonds in local currency, which will strengthen the domestic capital markets in the countries of operation of the GCF.
Currently, the T&C are silent on the trade-off between concessionality and the cost of hedging. **Typically, the more developed the capital markets, the lower the costs of hedging (which may imply that a lower concessionality may be needed); the less developed the capital markets, the higher the likelihood that some products are not available, or too risky, and therefore more expensive, which may justify a higher level of concessionality.**	Terms and conditions could be more explicit in determining and assuming pricing for the trade-off between concessionality and the cost of hedging, with the possibility for the AE to utilize or transfer a portion of the concessionality to cover the costs of hedging or to buy a currency swap.
The GCF can provide equity, but there are no specific terms and conditions determining volume, rates, or scope. Going forward, GCF can look into other instruments not currently provided for by the T&C. They could further support the reach of the GCF into all developing countries.	Equity can be included in the full framework of financial terms and conditions through a dedicated equity strategy that provides for the application of typologies of equity (start-up, growth, etc.) and a range of terms and conditions that can be taken into consideration. This could also define how to operationalize the equity strategy, for example through dedicated set-asides for equity products at GCFG. In the longer-term, GCF can include other

Findings	Recommendations
	'innovative' financial instruments such as bond issuance and crowdfunding.
The frequency of review is currently determined to take place every two years.	We recommend that the next review is conducted in three years, so as to allow sufficient time for the recommendations made in this review to be operationalized (in 2020) and for changes and results to be observed.

3 METHODOLOGY

3.1 METHODOLOGICAL APPROACH

The terms of reference of this review call for an assessment of "the degree of compliance of the terms and conditions of the GCF financial instruments with the GCF Board policies in approved funding proposals between Board Meeting 17 (B.17) to Board Meeting 23 (B.23), including substantial differences with projects approved before B.17". This corresponds to funding proposals numbered FPO46 to FP114 as well as proposals considered under the Simplified Approval Process modality, namely SAP001 to SAP007. A total of 69 proposals[4] were reviewed.

For the completion of this review, we have used the following methodologies:

- *Qualitative analysis*: desk research, literature review, consultations with focused group, structured interviews
- *Quantitative analysis*: dataset building and statistical analysis.

Qualitative and quantitative methods have allowed us to gather knowledge from a variety of sources in order to triangulate information and validate results. This is consistent with best practices in research, public policy, and the social sciences.

3.2 KEY QUESTIONS

For each of the sections, we were guided by key questions, which we presented to the interviewees as well as used internally for the conceptualization and development of this report.

Compliance and consistency

[4] The following FP lapsed or were withdrawn and are not counted towards this assignment or the statistics / analyses therein: FP054; FP055; FP057; FP079; FP082; FP088.

- Do GCF's principles and policies on financial instruments provide clear guidance to Accredited Entities (AEs) and GCF staff, as reflected in each project approved between B.17 and B.23, their corresponding Funded Activity Agreement (FAA) and term sheet?
- How can the Fund support and advance improvements to compliance with financial instrument-related policies, both at the Secretariat and AE level?
- What are the barriers, risks, and benefits associated with the current terms and conditions?
- Moving beyond compliance, what observations can be made with respect to the interpretation and application of the policies?
- What are the patterns that can be observed between concessionality and impact areas?
- What is the relation between the investment criterium "Effectiveness and Efficiency" and the concessionality observed and represented as the grant element?
- Can observations made from data analysis lead to principles of simplification for the setting of terms and Conditions?

Policy relevance

- Are the current T&C supportive of the mandate of the Green Climate Fund? What are the risk and opportunity patterns that can be derived from the analyses in phase II (e.g., full data set, including terms, conditions, interest rates, fees, GEC calculations)?
- Specific to GCF Public Sector Projects, how competitive are the terms and conditions as set in GCF B.09/04 with MDB sovereign rates? Are there elements of divergence / convergence?
- Specific to GCF Private Sector Projects, what are the T&Cs of non-grant co-financiers, if any / relevant? What patterns and other issues that could lead to additional guidance on the parameters (sector, geography, capacity of recipient, etc.)?
- On practices of other institutions, what financial instruments and associated T&C do these institutions offer to public and private sector projects approved since the last GCF review?
- What are the T&C of the financial instruments provided to public sector grants and for non-grant instruments: interest rate, commitment fee, service fee, other fees if applicable, and tenor/maturity and grace period, repayment profile), including guarantees?
- Are they appropriate for each project – how do they serve the intended objectives? What instruments are missing?
- What improvement can be made on the utilization of GEC and the conceptualization of concessionality?

Policy improvements

- What are the underlying reasons for the limited uptake of guarantee instruments and local currency lending in GCF financing?

- What gaps or inefficiencies, if any, can be observed in terms of providing the necessary policy infrastructure to encourage the use of such instruments by the GCF and its accredited entities?
- In what ways can the T&C be updated to include these instruments?
- What other business models could be made available for the design of guarantee products and local currency lending (e.g., revolving fund structures) that are not currently utilized?
- In addition to the above, what other financial instruments could be included in the context of evolving climate finance, with 'financial innovation' approaches?
- Regarding proposals for the regular reviews of the financial T&C, what are the key considerations to keep in mind for determining their frequency and content?

4 POLICY COMPLIANCE

4.1 SUMMARY

We analyzed the policies that are directly and indirectly related to the terms and conditions of the GCF financial instruments, and organized them into the following four categories (see detailed analysis and discussion in section 4.2 below):

- Those related to the mandate of the Fund and its strategic vision, including the GCF initial Strategic Plan and draft Strategic Plan 2020-2023, portfolio goals and allocation parameters, and the GCF Governing Instrument;
- Those related to terms and conditions of financial instruments of the Fund;
- Those related to the Investment Framework, including investment criteria and the co-financing policy, as well as draft documents on concessionality and incremental and full cost;
- Those related to the Risk Management Framework.

We focused on answering three strategic questions:

- Is the GCF complying with its mandates and goals?
- Is the GCF complying with its policies related to terms and conditions for financial instruments?
- Is the GCF demonstrating internal consistency between different projects?

In addition, for the quantitative and qualitative analysis of compliance, we constructed a dataset that includes terms and conditions and the grant element of public sector proposals, in order to verify the degree of compliance of the FP and SAP approved in the period between B.17 and B.23 with the given T&C parameters.

Our observations are made in view of decision B17/08, which introduced a level of flexibility in the determination of terms and conditions for public sector proposals. According to this decision, the financial terms and conditions set out in annex II to decision B.09/04 should be applied "in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein.”

In order to illustrate the distribution of the terms and conditions, we built a number of scatterplots and graphs (please see Section below Compliance with Policy). An analysis of the results derived by the data plotting is presented in sections 4.4. and 4.5, while all graphs are included in Annex 1. In these scatterplots:

- the x-axis represents the grant equivalency expressed in percentage terms (i.e., the ‘grant element’), and calculated by the GCF utilizing the GEC; and
- the y-axis represents the percentage of GCF financing into the proposals as a percentage of total financing. This percentage can give us a quick, illustrative summary of the levels of co-financing across the portfolio.

Based on the dataset analysis and the scatterplot analysis, we observe that the Secretariat and the accredited entities (AEs) comply with the parameters given by the terms and conditions of the Fund. This is mainly due to the fact that the Fund’s policies and related guidance are generic, so conditions can be interpreted to fit the general guidance provided by GCF principles, factors, and concepts such as “appropriate” or “the right level.” In the absence of project characteristic lists, or for instance, a definition of ‘vulnerability’ or ‘vulnerable countries’, there is no guidance on what constitutes a higher or lower concessionality proposal.

Thus, from this analysis, we can observe that the current terms and conditions offer a flexible framework in which proposals are appraised based on context-specific elements. In our view, this approach seeks to strike a balance between rule-setting, predictability and standardization on the one hand (through set T&C parameters), and responding to the needs of the project and of the recipient country on the other (waiving of fees when necessary). Yet, this balance may also leave unaddressed issues, such as the definition of vulnerability, or how to determine which proposals would benefit from grant-only, or from a higher or lower concessionality.

4.2 REVIEW AND ANALYSIS OF POLICIES RELATED TO FINANCIAL TERMS AND CONDITIONS

4.2.1 GCF Initial Strategic Plan

As an initial step, we undertook a comprehensive review of GCF’s financial policies and practices relevant to terms and conditions. Our aim was to determine how the GCF’s current terms and conditions are considered over the different stages of the GCF approval process by focusing on a broader set of policies related to how the Fund deploys its financial instruments, including the Fund’s Risk Management Framework and the Investment Framework.

We framed this analysis with reference to the strategic documents that guide the Fund, to assess how the deployment of the Fund’s financial instruments contributes to (or falls short of) achieving the key objectives of the Fund and its mandate.

The Fund's Initial Strategic Plan[5] did not provide explicit guidance related to the vision of the Board on the use of the Fund's financial instruments and how they can contribute to achieving the strategic goals of the Fund. However, the Initial Strategic Plan did emphasize in its vision the key role of the Fund in promoting a paradigm shift through innovative, cutting-edge technologies and investment practices, scaling up investment, and private sector engagement.

The Board left it to the operational level of the Fund to determine how financial instruments should be deployed to achieve a paradigm shift.

Additional strategic guidance for the Fund's operations was defined in its portfolio allocation parameters and targets[6] as follows:

- Balance between mitigation and adaptation (50/50 over time);
- Adaptation allocation for vulnerable countries including Least Developed Countries (LDCs), small island developing states (SIDS) and African States (50 percent of adaptation allocation);
- Geographic balance (reasonable and fair allocation of across a broad range of countries);
- Engagement with the private sector (maximize Fund-wide engagement with the private sector, including through significant allocation to the Private Sector Facility (PSF);
- Readiness and preparatory support (sufficient support for readiness and preparatory activities associated with the above).

The portfolio allocation targets were also silent in terms of how to strategically deploy financial instruments to support the goals of the Fund.

4.2.2 Draft Strategic Plan 2020

Although the 2020-2023 Strategic Plan will only be put forward for Board approval at B.25, the available draft, published in preparation for B.24, provides insights in terms of the expected strategic direction of the Fund. Among the strategic goals of the Plan in terms of programming and country engagement is the aim to:

> "(g) maintain the grant share of the portfolio funding mix while diversifying instruments from concessional finance to risk finance, so as to achieve higher co-financing from private sector investments"[7]; and to "drive a rapid paradigm shift towards low-emission, climate-resilient development pathways in line with the goals of the UNFCCC and Paris Agreement, and based on

[5] https://www.greenclimate.fund/documents/20182/761223/Initial_Strategic_Plan_for_the_GCF.pdf/bb18820e-abf0- 426f-9d8b-27f5bc6fafeb

[6] Decision B.07/06

[7] https://www.greenclimate.fund/documents/20182/1908411/GCF_B.24_Inf.01_-_The_Strategic_Plan_for_the_GCF_2020_2023.pdf/ef612592-bc92-43a2-dc2a-af412e4cc7ff

its comparative advantages" (GCF/B.24/Inf.01)[8].

The version for consultation of the Strategic Plan for 2020-2023 proposed "key actions" related to financial instruments and terms and conditions, such as:

- Examine how GCF risk and concessional finance can be used to encourage more private sector investment in adaptation and resilience;
- Diversify the use of GCF financial instruments by maintaining a relatively stable share of grant financing, but shifting from concessional lending towards greater use of risk mitigation instruments such as equity and guarantees to unlock innovation and potential for financing at scale;
- Demonstrate, through investment practices, how the risk appetite of the GCF differs from other investors using its flexible risk appetite statement to increase instances in which GCF takes calculated risks such as first-loss positions or participation in higher-risk tranches to demonstrate the viability of potentially paradigm-shifting interventions.

A mandate to include additional risk finance in the GCF portfolio has clear implications for how the Fund's leadership expects the Secretariat and AEs to use financial instruments. This is supported by prior research as well as by the Forward-looking Performance Review conducted by the Independent Evaluation Unit (IEU) of the Fund (a performance review of the Fund, conducted in early 2019 and published on 30 June 2019) that shows the need to revise how the Fund has used the instruments at its disposal for strategic purposes[9].

Previously CCAP and CFA conducted research on private sector-oriented climate finance portfolios of large Development Finance Institutions (DFIs) to develop the GCF's PSF strategy.[10] In a sample of 36 GCF recipient countries, estimates of DFIs financing by financial instrument showed that portfolios are heavily focused on hard currency debt. Private sector adaptation projects are also relatively scarce in the portfolio. Hard currency loans are also overrepresented in the portfolio, with equity and guarantees being under-used by GCF AEs relative to the overall GCF portfolio and the AEs portfolio.

Furthermore, the inclusion of additional 'innovative' instruments in the range of available instruments is part of the general evolution in the provision of climate finance. A number of institutions are looking at extending different financial instruments according to the specific risk or barrier they set to overcome in a program or in a project. In this regard, guarantees and local currency

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[8] https://www.greenclimate.fund/documents/20182/1908411/GCF_B.24_Inf.01_-_The_Strategic_Plan_for_the_GCF_2020_2023.pdf/ef612592-bc92-43a2-dc2a-af412e4cc7ff

[9] https://www.greenclimate.fund/documents/20182/1674504/GCF_B.23_20_-_Forward-Looking_Performance_Review_of_the_GCF.pdf/525f359f-cd33-81f2-0bf0-ff8e41353ede

[10] https://www.greenclimate.fund/documents/20182/1674504/GCF_B.23_12_Add.06_-_Review_of_the_initial_modalities_of_the_Private_Sector_Facility

lending are geared towards risk transfer or risk absorption that is not always feasible with other instruments[11].

4.2.3 GCF Policies

The Governing Instrument[12] states that the GCF 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."

The Fund deploys four types of financial instruments for both public and private sector projects/programs:

- Grants (with or without repayment contingency)
- Loans (at below-market conditions)
- Guarantees
- Equity

The figure below provides an overview of the main policies applicable to the determination of terms and conditions.

Figure 1 Key policies guiding the application of terms and conditions for GCF financial instruments

Terms and Conditions of Financial Instruments	Investment Framework	Risk Management Framework
• Principles and factors to determine terms and conditions (B.05/07) • Guidelines for public and private projects (B.09/04) • Use of financial T&C in a fit-for-purpose manner (B.17/08)	• Investment criteria and indicative assessment factors (B.09/05) • Investment Criteria Indicators • Linkages with the concept of incremental and full cost,	• Risk Guidelines for funding proposals • FX risk

4.2.4 Terms and Conditions of Financial Instruments

As a part of the discussions to set the business model of the Fund, the GCF Board guided the setting of T&C for GCF financial instruments through certain principles and factors[13] applicable to grants and concessional loans for public and private sector projects and programs. These foundational guidelines are described in table 1 below:

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[11] (GCF/B.24/Inf.01)

[12] Paragraph 54 GCF Governing Instrument

[13] Decision B.05/07 Annex III

Table 4 Principles and factors for grants and concessional loans

Guiding principles applicable to public and private sector operations	Factors to take into account in determining terms of financial instruments for both public and private sector operations
Grant elements should be tailored to incremental costs or the risk premium required to make the investment viable.	The average concessionality or grant element of the financial inputs to the Fund as well as the grant element of financial instruments of the Fund.
Seek the right level of concessionality, so as not to displace investments that would otherwise have occurred, including for private sector investment.	The grant element of concessional finance will be tailored to provide the appropriate incentives to facilitate mitigation and adaptation activities.
Take into account the indebtedness capacity of the recipient so as not to encourage excessive indebtedness.	Concessional forms of finance that minimize market distortions and potential disincentives to private investment.
Structure terms on a case-by-case basis to address specific barriers.	The expertise and capacity of financial intermediaries and implementing entities.
Avoid crowding out commercial financing.	
Leverage other financing, both public and private, to maximize leverage in the case of private financing.	Risk-sharing between public and private sector investment, when relevant.
Promote long-term financial sustainability.	
Apply due diligence to assess the risk of the investment.	

Furthermore, the Fund applies differentiated terms and conditions for public and for private sector projects/programs, as follows:

- Terms and conditions for private sector projects (whether for grant or non-grant instruments) are considered on a case-by-case basis.
- Terms and conditions for public sector projects using grants and loans are determined based on specific rules that guide the Secretariat and AEs as specified in Annex II of decision B.09/04, with high and low concessionality for loans, as shown in Table 5 below. It is unclear, however, when either of the two categories should be applied.
- The Board guided the Secretariat to work with AEs 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." (Decision B.17/08)14

- After this decision, the Secretariat has been able to apply the terms and conditions in a more flexible manner, as long as it is within the ceiling provided by the terms shown in the table. From consultations, we learned that this flexibility had been applied for fees and tenors.

Table 5 Overview of GCF's Current Terms and Conditions of Grants and Concessional Loans[15]

<table>
<tr><th>Instrument</th><th>Currency</th><th>Maturity</th><th>Grace period</th><th>Annual principal repayment (Y11-20/6-20)</th><th>Annual principal repayment (Y21-40)</th><th>Interest rate</th><th>Annual Service fee</th><th>Annual Commitment fee</th></tr>
<tr><td>Grant</td><td rowspan="3">Major convertible currency</td><td colspan="7">• Grants without repayment contingency: no reimbursement required, all grants will be subject to an obligation for repayment if the recipient is found to be in material breach of its contractual obligations towards the Fund or involved in a material violation of the Fund's integrity or fiduciary standards, including those on corruption and fraud.
• Grants with repayment contingency: terms adapted to the required concessionality of the project or program</td></tr>
<tr><td>Loans
high concession-ality</td><td>40 yrs</td><td>10 yrs</td><td>2%</td><td>4%</td><td>0%</td><td>0.25%</td><td>Up to 0.5%</td></tr>
<tr><td>Loans
low concession-ality</td><td>20 yrs</td><td>5 yrs</td><td>6.7%</td><td>N/A</td><td>0.75%</td><td>0.50%</td><td>Up to 0.75%</td></tr>
<tr><td colspan="9">Currency: All instruments are made available in major convertible currencies only. Currently, this is USD and EUR only.</td></tr>
</table>

4.2.5 GCF Investment Framework

The Investment Framework, which guides how the Fund prioritizes its investments in mitigation and adaptation, provides broad elements to be taken into account by those designing and assessing a funding proposal. Investment principles[16] guiding the Fund include:

- Finance projects and programs that demonstrate the maximum potential for a paradigm shift;

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[14] Decision B.17/08

[15] Adapted from GCF's Board Decision B.09/04. https://www.greenclimate.fund/documents/20182/24949/GCF_B.09_23_-_Decisions_of_the_Board___Ninth_Meeting_of_the_Board__24_-_26_March_2015.pdf/2f71ce99-7aef-4b04-8799-15975a1f66ef

[16] Decision B.17/08 https://www.greenclimate.fund/documents/20182/751020/GCF_B.17_08_-_Operational_Framework_on_complementarity_and_coherence.pdf/55b8605f-518a-4b91-8362-02eaee5a566a

- Account for funding received and extended by the Fund in grant-equivalent terms, based on a standard methodology to be developed by the Fund based on international practices, to provide an accurate comparison of funding amounts between financial instruments;
- Provide minimum concessionality funding (e.g., grant-equivalent subsidy element) necessary to make a project or program viable, which can be up to and including the full cost of the project/program.

Investment criteria relevant for determining applicable financial terms and conditions include:

- **Investment Criterion 2: Paradigm Shift Potential**. This requires proposal designers and reviewers to take into account factors such as innovativeness; market or economic barriers; and potential for replicability and scalability, which may require higher levels of concessional funding and risk-taking in order to achieve higher mitigation and/or adaptation impact.
- **Investment Criterion 4: Needs of the Recipient**. This requires proposal designers and reviewers to take into account factors such as degree of exposure to climate risk and vulnerability; the level of social and economic development (including income level) of the country and target population; size of population and/or social and economic assets or capital of the country exposed to climate risks and impacts; and existing barriers that create an absence of alternative sources of financing and how they will be addressed.
- **Investment Criterion 6: Efficiency and Effectiveness**. This requires proposal designers and reviewers to take into account factors such as the proposed financial structure (amount, financial instrument, tenor and term); demonstration that the proposed structure provides the least concessionality needed to make the project viable; leverage potential economic and financial rate of return; and long-term financial sustainability.

We note that the investment criteria do not make direct reference to the terms and conditions. Possible links could be made between market barriers or the cost of innovation and their effect on pricing; or between the needs of the recipient and the specific micro and macro context.

4.2.6 Risk Management Framework

According to the Fund's guidance on risk management for funded activities[17], the AE and the Secretariat both have a role in managing risk. The GCF applied different layers of control and due diligence. According to the first-level due diligence approach[18], the AE is responsible for conducting due diligence, i.e., a comprehensive appraisal of different aspects of the proposal (e.g., financial, risk exposure, technical) prior to submitting it to the Secretariat. In the second phase, which is

[17] Decision B.19/04 Annex IV: Investment Risk Policy

[18] Center for Clean Air Policy (CCAP) Analysis of the Green Climate Fund's Framework for Measurement, Reporting and Verification https://ccap.org/resource/analysis-of-the-green-climate-fund-framework-for-measurement-reporting-and- verification/

represented by second-level due diligence, the Secretariat is responsible for co-drafting a risk assessment of the Funded Activity in the Secretariat Review, based on the Risk Guidelines for Funding Proposals.

