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The views expressed in this paper represent those of CCAP and not necessarily those of any other institution or individuals mentioned above. For further information, please contact Hannah Pitt at hpitt@ccap.org.
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Introduction

As developing countries elaborate implementation plans for their Nationally Determined Contributions (NDCs), they are considering the role that the mobilization of private investment can play in achieving their climate and sustainable development goals. Many developing countries are looking to identify effective options to engage the private sector, including working with international partners.

Multilateral and bilateral financing institutions have developed a significant track record in mobilizing private sector investment, including the direct financing of private sector climate activities. Accelerating private sector action in line with country goals will require building upon best practices, further learning-by-doing and addressing key gaps. Donor climate finance will have a keystone role to play in catalyzing programmatic solutions. In so doing, it may be possible to bridge divides about private financing instruments and achieve greater consensus on some effective mobilization approaches to accelerate climate action.

The Green Climate Fund (GCF), working through its network of accredited entities, public and private, could play an important role. A cornerstone of the Paris Agreement, the GCF is meant to support achievement of country targets and efforts to make financial flows consistent with climate-compatible development. To advance this mission, the GCF Board established a dedicated Private Sector Facility (PSF) to galvanize and scale private sector investment in climate solutions. With the essential elements of the Fund in place, the GCF is now looking to scale up private sector operations, and direct PSF investments strategically to address key barriers to private sector engagement.

In this context, now is an opportune time to consider how best to proceed with respect to mobilizing private and non-sovereign climate finance in support of NDCs. This paper seeks to:

- Consider developing country interests and concerns in harnessing private investment to support climate and development goals.
- Identify multilateral and bilateral financing best practices and gaps based on a review of analyses done to date on the climate financing track record.
- Based on these inputs, identify established and new approaches that the GCF, other funding institutions, and bilateral donors could implement to accelerate ambitious NDC achievement.

The Center for Clean Air Policy (CCAP) engaged with partners, including national governments, representatives of private sector firms and financial institutions, the GCF, multilateral and bilateral finance institutions, and civil society experts, on key issues around effective engagement of the private sector to support climate action in line with NDCs. To further the conversation, CCAP brought these partners together for a one-day dialogue in May 2017. The dialogue helped to refine the issues identified by CCAP in a working draft of this paper, raised other ideas, and strengthened the ideas and recommendations presented here.
Scope and Definitions
Mobilized private finance implies private sector capital catalyzed as a result of a public policy or financial intervention. The term can be used to refer to private sector resources invested directly in a project or program, private resources mobilized through financial intermediation, or can refer to the broader policy or market interventions that improve the enabling environment for investment (e.g. via policy interventions, technical assistance and advisory services).  

Other than when discussing efforts to shape the broader investment environment that is relevant to climate finance programs, the focus of this paper is on primary investments in mitigation projects, including investments from banks and other corporate actors, project equity by project sponsors and developers, and investments by household, rather than on efforts to establish, broaden or deepen secondary markets for climate-related or green securities. We focus on private financing approaches that can be implemented without a sovereign guarantee from the host country. In general, this includes financing of private sector entities, as well as sub-sovereign and other public and quasi-public entities undertaking commercial activities without a government guarantee.

The Role of International Financial Institutions and Climate Funds in Supporting Mobilization Efforts
Given their mandates to advance sustainable development, as well as their long experience working in new markets, multilateral and bilateral institutions and agencies are well-positioned to promote private sector climate projects, as well as promote a broader shift in global financial flows to low-carbon development.

This paper looks at the experience of international financial institutions (IFIs) and dedicated climate funds, including:

- **Multilateral and bilateral financial institutions**, including public banks like the World Bank, and regional development banks, including Asian Development Bank (ADB), African Development Bank (AfDB), the Inter-American Development Bank (IADB), and bilateral institutions such as the French Development Agency (AFD) and Kreditanstalt für Wiederaufbau (KfW). A number of institutions have an explicit mandate to provide private and non-sovereign financing or have a private sector arm with this function, including the International Finance Corporation (IFC), the European Investment Bank (EIB), and the European Bank for Reconstruction and Development (EBRD). These institutions promote private sector investment through financing that directly or indirectly (e.g. through intermediaries) supports private sector projects.

