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Approach paper on contributions from alternative sources of funds

Summary

This document is an approach paper on contributions from alternative sources. It provides background information on the possible approaches to various types of alternative sources for resource mobilization purposes.

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I. Introduction

1. The Governing Instrument for the GCF states that GCF will receive financial inputs from developed country Parties to the United Nations Framework Convention on Climate Change, and it may also receive financial inputs from other sources, public and private, including alternative sources.[1]

2. In decision B.05/04, the Board decided that GCF will "maintain the flexibility to receive financial inputs on an on-going basis," and "receive grants from public and private sources and paid-in capital contributions and concessional loans from public sources and may receive additional types of inputs at a later stage to be decided by the Board".[2]

3. In decision B.11/05, the Board requested the Secretariat to prepare "a document for understanding and defining alternative sources of financial inputs to the GCF that would be additional to current contributions," and develop "policies and procedures for contributions from philanthropic foundations and other non-public and alternative sources to the Initial Resource Mobilization process".[3] However, in decision B.14/01, the Board decided to defer the consideration of the policies and procedures for contributions from philanthropic foundations and other non-public and alternative sources to the Initial Resource Mobilization process to its seventeenth meeting (B.17). The consideration of the policy was deferred during B.17, by decision B.17/01, paragraph (b) (viii).

4. In preparation for B.20, a document entitled "Policies for contributions from philanthropic foundations and other alternative sources" (GCF/B.20/08/Rev.01) was issued to the Board in anticipation of the matter being considered as a sub-item under the agenda item "Matters related to replenishment". However, the agenda as adopted by the Board did not include that particular sub-item and thus the matter was not opened for discussions. Then, at B.22, by decision B.22/02, paragraph (d), the Board decided to defer the consideration of policies and procedures for contributions from philanthropic foundations and other non-public and alternative sources to the workplan for the following year.[4]

5. In decision B.24/02, the Board approved the Policy for Contributions to the Green Climate Fund for the First Replenishment which states that "contributions from public and private entities, philanthropic foundations and alternative sources, may be accepted on the basis of pledges received by the GCF in accordance with the relevant policies approved by the Board."

6. The updated Strategic Plan for 2020–2023 (decision B.27/06) calls upon the Secretariat to enhance institutional capacities and to, "Undertake ongoing resource mobilization efforts, including seeking new contributors, updating policies to enable potential contributions from private and alternative sources, and building the scale and predictability of resource mobilization over time."

7. GCF's second replenishment (GCF-2) process was officially launched in July 2022 at at B.33 by decision B.33/11. GCF-2 will further strengthen the Fund's ability to respond urgently to the climate crisis for the period covering 2024 to 2027.

8. This document presents potential approaches to contributions from alternative sources for the Board's consideration and recommends two options for the Board`s actions on the way forward.

[1] Governing Instrument for the GCF, paragraphs 29 and 30.
[2] Decision B.05/04, paragraphs (c) and (d).
[3] Decision B.11/05, paragraphs (c) and (d).
[4] Decision B.22/02, paragraph (d).

II. The climate finance landscape

9. At the 2009 United Nations Climate Change Conference (COP 15) in Copenhagen, Denmark, developed countries committed to the goal of jointly mobilizing USD 100 billion a year by 2020 to address the needs of developing countries for climate action, with the understanding that funding may come from a wide variety of sources. An analysis by the Organisation for Economic Co-operation and Development (OECD) indicates that USD 83.3 billion was channelled from developed countries towards this goal in 2020. This comprises bilateral and multilateral public climate finance, climate-related export credits, and private sector finance mobilized by public climate finance. Public finance is channelled bilaterally from developed countries, as well as multilaterally via multilateral development banks, United Nations and United Nations Framework Convention on Climate Change (UNFCCC) funds for climate action. In addition, several programmes, facilities, and initiatives have been established to support climate action in developing countries by the private sector or in partnership with the public sector to further make financial flows consistent with a pathway towards low-emission and climate resilient development. Within the OECD total, around USD 13 billion in private investment is attributed to having been mobilized by public climate finance from developed countries.[5]

10. The climate finance landscape extends beyond the categories within the Copenhagen commitment, encompassing climate finance investments in developing countries that are sourced from private and philanthropic sources that are not deemed to have been mobilized by public climate finance from developed countries. Philanthropic investors and foundations have expressed a growing appetite for climate investments, and foundations have distinct programmes, teams or divisions that focus on climate action and climate finance. They deploy investment tools, pool resources and provide financing for projects, programmes and initiatives that support climate action.