The Risk Guidelines for Funding Proposals[19] are divided into four types, including a category on setting proposals' terms and conditions, which aim to establish a comparable standard to consider risk across different funding structures. According to these guidelines, the Fund may accept a range of deal structures with varying levels of complexity, participation of co-investors, blending of funding instruments and modalities, control and ownership structures, and financial terms and conditions.

Guidelines for risk officers also include instructions on risk-taking of the Fund compared to other co-investors and the need to set a clear disbursement and repayment schedule.

Although the Fund has not set any specific guidance on deploying local currency, the GCF Risk Management Framework does incorporate guidance on FX risk[20] on the asset side. The GCF operates with financial instruments in holding currencies that could be repaid in currencies other than holding currencies to meet the Fund's mandate. The overall FX risk appetite for FX risk is moderate. According to the risk rules, investments of the GCF that implement funding proposals with local currencies are subject to a risk of repayment in holding currencies.

4.3 POLICIES RELATED TO FUNDING PROPOSALS

The Board mandated the Secretariat to consider under the Investment Framework an integrated approach to concessionality, incremental cost, and co-financing. Up to B.24, only the co-financing policy has been approved.

The Board mandated the Secretariat to consider an integrated approach to concessionality, incremental cost, and co-financing under the Investment Framework. The Secretariat was required to propose for Board consideration policies to address what have been deemed as policy gaps of the Fund. As shown in documents prepared by the Secretariat, the policies on concessionality, incremental cost, and co-financing were envisioned as elements that should be taken into account to select the financial instrument to be deployed by the GCF as well as applicable terms and conditions[21].

So far, only the co-financing policy has been approved. In it, the Board defined co-financing as the financial resources, public or private, required in addition to GCF proceeds to implement a funded activity. The Board also approved definitions for terms such as expected, leveraged, mobilized, and

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[19] Decision B.17/21 Annex VIII

[20] Decision B.17/11

[21] https://www.greenclimate.fund/documents/20182/1908411/GCF_B.24_04_-_Review_of_the_initial_investment_Framework__Policy_on_co-financing.pdf/c774edc6-f664-0e6c-2f20-1a4d86658501 Page 4

parallel co-financing. Notably, the Board decided that there is no minimum amount of co-financing required for any project or program funded by the GCF, nor specific sources of co-financing that should be complied with. Thus, in determining the financial instrument to channel GCF resources or the amount of concessionality required from the Fund, AEs do not need to comply with pre-set levels of co-financing. Similarly, Secretariat staff is not required to vet funding proposals based on an expected co-financing ratio. The co-financing policy requires that projects and programs incorporate appropriate levels of co-financing to maximize impacts of GCF investment, noting that co-financing may not always be achievable or realistic. Appropriate co-financing levels are thus determined on a case-by-case basis. The policy, therefore, does not provide explicit guidance that guides the process of setting specific terms and conditions for a proposal's financial instruments. Finally, the co-financing policy also states that co-financing metrics should not be used as stand-alone targets so that they are not a disincentive for the GCF to finance projects with significant impact or paradigm-shift potential.

4.4 COMPLIANCE WITH POLICY

4.4.1 Analysis of Funding Proposals

Our dataset includes proposals presented and approved by the Board between B.17-23. This corresponds to all funding proposals between FPO46 to FP114, as well as all proposals considered under the Simplified Approval Process modality between SAP001 to SAP007.

For each project, we collected the following:

As evidence for compliance:

- Public or private sector financing
- Volume and type of GCF financing
- Volume of non-GCF financing
- Terms and conditions, including the grace period, tenor, and interest rate
- Application or waving of fees
- The 'grant element' derived from the GEC calculation, as proxy for concessionality

As evidence for relevance, we also added additional indicators:

- Background reference information, including historical benchmark rates, interest rate stability, financial, and economic analysis.

Capturing such information in the dataset allowed us to identify patterns, such as the application or waiving of fees applied or the general distribution of proposals by their concessionality level.

4.4.2 Data analysis of compliance

In our analysis of compliance, we constructed a dataset that includes terms and conditions and the grant element of public sector proposals, in order to verify the degree of compliance of the FP and SAP approved in the period between B.17 and B.23 with the given T&C parameters. Data from the private sector was not disclosed, so we worked with a number of assumptions, outlined further below.

Key observations:

- Our analyses are made in the context of decision B17/08, which introduced a level of flexibility in the determination of terms and conditions for public sector proposals. According to this decision, the financial terms and conditions set out in annex II to decision B.09/04 should be applied "in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein."
- For grants with no repayments: there is no application of service or commitment fees
- Only one project (FP083, Public Sector) has a tenor below the parameters of the terms and conditions. The applied tenor in FP083 is 10 years.
- Only one project (FP086, Public Sector) has a shorter grace period than those set in the T&C, at 2 years.
- The charts show no substantial difference in the overall terms and concessionality offered before B.17 and after.

Table 6 Summary table of terms and conditions

	Public sector	Private Sector
Fees	Waived or merged 4 / complied 14	Disaggregate data not disclosed
Tenors	Between 10 and 40 years	
Grace	Between 5 and 10 years	
Int. rates	Between 0 and 0.75%	

In order to illustrate the degree of compliance of approved proposals with the specific terms and conditions, we have additional created several scatterplots, based on the above data to analyze the distribution of FPs and SAPs on a Cartesian plane, where:

- The x-axis represents the grant equivalency expressed in percentage terms (i.e., the grant element), and calculated by the GCF utilizing the GEC.
- For some graphs, the y-axis represents the GCF financing into the proposals as a percentage of total financing, while in others, the y-axis represents the absolute amount of GCF financing into the proposals (in USD millions). This can be a visual way to a) reduce the height of the y axis; and b) see the role and position of the GCF co-financing as a percentage of the total financing.
- Color coding is utilized to show the various groupings of data. Groupings include projects that focus impact on mitigation, adaptation, or both; or on geographical splits by region, such as Africa, Asia Pacific (APAC), Eastern Europe, Latin America (LATAM), and global projects.

- "Labelled" means that we refer to the plot (point) by the FP number of the proposal, i.e., each dot corresponds to a FP or SAP, and the proposal number is included next to the dot;
- "Non-labelled" means that in the scatterplot we do not refer to the plot by the FP of the proposals.

In the plots (all annexed, see Annex 1), we have chosen to use the outcome of the GEC calculation – the 'grant element,' i.e., the figure that results from it, expressing the grant equivalency in percentage terms – because the variables of this calculation represent all the elements that characterize the terms and conditions of proposals, and as such, it can serve as an approximate summary of the degree of concessionality applied (from zero to 100%)[22].

The analysis of the scatterplots (elaborated below in section 4.5) presents the following patterns:

- Grant projects without revenue-generating mechanisms are 100% concessional in grant equivalency terms. This is because they are a considered a 'full' gift.
- All highly concessional proposals have a grant equivalency element of at least 66%.
- All low concessional proposals have a grant equivalency element of at least 33%.
- The private sector scatter-gram shows that in a low-concessionality context, private sector proposals are below the 33% concessionality mark. According to the IMF guidance on public lending, a loan is considered 'concessional' when its grant element is at or over 35%.23
- When we plot a number of scatterplots with the percentage of GCF financing against total financing to check potential links between co-financing and the terms and conditions, we did not see a clear pattern between these two variables.
- Subsequently, when we plot the same proposals against the volume (as expressed in absolute terms) of each proposal, we can observe a significant concentration of proposals towards the right side, i.e., towards higher concessionality.
- Thus, through this analysis, one can see that adaptation proposals are more concessional than mitigation or cross-cutting proposals.
- SIDS and LDCs tend to receive a higher concessionality – over 66% grant element, with many proposals at 100%. This reflects the higher vulnerability of these countries, and the lower levels of economic development, which in turn further exposes SIDS and LDCs to the adverse effects of climate change.
- There appear to be no clear distribution patterns in other geographical based plotting.

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[22] Further information on the GEC calculation and all elements included therein (and their definition) is included in Annex 6.

[23] www.imf.org/external/np/spr/2015/conc/index.htm

4.5 CONSIDERATIONS ON COMPLIANCE

Based on the policy and data analysis presented above, the following observations can be made:

4.5.1 Interpreting and using financial T&C - Principles and factors on B.05/07

- If decision B.05/07 were strictly applied, all public sector proposals would align with the specific terms and conditions in the T&C table. In other words, grant projects that do not generate revenue would have a 100% grant equivalency; proposals benefiting from high concessionality would have a 66% grant equivalency; and, proposals with low concessionality would have a 33% grant equivalency. Private sector proposals are treated on a case-by-case basis.
- We note that in the absence of selection criteria based on project characteristics, there can be inconsistencies with respect to the choice of instruments, of terms and conditions, and of concessionality levels.

4.5.2 Decision B.09/04

- Decision B.09/04 states that reimbursable grants or grants with a repayment contingency (in effect, loans with 0% interest) can only be extended to the private sector. In order to increase the flexibility and the availability of climate finance to proponents, it could be useful to extend the provision of reimbursable grants also to the public sector, subject to the requirements of the proposal.

4.5.3 Using the flexibility allowed in decision B.17/08 for project design and assessment

- Decision B.17/08 introduced a level of flexibility in the determination of some elements of terms and conditions for public sector proposals. According to this decision, pending the conclusion of the review of the financial terms and conditions (i.e., the first review conducted in 2017 by Nodalis Conseil), the "financial terms and conditions set out in annex II to decision B.09/04 should be applied in a fit-for-purpose manner, provided that such terms and conditions do not exceed the upper limits set out therein".

The interpretation of decision B.17/08 remains unclear in terms of the application of this flexibility. During the consultations with GCF staff, it was clarified that until now, this flexibility had been applied to fees and tenors. This has allowed for a better alignment of terms and conditions between the AE and the GCF, and to obtain more flexibility in setting tenors. Interviewees also noted that flexibility could be useful also for grace periods and interest rates. We therefore recommend that the GCF develop guidelines for the application and interpretation of conditions (as stated in the findings and recommendations to this section).

4.5.4 Applicability of terms and conditions, and eligibility assessment

As defined by OECD, a loan offered at market terms has a grant element of 0%. However, this becomes a positive percentage if the lender adds an element of "gift" or concession. The grant element measure of aid provides a more accurate estimate of the donor's effort towards development or climate finance. In short, the grant equivalent is an estimate, at today's value of money, of how much is being given away over the life of a financial transaction. In the case of grants,

They have a grant element of 100% as they are fully provided as "gifts"[24].

From the analysis of the scatterplots, we observe the following patterns:

- Grant projects without revenue-generating mechanisms are 100% concessional in grant equivalency terms. This is because they are a considered a 'full' gift.
- All highly concessional proposals have a grant equivalency element of at least 66%.
- All low concessional proposals have a grant equivalency element of at least 33%.
- The private sector scatter-gram shows that in a low-concessionality context, private sector proposals are below the 33% concessionality mark. According to the IMF guidance on public lending, a loan is considered 'concessional' when its grant element is at or over 35%.25
- When we plot a number of scatterplots with the percentage of GCF financing against total financing to check potential links between co-financing and the terms and conditions, we did not see a clear pattern between these two variables.
- Subsequently, when we plot the same proposals against the volume (as expressed in absolute terms) of each proposal, we can observe a significant concentration of proposals towards the right side, i.e., towards higher concessionality.
- Thus, through this analysis, one can see that adaptation proposals are more concessional than mitigation or cross-cutting proposals.

Specifically, with respect to SIDS and LDCs:

- SIDS and LDCs tend to receive a higher concessionality – over 66% grant element, with many proposals at 100%. This reflects the higher vulnerability of these countries, and the lower levels of economic development, which in turn further exposes SIDS and LDCs to the adverse effects of climate change.
- There appear to be no clear distribution patterns in other geographical based plotting.

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[24] https://www.oecd.org/dac/stats/What-is-ODA.pdf

[25] www.imf.org/external/np/spr/2015/conc/index.htm

Based on the analysis of the policies and of the graphs, there is little clarity in the application of the terms and conditions, with no eligibility criteria to determine which proposals would fit in the low concessionality/high concessionality group.

- Because of this, one can say that, on a portfolio level, proposals are consistent with the terms and conditions because they all fall within the given benchmarks. However, one cannot specifically say, at the level of individual projects, whether there is alignment with any particular level of concessionality, as those are determined on a case-by-case basis.
- The establishment of the terms and conditions table and the utilization of the GEC are elements of a rule-based approach. This approach gives clarity and predictability to the AEs in their conditions setting and in their negotiations with governments or clients. In our consultations we have heard two different views in this respect: on the one hand, a number of accredited entities mentioned that having rates and conditions already set (as shown in Table 4) gives them assurance and predictability, thus reducing negotiating time; on the other hand, other financial institutions mentioned that set terms and conditions, notable for interest rates, can run counter to ensuring that minimum concessionality is applied in revenue-generating public sector proposals.
- In addition, the absence of eligibility criteria in public sector non-grant structures also means that a proposal’s need for high or low concessionality will be determined on a project-by-project basis. Below we described possible benchmarks and data that could be included (or strengthened) to inform decision-making in the financing structure.

A rules-based approach to set terms and conditions could be considered as follows:

- On the basis of the scatterplot analysis and the observations above, we recommend that the GCF consider the introduction of guidelines, which would be stated expressly, with regard to terms and conditions where the pattern of decision-making is already clear.
- The stable pattern of setting levels of concessionality, as described above, means the GCF can be confident that the introduction of guidelines would codify decision patterns that are already in place, not impose a rule that would change the outcome.
- The provision of guidelines that reflects this existing pattern would make explicit a pattern that is anyway present but currently implicit.
- Further, we believe the GCF will enjoy significant benefits from making this framework more explicit because this additional transparency would reduce a potentially important source of transaction costs for any counterpart in dealing with the GCF: lack of up-front clarity on terms and conditions.
- Guidelines would help resolve this lack of up-front clarity, reduce uncertainty, lower the transaction costs of dealing with the GCF, and therefore accelerate the GCF's ability to finance projects and deliver impact more efficiently.

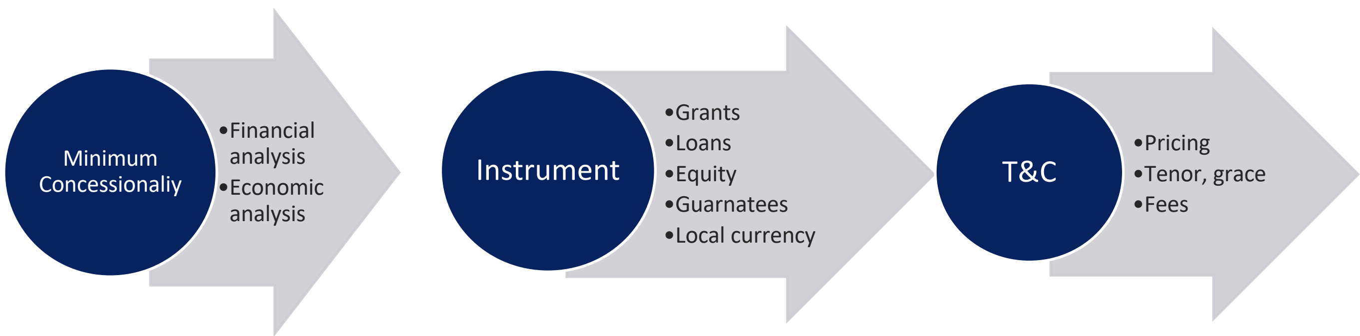
Table 7 Preliminary framework for a rules-based approach

Grant element			
0-32%	**33-65%**	**66-99%**	**100%**
Very low concessionality	Low concessionality proposals	High concessionality Proposal	Grant only
Number and percentage of number of proposals in each category			
15 (14 FP; 1 SAP)	6	7	41 (35 FP; 6 SAP)
21.8%	8.7%	10.1%	59.4%
To develop across: what typology of projects and financial instruments can be included in this range?			
e.g., Private sector proposals	e.g., Public sector projects with revenue-generating mechanisms	e.g., Public sector adaptation; all LDCs and SIDS	e.g., Public sector adaptation, SIDS and LDCs

A principles-based approach to set terms and conditions could instead be considered as follows:

- To consistently uphold the principle of extending the minimum necessary concessionality required, the economics of the proposal, as determined in the financial and economic analysis components, could drive a different approach to set T&C.
- Those are already provided to the GCF as part of the funding proposal packages, to determine the ratings in the Investment Criteria.
- Following the financial and economic analysis, the project / program can be appraised on the basis of its revenue generation (financial viability), which determined the most appropriate instrument that can be applied.

Figure 2 Other determinants of T&C setting (principles-based)



4.5.5 Private sector proposals

- Terms and conditions from private sector proposals are determined on a case-by-case basis and in light of their financial models, profitability ratios, and sensitivity analyses.
- In loan products, the availability of long-term financing is critical to overcoming one of the most common barriers to scaling up climate finance: the lack of long-term financing for the private sector in a number of strategic areas for the GCF.
- Accredited financial institutions – whether international or national – often have capital constraints in terms of ceilings that cap their participation in debt structures, with typical restrictions being at around 30-50 % of the total project value. This means that the rest of the financing may need to be covered by a mix of additional private sector participation, syndication, and public climate finance, such as via the GCF.
- Capital requirements set by the Basel III regulations on financial stability24 26 can also constrain banks, whereby they must hold capital against their assets. It can be argued that if there is an explicit or implicit risk arising from the climate components (e.g., higher technology risk, higher risk profiles of clients), then commercial banks may be disincentivized to take on that risk, considering that the regulations make no differentiation between green and standard finance, unless mechanisms to minimize or transfer that risk, such as through blended finance structures, are available.
- In the context of setting terms and conditions, pricing is an important element of concessionality. It is informed by the cost of business of that proposal, its economic and financial analysis, including financial models, in order to strike the right balance between financing requirements and the additionality of the proposal. The exact methodology for pricing is generally not disclosed in private sector operations.

4.5.6 Application of fees

- Different types of fees can be applied to financial instruments; those fees are included in the calculations to derive the grant element. The data indicates that where service fees and commitment fees are applied, they are within the parameters given by the terms and conditions table.
- In a number of cases, service fees have been merged with the overall applicable interest rate. In some cases, this was done to reduce the costs of the proposal for the client and simplify the costing structure, thus raising the level of concessionality and the grant element of that proposal.

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[26] For additional information on BASEL and their capital requirements, see here: file:///Users/martasimonetti/Downloads/DocapitalrequirementsinBaselIIIrestrictthefinancingofgreeneconomy%20(1).pdf; and https://www.investopedia.com/articles/economics/10/understanding-basel-3-regulations.asp

- We note from interviewers that in the case of public sector proposals, the application of commitment fees can raise the costs of borrowing for the client if they are applied on top of the interest rates.
- There is confusion among accredited entities regarding the application of service fees, which are often seen as a doubling of charges over the interest rate. When compared to other climate funds (e.g., Clean Technology Fund), the GCF fees may make the cost of the loan more expensive. Interviewees from both national and multilateral institutions mentioned this, with specific relevance for public sector proposals in lower-income countries.

5 POLICY RELEVANCE

5.1 SUMMARY

To what extent are the terms and conditions 'fit-for-purpose' to achieve the corporate targets that the GCF has set for its operations? This section makes a case for further guidance on the utilization of context-specific benchmarks, in line with practices from other institutions that offer both rule-based approaches and negotiations using financial and economic analyses.

At the portfolio level, determining terms and conditions and the appropriateness of the instrument based on specific barriers and contexts can enhance the overall effectiveness and efficiency of the distribution of climate finance globally. In this way, T&C and pricing reflect risk. Risk includes risks associated with the project (e.g., technology risk) and country risk. Having parameters within which to apply T&C can reduce negotiating times and offer more predictability to countries and entities.

Hurdle rates, profitability ratios, and ranges of discount rates based on the typology of instruments and project characteristics are important decision criteria that can facilitate the negotiations with clients, create additional transparency, lower the costs of doing business with the GCF, and increase investment rates and overall impact.

In this section, we also make further considerations on concessionality, pricing, and utilization of the grant element.

5.2 METHODOLOGY: BUILDING ON COMPLETENESS OF INDICATORS

The key question is to determine the extent to which the current terms and conditions are fit-for-purpose for the GCF to fulfill its mandate and deliver on its objectives. Here we expanded the indicators and benchmarks to include financial and economic criteria. In our interviews with task managers from both the public sector and the private sector team, we understand that some of the criteria are already considered as part of the economic and financial analysis at the time of concept notes and funding proposals submissions.

Building from the findings and recommendations of the previous sections, the below indicators could be benchmarked to achieve higher transparency in the choice of financial instruments, the determination of terms and conditions, and the concessionality level of each proposal. We think that these indicators can enhance the analysis of project characteristics and provide a reference template to strengthen the application and relevance of the T&C, both for private and public sector proposals and across all eight strategic areas of investment of the GCF. Those indicators are either accessible from public sources or can be developed or derived by the applying AE. GCF could also support AE is their efforts to complete proposals, including om the provision of the required analytics.

Some of these indicators are already captured within the context of the investment criteria, such as financial and economic indicators being part of the criteria on effectiveness and efficiency. Similar to recommendations made by Nodalis Conseil, we find a weak link between the criteria as outlined in the Investment Framework and the determination of the specific terms and conditions in a given proposal.

