Request for Input to GCF's Strategic Plan

A. Demand: The Secretariat is seeking ideas and recommendations on setting the Fund's overall strategic directions and priorities of action that:

a) Reflect your views on GCF's strategic directions, priorities, approaches, and plans;
b) Respond to your views, needs and priorities on pursuing impactful implementation of climate actions to address climate change; and
c) Lead to the improvement and enhancement of the Fund's overall operations.

B. Input:

i. Context

The comments bellow seeks to bring light to the board decision to "update the core operational priorities and underlying action plan with a view to continuous improvement of the accessibility, efficiency, effectiveness, impact, scale and reach of the GCF".

The focus of this recommendation is on the private sector approach, in particular from the MSME point view and its hurdles to access funding, which are the majority of the enterprises available in the LDCs and SIDs world-wide.

ii. Analysis on the report on the implementation of the initial Strategic Plan of the GCF

Based on the IRM (2015–2018), with regards the Private Sector Engagement, the operational priorities seemed to be met, nonetheless, there are room for improvement and further development and local and regional increase institutional capacity and strengthening in this area. Report states that "work over the period to 2018 has seen substantial growth in the private sector portfolio to USD 1.8 billion or 40 per cent of the current portfolio".

To keep and improve engagement of the Private Sector, the stated in the report is valid and should be a continued effort of the GCF, to "include investment in establishing national green banks that can serve as financial intermediaries, more diversified use of instruments, improving access modalities, including through consideration of a direct investment approach, and addressing barriers such as local currency risk". These should be part of the strategic directions, priorities, approaches, and plans of the Board and Secretariat.

The progress report against the initial Strategic Plan also states that "analyze barriers to crowding-in and maximizing the engagement of the private sector, including based on a survey amongst private sectors actors, to develop a private sector outreach plan" has been concluded and that "private sector strategy developed for Board consideration in 2019". In addition, the report states to "reconsider the extensive Private Sector Advisory Group (PSAG) recommendations on: enhancing Secretariat capacity, readiness for private sector, accreditation modalities and options to reduce currency risks" is an "ongoing as part of private sector strategy".

The above confirms a few of the most relevant points for the Private Sector, which translate to creating a more favorable business environment for investors, to reduce capital risk and overall MSME exposure currency variation risks and project development in uncharted areas, such the adaptation projects (which still lacks a basic understanding from the local financing institutions). As stated in the above mentioned report, "a key challenge GCF faces in managing and maximizing impact is the still-evolving state of global knowledge on how to define, articulate and evaluate paradigm shift and transformation, in particular for adaptation".

All the above is in light with the Board's Strategic Vision for the GCF to support of the implementation of the Paris Agreement within the evolving climate finance landscape, in line with the Fund's willingness "take on risks that other funds/institutions are not able or willing to take, including risks associated with deploying innovative climate technologies".

Another biggest hurdle for bigger private sector is the accreditation process that is too long (time and resource consuming) to interest or justify major participation, in addition to the long cycle for the approval process. Project approval could be expedited in cases where the technology or process has proven record and widely accepted by international community or other international funds (GEF, CIF, etc), such as the use of renewable energy, reforestation, energy efficiency, sustainable agriculture, and so on. This would bring in more private sector funding, above the 40% seen so far.

The accreditation process has been partially addressed with the more simplified approval process requested by the Board in particular for micro scale activities, nonetheless, for bigger scale projects, the barrier remains.

To date, the majority of projects are in the energy results area, weather for "market-opening investments in renewables and access to finance for clean energy businesses" and "there is emerging potential for private sector investment in areas such as forests, transport and adaptation services, as well as yet-untapped potential to attract greater institutional investment into climate action".

PSAG has put together "recommendations around supporting national governments to establish adequate regulatory frameworks, actively deploying fit for purpose instruments and putting in place mechanisms for facilitating technology and knowledge transfers". These recommendations should continue to be included in future GCF planning. Continuous improvement of business environment is crucial for private sector.

PSAG past suggestions should be addressed as the Strategic plan moves ahead. It is fundamental to continue enhancing "opportunities to engage the private sector in adaptation and explored barriers to private sector engagement in LDCs and SIDs, which included the important role of readiness in closing information gaps and risk perceptions, the value of deploying risk-transfer products and establishing public–private structures to address market failures".

Prepared by Aurelio Souza (PSAG Member)

Finally, the report states that "will include concrete recommendations for future private sector engagement, including identifying reforms and new initiatives that will help GCF to better unlock its potential for engaging the private sector in country-driven climate action.". Nonetheless, it was noted that the "AE model has not been well suited to realizing this impact potential", which was also agreed by PSAG in the past.

Take away from the summary of the report related to private sector engagement should be the continued improvement of sector mobilization, including enhancing readiness support based on the upcoming private sector strategy, new formats for access modalities and improvement of the accreditation framework and improve the utilization of a diversity of instruments and operational modalities for broader mobilization of the private sector, such as but not limited to, providing local currency facility, more efficient guarantee mechanisms, etc.