11. As part of this, global philanthropy and foundation funding for climate change mitigation has grown steadily in recent years, from nearly USD 900 million in 2015 to at least USD 1.9 billion in 2020, among leading foundations with climate-focused programmes.[6] However, when one considers that total global philanthropic giving in 2020 is estimated to be around USD 750 billion, one should note that still less than 2 per cent is dedicated to climate change mitigation, with an even smaller proportion of this funding directed to developing countries.[7]

12. The commitment to low carbon development pathways expressed within the Paris Agreement in 2015 creates huge opportunities for further climate finance investment, well beyond current levels of climate finance. The transition to low-carbon development pathways, targeting aggressive growth in climate solutions, including renewable energy, low-carbon cities, energy efficiency, sustainable forest management, and climate-smart agriculture opens vast opportunities for climate investments in emerging and developing countries estimated at more than USD 23 trillion between now and 2030.[8]

13. In addition, there are financial mechanisms which could further enhance the level of climate finance. These could include, but not be limited to, usage of Special Drawing Rights (SDRs) in GCF's funding operations, issuance of green bonds, debt-for-climate swaps, acceptance of loans/debts from alternative sources, insurance mechanisms, and market mechanisms and non-market approaches under the Paris Agreement.

[5] https://www.oecd.org/climate-change/finance-usd-100-billion-goal/aggregate-trends-of-climate-finance-provided-and-mobilised-by-developed-countries-in-2013-2020.pdf
[6] ClimateWorks Foundation Funding Trends 2021: Climate Change Mitigation Philanthropy,
[7] ClimateWorks Foundation Funding Trends 2021: Climate Change Mitigation Philanthropy,
[8] See Climate Investment Opportunities in Emerging Markets: An IFC Analysis

14. A potentially significant new source of climate finance is the use of SDRs under the International Monetary Fund (IMF). The Group of Seven (G7) and the Group of 20 (G20) have called upon the IMF to explore avenues for developed countries to voluntarily channel some of their SDRs to more vulnerable and poorer countries and redirect them to help rebuild economies towards a green and resilient coronavirus disease 2019 (COVID-19)recovery. In August 2021, the IMF approved a general allocation of SDR equivalent to USD 650 billion to help poorer countries with long-term challenges including changing climate. It has proposed an IMF-administered Resilience and Sustainability Trust for channelling SDRs to prescribed SDR holders to address long-term challenges that countries face.

15. Another potentially significant new source of climate finance is the development of innovative instruments. Innovative financing refers to a range of non-traditional mechanisms to raise additional funds for official assistance through "innovative" projects such as taxes, public–private partnerships and market-based financial transactions. Innovative financing mechanisms can be traced back as far as 1972, when Nobel Prize Laureate James Tobin suggested a currency transaction tax to penalize short-term financial round-trip excursions into another currency. Several innovative financing mechanisms were born out of a need to reach the Millennium Development Goals at the turn of the millennium and were initially designed and allocated for the health care sector. For example, Unitaid is an international innovative facility for the purchase of drugs against human immunodeficiency virus (HIV)/acquired immunodeficiency syndrome (AIDS), malaria and tuberculosis. It is supported by a so-called "air ticket solidarity levy", or a tax on airline tickets. Another illustration is the International Finance Facility for Immunisation (IFFIm),[9], which has issued bonds in the capital markets, converting long-term government pledges into immediately available cash resources.

16. More recently, several innovative instruments have been proposed to scale up climate action. For example, it was agreed at COP 26 that an equivalent of 5 per cent of the "share of proceeds" from traded internationally transferred mitigation outcomes (ITMOs) linked to the multilateral mechanism established under Article 6, paragraph 4, of the Paris Agreement[10]) will be transferred to the Adaptation Fund to help developing countries finance their efforts to adapt to the impacts of climate change. While this innovative instrument taps into the carbon markets, others have been proposed to penalize high carbon activities (for example, a tax on airline business class tickets) or internalize the external costs of carbon emissions (for example, a tax on exports of oil and gas, etc.).

III. Approach to alternative sources of contributions

17. GCF is already channelling additional climate finance from a wide variety of sources, further to its mandate under the Governing Instrument to "play a key role in channelling new, additional, adequate and predictable financial resources to developing countries", and to "catalyse climate finance, both public and private, and at the international and national levels". However, direct contributions to GCF are currently limited to sovereign governments, subnational governments and cities.

18. There is a longlist of potential alternative funding options reflecting a diversity of potential sources of funds, funding purposes and instruments, as well as mechanisms and structures for the intake, governance, and programming of funds.