Table 8 Additional criteria to determine pricing, concessionality, instrument choice

Type of criteria	Detail of the analysis	Proxy / indicator to use
Financial analysis of the proposal	This is to determine the financial standing of the transaction including expected returns	Investment criteria: effectiveness and efficiency; profitability ratios (ROI, IRR); payback information
Degree of capital market development	To assess the degree of strength of capital markets to determine the overall breadth of available financial mechanisms and the cost of borrowing from the market.	Benchmarking from statistics on local capital market development
Macro-economic conditions	To assess the ability of a country to borrow	Index from IMF Debt Sustainability Framework; GNI
Economic analysis of the proposal	To compare the benefits of the intervention versus its costs; to consider social benefits.	Investment criteria: sustainability; impact potential; investment criteria (effectiveness and efficiency); EIRR
Interest rate stability/volatility	To assess the level of stability in the borrowing market of a country and risk minimization for businesses	Historic benchmark rates, e.g., captured on a yearly basis

Type of criteria	Detail of the analysis	Proxy / indicator to use
Countries' sovereign ratings	To assess the overall risks to investments as assigned by the major risk rating houses, e.g., Fitch Ratings, Standard & Poors, and Moody's.	Rating data at the sovereign level, e.g., as captured on a yearly basis
Known limitations or restrictions at the level of country or institutions	This is to assess whether there are already existing limitations on countries' borrowing as established by the IMF or by the entity, e.g., in grant-only situations.	Specific data arising or published by the institutions; credit risk framework of the AE

The introduction of additional context-based indicators could facilitate (or at least illustrate for the Board) the analysis of the needs of a proposal. For example, as financial terms and conditions for the private sector are set on a case-by-case basis, the GCF does not use specific ranges or thresholds (of profitability, of internal rates of return or IRR, for example) to determine the bankability of a proposal. For other criteria, such as ensuring a paradigm shift, climate impact potential or sustainable development may imply a cost. In these cases, thresholds (e.g., ranges for hurdle rates) could inform negotiations with clients, in particular for Direct Access Entities (DAEs). Early estimations of profitability are paramount for clients to establish their own cash flow and to determine the level of co-financing and concessionality needed. These indicators can be accessed or derived and can be done by the AE as part of their proposals, with the GCF as a back-up should there be difficulties in deriving this information.

5.3 EXAMPLES FROM DATASET AND OTHER INSTITUTIONS

Findings from public sector lending:

- In public sector lending, most DFIs determine lending rates, conditions, and choice of instrument on the basis of specific macro-economic characteristics, such as indebtedness and gross national income (GNI) per capita. Countries are generally included in specific groups, which are updated on a regular basis. These groupings ultimately benefit lower-capacity capacity countries, e.g., LDCs that are, in most instances, grant-only countries.
- In cases of public sector lending to LDCs by MDBs, the GCF terms and conditions do not appear to be competitive vis-à-vis public sector lending in developing countries. It was noted during the consultations with a number of accredited entities that, when all fees and interest rates are applied, the resulting costs to the counterpart may be too high. In those cases, grant-only or very concessional lending is appropriate.

- For direct access entities, GCF terms and conditions can be competitive, as GCF rates tend to be lower (i.e., more concessional) than those available from lenders in the country, in local currency. Co-financing with GCF in these cases can lower the overall costs of borrowing and provide access to a more comprehensive range of financial instruments. In addition, local currency lending for DAEs is also a much-needed instrument in order to lower certain risks and ensure a wider uptake of loan products.

Findings specific to private sector lending:

- Because of confidentiality agreements between the GCF and accredited entities, the terms sheets of private sector proposals could not be shared. (While CFA has a confidentiality agreement with the GCF, lack of disclosure in private sector operations is in line with market practice.) This limited our ability to study the financial information of these proposals and compare them to the market. The availability of granular data on financial terms and conditions and fees can inform analyses on the level of concessionality of transactions (e.g., by allowing comparison between mitigation and adaptation proposals).
- With respect to terms and conditions and concessionality levels in climate finance private sector operations, the DFIs included in this study apply the Enhanced Blended Concessional Finance Principles for Private Sector Operations, which include27:
    - Rationale: DFI support for the private sector should make a contribution that is beyond what is available, or that is otherwise absent from the market, and should not crowd out the private sector.
    - Blended concessional finance should address market failures.
    - Crowding-in and Minimum Concessionality: DFI support for the private sector should contribute to catalyzing market development and the mobilization of private sector resources
    - Commercial Sustainability: DFI support for the private sector and the impact achieved by each operation should aim to be sustainable. DFI support must contribute to the commercial viability of their clients. The level of concessionality in a sector should be revisited over time.
    - Reinforcing Markets: DFI support for the private sector should be structured to address market failures and minimize the risk of disrupting markets or crowding out private finance.
    - Promoting High Standards of conduct by clients, including in corporate governance, environmental impact, social inclusion, transparency, integrity, and disclosure.

- The private sector lending policies of relevant DFIs require that their debt be priced at an interest rate that reflects country and project risk. Interest rates on concessional loans, therefore, tend to

[27] DFI Working Group on Blended Concessional Finance for Private Sector Projects Joint Report, October 2018 Update.

be in line with market rates. Local currency loans generally come with a higher interest rate than Euro or US dollar-denominated loans.

- Relative to commercial bank financing, DFIs provide debt financing on terms that are 'concessional' insofar as one or more of the following conditions may apply:
    - longer maturities
    - longer grace periods
    - lower collateral requirements
    - subordinated debt or other forms of quasi-equity finance
    - anchor equity, to first capitalize an equity fund through donor or blended finance
    - risk minimization through co-financing and syndications
    - complementary technical assistance grant

- There are also non-financial elements or benefits that count towards 'concessionality,' such as the ability of a country to participate in the wider climate finance architecture; or socio-economic and environmental co-benefits ensuing from the investment.

In addition, each DFI uses its own internal pricing methodologies to determine the commercial price for financing a project. The commercial price would then be used to evaluate the level of concessionality from concessional sources using various types of discounted cash flow calculations[28] such as:

- Discounted cash flow difference
- Discounting the concessional flow
- Estimated commercial price from a simplified risk framework.
- Modeling revenues and expected losses.

[28] See for example: Annex 3 - DFI Working Group on Blended Concessional Finance for Private Sector Projects Joint Report, October 2018 Update

https://www.ebrd.com/documents/comms-and-bis/blended-finance.pdf?blobnocache=true

Table 9 Summary table of terms and conditions set by selected institutions

	Private	Public	Comments
IDA	Case-by-case depending on instruments, context Private sector window	Rules-based, regularly updated on the IDA website. The lending terms are determined with reference to recipient countries' risk of debt distress, the level of GNI per capita, and creditworthiness[29].	Recipients with a high risk of debt distress receive 100 percent of their financial assistance in the form of grants, and those with a medium risk of debt distress receive 50 percent in the form of grants. Other recipients receive IDA credits on regular or blend and hard-terms with 38-year and 25- year maturities respectively
CTF	Case-by-case	IDA terms	
EBRD	Case-by-case, based on Risk adjusted return on capital	1% over Euribor / Libor / benchmark	
ADB	Case-by-case: A loans B Loans Commercial co-financing Guarantees	Libor-based loans	ADB offers its sovereign and sovereign-guaranteed borrowers London Interbank Offered Rate (LIBOR)-based Loans (LBL) with a floating rate based on 6-month LIBOR plus an effective contractual spread and a maturity premium (where applicable) that are fixed over the life of the loan[30]
	Local currency loans	Local currency loans	
		Concessional lending; grant only countries	T&C are set but differentiated based on country characteristics

[29] http://ida.worldbank.org/sites/default/files/pdfs/ida_terms_effective_october_01_2019.pdf

[30] https://www.adb.org/documents/overview-libor-based-loans-sovereign-and-sovereign-guaranteed-borrowers

	Private	Public	Comments
			(group A, B or C)[31]
NABARD	Rate setting depending on client and product	Rate setting depending on client and product	Interest rates are published regularly, and they can be either fixed or variable[32]
Xac Bank	Market-based	Market-based	Negotiated on a case by case basis.
DBSA[33]			

5.4.1 Concessionality

The level of concessionality offered by the GCF is an important element of the terms and conditions for the financial instruments that the Fund deploys. There is currently no GCF policy on concessionality, although concessionality principles have been stated in a number of Board deliberations.

Board guidance on concessionality guides 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 the 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 manner34
- Consider linkages to other factors such as incremental cost, grant element calculation, co-financing, viability, economic and financial analysis, and risk premium.

Through a number of decisions, the Board has mandated the Fund to support the scaled-up implementation of climate action through the provision of finance in a manner that further supports private sector mobilization. In particular, the Board has mandated the GCF to leverage GCF interventions in a way that avoids 'crowding out' private sector investments and emphasizes actions that 'crowd in' additional finance.

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[31] https://www.adb.org/site/public-sector-financing/lending-policies

[32] https://www.nabard.org/interestrate.aspx?cid=502&id=24

[33] Awaiting confirmation of rates.

[34] Decision B.17/08

The Secretariat's approach to concessionality has evolved over time since the tenth Board meeting (B.10). Board discussions on concessionality reflect the complexities of designing guidance that includes multiple perspectives and views. Those appear to revolve around:

- Rules based-methodologies (e.g., based on specific characteristics) versus a framework to be applied on a case-by-case basis;
- Using country-categorizations outside UNFCCC and other concepts that "depart" from UNFCCC categories (e.g., use of income level or GDP, and the use of concepts such as blended finance);
- Leverage of other sources of funding;
- Interpretations of the purpose of concessionality;
- Interpretations regarding shifting financial risk to countries;
- Ensuring that concessionality deployed by the GCF is passed on to end-beneficiaries and does not benefit AEs exclusively; and,
- Unit analysis of concessionality, e.g., to simplify its calculation and interpretation by using the grant element (GEC calculation).

Table 10 Observations on concessionality approaches GCF/B.23/19[35]

Secretariat's proposed approach to concessionality	Board reactions
Proposed in GCF/B.10/06 "Levels of Concessional Terms for the Public Sector" Options for applying various levels of concessionality for the public sector: 1. Project-based: Levels of concessionality based on project characteristics, such as revenue generation and economic viability 2. Project and income level based: Levels of concessionality based on project characteristics and country income levels 3. Project, income level and vulnerability-based: Levels of concessionality based on project characteristics, country income levels and the degree to which the project targets vulnerable communities	• Absence of definition of vulnerability • Categorization of developing countries based on their income level contradicts the UNFCCC framework • Criteria relating to income and sovereign indebtedness is useful and should be taken into account • Proposed approach prejudges the ability of countries to promote a paradigm shift through the Fund • Need to consider countries' access to finance. • Need to take into account country capacities and existing debt structures • The level of concessionality must be determined on a case-by-case basis

[35] https://www.greenclimate.fund/documents/20182/1674504/GCF_B.23_19_-_Review_of_the_initial_investment_framework__Matters_related_to_incremental_and_full_cost_calculation_methodology_and_policies_on_co-financing_and_concessionality.pdf/30db3f98-4022-c306-8b06-2cec8f85e5e7

Secretariat’s proposed approach to concessionality	Board reactions
Proposed in GCF/B.19/12/Rev.01 “Concessionality: potential approaches for further guidance The proposed decision on further guidance on concessionality proposed the following three 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 3. Implement concurrently options 1 and 2 **Important to note that this item was opened but ultimately suspended. No decision was made by the Board*	• Concessionality should be calculated based on the characteristics and requirements of each project, not the overall characteristics or income level of the country concerned • A rules-based approach may not be consistent with the UNFCCC. Any country classification should be in line with the Governing Instrument • In a purely rules-based approach, entities co-financing GCF projects could use GCF concessional finance as a way to minimize their own concessional rates and financial risk • A rules-based approach helps in cost efficiency and predictability. GCF should build on existing work such as the “Hamburg principles” and the DFI Working Group on blended concessional finance for its private sector operations • Financial risks should not be shifted from GCF to developing countries. The purpose of GCF is to provide developing countries with funding that does not necessarily need to be repaid. • To maximize the transformational impact of a project, it would be necessary in certain cases to increase, rather than reduce, the concessionality offered

Secretariat's proposed approach to concessionality	Board reactions
Proposed in GCF/B.20/19 "Interrelated policy matters on incremental cost and full cost, concessionality, and co-financing." Proposed principles to determine concessionality: 1. Private sector projects: Case-by-case basis + 3 variables (climate impact, paradigm shift potential, the potential for reflows) 2. Public sector with reflows: Case-by-case basis + 3 variables (climate impact, paradigm shift potential and potential for reflows) within boundaries of T&C 3. Public sector no reflows: Per current T&C Secondary principles proposed: 1. Avoid market disruptions or crowding out private sector 2. Catalyze co-financing, crowd-in investors 3. Ensure sustainability of the intervention 4. Address root cause of market failures *Agenda item was not opened	From informal consultations conducted by the Secretariat, not shared during a formal Board session • Diverging views on the mobilization effect of the instruments or the grant equivalent and its size compared to alternative transaction structures • Restriction of the use of potentially highly efficient and catalytic grants to a very small number of projects • Absence of definition of the concept of reflows, particularly considering economic viability

5.4.2 Passing-on of concessionality

A concern expressed by several stakeholders is the lack of clarity in the way concessionality is captured and passed on, particularly in intermediated and programmatic structures with several sub-projects. Current policies and guidelines are silent in this specific area.

A revised set of terms and conditions could make it explicit in which cases concessionality ought to be passed on, and in which cases concessionality can be used:

- Concessionality may have a specific purpose, such as covering the costs of hedging the risk for local currency lending by the local partner banks. In the GCF proposals, the two cases where local currency has been deployed had used the concessionality to cover the cost of swaps, and then they offered the on-lending in local currency. These examples are detailed in the section below on local currency.

5.4.3 Pricing

Pricing is the process of determining the interest rate of a loan product. Pricing is one of the variables in the equation to calculate the grant element of proposals. Below is a table with some of the most common determinants of pricing in loan transactions.

Table 11 Typical determinants of pricing

Type of indicator	*Application*	*Comment*
Benchmark, reference rates	Libor, Euribor, Ameribor, other indexes	Widely used by financial institutions to set minimum benchmarks
Project spread, credit default spread		Determined by project characteristics and based on technology risk, credit risk, liquidity, inflation forecasts.
Lender's access to capital market	Corporate credit rating	The higher the rating, the lower the cost of borrowing of that institution (e.g. bank) in capital markets; this can result in 'cheaper' loans
Borrower's access to capital markets	Corporate credit rating and sovereign credit rating of the country	Rating of the borrower will affect risk profile and thus cost of borrowing
Grace periods	Over 1 year	De facto a subsidy; it enhances loan profile
Longer tenor	Over 15 years	De facto a subsidy; it lowers the overall cost of borrowing. It provides a product that often doesn't exist in commercial financing.
Local currency	Buffers for forex fluctuations; cover the costs of currency swaps	May lower needs for subsidy and concessionality. Borrowing in local currency may be more expensive.
Guarantees	Callable guarantees, Guarantee revolving funds Insurance packages	To address, absorb, or transfer certain risks. The presence of a guarantee may lower the price of a loan.

In addition to the references above, a pricing strategy will also benefit from a close alignment to the corporate strategy of the Fund. For example, scaling up riskier investments or maximizing the climate impacts in a proposal may entail costs and may also have some future benefits from earnings and savings that need to be quantified. Cost-benefit and risk-return trade-offs are key aspects of pricing. The higher the credit, technological, or political risks, the higher the cost of borrowing. In this respect, concessionality is seeking to re-adjust the pricing towards a level that is accessible by the borrower.

For example, if we were to look at pricing from a purely market perspective, risk would be reflected in higher prices (through higher interest rates, or additional expenditure for risk transfer instruments). If no concessionality were offered, some projects would not realize because of their market / credit / technological risk, or for lack of collateral or sufficient capex (i.e. capital for physical expenditures). In concessionality, the subsidy that is offered is dependent on context, and seeks to answer the following questions: what is the risk / barrier / failure that climate finance is seeking to rectify? What is the best instrument to achieve this? Which is the best executing entity to do that? What are the most appropriate terms and conditions?

5.4.4 Considerations on GEC and concessionality

Using the value derived by the GEC calculation ("the grant element") can be useful to obtain a summary value of the degree of concessionality in proposals, based on the terms and conditions applied, as well as the investment itself (e.g., grant, high or low-interest concessional loan). This calculation can be useful to summarize concessionality into a single understandable figure, yet its validity rests on using the appropriate discount rate. The appropriate discount rate could be derived by using the weighted average cost of capital (WACC), a tool to assess an investor's returns on an investment in a company. The discount rate is a widely used tool on climate and development finance to provide 'summary' indicators of the terms and conditions applied, which can, in turn, give insights into the nature and size of the concessionality of a proposal. Currently, GCF and IMF use 5%. This rate can be appropriate for public sector proposals but may skew results in private sector proposals, which require different discount rates. The current model (i.e., the GEC that GCF uses) can support the changes in the discount rates in the calculation.

Utilizing a uniform discount rate enables broad comparisons across the GCF portfolio, while a differentiated rate provides the most precise and accurate estimate for a particular project. From consultations with GCF staff members, we understand that using differential discount rates may also be difficult for many GCF projects, as the discount rate should be based on the cost of capital in-country. However, financial markets in many GCF countries do not provide financing for such long tenors, which is the reason GCF funding is requested, meaning that a discount rate based on a long-term cost of capital cannot be precisely estimated. In this respect, a revision of the Grant Equivalency calculator (e.g., GEC 2.0) could benefit from: (a) the introduction of a conceptual component that could aid countries and entities to determine the best ranges of grant elements depending on project characteristics; (b) the model to include different assumptions for the discount rate percentage, with differentiation based on instruments (equity; loans; grants); on project context characteristics; on country-level macroeconomic and financial market indicators; (c) the calculator to allow for manual changes in all variables (including discount rate settings).

6 POLICY IMPROVEMENTS

6.1 SUMMARY

The Fund has a unique mandate to realize a paradigm shift toward low-carbon and climate-resilient development. The draft Strategic Plan 2020-2023, published ahead of B.24, offers high-level direction for the development of the theory of change towards a more ambitious paradigm shift. The Strategic Plan sets the goal of broadening the use of financial instruments, for example, by using more risk mitigation and risk transfer instruments in addition to the currently used instruments (primarily grants and concessional loans) as a means to link the Board's risk appetite to GCF funded projects.

To this end, the following instruments are considered by the consultants' team, as important developments for the GCF:

- **Guarantees** can be effective instruments to either reduce or transfer risk in order to mobilize investors and reduce the cost of capital. Despite these potential benefits, guarantees have been rarely used in GCF proposals.
- **Local currency lending** would support local capital markets development and to reduce project risk, as it boosts resilience by alleviating countries' and/or final beneficiaries' exposure to foreign currency risk. The utilization of local currency lending is currently also limited in GCF proposals.
- **Equity**, while provided for as an instrument in the initial GCF Instrument, could be more utilized. Equity has untapped potential to provide the initial support (or 'anchoring") of concessional capital and the mobilization effect needed to catalyze private sector investment further.
- **Other innovative financing structures** that could also be considered for development in the medium term – include:
    - supporting the issuance of green bonds (e.g., in local currency platforms);
    - direct co-financing in crowdfunding and impact investment platforms.

To ensure greater effectiveness and efficiency in the delivery of climate finance by the GCF and to help the GCF achieve greater impact, the above instruments could be deployed more widely. We propose a number of modalities to give an illustration of the possibilities available for the structuring of the instruments. We do not assess the costs of guarantees or local currency lending platforms, which should be undertaken once (a) the possibility of utilizing these additional instruments is approved, and (b) the modalities for operationalizing the instrument are approved.

6.2 GCF'S STRATEGIC VISION, GOALS, AND RISK APPETITE

The Fund has a unique mandate to realize a paradigm shift toward low-carbon and climate-resilient development.

In recent years, we have seen a gradual shift in climate finance to introduce additional financial instruments and modalities to complement grant financing. Several bilateral and multilateral funds have begun providing non-grant instruments, including concessional loans and concessional equity. More recently, blending in climate finance is also taking stock of a wider range of "innovative" instruments and modalities, such as guarantees, insurance, revolving funds, incentive payments, securitization, green bonds, and pay-per-service models. The draft Strategic Plan 2020-2023 published ahead of B.24 sets the strategic goal of using more risk mitigation/risk transfer instruments as opposed to concessional finance as a means to operationalize the Fund's risk appetite. As also confirmed by the Forward-Looking Performance Review of the Fund, equity and guarantees are currently underutilized.

Shifting away from concessional lending and increasingly to the deployment of risk mitigation and risk transfer instruments will require a higher degree of risk-taking by the GCF. The Fund's risk appetite[36], as stated in its Risk Management Framework, allows the Fund to take more risk in order to achieve higher impact. The risk appetite statement provides a framework for the Fund's investments and operations, as follows:

i. The GCF seeks a stable and moderate enterprise risk profile which will enable the Fund to ensure adequacy and predictability of financial resources, maintain a well-balanced portfolio of projects/programs consistent with the principles of country ownership and the Conference of the Parties' guidance, and operate in a transparent, accountable, and efficient manner.
ii. In order to realize significant impact and promote a paradigm shift to meet the Fund's strategic objectives, the Fund is willing to accept uncertainties around investment risks in return for impact potential, which is to be evaluated on a case-by-case basis recognizing the specifics of each proposal. The Fund will strive to mitigate program risks to provide reasonable assurance that investments can fulfill their stated objectives.