My understanding is that the "Report on the implementation of the initial Strategic Plan" captures well the achievement, the constraints and reflects the special moment the GCF is going through right now. The overall considerations that Fund should maintain its focus and look ahead to better define the "approach to innovation and technology, including risk appetite, to assist with bringing relevant proposals for GCF investment and mobilizing the private sector" very relevant to leverage private sector funding.

iii. **<u>Improvement and enhancement of the Fund's overall operations and strategy.</u>**

To address improvement in the Fund's overall operations one must carry out a detailed analysis of the operational details and compare it against the expected objectives. My understating from the proceedings and above mentioned report is that Fund's initial IRM has been a learning process and have achieved impressive results to date.

However, the procedures and process seem too complex and bureaucratic for both MSMEs and to attract private sector entities. A recommendation for CGF's strategic planning and funding opportunities could include an analysis of Macro Trends aiming to target such areas as priority when considering private sector engagement and decentralized climate finance.

Although the following ideas are presented in a very simplicity way and not sharing any in depth analysis, these are couple of ideas that I have come across lately and though of sharing.

a) <u>Macro trends analysis integrated into the strategic planning.</u>

Macro Trends (MT) are defined as long-term, pervasive shifts that affect a large population. MT also helps investors gauge the market expectation, which in turn help drive long-term price trends, investment opportunities and return on investment. Generally, they fall into the following categories: (i) Demographics; (ii) Economics; (iii) Technology; (iv) Environment; (v) Government and (vi) Society.

Macro trends are the big waves that shape the future, and in order to surf them, one need to pick the best opportunities in these sectors – this is exactly what the private sector will be looking into – the champions on each sector. Likewise, GCF should be look into global MT to address private sector portfolio considering that those will be the areas that consumption, resources, revenues and potential for paradigm shift will be concentrated.

There are a couple of main ways to identify (or influence) macro trends: via government policy and / or economic cycles. In general, government policies are a precursor to change, shaping macro trends and creating opportunities. This falls quite well on the Fund's role and capabilities. Whilst, the cyclical nature of the economy means that investors can also use history to identify macro trends that lead to an expanding economy or a contracting economy.

Macro trends are a key tool for discovering long-term market and investment opportunities. They are beneficial because they are: (i) unbiased and data-driven; (ii) not shaken by daily headlines; (iii) tend to avoid riskier, niche industries (which presents a space for GCF strategy to play a bigger role and improve conditions for private sector, in special in adaptation area); (iv) can be diversified by sectors and regions.

In today's hyper-connected world, it's easy to get lost in data overload and miss the next wave opportunity. Focusing on the bigger picture (as GCF has been doing) allows investors to clearly see trends that have a long-term outlook, affect a large population and create a clearer vision of the future;

Thus, after a comprehensive MT analysis, CGF can target specific actions and investments in the most promising regions and sectors (off course this does not exclude the core areas and primarily focus of GCF) that can deliver greatest changes and impact results.

When used effectively, this approach enables investors (GCF) to surf the next big wave that will shape markets in parallel with private sector interests, which would help many nations to meet its "paradigm shift towards low-emission and climate-resilient development pathways in the context of sustainable development".

b) <u>Decentralized Climate Finance Could Make Investing More Accessible</u>

Most people (countries) have not invested in low carbon technologies and climate resilient projects for a series of characteristics and barriers, such as: geopolitics, country income, technology costs and even the understanding of climate finance literacy.

The approach of decentralized finance can facilitate local private sector to hedge against inflation and make people and companies more resilient during periods of chaos and extreme events. Although the global investment in financial market is not universal, there are certain barriers that are common to all countries:

i. Geography pay a huge role, as the available resources from public and private sector are limited;
ii. Financial institution with no understanding of the benefits from investing in climate related projects and program is big. There is a lack of climate financial literacy on the subject, from the technology to institutional capacity up to risk diversification and mitigation point of view. I believe that LCDS and SIDs should have the opportunity to continue learning and experimenting new concepts to address such barriers in special when it is a small investment from GCF support.
iii. Local markets will always play an important role to private sector investment. If local economy is a turmoil, it is practically impossible for private sector to invest in such economies. An alternative should be a regional approach to help mitigate risks and allow a cross border joint implementation project in frontier areas.
iv. Cross-cutting (and even cross frontier) investment would allow private sector from across the borders to internationalize its activities and strength neighbor companies. This joint implementation should benefit from reducing transactional costs and other exchange fees, reducing overall costs and dedicating more resources to the main objective (somehow a similar approach has been done by AE).

In other words, decentralized financing could change the way investment is done and make it more attractable to private funding at a local level. In order for this to happen, automation of processes and contracting (use of smart contracts, known as self-executing contracts), transactions regulated by smart contracts and removal of costly intermediaries like brokers and banks will benefit climate finance. This represents an approach different from the AE funding mechanism.

Private sector can benefit from entering into a smart contract agreement with the GCF to fund climate mitigation and adaptation projects / programs. More and more the finances are digitally managed, such as that by the end of 2018, there were close to 2 billion digital bank users in the world and nearly 1.8 billion of the population in developing regions who will use mobile financial services by 2022 (nearly 1/3 of the global population)1. Like the internet, decentralize finance can play a tremendous role in funding MSMEs world wide.

[1] Juniper Research, 2017. Access lnk: https://www.juniperresearch.com/analystxpress/september-2017/microfinance-with-macro-potential