19. For the Board`s consideration of contributions from alternative sources, this document discusses two main contribution approaches: (i) contributions channelled through GCF

[9] https://iffim.org/
[10] UNFCCC decision 3/CMA.3, annex, chapter VII, paragraph 67.

(referred to as "direct contributions"); and (ii) financing **catalysed** by GCF (referred to as "indirect funding").

20. Contributions channelled through GCF will involve receiving contributions directly from alternative sources into the existing GCF Trust Fund or other designated account(s) owned by the Fund.

21. On the other hand, contributions catalysed by GCF refer to mechanisms where alternative sources could provide funds/investments to funds, investment platforms or projects funded or supported by GCF. This includes some existing models of GCF projects, as well as others that may require policy changes to implement.

22. To inform the Board on possible approaches to financing from alternative sources, the following sections provide an initial assessment of modalities that could further develop the ability of GCF to receive and catalyse additional sources of climate finance. Direct contributions are considered first, followed by indirect funding. In each case, the analysis is structured around an assessment of the funding model, as well as on the operational requirements to implement the model. Consideration of both approaches is necessary to assess the likelihood of potential alternative contributors choosing to make direct contributions to GCF in future, rather than preferring indirect collaboration.

3.1 Consideration of alternative sources of direct contributions to GCF

23. Additional contributions to supplement those made by existing contributors, if mobilized from philanthropies, foundations and alternative sources, could potentially be paid into the GCF Trust Fund held at the World Bank and/or into other account(s) held by GCF. Further arrangements with the current Trustee would be required to allow for such contributions. Another possibility that could be explored would be to designate an external partner organization or existing tax-exempt entity that could receive contributions on behalf of GCF and then transfer those resources to GCF.

24. Some of the sources of contributions from alternative sources are set out below. Such sources include, but are not limited, to:

(a) Philanthropic foundations;
(b) Philanthropic arms of endowment funds;
(c) Philanthropic arms of sovereign wealth funds;
(d) Philanthropic arms of public and private pension funds;
(e) Other funds including private–public funds;
(f) Philanthropic arms of public and private insurance companies;
(g) Philanthropic arms of other private companies (e.g. project developers, private equity, venture capital);
(h) Philanthropic arms of financial institutions;
(i) High-net-worth individuals (HNWIs);[11]
(j) Family offices;
(k) Private individuals;
(l) Civil society organizations; and
(m) Other innovative sources of finance, such as globally agreed mechanisms/initiatives, including SDRs, insurance schemes, and proceeds from traded ITMOs under Article 6, paragraph 4 of the Paris Agreement.

25. Given that direct contributions to GCF would not attract a commercial rate of return (although contributions could be made in the form of loans), it would be anticipated that

[11] High-net-worth individuals is a term often used to designate individuals who hold financial assets with a value greater than USD1 million.

contributions from alternative sources would be from the non-profit sector, rather than the private sector. These potential contributions could be categorized into two main categories (see figure 1): (a) large contributions in the form of grant fundraising from philanthropies, foundations, HNWIs, corporate donors, and other innovative sources of funding; or (b) small grant contributions through crowdsourcing or from the general public (e.g. less than USD 10,000 and a potential maximum threshold to consider exemption from Know Your Customer (KYC)[12] considerations), with both approaches requiring extensive outreach and relationship-building by GCF.

Figure 1: Two main categories of direct contributions

(a) Large contributions **(b) Small contributions**

3.1.1. Assessment of potential direct contributions from alternative sources

26. A policy to accept direct contributions from alternative sources could potentially generate additional resources and diversify the contributor base for GCF.

27. However, the preliminary assessment of the Secretariat is that under the current governance and business model of GCF there will be significant challenges to successful implementation of a policy on direct contributions from alternative sources, whether from category (a) or (b).

28. Regarding potential contributors from category (a), a study undertaken for the Secretariat in 2021 (the Study)[13] considered potential alternative sources of contributions. The authors conducted a number of interviews with potential sources, principally foundations, in order to evaluate the likelihood of them contributing directly to GCF. The views and opinions expressed indicated an unwillingness to contemplate direct contributions to GCF owing to its governance and business model which does not allow alternative contributors to exercise control as to how their funds would be allocated and managed.

29. Since the power to determine the approval of GCF funded activities and other expenditure lies solely with the GCF Board, contributors to GCF are not able to earmark funds for specific purposes. Furthermore, Board membership determined by the Governing Instrument is limited to representatives from developed and developing country Parties to the UNFCCC, hence alternative contributors could not have a seat on the Board. As alternative contributors would not have control over the use of their funds, from the perspective of a potential alternative contributor it would be much more attractive to seek an arrangement to partner using indirect funding to GCF.