[36] Decision B.17/11 Annex VI: Risk Management Framework component II – risk appetite statement

6.3 GUARANTEES

6.4.1 Introduction to the instrument

Guarantees can be effective instruments to either reduce or transfer risk in a transaction and to enhance the credit / risk profile of a borrower, in order to mobilize investors and reduce the cost of capital. A full or a partial guarantee can enhance the risk profile of a client, potentially leading to upgrades in their corporate credit ratings, which in turn reduces their costs of borrowing. Despite these potential benefits, guarantees have rarely been used in GCF proposals. To date, almost 90% of funding allocated by the GCF has been in the form of grants and senior loan instruments, with only 9% equity investments and 2% guarantees[37]. This corresponds tothree funding proposals. Extending the use of guarantees and other credit enhancement products (such as insurance packages) can be significant in supporting the GCF in its efforts to maximize the leverage of public funds and in reaching its corporate targets.

Typically guarantees can minimize or transfer:

- Variability in revenue / Revenue risk;
- Variability in performance (e.g. of technologies);
- Technical/project risk;
- Financial risk;
- Lack of creditworthiness of buyers/off-takers;
- Lack of scalability of small-scale projects;
- Asset liabilities, e.g., on collaterals.

GCF has deployed guarantees in three funding proposals, listed in the table below. A more comprehensive description of these projects is also included in Annex 3.

Table 12 GCF Proposals deploying guarantees

• **FP048 - Guatemala, and Mexico (IDB)** This is a proposal for a low emission climate resilient agriculture risk-sharing facility for MSMEs. The total guarantee size is USD 1.5 million out of USD20 million GCF investment for a total

[37] https://www.greenclimate.fund/what-we-do/portfolio-dashboard

project value of USD158 million.
• **FP071– Vietnam (World Bank)** This is a proposal for scaling up energy efficiency for industrial enterprises in Vietnam. The project benefited from a USD 75 million guarantee by the GCF as part of a GCF Risk Sharing Facility. This is the largest guarantee among the three FPs providing this instrument and the only project where the guarantee is the primary financial instrument.
• **FP093: Burkina Faso (African Guarantee Fund)** The proposal is for the Yeleen rural electrification project in Burkina Faso. Guarantees are used as one of the financial instruments for a total project investment of USD 59 million. GCF financed a guarantee of USD 3.1 million out of USD28m total GCF investment to cover the loans extended by a micro-finance institution for the purchase of productive use equipment by rural entrepreneurs and support for the development of micro-businesses.

6.4.2 Barriers for GCF

GCF lacks a corporate credit rating, which means that callable guarantees from the Fund would require 100% cash provisioning, i.e., set aside as a capital reserve, for the reasons explained in the paragraph below.

Typically, guarantees provided by banks are considered by the beneficiary against the rating of the bank, the risk profile of the portfolio, and the size of the callable capital, which indicates financial standing of the institution, and the likelihood that it will be able to honor a guarantee in case it is called[38]. An A-rated bank would, for example, provision 10-15% of the guarantee, which serves the function of reducing risk exposure in a transaction, but without apportioning or setting aside capital for the entire guarantee. Guarantees issued by banks are therefore quite efficient in terms of capital utilization.

The inability to partially provision means that guarantees issued by the GCF need be provisioned at face value (i.e., 100% of the committed amount) since from the perspective of the beneficiary of the guarantee there is no certainty that any provisioning shortfall could be made up by the Fund in the future. Even if the GCF were not transferring the guarantee amounts to the AEs, those resources are committed and cannot, therefore, be fully or partly invested in other income-generating activities.

[38] For example, the DBSA has callable capital (ZAR 20 billion or USD 1.4 billion as of July 2019), representing "high capital buffers" compared to ZAR52 billion in borrowing. The capital base was scaled up from ZAR 4.8 billion in 2010 in an attempt to boost the bank's delivery mandate and its ability to support infrastructure investment in public entities (https://www.iol.co.za/business-report/economy/more-security-afforded-to-dbsa-699915).

Combined with the normally much lower pricing for a guarantee, compared to a loan, this makes a guarantee a very inefficient financial instrument for the GCF at present.

Obtaining and maintaining a credit rating is a comprehensive process, however one that while it has costs, it also presents with several opportunities, such as those described above. In a nutshell, it can widen the possibilities of the GCF to offer more resources and instruments[39].

Table 13 Theoretical example of provisioning of guarantees

	Resources available for guarantees	Products extended	Provisioning of capital against the guarantee	Need to disburse or set aside	Resources available for other projects
GCF (no rating)	$100 M	$50 M	100%	$50 M	-
		$50 M		$50 M	
A-rated Financial Institutions	$100 M	$50 M	20%	$10 M	$80 M
		$50 M		$10 M	

The table above illustrates a situation whereby GCF (no rating) and another A-rated financial institution are given a similar set-aside to be used in guarantee instruments. With no rating, GCF will find it necessary to provision 100% in order to overcome the possible risk of lack of resources further down and during the implementation of the investment. For a rated institution, there is the assumption that the ratings reflect its creditworthiness based on a number of checks by a rating agency (financial and non-financial factors, including key performance indicators, economic, regulatory, political factors, management, and corporate governance attributes, and competitive position[40]).

In terms of obtaining a rating, there are several elements of risk that could affect the Fund's ability to receive a rating. Importantly, the GCF has a high share of grant-only projects in its portfolio, with a limited amount of reflows from interest-bearing loan repayments. The risk inherent in the underlying portfolio is also determined by the fact that many operations have long grace periods and tenors, and by a triple-layered risk exposure of (i) final beneficiary risk, (ii) AE risk, and (iii) country risk,

[39] In a way, we could look at this process in the same way as GCF seeks to understand all processes and fiduciary standards of prospective accredited entitles at the time of the accreditation. More specific information can be found here: https://www.fitchratings.com/research/structured-finance/the-ratings-process-22-05-2019

[40] For further information, see: https://www.spratings.com/documents/20184/760102/SPRS_Understanding-Ratings_GRE.pdf

to which the reflow forecasts are exposed.

While cash deposits in the GCF trust fund could be considered, those are dependent on the regularity of payments of pledges from contributors. In addition, pledges made but paid only over a number of years may also entail forex risk. This situation may be considered high-risk by rating agencies. In addition, while guarantee instruments can absorb or transfer risk, and may indirectly increase other lenders' confidence into a proposal, they do not themselves provide much needed long-term capital for capital expenditures and operating expenditures.

Because of this, the perception from accredited entities is that the GCF is not yet ready to deploy guarantees in a way that is cost-effective vis-à-vis, for example, subordinated debt. Their key concern centers on the view that guarantees have not been primary instruments for the GCF, and as such, there is more limited expertise and capacity vis-à-vis other guarantee providers. For example, European institutions have access to the European Fund for Sustainable Development (EFSD), which is one of the EU financial instruments for development aid policy, with a dedicated financing pillar that includes blending and guarantee instruments. This fund is guaranteed by the External Action Guarantee (EAG), with a provisioning rate ranging from 9% to 50%.

In addition, other factors limit the demand for guarantees from the GCF, including:

- Limited knowledge or appetite for guarantees by NDAs;
- In some instances, a subordinated debt position is more cost-effective compared to a guarantee to achieve the climate impacts of a proposal; and,
- In some cases, a highly publicized guarantee, such as the type that is offered by the GCF, can discourage demand from some AEs (for example, for private sector entities) that prefer a 'silent' guarantee, in order not to create a disincentive for repayment by the borrowers.

6.4.3 Selected examples from other institutions

Callable guarantees and contract-specific or product-specific guarantees are deployed by a number of institutions and funds. These include, for example:

- Energy Savings Insurance: An instrument to guarantee the financial performance of energy efficiency savings projects for SMEs in developing countries (IDB);
- Callable guarantees (all MDBs);
- Contracts for Difference (Regulators).

See Annexes 2 and 4 for further examples.

6.4.4 Structuring

Guarantees can be structured in different ways:

- As a full callable guarantee linked to a project or program. This type of guarantee can support additional capital flows by allowing investors to transfer part of the risk. This is a common product offered by banks to clients. In this case, it is important to determine the percentage of provisioning that is required by the accredited entity requesting the guarantee, which is now typically 100 percent in the case of a GCF-backed guarantee.
- As a partial callable guarantee, with a predefined window, time-limited; this type of guarantee is generally used to cover temporary asset-liability mismatches.
- As a revolving guarantee fund, part-funded by an initial grant, with additional revenues from fees paid by the service user. A successful revolving fund will ultimately be self-sufficient, i.e., no additional grant contributions are needed. Proceeds from the guarantee funds can be deployed to guarantee or insure a specific element of a program (e.g., energy savings guarantee). The floating resources of the revolving fund would need to be invested in a mix of long-term, medium-term, and short-term vehicles in order to ensure that the guarantee fund self-generates revenue and remains liquid. Revolving funds can be used in all strategic / sectoral areas and can be structured as one of the components in a program, where they serve as a risk mitigation instrument.
- As a specific 'contract-guarantee" product, such as guarantees for power purchase agreements (PPAs, a contract between the purchaser /off-taker and a privately-owned power producer), and contracts for difference (CfD, a long-term contract between, for example, an electricity generator

and Low Carbon Contracts Company (LCCC) for the establishment of a set price for the energy[41]). These products can incentivize investment in renewable energy by providing project developers (who would typically bear high upfront costs for capital expenditure and long lifetimes for returns on investments) with direct protection from volatile wholesale prices, and they protect consumers from paying increased support costs when electricity prices are high.

Below we give estimates on the potential pricing of guarantees, based upon the assumed level of concessionality that a proposal has, with different pricing for different concessionality levels. For the private sector, the market pricing is indicative and will also include variations in price on the basis of other factors, such as risk profile of the client.

Table 14 Draft and indicative pricing for a full or partial guarantee

	Market	Low concessionality	Medium concessionality	High Concessionality
One-off Registration or front-end fee[42]	1%	0.75%	0.50%	0.25%
Guarantee fee[43] [44]	1.5% ± market spread	1%	0.75%	0.5%
Commitment fees[45]	0.5- 1%	0.25-0.5%	0.1-0.5%	0- 0.25%
Maximum guarantee period	Same as loan tenor	Same as loan tenor	Same as loan tenor	Same as loan tenor

[41] Contracts for difference have been piloted by the UK government. Additional information can be found on: https://www.gov.uk/government/publications/contracts-for-difference/contract-for-difference

[42] As percentage of guarantee amount. This can be of a full guarantee or of a partial guarantee.

[43] As a percentage of the guaranteed portion of the principle and interest outstanding. It can be paid semi-annually or annually. In comparable markets, the length of tenors may also affect the rates of the guarantee fee, i.e. the longer the tenor, the higher the fees. See for example IDA (tables in annexes).

[44] For guarantees to private sector loans, guarantee fees may reflect also additional costs based on a number of other factors such as risks, client's equity etc.

[45] As a percentage of the guaranteed principle that is not yet disbursed.

Table 15 Draft / indicative pricing and structure for a revolving guarantee fund

	Market	Low concessionality	Medium concessionality	High Concessionality
Revolving fund				
Grant capitalization	n/a	Aim for 20% to 40% of platform	30% to 50%	60-70%
Users' service fees	Market-based	Market-based minus context-based discount	Market-based minus context-based discount	Market-based minus context-based discount
Revenue from medium and long terms investment of platform	Market-based	Market-based	Market-based	Market-based

6.4.5 Recommendations

In the short term, we recommend that the GCF consider structuring guarantee products as a revolving fund or as a specific contract-guarantee to PPAs and CfD. Those structures do not require a corporate credit rating of the GCF by a rating agency.

In the medium to long-term, GCF can initiate the process of obtaining a corporate credit rating on the basis of:

- Forecast of reflows over time;
- Forecast of payment of pledges;
- Cash on its balance sheet.

This will allow the GCF to reshape the risk attached to the currently low levels of reflows and to the lack of predictability of payments of pledges, which in turn can allow for a corporate credit rating to be provided and for partial provisioning of guarantee products. Over time, partial provisioning will support several projects and programs with leverage.

As illustrated by the table below, seeking a rating to enable the deployment of guarantees may entail higher risks than the other structures proposed. In the former case, the process may be lengthier and costly, and there is uncertainty as to the result. In other cases, guarantees as part of a proposal do not incur additional processing / institutional risk to the GCF.

Table 16 Draft and indicative pricing for other guarantee products

Product type	Process	Timelines	Risk profile
Guarantee Revolving Fund	Structured as part of a proposal, with separate fund management and account	Short-term	Low (can be structured as part of a programmatic proposal)
Contract Guarantees (PPAs, CfDs)	Structured as part of a proposal	Short-term	Low (can be structured as part of a proposal)
Callable guarantees (full or partial)	Establish the process to obtain corporate credit ratings with one Credit Agency	Medium-term	Medium (process, uncertainty over rating, potential cost and capacity issues)

6.4 LOCAL CURRENCY LENDING

6.5.1 Introduction

The development of local currency finance remains a challenge in many developing countries due to high exposure to currency risks. Local currency lending is paramount to support local capital markets development, as it boosts resilience by alleviating countries' vulnerability to foreign currency risks (Brouwer, 2019, Financial Times). The level of foreign currency debt affects the stability of economic growth, the volatility of capital flows, and the credit ratings of emerging economies (Eichengreen and Hausmann 2005).

Entities in developing countries are exposed to exchange rate risk when borrowing from the GCF. Revenue streams and budget lines of GCF funding proposals are usually defined in local currencies, yet GCF financing is deployed in hard currencies, and repayments have to be made in hard currencies as well.[46] This situation exposes the end-beneficiary to risks, and as a result of these risks, may ultimately undermine any concessionality that may have been extended.

For foreign investors, foreign exchange (FX) risk is a significant barrier to investment in developing

[46] Risk Dashboard Q4 2018 https://www.greenclimate.fund/documents/20182/1141761/GCF_Risk_Dashboard_-_Q4_2018.pdf/54a85533-0280-807c-92a5-96dd1a9d7c7f Note this data does not yet take into account potential changes in the portfolio based on proposals approved at the twentieth second meeting of the Board on February, 2019

countries. Financing in local currency may be a concrete way in which the GCF could take risk strategically and broaden its paradigm shift potential to catalyze shifts in financial flows and strengthen local capital markets, which supports the broader paradigm shift.

The deployment of GCF resources in local currency has broad support within the Secretariat, the Board, and accredited entities. Currently, the concessionality offered is used to buy a currency swap, if one is available, which reduces the risk exposure of the client to the currency fluctuations. However, typically, from a client perspective, borrowing in USD or EUR (or, theoretically, any other major currency) bears lower interest rates than borrowing in local currency. This trading between local currency and interest rates, with subsidization used to hedge the risk, can be structured in countries with stable and developed capital markets, such as in the case of the two proposals (DBSA and NABARD, see below) but would not be feasible in frontier markets, with less developed capital markets and higher interest rate volatility.

Key advantages of local currency lending include that it:

- Mitigates the currency risks involved in foreign currency borrowing (where borrowers are more vulnerable to overheating, macro imbalances and systemic risks which prevent them from being able to pay the loan back);
- Addresses currency mismatches, as it matches the currency denomination of assets and liabilities, which enables companies to focus more on their core business rather than on managing exchange rate movements;
- Assists sectors that are crucial for sustainable development, such as infrastructure, housing and SMEs (who are particularly vulnerable to currency exchange rate fluctuations);
- Develops local capital markets (in terms of resilience especially), which have been linked to economic growth; and,
- Improves debt sustainability by contributing to debt predictability.

Table 17 GCF utilization of Local Currency Lending

FP081: Line of credit for solar rooftop segment for commercial, industrial, and residential housing sector (National Bank for Agriculture and Rural Development NABARD) This program has requested USD 100 million from the GCF in the form of senior loans to address barriers to low-carbon investments by enabling access to credit to local solar rooftop developers. Per the proposed structure and financial model, NABARD will on-lend GCF funding to the executing entity, Tata Cleantech Capital (TCCL), in local currency (Indian rupees). In turn, TCCL would provide loans to solar rooftop developers. Per the funding proposal, NABARD will assume the FX risk of repaying the funding in USD.
FP106: Embedded Generation Investment Program (Development Bank of Southern Africa DBSA) DBSA requested USD 100 million from the GCF to structure a credit support mechanism to support non-sovereign backed Power Purchase Agreements (PPAs) for renewable energy projects in South Africa, implemented by private sector entities and local governments. DBSA committed to entering into appropriate hedging arrangements to cover the entire tenor of the relevant program loan, including swapping arrangements with commercial banks on behalf of the sub-borrowers. As described by DBSA, the hedging arrangements would ensure that any South Africa Rand (ZAR) amounts received from the relevant sub-borrower for the GCF-funded portion of the program loans are converted to USD, so that payment obligations from DBSA to the GCF are fully met.

6.5.2 Barriers

The GCF cannot take the forex risk in any transaction at the fund or at the portfolio level. The "Amended and Restated Agreement on the Terms and Conditions for the Administration of the Green Climate Fund Trust Fund between the Green Climate and the International Bank for Reconstruction and Development (IBRD) serving as the Interim Trustee of the Green Climate Fund Trust Fund," provides for contributions to be made in any of the holding currencies (US dollar, Euro, Japanese Yen, and GBP sterling). In terms of disbursement, no specific reference to currency risk is made in the main text, although the above Agreement cross-references other applicable GCF policies in Attachment A. The Terms and Conditions table also specifies that instruments be offered in major convertible currencies only.

If we look at all the Trustee Reports on the GCF as one of the Financial Intermediary Funds, disbursements in transactions are made in either EUR or USD[47]. Similarly, the trust funds or special

[47] For all Trustee Reports on GCF, please check https://fiftrustee.worldbank.org/en/about/unit/dfi/fiftrustee/reports?fundName=GCFTF&folderName=Summary%20Status%20Reports

funds of DFIs and MDBs cannot take on the forex risk associated with financing via the GCF (or other climate funds such as CTF and GEF), as part of their statutes. In addition, in the absence of a corporate credit rating and lacking a full treasury function, the GCF cannot itself buy swaps or hedging products.

Country macro-characteristics can also affect the availability of platforms for local currency, including:

- Exchange rate policies;
- Poorly regulated and/or capitalized banking system;
- Lack of credible market indices, liquid money markets, and secured instruments;
- High domestic interest rates; and,
- Inadequate market infrastructure.

There are currently no guidelines in terms of who bears the cost of hedging within a GCF proposal. In this respect, the GCF could benefit from a more formalized approach or issue paper specifically on local currency lending, and its benefits to the operations and goals of the Fund.

6.5.3 Structuring and Recommendations

In the absence of a GCF-led treasury function, GCF is not able to exchange currency or issue local currency bonds itself. There are, however, other possibilities to overcome this barrier:

- In order to scale up local currency lending in its portfolio, the GCF could structure a local currency lending platform as a revolving fund, with initial partial capitalization from contributors in the form of a grant and additional revenue generated from service fees that are charged to service users. The fund could either partially subsidize the costs of currency hedging in an investment or guarantee to cover the loss ensuing a currency devaluation up to a pre-determined amount. In addition, the revolving fund could be invested in a mix of short, medium, and long-term products (as part of the fund's financial investment strategy via its trustee or fund manager). This is a structure similar to the Currency Exchange Fund or TCX[48] but could be targeted to frontier markets not covered by currently available instruments. Alternatively, GCF could work closely with or alongside existing platforms such as TCX, to cover the specific gaps not covered by TCX (for example, in frontier markets).
- In addition, the GCF could pilot a partial subsidization of local currency platforms in a selected number of MDBs and NDBs in order to issue green bonds in local currency, which will strengthen the domestic debt capital markets in the countries of operation of the GCF. This type of platform could widen the range of currencies utilized by the GCF. Even so, it may not be sufficient for the

[48] https://www.tcxfund.com/about-the-fund/

GCF to enter frontier markets, e.g., in countries with underdeveloped capital markets and unstable currencies.

- Terms and conditions could be more explicit in defining and detailing the potential trade-off between concessionality and the cost of hedging, with the possibility for the AE to transfer a portion of the concessionality received to cover the costs of hedging or to buy a currency swap. Typically, the more developed the capital markets, the lower the costs of hedging (which may imply that a lower concessionality may be needed). On the other hand, the less developed the capital markets, the higher the likelihood that some products are not available, or too risky, and therefore more expensive (which may justify a higher level of concessionality). This is a situation that needs to be addressed on a case by case basis and on the merits of the project, for example by seeing whether the borrower is in need of liquidity at a lower cost or to protect repayments against currency fluctuations.

Table 18 Draft and indicative structure for currency platforms

Product type	Process	Timelines	Risk profile
Local currency lending revolving fund	Set aside proposal as GCF-managed fun, up to 50% concessional (grant) contribution as first capitalization.	Short-term	Low (can be structured as part of a programmatic proposal; can achieve target to reach frontier markets)
Local currency lending platform (bonds)	Working with AEs, national entities	Medium-term	Medium (process uncertainty; may still not tackle frontier market)

6.5 EQUITY AND OTHER FINANCIAL INSTRUMENTS

6.6.1 Equity

Equity can be utilized in all strategic areas of investment of the GCF. Concessional equity, in particular, can serve as an anchor (i.e. initial, start-up) investment (and thus catalyze additional financing, in particular from the private sector) and can take a subordinated position as first loss, or as an equal investor to other investors (*pari passu*). Equity may also be structured alongside debt financing and other risk mitigation products.

Equity is among the instruments (alongside grant financing and concessional lending) provided for in the GCF Instrument. Yet, its utilization remains limited compared to other instruments, as it entails – or is perceived to entail -- higher risk. The Forward-Looking Performance Review of the Fund has also confirmed the need for the Secretariat to create a culture of risk-taking and innovation. Some AEs noted they feel discouraged to bring some more 'innovative' transactions to the GCF, such as guarantees and equity by the complex and lengthy GCF assessment process. Therefore, they prefer applying for standard loans and more straightforward financial structures.

Under the current terms and conditions, the GCF could already expand on the utilization of equity, providing:

- Start-up capital;
- Anchor equity, or equity that can be the starting capitalization into the equity fund, thus “anchoring’ the capital to attract additional investments into the fund itself;
- First loss / C-shares to boost investors’ profitability by enhancing expected rates of return, for example, the internal rate of return (IRR), or overall a general rate of return (ROR);
- Asset build of dedicated CAPEX investment (that is capital expenditure for physical infrastructure, goods, and material); and,
- Growth capital.

GCF could formalize the above understanding on equity in an Equity Strategy. This Strategy could also include ways or approached to then operationalize strategy itself, for example by creating dedicated set-asides for equity products at GCF. Several set-asides could be created for different types of equity, for example for start-up, acceleration, venture.

6.6.2 Other instruments

- The GCF could consider direct green/resilience bond purchases with defined use of proceeds, similar to MDBs/DFIs, for example, accepting a lower return or subordinated position, or provide a guarantee to investors in local currency-denominated bonds.
- The GCF could pilot the use of securitization to bundle smaller projects together and / or to provide off-take for project developers (thus releasing equity / liquidity for new assets), similar to the structure trialed in FP099 with FMO.
- The GCF may wish to consider direct investment in or co-financing of crowdfunding platforms (with impact investors or impact / ethical banks).

6.6 RECOMMENDATIONS ON FORMAT AND TIMELINES OF FUTURE REVIEWS

In addition to the lessons from this analysis of the financial terms and conditions of the GCF and all instruments, the review also made recommendations with respect to the future timing and structuring of the review itself.

In decision B.BM-2019/08, the Board asked the Secretariat to conduct biennial (every two years) reviews of the financial terms and conditions of the GCF financial instruments, based on approved terms of reference, and report to the Board the outcome of these reviews.

The authors of this review suggest that it may be appropriate for a subsequent review of the terms and conditions of the financial instruments of the GCF to take place three years after the presentation of this current review before the Board. This would allow sufficient time for the Secretariat to operationalize the proposed recommendations in 2020, to observe patterns arising from implantation of changes, and to be able to gather initial findings from the changes.

Therefore, the terms of reference for the third review could include:

- Review of the portfolio from B.24 projects onwards (to a predetermined Board three years after the presentation of the review, e.g., B.33 or B.34, spring 2023);
- Verification and considerations of changes made in the guidelines for the application of the terms and conditions, and considerations as to whether there have been efficiency gains in the negotiations of T&C, concessionality, and pricing as a result of the changes applied;
- Review on the enhanced the rationale and utilization of the GEC; and,
- Review of the application of additional instruments, in particular, guarantees local currency and equity, as proposed in this review.

7 CONCLUSIONS

This review has studied the terms and conditions of the GCF financial instruments and the ecosystem of policies, formal decisions as well as key stakeholders around the application of T&C, from three main perspectives:

- Consistency and compliance in the application of terms and conditions in GCF funding proposals;
- Relevance and 'fit-for-purpose' nature of the current terms and conditions; and
- Policy adjustments and selection of additional instruments.

The current terms and conditions offer a flexible framework, within which proposals are appraised based on context-specific elements. This approach is intended to strike a balance between rule-setting, predictability, and standardization on the one hand and responding to the needs of the project and of the recipient country on the other hand. In this respect, we provide two different ways in which the financial terms and conditions could be strengthened, in order to further enhance the effectiveness and efficiency of the Fund, and ultimately its ability to scale up climate finance in developing countries: a rule-based approach, on the basis of established patterns; and a principle-based approach, which rests on the economics of the proposal in order to uphold the principle of extending the minimum concessionality needed for a proposal to become viable (technically and financially). Both proposals will aim to support the consistency in the application of the terms and conditions, for example, across the same result area and across ownership type (whether private or public sector).

Relevance and the ‘fit-for-purpose’ nature of the terms and conditions can be strengthened through the inclusion of additional indicators and benchmarks, guidelines for the application and interpretation of terms and conditions and their policies. This includes recommendations on merging fees, the strengthening of the arguments for the utilization of the grant element as a summary indicator of concessionality levels, considerations on the linkages between pricing and concessionality, and finally an overview of a case where concessionality can be swapped by the AE to provide local currency on-lending.

Finally, this review concludes that in order to ensure further effectiveness and efficiency in the delivery of climate finance by the GCF, certain instruments – such as guarantees and local currency lending – could be added to the range of available instruments. We proposed a number of modalities to clarify how those instruments could be deployed to give an illustration of the possibilities available for the structuring of those instruments.

The proposed recommendations entail different levels of risk for the Fund and can also be undertaken in stages.

Below is a table that seeks to position recommendations by their assumed level of risk and by a tentative timeline for their application. This table is based on our assessment of policies and from a knowledge of the Fund from past and current work with GCF, from the consultations with staff and entities, and from early exchanges with the Chairperson of the Investment Committee for the GCF.

Table 19 Risk assumption and implementation timeline of recommendations: compliance and consistency

	Short-term	Medium-term	Longer-term
Low risk	GCF provides further guidance for the use and interpretation of the T&C parameters, including fees, in order to ensure clarity and predictability in the process of setting and negotiating terms and conditions, concessionality levels, and the choice of instrument. Service fees and interest rates could be merged to simplify the cost structure of the loan and to offer better comparability with public sector terms and conditions provided by other institutions.	Provide guidance on the definition of private / public sector (e.g., whether this is based on ownership of implementing AE; ownership of end-beneficiary; sovereign guarantee requirements; or on project components)	
Medium Risk		The GCF could strengthen the use of financial terms and conditions by adopting: - a rules-based approach, on the basis of guidelines that would make explicit a pattern that is already present but currently implicit; ***[or]*** - a principles-based approach, with a focus on minimum concessionality, as defined by the economics of the proposal.	

Table 20 Risk assumption and implementation timeline of recommendations: relevance and 'fit-for-purpose.'

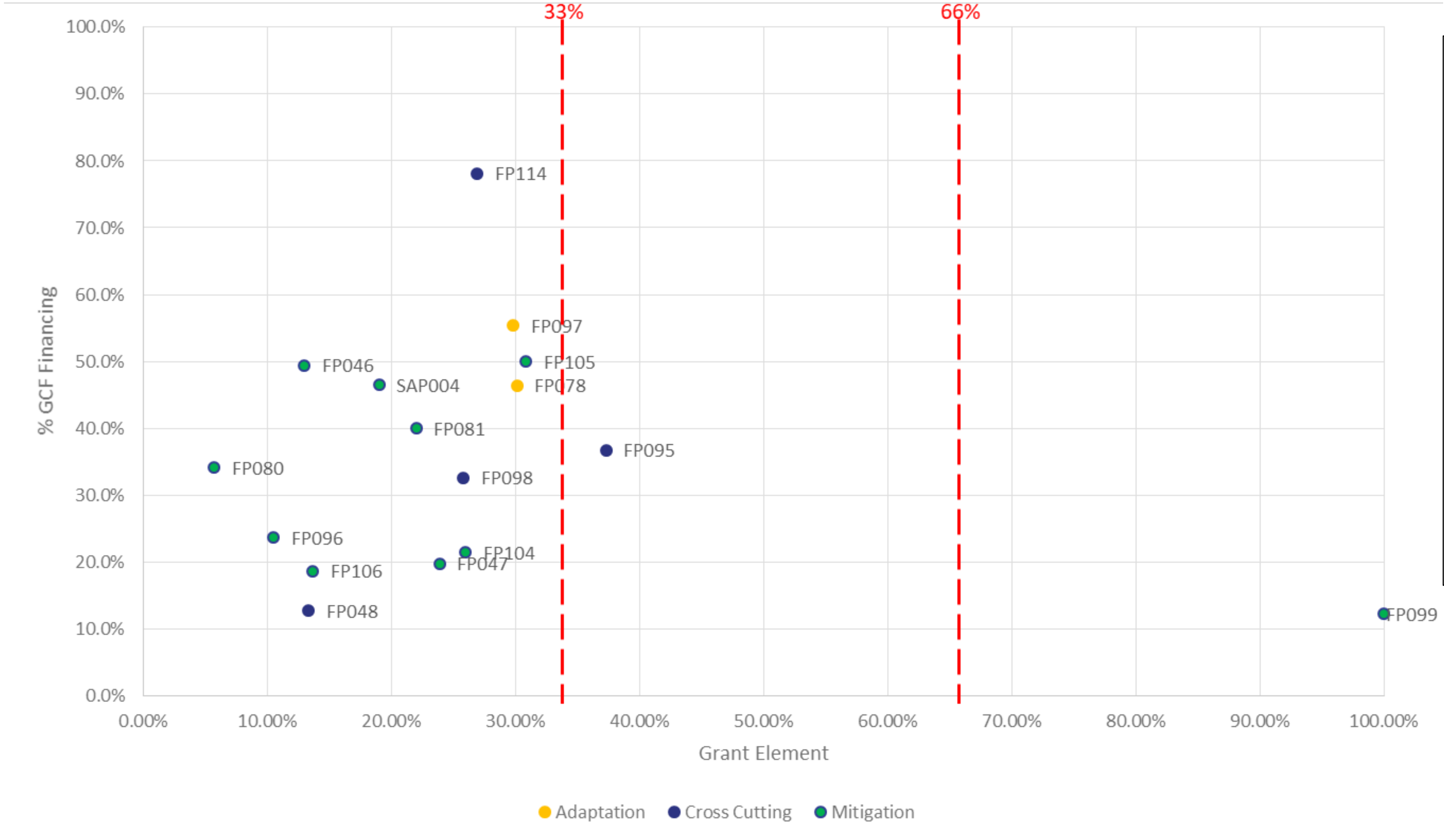
	Short-term	Medium-term	Longer-term
Low risk	Develop a "GEC 2.0": - strengthen the tool to change the discount rates - issue accompanying guidelines that explain and offers ranges of discount rates y instrument type and country characteristics); - provide internal guidance for Secretariat staff to use more appropriate discount rates to calculate the GE; - provide guidance on how to use benchmarks and reference points to interpret GEC calculations.	Issue guidelines for the interpretation and use of the GEC, in particular on the values and meaning of the grant element. This could entail the creation of a positive list of typical project characteristics that one would see, for example, in the 0-32% grant equivalency range; in the 33-65% low concessionality range; in the 66-99% high concessionality range; and in 100% concessionality. T&C could be more explicit in defining the instances when the concessionality obtained by an AE can be retained for a specific purpose, e.g. to buy currency swaps in order to offer local currency on-lending.	
Medium Risk	Complement the application of the existing T&C policy with data from a comprehensive dataset that includes context-specific benchmarks	In the pricing table given in the report, quantitative benchmarks can be complemented by qualitative considerations, in particular with emphasis on the links between a pricing strategy and its alignment with the GCF corporate strategy.	

Table 21 Risk assumption and implementation timeline of recommendations: policy adjustments and instruments

	Short-term	Medium-term	Longer-term
Low risk	GCF can look at structuring guarantees in a number of ways that do not require a corporate credit rating, such as: • Revolving funds; • Guarantee (insurance) products: ○ Guarantees to PPAs ○ Guarantees for Contracts for Difference	GCF could benefit from policy approach that targets local currency lending, its benefits to the operations and goals of the Fund, current barriers, and risk, including on tradeoffs between concessionality and currency swaps. GCF could structure a local currency lending platform as a revolving fund, with an initial part capitalization from contributors in the form of a grant and additional revenue generated from service fees, targeting frontier markets. GCF can pilot a part-subsidization of a local currency platform with interested MDBs and NDBs in order to issue green bonds in local currency, which will strengthen the domestic capital markets in the countries of operation of the GCF.	
Medium Risk		GCF can seek to obtain a corporate credit rating by a rating agency.	

8 ANNEX 1: Graphs and scatterplots

Graph 1: Private sector projects organized by impact area (labelled)

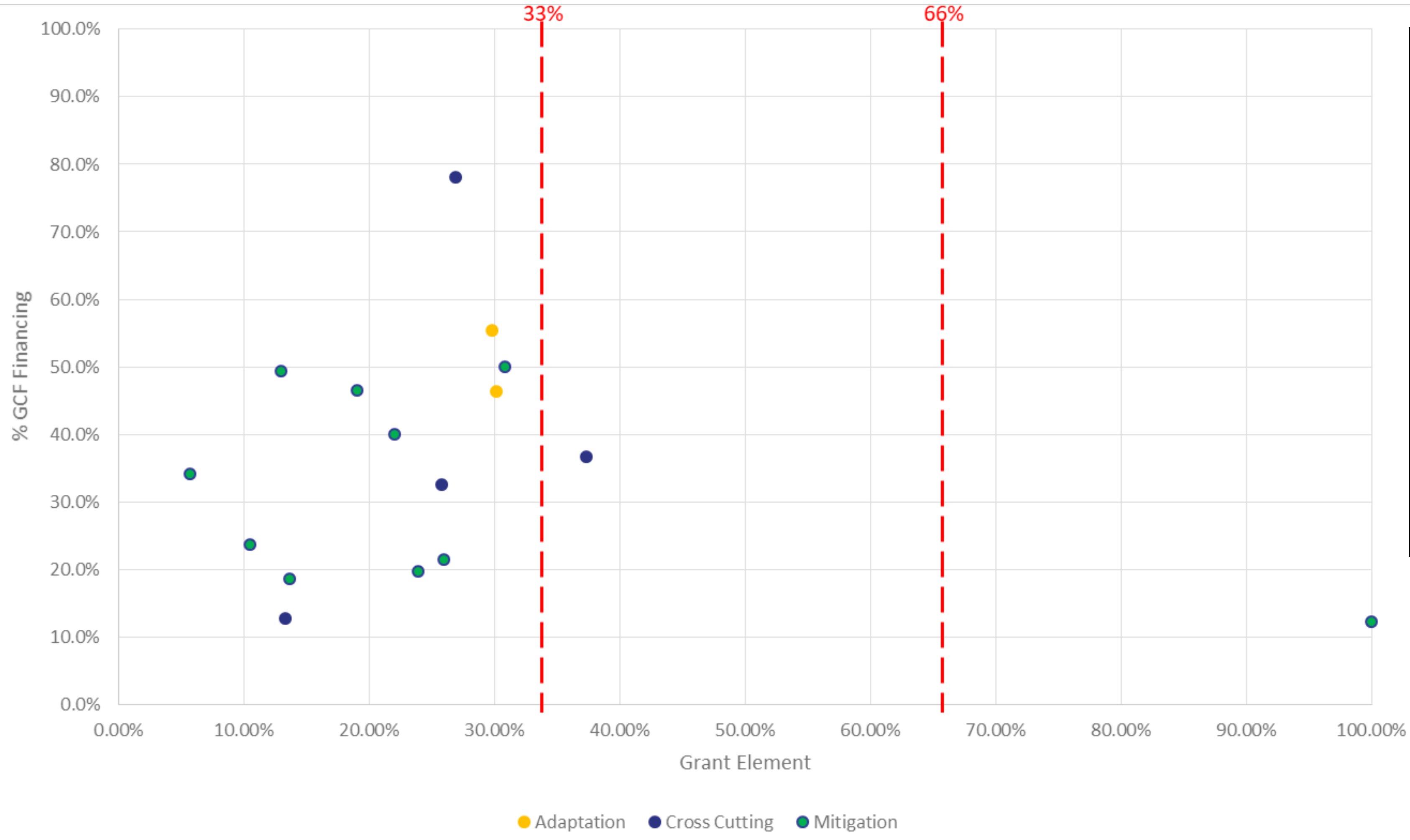


The y-axis is expressed as a percentage of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element.

This graph shows that private sector projects are typically receiving low concessionality.

Graph 2: Private projects organized by impact are (not labelled)



The y-axis is expressed as a percentage of GCF financing versus total financing.

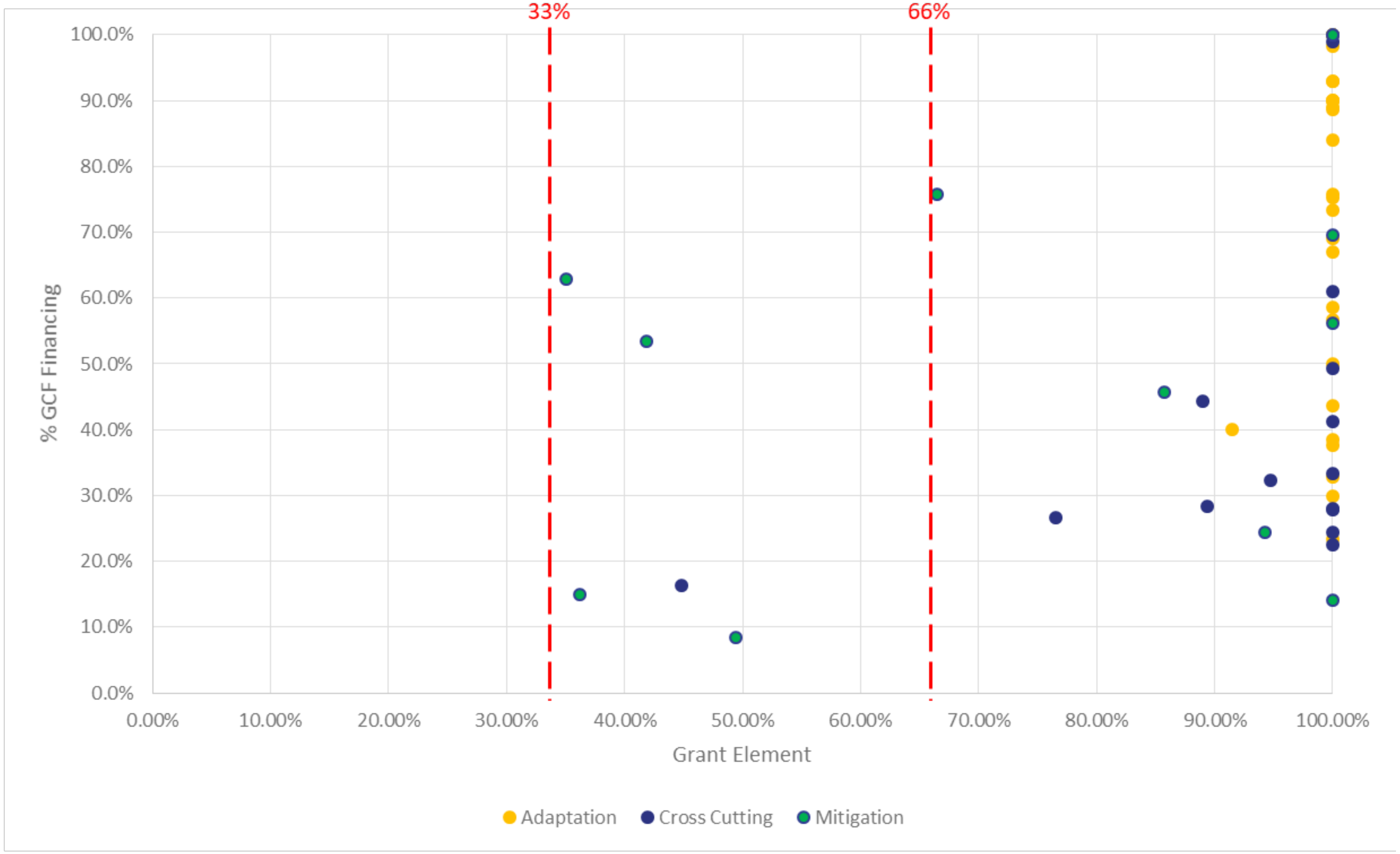
The x-axis represents the concessionality expressed as grant element.

Graph 3: Public sector projects organized by impact area (labelled)

The y-axis is expressed as a percentage of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element. This graph shows that typically public sector projects receiving a higher concessionality, and un the majority of cases this is a full grant.