30. Further, as the amount of philanthropic funding for climate change is still small, the competition to access these funds will be fierce. Based upon the industry-standard fundraising ratios, GCF would need to invest significant resources in fund-raising - at least 10 per cent of the

[12] Know Your Customer: standards used to verify customers and know their risk and financial profiles. This process will also need to be set up.
[13] Climate Finance Advisors, BLLC, 2021, *Philanthropic and Alternative Sources of Funding Report.*

targeted amount. In soliciting direct contributions from alternative sources, GCF may also be seen as crowding out other smaller organizations from receiving climate change finance from alternative sources of funding, particularly foundations.

31. There are also significant challenges regarding contributions from crowdsourcing/the general public (category (b)). Successful mobilization of funding from such sources would require extensive investment in fundraising, to an even higher level than in category (a); a major outreach by the fund among the general public in targeted countries in order to raise its visibility and profile. Industry standard ratios for philanthropic fundraising from a public campaign range from 10 to 15 per cent, in other words an additional budget of at least USD 50 million would be required to target mobilization of USD 500 million. However, further research and market analysis will be required to establish whether such a fundraising campaign would be successful, even if sufficiently resourced. As an international governmental organization operating as a second-level due diligence organization via over 100 implementing partners, and without regional or country presence, GCF is not well positioned to establish the visibility and brand recognition required for such campaigns. This may lead to the amount of funding mobilized being very low when compared to the actual mobilization costs (cost-efficiency may be low). GCF may also be seen as crowding out other organizations from mobilizing funds from such sources.

3.1.2. Operational impact assessment

32. **Frameworks and processes**: Before turning such an approach into a policy, certain operational frameworks, control mechanisms, and processes must be amended and/or established. These include: the risk management framework including legal risks and liabilities; Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Policy; standards for implementing the AML/CTF Policy (AML/CTF Standards) and compliance risk policy; and financial reporting to meet new contributor requirements. Also from a risk perspective, the process, structures, and systems for due diligence of the source of these new resources also need to be considered, which, would call for an assessment and potential revision to the risk appetite to receive these contributions. Further, arrangements on where and how to manage these new assets will need to be assessed. As paragraph 24 of the Governing Instrument states that "The Fund will have a trustee with administrative competence to manage the financial assets of the Fund", the Trustee will also need to be consulted on whether the GCF Trust Fund is able to receive some or any of these contributions.

33. **Costs**: These arrangements would have budgetary implications for the Secretariat, especially related to: (i) conducting necessary due diligence on new contributors, as well as assessments on the source of funds; (ii) staffing for management and outreach to secure funding, monitoring and reporting; and (iii) systems to manage the new contributors, funds and reports. The Study shows that the cost to implement such approaches is estimated to be between USD 1 million and USD 1.5 million per annum, excluding the initial set-up costs, and these costs would cover activities for legal counsel with international tax expertise, outreach in local areas and major markets. The choice of whether to outsource the due diligence process and the actual collection of contributions may also increase these annual costs further, especially if the industry standard ratios for philanthropic fundraising from a public campaign range from 10 to 15 per cent of the actual funds mobilized.

34. **Earmarking**: While there needs to be further consideration by the Board on whether to allow earmarking of contributions, to what extent or how, currently, any contributions from alternative sources would be subject to the existing governance structure and same limitations on earmarking as applied to existing contributors.

35. **Tax exemption**: Large contributions require a local, tax-exempt presence in key markets to enable contributors to receive tax benefits. This would require personnel resources

for grant reporting to streamline existing due diligence policies and apply them to contributor partners. It would also involve the inclusion of a reputational risk review as part of this process. For contributors to receive tax benefits, GCF would have to demonstrate that donated funds do not go to non-tax-exempt purposes, even if contributors themselves cannot earmark funds.

36. Laws on tax treatment of charitable contributions differ from country to country, but to receive favourable tax treatment, contributions need to be made to a tax-exempt entity organized under that country's domestic laws.[14] The domestic tax-exempt organization(s) can distribute funds in other countries but can only do so to entities or activities that would meet the same criteria to qualify as tax-exempt under the contributors' countries' domestic laws. The tax-exempt organizations must also retain enough control over distributions in other countries (i.e. through contributor agreements and reporting requirements) to demonstrate to domestic tax authorities that the monies they disbursed abroad were used appropriately.