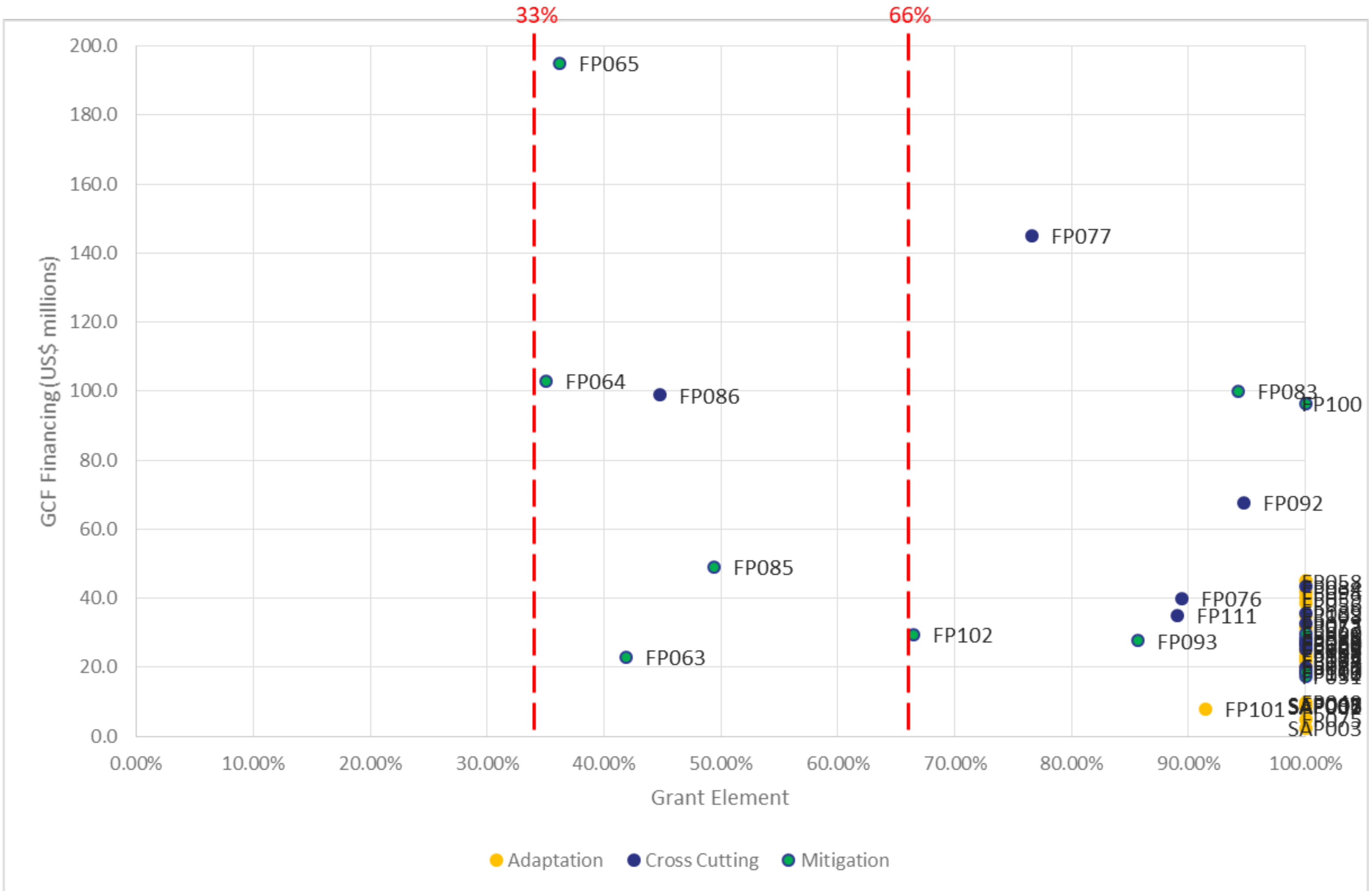
Graph 4: Public sector projects organized by impact area (not labelled)



The y-axis is expressed as a percentage of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element.

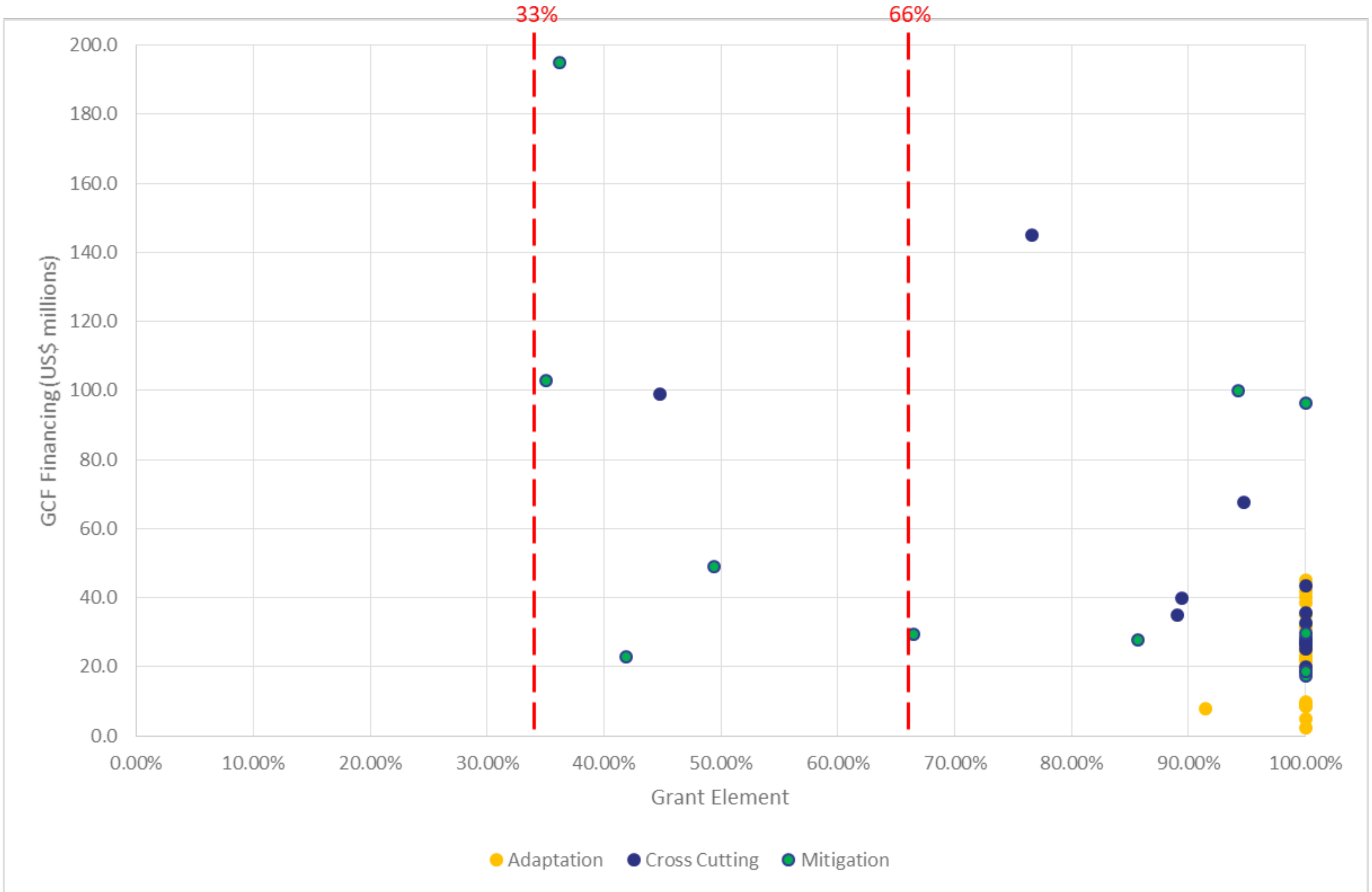
Graph 5: Public sector Projects (in absolute volume of GCF Financing) organized by impact area (labelled)



The y-axis is expressed in absolute terms as the volume of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element. This graph shows that typically public sector projects are relative smaller-volume and receive higher concessionality.

Graph 6: **Public sector Projects (in absolute volume of GCF Financing) organized by impact area (not labelled)**

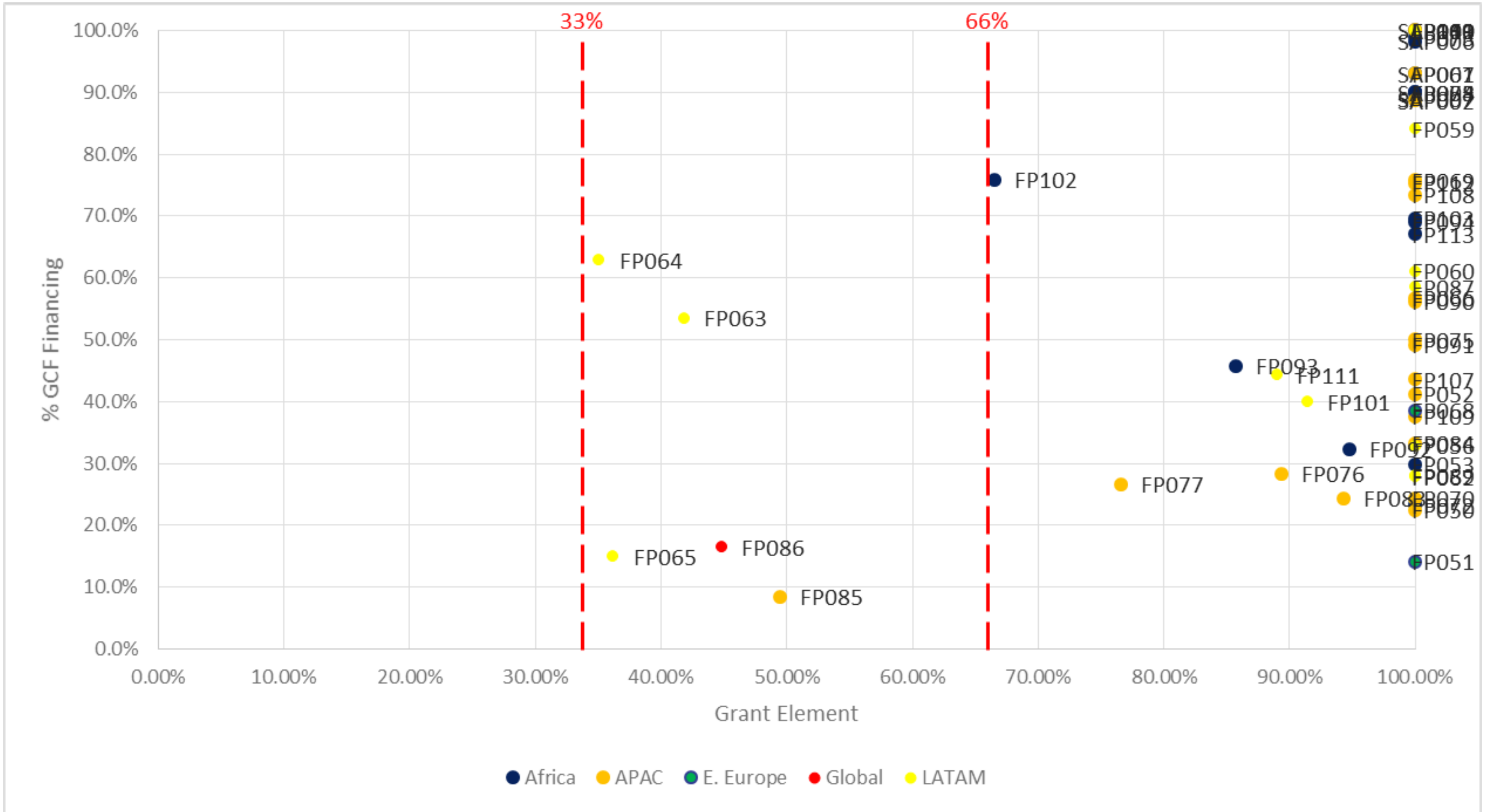


The y-axis is expressed in absolute terms as the volume of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element.

The projects are organized according to their impact area – mitigation, adaptation, or ones that cut across both (cross-cutting).

Graph 7: Public sector Projects organized by region (labelled)

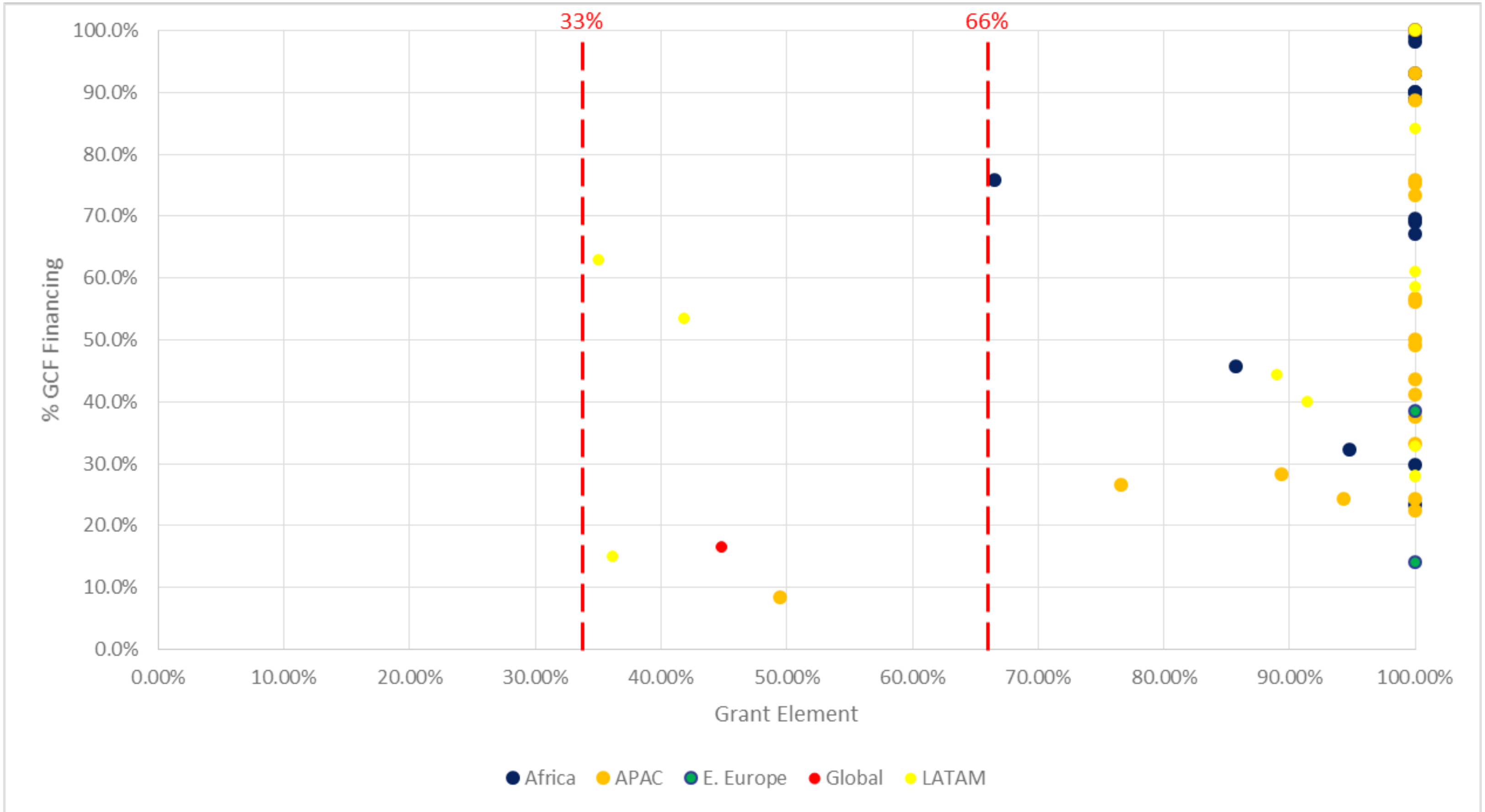


The y-axis is expressed in absolute terms as percentage of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element.

This graph shows a high concentration of public sector projects receiving the maximum concessionality, regardless of the GCF contributions to the total project volume.

Graph 8: Public sector Projects organized by region (not labelled)



The y-axis is expressed in absolute terms as percentage of GCF financing versus total financing.

The x-axis represents the concessionality expressed as grant element.

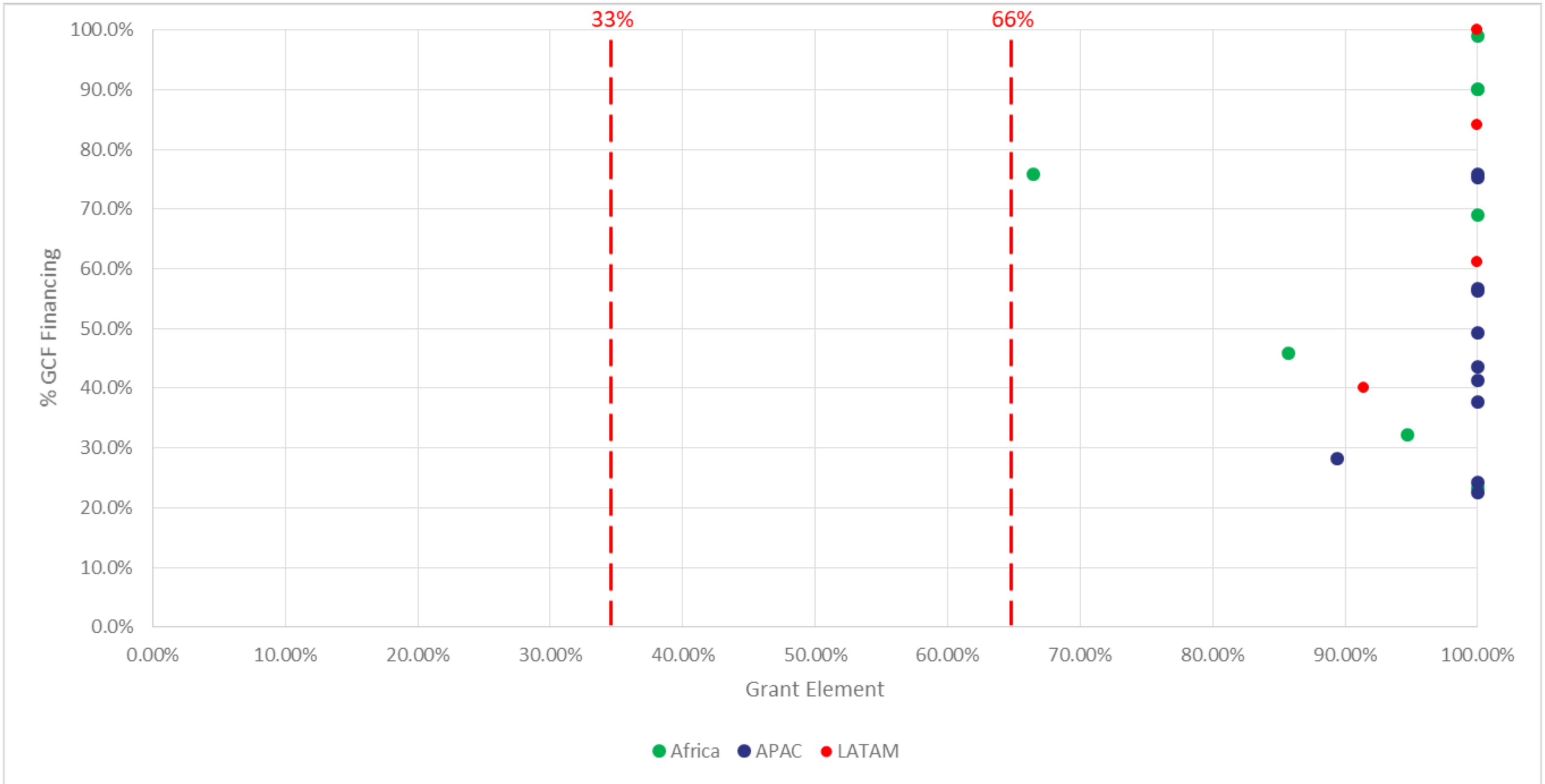
This graph shows a high concentration of public sector projects receiving maximum concessionality, regardless of the GCF contributions to the total project volume.

The graphs above have been organized by the geographical region in which a project is focused. The four regions are Africa, Asia Pacific (APAC), Eastern Europe, and Latin America (LATAM). There was also one project that had a global focus.

Graph 9: Public sector Projects in LDC and SIDS countries organized by region (labelled)

This graph shows that most LDCs and SIDS with public sector proposals receive higher concessionality, in particular grants.

Graph 10: Public sector Projects in LDC and SIDS countries organized by region (not labelled)



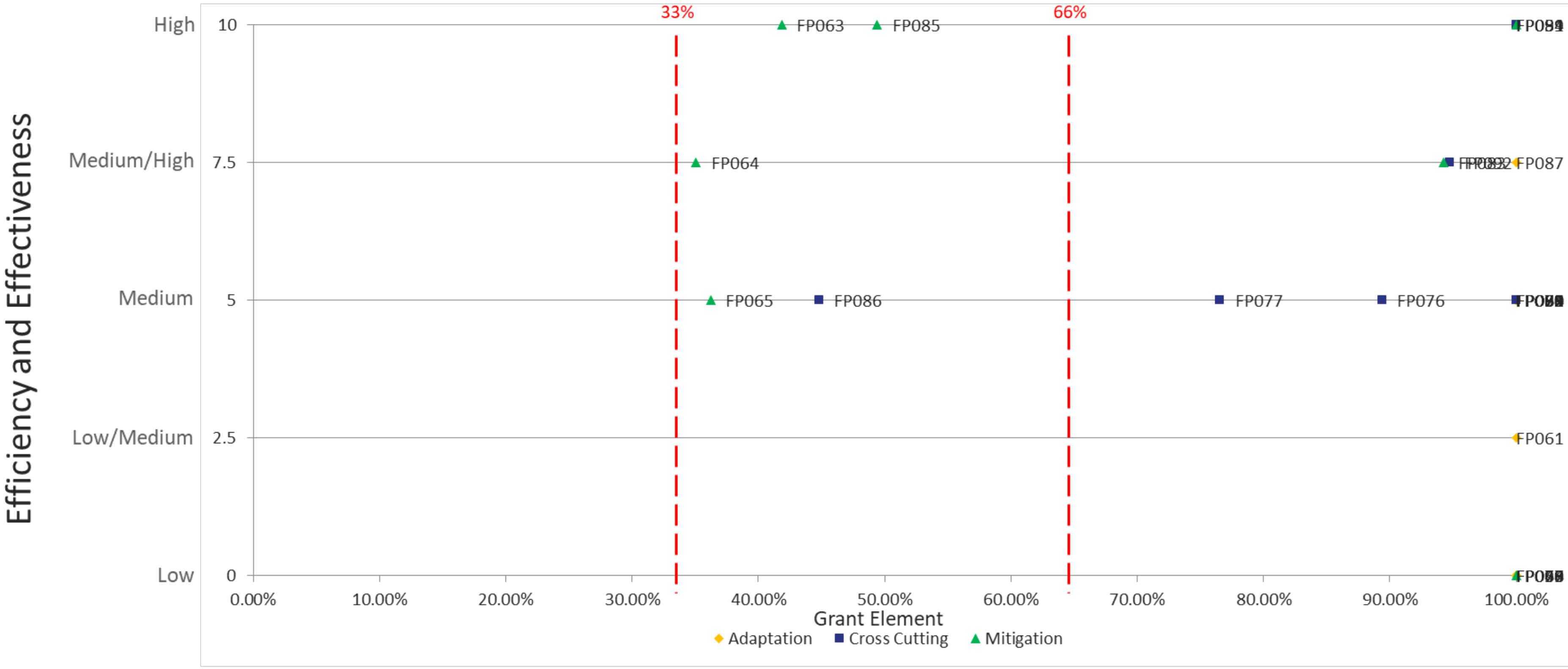
The graphs above have selected for projects in Least Developed Countries and in Small Island Developing States, then organized by the respective geographical region. Note that there are fewer regions represented since there are no LDCs or SIDS in Eastern Europe.

Graph 11: Public sector Projects by Efficiency and Effectiveness (labelled)

These graphs (graph 11 and 12 in the following two pages) plot the grant element against numerical values given for the levels of Efficiency and Effectiveness as investment criteria, organized by impact area (adaptation, mitigation, cross-cutting). This analysis could only be done for public sector projects, whose investment criteria are public. The five numerical values given are:

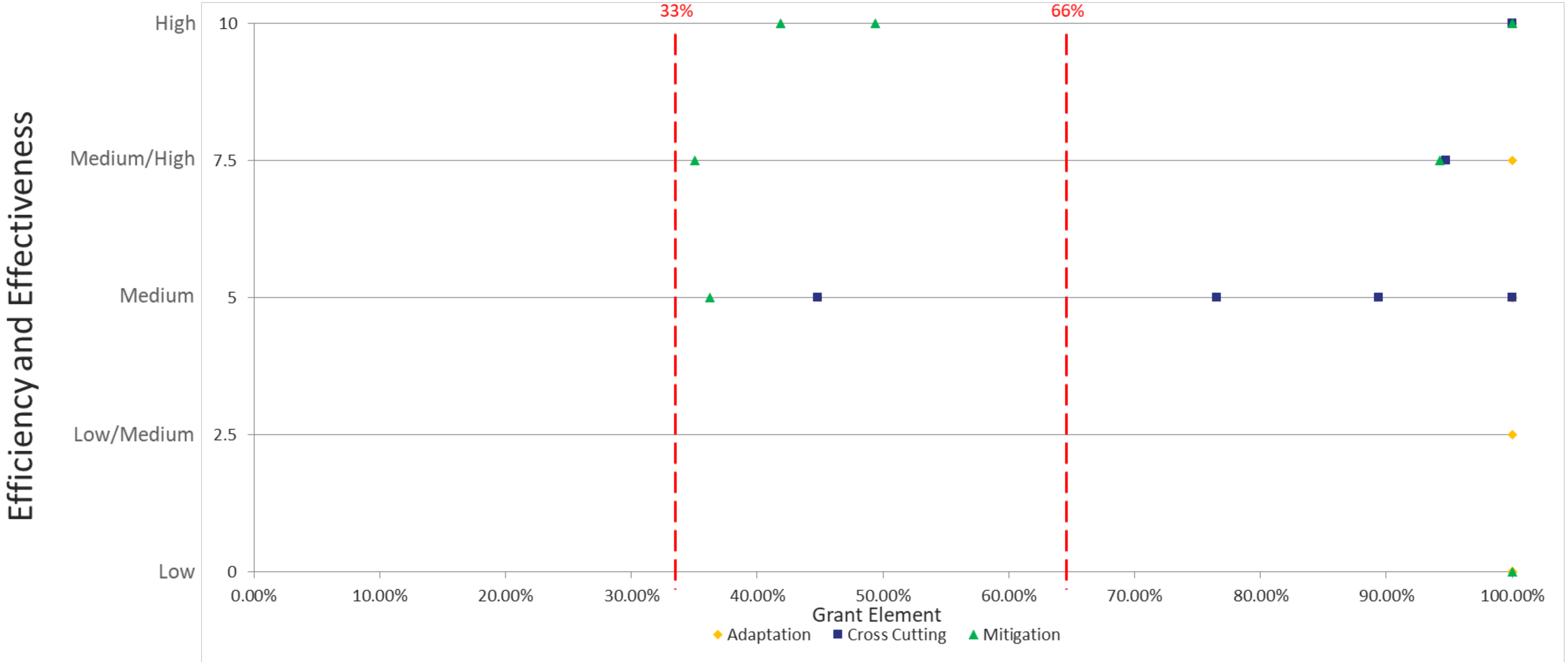
Efficiency and Effectiveness rating by the GCF Secretariat	High	Medium/High	Medium	Low/Medium	Low
Numerical value	10	7.5	5	2.5	0

These graphs show no clear correlation or link between the grant element and the specific investment criterium selected (effectiveness and efficiency). This means that we cannot clearly derive a pattern to make a conclusion between the role of concessionality and the criterium of effectiveness and efficiency in a project.

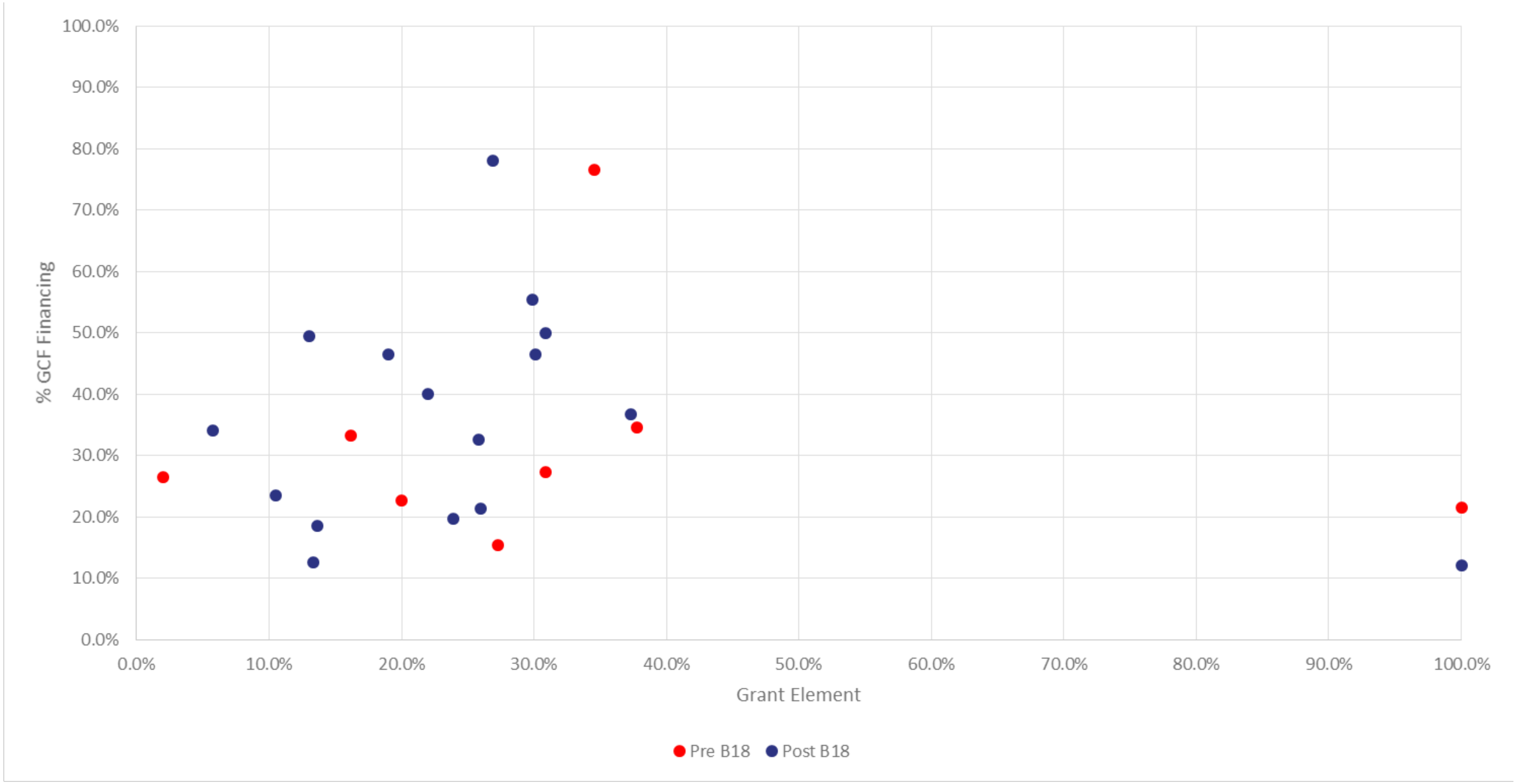


Efficiency and Effectiveness
High
Medium/High
Medium
Low/Medium
Low
10
7.5
5
2.5
0
33%
66%
FP063
FP085
FP064
FP087
FP065
FP086
FP077
FP076
FP061
0.00%
10.00%
20.00%
30.00%
40.00%
50.00%
60.00%
70.00%
80.00%
90.00%
100.00%
Grant Element
Adaptation
Cross Cutting
Mitigation

Graph 12: Public sector Projects by Efficiency and Effectiveness (not labelled)

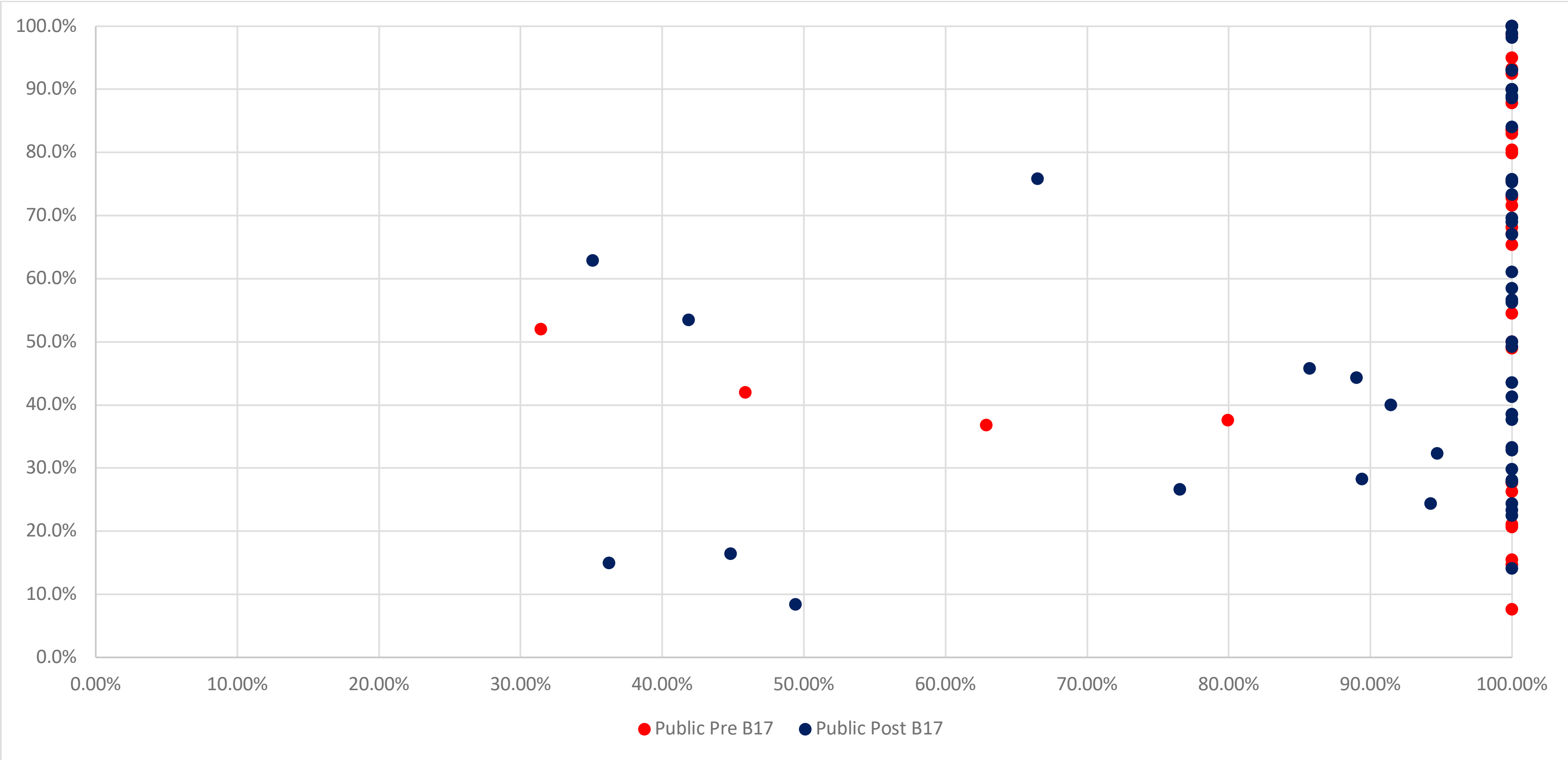


Graph 13: Private sector projects distribution before and after B18



This distribution shows no significant difference in concessionality terms for proposals before and after B.18, specific to the private sector.

Graph 14: Public sector projects distribution before and after B18



This distribution shows no significant difference in concessionality terms for proposals before and after B.18, specific to the public sector.

9 ANNEX 2: TERMS AND CONDITIONS FOR LOANS AT VARIOUS MDBS

IDB – Investment (INV) and Policy-Based (PBL) Blended Loans

	Concessional OC	Standard Regular OC terms terms
Source of Funding	Ordinary Capital (OC)	Ordinary Capital (OC) – Flexible Financing Facility (FFF)
Currency	US dollars	US dollars
Interest Rate	0.25% fixed rate	LIBOR-based rate
Maturity	40 years	PBL: 20 years; INV: 25 years
Grace Period	40 years	5.5 years
Weighted Average Life	40 years	PBL: 12.75 years; INV: 15.25 years
Amortization	Bullet repayment	Equal semiannual payments
Lending Spread	N/A	As periodically determined by the Bank.

IDA Terms

	Maturity	Grace Period	Principal Repayments		Acceleration Clause
Grants	N/A	N/A	N/A	N/A	N/A
Small Economy	40	10	2% for yrs. 11-20	4% for yrs. 21-40	Yes
Regular	38	6	3.125% for yrs. 7-38		Yes
Blend	30	5	3.3% for yrs. 6-25	6.8% for yrs. 26-30	Yes
Guarantees	N/A	N/A	N/A	N/A	N/A
Non-concessional Financing	Up to 35 yrs. maximum maturity; up to 20 yrs. average maturity		Flexible		N/A

ADB Terms and Conditions of concessional loans

	Maturity (years)	Grace Period (years)	Interest	Other Features
Group A (CA-only)*: Project Loans	32	8	1% during the grace period 1.5% during the amortization period	Equal amortization; No commitment fee
Group A (CA-only)*: Program Loans	24	8	1% during the grace period 1.5% during the amortization period	Equal amortization; No commitment fee
Group B (OCR blend)**	25	5	2% interest per year	Equal amortization; No commitment fee
Emergency Assistance Loans	40	10	1% interest per year	Principal repayment at 2% per year for the first 10 years after the grace period and 4% per year thereafter; No commitment fee

*CA: Concessional Assistance

**OCR: Ordinary Capital Resources AfDB

Loans approved before 4-May-2005 & loans approved after 21-Jan-2009					
	USD	EUR	Yen	ZAR (6M JIBAR / 3M JIBAR)	
Floating Base Rate	2.16193	-0.35500	-0.03400	7.30800	6.83300
Funding Margin	-0.01000	-0.10000	0.00000	0.27000	0.27000
Lending Spread	0.8	0.8	0.8	0.8	0.8
Applicable Lending Rate	2.98163	0.34500	0.76600	8.37800	7.90300

World Bank - IBRD

Average Maturity						
IBRD Flexible Loan (IFL)	8 years and below	Greater than 8 and up to 10 years	Greater than 10 and up to 12 years	Greater than 12 and up to 15 years	Greater than 15 and up to 18 years	Greater than 18 and up to 20 years
Commitment Fee	25	25	25	25	25	25
Front-end Fee	25	25	25	25	25	25
Contractual Spread	50	50	50	50	50	50
Maturity Premium	0	10	30	50	70	90
Default Interest Rate	50	50	50	50	50	50

XacBank Project Loans[49]

Project Loans	
Period	Depends on the project. Examples range from 3 years to 10 years
Rate	7% - 12% Different rates for different currencies

NABARD[50]

[49] https://www.xacbank.mn/product/126

[50] https://www.nabard.org/interestrate.aspx?cid=502&id=24

Sr.No	Particulars	Interest Rate (%)
1	**Short Term refinance assistance:**	
a	State Cooperative Banks for financing crop loans	4.50
b	RRBs for financing crop loans	4.50
c	DCCBs directly financing for crop loans	4.50
d	Commercial Banks./RRBs in respect of their finance to PACS towards crop loans	4.50
e	ST – Additional SAO/ST(Others)/ ST (SAO) -SCARDBs (Annual Product)	7.35
f	StCBs/RRBs - Conversion of Short Term- crop loans into Medium Term loans (3% less than the interest rate charged by banks to ultimate beneficiaries subject to minimum interest rate at 8.10%)	8.10
2	**Long Term refinance assistance**	
a	LT loan to State Govt. for contribution to share capital of coop. credit institutions	8.50
b	**RRBs/ StCBs/SCARDBs**	
	- Refinance for 5 years and above	8.35
	- Refinance for 3 years to less than 5 years	8.45
	- Refinance for 18 months to less than 3 years	8.35
3	**Direct Lending**	
a.	Warehouse Infrastructure Fund (WIF)	
	State Governments	Bank rate – 1.50%
	State Government Corporation (with State Govt. Guarantee)	Bank rate – 1.50%
	Entities promoted by State / Central Government owned/assisted (without State Govt. Guarantee)	PLR + risk premium
	Other entities	PLR+risk premium
	* Current Bank Rate – 5.4%	
b.	Food Processing Fund (FPF)	
	State Governments	Bank rate – 1.50%
	Entities promoted by State Governments (with Govt. Guarantee)	Bank rate – 1.50%
	Entities promoted by State Governments(without Govt. Guarantee)	PLR + risk premium
	Other entities	PLR+risk premium
	* Current Bank Rate – 5.4%	

Inter-American Development Bank (IDB)

Flexible Guarantee Instrument		
	Concessional Sovereign Guaranteed Operations[51]	**Sovereign Guaranteed Operations**[52]
Coverage	Up to 100% of project costs	Up to 100% of project costs
Currency	USD	US dollar, Euros, Swiss francs, Japanese Yens, or borrowing member local currency, subject to risk management and operational considerations
Maximum guarantee period	Up to 25-years for investment operations (INV) and 20-years for policy-based interventions (PBL) with a maximum weighted average life (WAL) of 15.25 years and 12.75 years, respectively.	Up to 20-years for policy-based interventions with a maximum weighted average life (WAL) of 12.75 years, and up to 25-years for investment operations with a maximum WAL of 15.25 years.
Guarantee fee	Fee equivalent to the blend of regular OC and concessional OC resources; OC sovereign loan spread for the regular OC portion, and 0.25% for the concessional OC portion; applied on actual guarantee amount callable at any time and payable semi-annually from effective date	Charged at same level as IDB's SG loans variable lending spread; applied on actual guarantee amount callable at any time and payable semi-annually from effective date,
Stand-by Fee	Applicable to the regular OC portion of the guarantee charged at same level as Credit Fee for IDB's regular OC loans; applied on the difference between the approved maximum guarantee amount and the actual guarantee amount callable at any time from the effective	Charged at same level as Credit Fee for IDB's SG loans; applied on the difference between the approved maximum guarantee amount and the actual guarantee amount callable at any time from the effective date of the guarantee coverage

[51] http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=40852576

[52] http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=39682787

	date of the guarantee coverage.	
Inspection and Supervision Fee	Applicable to the regular OC portion of the guarantee charged at same level as IDB's regular OC loans, and applied on the approved maximum guarantee amount as a one-time fee on the effective date of the guarantee coverage.	Charged at same level as IDB's SG loans, and applied on the approved maximum guarantee amount as a one-time fee on the effective date of the guarantee coverage.