37. To receive contributions from contributors that do not disburse funds internationally, GCF could explore either partnering with an existing tax-exempt entity in a country (especially in the United States of America) or forming a new one. An example of the former approach is the United Nations Foundation receiving contributions for the Adaptation Fund. These are typically organized as "Friends of" organizations that receive contributions in the United States for international entities. However, a "Friends of" organization cannot simply be a pass-through entity, meaning that an existing tax-exempt entity or a United States "Friends of" organization needs to (at minimum): (i) have a board of directors with a majority of independent members; (ii) retain authority to exercise independent judgment about the use of contributions received; and (iii) have the capacity to receive and review reporting on the use of funds and make necessary tax filings in the United States. Using United States law as an illustrative example, approximately 70 per cent of cross-border charitable contributions originate in the United States, and although these challenges are surmountable (evidenced by the fact that tens of billions of dollars of charitable giving crosses borders each year), its implementation will require considerable capacity in terms of staffing and the required knowledge and expertise.

38. Foundations, in general, will only contribute if the contributor agreements allow them sufficient monitoring and control to satisfy their reporting obligations to tax authorities (e.g. the United States Internal Revenue Service (IRS)). Alternatively, foundations can donate to a foreign entity if they decide that such entity (including all of its activities) is equivalent to a United States tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code. As a result, such foundations are likely to be cautious in their approach because if funds they contribute are found to be used for non-exempt purposes, it could jeopardize a foundation's overall tax-exempt status.[15]

39. While not an exhaustive list, the following key internal and external steps must take place (projected to take an estimated 12–24 months) to determine, in sufficient detail, how to implement such an approach along with the necessary cost-benefit analysis and estimation of the required budget, before developing a comprehensive policy to describe and govern it:

(a) Internal:

  (i) Hire a legal team (or individual) to seek specialized legal advice on international tax considerations, including across multiple jurisdictions

  (ii) Develop a due diligence framework for the policy, including due diligence by the Trustee or any other external parties involved;

  (iii) Establish eligibility criteria for alternative sources;

  (iv) Develop a fundraising strategy;

[14] https://www.oecd-ilibrary.org/sites/cfac7a8c-en/index.html?itemId=/content/component/cfac7a8c-en
[15] https://www.irs.gov/pub/irs-tenge/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf

(v) Outline a master agreement template for alternative fund sources;

(vi) Establish administrative cost percentage charge on incoming funds;

(vii) Establish a local presence for GCF (contingent on needs identified in the market analysis and funding strategy could be outsourced);

(viii) Secure outreach support and amend current staff terms of reference to conduct outreach; and

(ix) Hire new staff or amend organizational structure and staff job descriptions to ensure dedicated personnel for monitoring, due diligence, and reporting of impact and flow of funds; and

(b) External:

(i) In-depth market analysis of opportunity and operational/legal requirements; and

(ii) Review agreement and discuss whether or not the Trustee or new trustee can accept these such funding.

40. Although it would be possible to put in place the technical measures outlined above that would be required for a policy on alternative sources that allows direct contributions, it is not likely to bring expected results without investing significant resources in policy implementation (by building fundraising capacity) and by making changes to the governance and business model of GCF. It should be noted that changes to policies or the governance model will require further review on whether those changes are at all feasible, as certain cornerstone requirements stem from the Governing Instrument. Adopting a policy without such considerations may also give rise to reputational risks for GCF, given the potential expectations regarding the potential resources mobilized, and to avoid perceptions that the policy was unsuccessful.

3.2 Approach to indirect funding

41. Indirect funding refers to mechanisms where contributors and investors could provide financing/investments directly to funds, investment platforms or projects instead of directly contributing to the GCF Trust Fund. These could include various innovative mechanisms and modalities. As illustrative examples, the following approaches for structuring GCF mobilization of funding from alternative sources are analysed in this section: (i) parallel funds; (ii) co-investment platforms; and (iii) partnership agreements. In addition to the above modalities, other innovative mechanisms could include, but not be limited to, usage of SDRs in GCF's funding operations, and debt-for-climate swaps, among other modalities.

42. The Board acknowledged the need to mobilize funds at scale from, inter alia, institutional investors, such as pension funds and sovereign wealth funds, and to design modalities to that end (decision GCF/B.04/08). As a response, the GCF Private Sector Facility is aimed at mobilizing capital from institutional investors to co-invest in GCF private sector projects, considering the mechanisms that are explained below.

43. As per the Private Sector Strategy (decision GCF/B.32/06 paragraph (d)), GCF will continue to build partnership coalitions with non-accredited entities, notably through its efforts to scale up the development of co-investment platforms that could be implemented through existing accredited entities (AEs) and other existing funding modalities. GCF will aim to become the hub of climate finance by connecting AEs with investors in this regard.

44. Several options have been identified to further develop the ability of GCF to leverage indirect contributions: co-investment platforms, parallel funds, and partnership agreements. Each are analysed below, together with their advantages and disadvantages.