World Bank[53]

Fees		Private Projects		Public Projects (incl. Policy-Based Guarantees)	
		IDA Concessional	IBRD & IDA Non-Concessional	IDA Concessional	IBRD & IDA Non-Concessional
Upfront Charges (one-time fees charge on guarantee amount)	**Front-End**	-	25bps	-	25bps
	Initiation	Greater of 15bps and $100k		-	
	Processing	50bps		-	
Recurring Charges (per annum)	**Standby**	-	25bps	-	25bps
	Guarantee	75bps	50-165bps[1]	75bps	50-165bps[1]

[1] Guarantee fee applicable to IBRD & IDA Non-Concessional Guarantees per average maturity and pricing group

Guarantee Average Life	Group A	Group B	Group C	Group D
Up to 8 years	50 bps	50 bps	50 bps	55 bps
From 8 to 10 years	60 bps	60 bps	60 bps	65 bps
From 10 to 12 years	70 bps	75 bps	80 bps	90 bps
From 12 to 15 years	80 bps	90 bps	100 bps	115 bps
From 15 to 18 years	90 bps	105 bps	120 bps	140 bps
From 18 to 20 years	100 bps	120 bps	140 bps	165 bps

[53] https://www.worldbank.org/en/programs/guarantees-program#5

Asian Development Bank (ADB)[54]

Partial Credit Guarantees	
Eligible Sectors and Borrowers or Issuers	Financial services and capital markets (e.g., banking, leasing, insurance, and funds); and infrastructure (e.g., power, transportation, water supply and waste treatment, and telecommunications). Partial credit guarantees can be applied to loans or other debt instruments issued by private and public sector projects (limited recourse financings), public-private partnerships, corporates, as well as (sub)sovereign entities.
Amount of Guarantee	Upper limit: • 25% of the total project cost (in project finance transactions); • 25% of total assets (in corporate transactions); • 50% of net worth (in bank transactions); and • $250 million. Upper limits may also be increased where ADB's risk is subject to risk-sharing arrangements with participants with a credit rating of A- or better assigned by an acceptable credit rating agency.
Guaranteed Percentage	Up to 100% of a lender's exposure to loss under a guaranteed loan in certain circumstances.
Term	15 years, possibly longer in certain cases.
Fees	Fees applied by ADB are market-based for comparable guarantee operations, and take into consideration, among other things, the project, sector, and country risks, as well as the specific terms of the contract of guarantee.

World Bank IBRD[55]

Policy-Based Guarantees (PBG)

[54] https://www.adb.org/sites/default/files/publication/29015/brochure-partial-credit-guarantee.pdf

[55] http://siteresources.worldbank.org/INTGUARANTEES/Resources/IBRDPBG.pdf

Eligible Sectors and Borrowers or Issuers	PBGs can be used for any commercial debt instruments (loans, bonds) provided by any private institution
Amount of Guarantee	Upper limit: • 25% of the total project cost (in project finance transactions); • 25% of total assets (in corporate transactions); • 50% of net worth (in bank transactions); and • $250 million. Upper limits may also be increased where ADB's risk is subject to risk-sharing arrangements with participants with a credit rating of A- or better assigned by an acceptable credit rating agency.
Coverage	Guarantee structure and coverage can be determined flexibly on a case-by-case basis at the level required by a specific debt instrument and the market, to the extent that commercial lenders share the credit risk of the borrower in a meaningful manner and allow the extension of debt maturity and/or lower interest rate costs.
Front end fee	One-time fee of 0.25% on the amount of the guarantee
Guarantee Fee	0.5% per annum on the disbursed and outstanding guarantee exposure, where such exposure is calculated as the present value of the guarantee amount to the earliest call date.

African Development Banks (AfDB)[56]

Table 1: Summary terms for ADB Partial Risk Guarantees and Partial Credit Guarantees	
Borrowers	All ADB borrowers (MICs and non-sovereign entities – public and private)
Currencies	The Bank's lending currencies: EGP, EUR, JPY, KES, UGX, USD and ZAR. On a case-by-case basis, the guarantees maybe extended in other local currencies.
Maturity	Up to twenty (20) years for sovereign guaranteed borrowers Up to fifteen (15) years for non-sovereign guaranteed borrowers
	The principal repayment period should match the project financing requirements. NB. Maturity restrictions may also apply to certain guarantee structures and currencies, which may reflect particular market conditions e.g. bullet repayments are limited to a 15 year tenor (10 year average life).
Fees	**Front-end-fee:** No charges for Sovereign Guaranteed Loans (SGL) 1% of the Bank's possible maximum exposure under the guarantee for Non-Sovereign Guaranteed Loans (NSGL)
	Standby-fee: Charged on the un-disbursed portion of the underlying loan. Between 0 and 1% for NSGL borrowers from MICs Between 0.5 and 1% for NSGL borrowers from other countries
	Guarantee Fee: The level of the guarantee fee will be equal to the lending spread that would have been charged if the Bank made a direct loan, plus a risk premium (the risk premium would reflect the risks associated with the guarantee structure).
	Other Fees: Legal and other expenses incurred by the Bank during the initiation, appraisal and underwriting process of a guarantee, other than the Bank's traditional operational expenses, will be charged to the borrower/lender and are payable upon request by the Bank.
Late Payment Fee	The Bank may charge a late payment fee to cover the costs of delays in receiving payments of the front end, standby and guarantee fees. In line with the Bank's prevailing practice on loans, the fee will be at least 2% per annum above the applicable guarantee fee
Prepayment Premium	The borrower and lender may reduce the outstanding guaranteed amount by mutual agreement or prepayment of the underlying loan without penalty.
Cancellation	The borrower and lender may cancel undisbursed portions of the guarantee without penalty.

56 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/Stewart%20Kinloch%20Presentation.pdf

Table 2: Summary terms for ADF Partial Risk Guarantees	
Borrowers	NSGL borrowers in ADF countries
Currencies	The Fund's guarantee will be denominated in one of the approved currencies (USD, GBP, and JPY). On a case-by-case basis, guarantee for financing in local currency or convertible currencies that are not one of the Fund's lending currencies, may be considered.
Maturity	Depending on project needs and capped at the maturity of an ADF loan to the host country (up to 40 years)
Fees	**Front-end-fee:** 0-1% of the loan amount
	Standby fee: 0.5% charged on the unused portion of the guarantee
	Guarantee Fee: The level of the guarantee fee will be equal to the service charge applicable to ADF loans, currently 75bps. The guarantee fee will accrue on a daily basis and is payable either according to a schedule approved by the Bank or as a one-time up-front payment.
	Other fees: Legal and other out of pocket expenses incurred by the Bank during the initiation, appraisal and underwriting process of a guarantee, other than the Bank's traditional operational expenses, will be charged to the beneficiary and are payable upon request by the Bank.
Late Payment Fee	The Bank may charge a late payment fee to cover the costs of delays in receiving payments of the front end, standby and guarantee fees. In line with the Bank's prevailing practice on loans, the fee will be at least 2% per annum above the applicable guarantee fee
Cancellation	The beneficiary and the country may cancel unused portions of the guarantee without penalty. They may also reduce the outstanding guaranteed amount by mutual agreement without penalty

Xacbank[57]

TERMS	FEE
Advising fee	USD 15
Inform of amendments to terms and conditions	USD 10
Issuance of a foreign bank guarantee	0.1%
	Min. USD 50
	Max. USD 150
Inquiry from a foreign bank	USD 20
Cancellation of a guarantee	USD 40
Monthly rate of risk fee for uncovered guarantees is as per decision by the credit committee of the Bank.	
Uncovered DC credit analysis fee is as per standard terms and conditions of the Business	
Additional fees associated with the foreign bank services and courier may apply for the account of the applicant	
Domestic bank guarantee service fees:	
Issuance of a bank guarantee	MNT 15,000
Amendment to terms and conditions	MNT 5,000
Cancellation of a guarantee	Covered - free of charge
	Uncovered - MNT 10,000
Uncovered DC credit analysis fee is as per standard terms and conditions of the Business Loan.	
Monthly rate of risk fee for uncovered guarantees is as per decision by the credit committee of the Bank.	

[57] https://www.xacbank.mn/product/86?lang=en

11 ANNEX 4: GCF UTILIZATION OF GUARANTEES

FP048 - Guatemala and Mexico (IDB)

This is a proposal for a low emission climate resilient agriculture risk-sharing facility for MSMEs.

- Guarantees used as one of the financial instruments for a total project investment of USD158 million
- Total guarantee size: USD3 million blended funding from GCF and Inter-American Development Bank (IDB)
- GCF financed guarantee of USD1.5 million; IDB co-financed guarantee of USD1.5 million
- Guarantee provided as collateral to financial intermediaries' debt portfolio on sustainable agroforestry.
- Guarantee flat return is projected to be 0.5%.

FP071– Vietnam (World Bank)

This is a proposal for scaling up energy efficiency for industrial enterprises in Vietnam.

- The project benefited from a USD 75 million guarantee by the GCF. This is the largest guarantee among the three FPs providing this instrument. Under this guarantee, participating Vietnamese banks (PFIs) are partially protected against payment default by their borrowers. The guarantee is fully provisioned and priced at 0.1%. The RSF will charge PFIs a higher price for the facility, in order to avoid/delay drawing on the GCF guarantee and to cover the cost of its operations.

FP093: Burkina Faso (African Guarantee Fund)

The proposal is for the Yeleen rural electrification project in Burkina Faso.

- Guarantees used as one of the financial instruments for a total project investment of USD59 million
- GCF financed a guarantee of USD3.1 million, to cover the loans extended by a microfinance institution for the purchase of productive use equipment by rural entrepreneurs and support for the development of micro-businesses.
- Executing Entities: Burkina Rural Electrification Agency (ABER) under the authority of the Ministry of Energy and Mines) for components 1 & 2 (restructuring of the legal, regulatory and institutional framework for a rural electrification model and installation of 100 mini-grids).
- Implementation is through the African Guarantee Fund (AGF), which is an agency of AfDB and handles the guarantee mechanism.

ENERGY SAVING INSURANCE GUARANTEES[58]

Energy-saving insurance (ESI) is a financial risk mitigation package that includes an insurance product. It aims to address the financial and non-financial investment barriers in the energy efficacy market for small and medium-sized enterprises (SMEs). Key barriers addressed by the ESI include:

- SMEs don't trust the new technologies or the energy services providers looking to finance technological upgrades in energy-saving - the uncertainty of returns from energy-saving investments;
- Both SMEs and local banks often lack the technical and financial capacity to integrate these investments into the credit conditions for SMEs;
- Current investments in energy efficiency are mainly limited to those with very short payback periods (e.g., lighting upgrades) rather than more capital-intensive measures - energy efficiency lacks investment priority.
- These prevent the development of energy-saving investments in small and medium-sized enterprises (SMEs) in developing countries, which can be instrumental in achieving sustainable development goals.

ESI was proposed by the Danish Energy Agency and developed and led by the Inter- American Development Bank. ESI as a package of measures to address barriers where technology solutions providers will purchase the ESI to support the contractual guarantees to SMEs. Package includes the following:

- Standardized performance contract: where SMEs (borrowers) and technology solutions providers share the risk of investment equally + transaction costs are reduced
- Energy-saving insurance: to guarantee the commitments of the technology provider.
- Local verifier: third party validation and verification to give parties credible assurance (services quality or service and project)
- National development banks are the key actors who coordinate this third-party verification process.
- Multiple financial sources (private and public money): donors, multilateral development banks, national development banks, and local financial institutions Donor contributions to cover market studies, costs of setting up and the standardized contract, and the third-party validation mechanism.

[58] https://www.climatefinancelab.org/project/insurance-for-energy-savings/

Contracts for Difference (CfD)

This scheme is the government's main mechanism for supporting low-carbon electricity generation.[59]

CfDs incentivize investment in renewable energy by providing developers of projects with high upfront costs and long lifetimes with direct protection from volatile wholesale prices, and they protect consumers from paying increased support costs when electricity prices are high.

Successful developers of renewable projects enter into a private law contract with the Low Carbon Contracts Company (LCCC), a government-owned company. Developers are paid a flat (indexed) rate for the electricity they produce over a 15-year period; the difference between the 'strike price' (a price for electricity reflecting the cost of investing in a particular low carbon technology) and the 'reference price' (a measure of the average market price for electricity in the GB market).

[59] https://www.gov.uk/government/publications/contracts-for-difference/contract-for- difference

13 ANNEX 6 - SELECTED EXAMPLES OF LOCAL CURRENCY LENDING FROM MDBS

IBRD

Local currency financing is offered by the IBRD through the following 2 options:

- Loan conversion options: included in the loan agreement to allow borrowers to convert current disbursements and disbursed and outstanding loan balances into local currency. Conversions are facilitated by IBRD through hedging with swap market transactions or local currency bond issuance;
- Free-standing local currency swaps: allows borrowers to convert disbursed and outstanding balances of existing IBRD loans into local currency without changing the terms of the underlying loan60.

IFC / EBRD local currency bond issuance[61]:

Aim to develop local capital markets through local currency bond issuance. The rationale for the use of local currency bonds to achieve this objective:

- Provides an alternative to foreign currency borrowing, thus reducing risks
- Diversifies sources of funding
- Supports major economic and financial growth trends
- Strengthens the financial sector

AfDB Synthetic Local Currency Loan products (SCLCs) provide loans in the currencies of its Regional Member Countries (RMCs). These products aim to:

- Established as a response from client demands for financing in their own currency in order to reduce their exposure to FX risk;
- support long-term funding in RMC currencies;
- help develop local capital markets.

Currently, in addition to the South African Rand, the Bank offers the following as lending currencies: Egyptian Pound, Ghanaian Cedi, Franc CFA currencies (XOF and XAF), Kenyan Shilling, Nigerian Naira, Tanzanian Shilling, Ugandan Shilling, and Zambian Kwacha. They simulate local currency financing

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[60] https://treasury.worldbank.org/en/about/unit/treasury/ibrd-financial-products/local-currency-loan; http://pubdocs.worldbank.org/en/204311507314967032/product-note-ibrd-local-currency-financing.pdf

[61] https://www.ifc.org/wps/wcm/connect/d3850eb8-601c-41a5-9b0a-a74e6f88009c/IFC_LocalCurrency+and+Hedging+Solutions+Pitchbook+-+Updated+10- 2017.pdf?MOD=AJPERES&CVID=marVqgH

by indexing payments of interest and principal (paid in an approved loan currency) to local currency interest and exchange rates through an agreed formula[62].

ADB

Local currency lending (local Currency Loan or LCL) meet the financial demands of the region's rapid growth, where exposure to foreign currency risk would be detrimental. Local currency lending aims to:

- Reduce currency mismatches in emerging economies
- Contributing to local capital market development
- Act as 'icebreaker,' especially on international investors, to increase confidence in the local currency market;
- Increase investor diversification;
- Develop liquidity in derivative markets; and facilitating knowledge transfer.

Local currency funds raised either via bond issues or via cross-currency swap (CCS) depending on costs.

LCL pricing based on a) the ADB's cost base rate (back-to-back funding vs. pool-based approach); b) interest rate basis; c) lending spread (sovereign guaranteed loans vs. non- guaranteed loans); d) front-end fee (sovereign guaranteed loans vs. non-guaranteed loans); e) commitment charge (sovereign guaranteed loans vs. non-guaranteed loans)[63].

EBRD SMEs Local Currency Lending Program

This program combines EBRD capital, donor resources, and policy dialogue to provide eligible companies with access to affordable funding and acceleration in reforms to develop local currency intermediation and local capital markets.

- To increase intermediation and support the development of local capital markets, the EBRD provides local currency loans by procuring local currency funding or hedging, by entering into currency swaps with third-party providers, such as the Currency Exchange Fund, called TCX.
- Viability and affordability of interest rates for SMEs are mediated through risk-sharing agreements between the EBRD and donors.
- Local currency loans under the program are channeled to small and medium clients only in countries that have explicitly committed to improving their policy and regulatory frameworks.

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[62] https://www.afdb.org/fileadmin/uploads/afdb/Documents/Financial-Information/Financial%20Products%20-

%20Offered%20by%20the%20African%20Development%20Bank.pdf

[63] https://www.adb.org/sites/default/files/institutional-document/32040/local-currency-loan-product.pdf;
https://www.adb.org/sites/default/files/publication/29695/adb-lclp.pdf

This is aimed at supporting local currency intermediation, the development of domestic money markets and capital markets[64].

[64] https://www.ebrd.com/what-we-do/sectors-and-topics/sme-local-currency-programmes.html

14 ANNEX 7- GEC CALCULATION ELEMENTS

Discount Rate (in percent)	Unified discount rate (5%)
Repayment profile	Equal principal payment Annuity Lump sum principal Lump sum principal & interest Lump sum principal & compounded interest
Face value of loan	Nominal amount in the currency of loan
Grant (as part of financing package)	Nominal amount
Upfront commission (in percent)	**%**
Management fees (Amount in percent of outstanding loan; or Per payment period	**%**
Interest rate (in percent)	**%**
Maturity (in years)	
Payments per annum	(e.g.) 1 2 3 4 5
Grace period (in years)	

Grant Element Calculation[65]

Discount rate (in percent): The discount rate is used to calculate the present value (PV) of the loan (or financing package). PV calculations are used to compute the grant element of individual loans and to assess observance with concessionality requirements. A repayable grant is for these purposes a zero percent interest loan.

Repayment profile: This refers to the repayment characteristics of the loan (or a financing package). There are typically five options to choose from: Equal principal payment, Annuity (repayment with fixed total annual amortization amount), Lump sum principal (the entire principal or nominal amount is paid on the last repayment date while the interest is paid throughout the repayment period), Lump sum principal & interest (both principal and the interest are paid on the

[65] https://www.imf.org/external/np/pdr/conc/calculator/#discl

last repayment date), Lump sum principal & compounded interest (both principal and interest are paid on the last repayment date; however the interest is capitalized over the repayment period).

Face value – Nominal amount in the selected currency of the loan contract (or a financing package) that needs to be repaid to the creditor. The face value of a loan (or financing package) should not include the interest paid, nor should it include any grants included in the financing package. The calculator assumes an upfront disbursement of a hundred percent.

Grant (as part of financing package): This is the nominal amount granted as a part of a financing package that will not be repaid to the creditor.

Upfront commission (in percent): These are amounts paid as commissions for contracting the loan or financing package. Typically, these commissions are quoted as a percent of the contracted nominal amount. Upfront commissions (and/or management fees) throughout the lifetime of the loan constitute a cost of contracting/managing the loan and, therefore, an implicit interest cost, which should be included in calculating the level of concessionality. There is no commitment fee, or any charges imposed on un-disbursed portions of the loan since the calculator assumes that the full amount is disbursed upfront.

Management fees: These are fees paid per payment period and are quoted in the contract as either a fixed nominal amount or a percent of the outstanding nominal amount.

Interest rate (in percent): This is a negotiated rate of interest on the loan. The calculator only allows for fixed rates of interest and cannot accommodate variable rates of interest.

Maturity (in years): The number of years required to service the loan. The maturity period includes the grace period.

Payments per annum: The number of payments made on an annual basis while servicing the contracted loan (or financing package).

Grace period (in years): The grace period is defined as the period during which only the interest and no principal payments are payable by Borrower to the creditor.

Grant element (in percent): The grant element measures the concessionality of a loan. It is defined as the difference between its nominal value (face value) and the sum of the discounted future debt-service payments (net present value) to be made by the borrower, expressed as a percentage of the face value of the loan.

First Review of the GCF Financial Terms and Conditions

The firm Nodalis Conseil conducted the first review of T&C of the Fund's financial instruments[66]. The review was finalized in September 2017 and analyzed the Fund's portfolio between B9 and B 17. It is worth noting that at the time that the review was completed, no proposals under the Simplified Approval Process (SAP) had yet been approved by the Board.

Among Nodalis' findings were:

- A lack of connection between (a) concessionality, leverage, and the choice of instrument, and (b) the six investment criteria in decision B.05/07.
- A lack of connection between (a) concessionality and the choice of instrument and (b) country income or debt-distress status.
- Project-level analyses did not identify issues of non-compliance with Board- approved guidelines on choice of instrument and T&C. However, a small number of private programmatic sector mitigation projects (line of credits to lower renewable energy or energy efficiency financing costs) could be at risk of running askance of Board guidelines in the course of their implementation, depending on how term sheet commitments are interpreted, effectively applied, and monitored. This due to the absence of mechanisms to ensure that GCF concessionality is effectively transferred down.
- No clear correlation between concessionality and the quality of funding proposals in public sector projects

The firm's recommendations were divided into those pertaining to the public sector and those relevant to private projects/programs, as follows:

Public projects

- The level of concessionality of financial instruments should be the key parameter of a revised policy on financial T&C for public sector projects. Nodalis noted the "impossibility of calculating a minimum required concessionality."
- Define a limited number of levels of concessionality for GCF participation in a project/program (e.g., 33 percent, 66 percent, and 100 percent), and within those levels, allow the AE to tailor the type of financial instrument and T&C to the needs of the project and co-financing instruments.

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- Define a set of criteria to incentivize a more frequent use of loans, including country macroeconomic characteristics (Gross Domestic Product (GDP), poverty, indebtedness), the vulnerability of the recipient, result area, and level of concessionality of co-financiers resources
- Set a cap on the share of the total project expenditure financed by the GCF to encourage co-financing.

Private sector projects

- Maintain a case-by-case approach, but differentiate the level of scrutiny required on concessionality between “pilots, scale-up, and funding proposals.”
- Transfer concessionality equitably and efficiently in country-wide energy efficiency and renewable energy programs.
- Incentivize adopting internal concessionality review mechanisms either through the GCF approval process, the Accreditation Master Agreement (AMA) or through T&C.

While the Project Team will take these findings and recommendations into account, it is also worth emphasizing that the evolution of the Fund and the context of the first replenishment of the Fund warrant a substantially different approach to the review as that used by Nodalis.

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