3.2.1. Co-investment platforms

45. This modality is already within the GCF's governance and existing business model. GCF is increasingly using co-investment platforms (see figure 2) to broaden its range of partners and catalyse climate finance. Co-investment platforms focus primarily on return-seeking investment, so partners are often from the private sector. It is also possible to include philanthropic funds, for example, through a blended finance structure inclusive of a grant-making component. In such a case, they can help to build strong relations with GCF which could be a precursor to other forms of collaboration including direct financing in future.

46. Under this model, investors and GCF together capitalize a platform set up to invest in predefined project types according to a set of investment criteria. GCF approves a co-investment platform as a funded activity programme, with the AE or executing entity then managing the funds and allocating them to projects according to the approved investment criteria. Forms of such platform currently within the GCF portfolio include GCF-funded investment funds such as FP180 (Global Fund for Coral Reefs) and FP181 (Catalytic Capital for First Private Investment Fund for Adaptation Technologies in Developing Countries (CRAFT)) managed by Pegasus Capital Advisors; FP099 (Climate Investor One) and FP190 (Climate Investor Two), managed by Nederlandse Financierings- Maatschappij voor Ontwikkelingslanden (FMO).

Figure 2: Example of co-investment platform

47. The use of a co-investment platform can leverage GCF concessional capital to attract private sector investors. It provides an opportunity for investors to partner with GCF outside of the structure of accreditation and has a high potential to increase leverage for higher overall climate investments. Co-investment platforms encourage GCF and private sector investors to mutually benefit from project development and implementation experience through collaborative work.

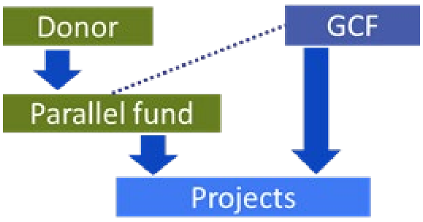
48. Challenges in the use of co-investment platforms include operational hurdles and costs. As with other programmes, there may also be challenges regarding oversight of the sub-projects financed under the platform and dedicated information disclosure protocols might be required. These will be considered as part of the Board paper on programmatic approaches.

3.2.2. Parallel fund

49. A second modality is the creation of a parallel fund. A parallel fund (see figure 3) would be created in partnership with a large donor or several donors to support specific, predefined and Board-approved goals of the partnership. This is a well understood and tested model used by many multilaterals to collaborate with philanthropic organizations on accomplishing shared goals. However, in contrast to co-investment platforms, this modality would require a Board decision to define the relationship between the parallel fund and GCF. This modality would allow contributors to provide funds through the parallel fund to GCF projects, meaning the

funds will not flow through the general GCF Trust Fund. This option could allow for partnership in oversight of these funds and is likely to be more attractive to philanthropies since it could allow contributors to direct funds to specific purposes more easily.

Figure 3: Example of a parallel fund



50. The advantages of a parallel fund structure for potential contributors would be that the structure is well known to philanthropic contributors and used regularly. It would allow control over the destination and purpose of funding, as well as the governance of the fund and (depending upon project agreements) the eventual projects. From the perspective of GCF, such an arrangement would increase the funds available for GCF projects without a requirement for accreditation.

51. The challenges of using a parallel fund model would include the need to identify which "target areas" would be best for this approach or whether it would be a specialized window. There would also be governance and legal considerations as to the place of such fund under the Governing Instrument. The use of such parallel funds would also require consideration of tax rules of several jurisdictions and could create reputational risks to GCF associated with partnering with non-AEs that have not been through GCF's due diligence process for AEs.

3.2.3. Partnership agreement

53. A third option is a partnership agreement. In this mechanism, GCF would develop partnership relationships with contributors/investors outside of the accreditation structure (see figure 4). Once synergies are identified between GCF and the partner in relation to investment opportunities, GCF would work to match these funders with AEs that are developing projects that meet the criteria outlined in the partnership agreement. The project would be implemented by the AE which would also use the investment from the funding partner to execute the project. In addition to the development of new projects, partnership agreements could also lead to the partner investing in existing GCF funded activities which are in need of additional capital to facilitate increased climate investment.

Figure 4: Examples of partnership agreements

54. A partnership agreement would allow GCF to formalize relationships with potential investors/philanthropies, outside of the structure of accreditation, in order to plan longer-term co-investment. Such agreements could attract capital to niches that have historically been difficult for GCF to finance at scale.

55. As GCF would be partnering with sources outside of its AEs, a potential challenge of partnership agreement could be that this may create a perception that GCF is giving preference to some sources and constituencies over others.

3.2.4. Other options

56. Another option is the consideration of using IMF's SDRs in GCF funding operations for mitigation and adaptation projects. Currently, SDRs can be held by a list of 15 prescribed holders,[16] where some GCF AEs are already included. GCF can leverage its extensive network of AEs and members countries, its position at the center of the global climate finance architecture, and its experience in delivering more than USD 10 billion in mitigation and adaptation finance to support the global effort to magnify the impact of this general allocation for countries most in need and engaged in mitigation and adaptation efforts. GCF could be complementary to proposed approaches aiming at scaling up the IMF Resilience and Sustainability Trust.

57. There are multiple delivery models GCF could pursue to deliver SDR financing. Initially this could be achieved by GCF mobilizing SDRs from existing prescribed holders into funds and projects outside of GCF itself; an indirect approach. Subject to a Board decision, at a later stage, GCF could consider becoming a prescribed holder to receive SDRs directly.

3.2.5. Operational impact assessment and implementation arrangements

58. While these mechanisms and arrangements fall into a broad scope of mobilizing resources from alternative sources of funding, the discussions and considerations are already part of regular engagements with AEs and a broad range of non-AE partners in developing cooperation partnerships and funding proposals. Due to the ongoing discussions internally and with a broad range of GCF stakeholders, the recommended approach is to consider these options, including whether or not these may affect the governance and/or business model of GCF, the relationship with the Trustee, the AML/CFT Policy and its Standards and the risks associated with these, as part of the implementation of the Private Sector Strategy, project-specific assessment approach (PSAA), or other partnering options rather than the Policy for Contributions from Alternative Sources of Funds.

IV. Summary of analysis and recommendations

59. Based upon the analysis above, whilst a policy to accept direct contributions from alternative sources could potentially generate additional resources and diversify the contributor base for GCF, at this stage there does not seem to be much appetite from philanthropic funders to channel their contributions directly through GCF. This is illustrated in table 1, which compares control over contributions for indirect funding versus direct contributions for a potential GCF partner. Therefore, the likelihood of attracting significant additional resources from alternative sources is low without significant governance reforms to allow alternative contributors much greater control over the use of their contributions. Furthermore, there are significant challenges at present for GCF in leveraging contributions from small-scale donations from the public.

[16] https://www.imf.org/en/About/FAQ/special-drawing-right

Table 1: Comparing advantages of direct vs indirect contributions for potential alternative contributor

Control over use of funds	Indirect funding	Direct contribution
Select type of climate investment (adaptation or mitigation)?	Yes (parallel fund, co-investment platform, partnership agreement)	No
Select geographic area of investment?	Yes (parallel fund, co-investment platform, partnership agreement)	No
Select sector of intervention?	Yes (parallel fund, co-investment platform, partnership agreement)	No
Apply own ESS / investment assessment ahead of project?	Yes (partnership agreement), depends (parallel fund, co-investment platform)	No
Participate in governance of project?	Yes (partnership agreement), depends (parallel fund, co-investment platform)	No
Undertake own M&E during project lifecycle?	Yes, depending on project agreement	Subject to agreement with GCF/AE

Abbreviations: AE = accredited entity; *ESS = environmental and social safeguards; M&E = monitoring and evaluation.*

60. As outlined in the introduction to this paper, the Secretariat is mandated to prepare “a document for understanding and defining alternative sources of financial inputs to the GCF that would be additional to current contributions,” (B.11/05) and to, “undertake ongoing resource mobilization efforts, including seeking new contributors, updating policies to enable potential contributions from private and alternative sources, and building the scale and predictability of resource mobilization over time” (B.27/06). In line with this mandate, and based upon the analysis above, the Secretariat therefore recommends a phased approach to resource mobilisation from alternative sources, starting with indirect mobilisation, with the aim of moving to direct contributions from alternative sources over time.

Phase one

61. In the first phase, GCF would focus upon further developing its collaboration with partners from the philanthropic sector, using GCF’s current modality for the creation of co-investment platforms. This approach will consolidate and diversify the sources of parallel financing for GCF-convened co-investment platforms. It would aim to build trust and mutual understanding between GCF and philanthropic partners that could facilitate other forms of partnership or contributions in the future.

62. Also within this first phase, GCF would work with prescribed holders of SDRs that are accredited to GCF, as a precursor to consideration as to whether GCF should itself seek to become a prescribed SDR holder.

Phase two

63. In the second phase, the Board could consider the use of parallel funds and other partnership agreements, as well as becoming a prescribed SDR holder and potential recipient of other sources of innovative financing. As outlined above, SDRs could be a source of direct financing should GCF become a prescribed holder (GCF would become the first dedicated climate prescribed holder). Similarly, the proceeds of innovative sources of funding could be directly allocated to GCF in a manner similar to the 5 per cent of the "share of proceeds" from ITMOs to the Adaptation Fund or indirectly through its incorporation as a source of finance within a co-investment platform, parallel fund, or partnership agreement. Further analysis would first be required in relation to governance issues, as well as implementation considerations including tax and legal.

64. Such arrangements, if agreed by the Board, would enable GCF to build broader funding partnerships that would increase the ability to leverage other sources of climate finance towards specific climate goals. The Secretariat proposes to undertake analysis on these issues, and to revert to the Board for its consideration of these financing pathways.

Phase three

65. Based upon the ongoing work of establishing successful relationships with philanthropies under phase one, and possible experience under phase two depending upon Board decisions, in two to three years it would be appropriate to re-visit the potential of soliciting direct contributions from alternative sources, taking into account the governance considerations. It is therefore proposed that the Secretariat should revert to the Board on this issue no later than the end of the GCF-2 programming period, informed by the experience of the first two phases, and by the views of potential philanthropic contributors.

Annex I: Draft decision of the Board

The Board, having considered document GCF/B.34/18 titled "Approach paper on contributions from alternative sources of funds":

(a) Notes the information provided in this document;

(b) Endorses the phased approach towards contributions from alternative sources as set out in this paper;

(c) Requests the Secretariat to:

(i) continue to develop relations with philanthropic organisations as part of its existing use of co-investment platforms; and

(ii) explore with prescribed SDR holders which are also Accredited Entities how to leverage SDRs as an indirect source of GCF financing;

(d) Requests the Secretariat to undertake:

(i) an analysis of the potential use of parallel funds and partnership arrangements including consideration of tax and legal implications; and

(ii) an analysis of the potential for the Fund to become a prescribed holder of Special Drawing Rights (SDRs) and the use of other innovative sources of financing;

and to present these analyses for the Board's consideration by the thirty-sixth meeting of the Board; and

(e) Requests the Secretariat to report to the Board on the potential for direct contributions from alternative sources of funds no later than the end of the GCF-2 programming period.

Annex II: Matrix of direct and indirect contributions

	Direct contributions	Indirect funding
Description	Contributions channelled through GCF	Financing catalysed by GCF
Approaches	(1) Large contributions from philanthropies, foundations, high net worth individuals (HNWIs), corporate donors, and innovative sources of funding or (2) Small contributions through crowdsourcing or from the general public	(1) Co-investment platform (2) Parallel fund (3) Partnership agreement (4) Other innovative mechanisms such as usage of Special Drawing Rights in GCF's funding operations, debt for climate swaps, etc.
Estimated budget	USD 1-1.5 million per annum, or 10-25 per cent of funds raised not including start-up costs and increased staffing needs for legal counsel, outreach and marketing, finance, risk management and compliance, monitoring and reporting, ICT and back-office processing	Options ranging from USD 1 million to USD 10 million and increased staffing needs for legal counsel, outreach, finance, monitoring and reporting, and fund management
Timeline for implementation	12-24 months	6-48 months (depending on approach option)
Policy and governance gaps	• Earmarking policy • Due diligence and reputational risk review of contributors including eligibility criteria for contributors • Governance structure that allows the GCF Secretariat and contributors to participate in the decision-making process. • Policy for hedging foreign exchange risk (in progress) • Policy on cross-border transfer of tax-exempt funds	• Earmarking policy • Legal framework, accredited entity access framework, reporting procedures, due diligence policies, etc.
Contributor perceptions	• Large donors unlikely to contribute funds directly because of requirements related to earmarking and governance/decision-making. • Contributions from the general public will have positive impact by laying the groundwork to increase awareness of GCF to other large alternative funders.	• Indirect contribution structures are well-known, attractive, and regularly used by contributors. • Strong interest in investment communities in climate projects. Some approaches are already being implemented such as co-investment platforms (see "examples").
Examples	(1) Global Fund Friends of the Global Fight Against AIDS, Tuberculosis, and Malaria (2) UNICEF, UN Foundation fundraising for the Adaptation Fund	(1) FP180 - Global Fund for Coral Reefs, FP181 - CRAFT, FP099 - Climate Investor One, FP190 - Climate Investor Two (2) Forest Carbon Partnership Facility (3) MCPP – IFC loan syndication platform or Blackstone Co-Investment Opportunities (4) MacArthur Foundation Catalytic Capital Consortium

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