- **International climate funds**, including the Climate Investment Funds (CIFs) and the Global Environment Facility (GEF). Some have special programs or facilities designed to mobilize private

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1 Climate Policy Initiative, 2015.
investment, including the CIF’s Private Sector Set-Asides and the GEF’s non-grant pilot program. In general, these climate funds channel resources through multilateral, bilateral and, in some cases, national financial institutions to projects and programs.

Key instruments deployed to mobilize private sector investment include concessional and non-concessional debt, equity, guarantees and other de-risking instruments, including insurance, local currency facilities, swaps and derivatives. IFIs with a private sector mandate, including the private sector arms of multilateral development banks, tend to offer a wider range of financial instruments. The CIFs and the GCF can also deploy a variety of financial instruments, including grants, loans, equity and guarantees. IFIs and climate funds also provide advisory services and technical assistance support, generally as grants.

Developing Country Interests and Concerns in Mobilizing Private Finance for Climate Action

The tools used to mobilize private finance can create powerful incentives for private sector action in line with national policies. To be effective, these incentives should be complementary and supportive of national efforts, without necessarily being exclusively linked to them.

Based on CCAP's engagement with stakeholders, we identify a number of potential developing country interests and concerns with respect to mobilizing private finance in support of climate action. Developing country interests include:

- **Optimizing the use of public resources**: With limited public budgets, private financing can provide a complement or substitute for government-funded activities, lessening the need for public expenditure and enabling more strategic use of public resources. Moreover, private and non-sovereign financing approaches do not place a guarantee or borrowing obligation on the government, and therefore do not contribute to sovereign debt.

- **Support long-term sustainable economic development**: In many developing countries, firms face financial constraints that limit investment, including lack of access to credit and equity. Efforts to mobilize private investment in climate-related activities can help lift these constraints to advance broader sustainable economic development, promote the development of domestic markets, and build local business capacities. In particular, many of the most promising climate solutions include a strong role for the local private sector, including the delivery of green goods and services by micro, small and medium-sized enterprises (MSMEs), which account for 90% of firms in developing countries.

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2 The GEF offers grant financing except through its non-grant pilot program, through which it can deploy loans, equity, and guarantees.
3 Dalberg and CDKN, 2015.
• **Promote technology transfer:** Private companies provide technology solutions and business innovations that can support climate and economic development goals. Engaging the private sector can accelerate access to these solutions, build local expertise with new technologies, and introduce new business models.

• **Accelerate ambition:** Under the Paris Agreement, Parties report on progress toward their commitments, and strengthen the ambition of their targets every five years. Promoting private sector participation can encourage efficient action at scale due to the private sector’s expedited project development and implementation timelines, and by unlocking a greater volume of finance than the public sector alone. By supporting early action, private investment can accelerate climate efforts in support of countries’ NDC goals in the first commitment period and lay the groundwork for increased ambition for the next five year cycle.

### The Role of Private Sector Finance in Achieving Vietnam’s NDC

Vietnam’s Green Growth Strategy provides a pathway to achieve its NDC goals. Private investment will play a significant role in meeting Vietnam’s demand for green finance, with 70% of $21 billion in total investment needs expected to come from the private sector. In addition to supporting the achievement of the country’s mitigation and adaptation goals, the participation of the private sector will help advance the country’s sustainable development objectives, including promoting the more efficient use of natural resources, cutting costs for households and firms, and improving the competitiveness of the economy. The NDC strategy highlights the key role that private sector finance will need to play beyond more traditional sectors for green investment, such as renewable energy. For example, $12 billion in international support will be needed in the agricultural sector to meet Vietnam’s NDC target, more than twice the amount needed in the energy sector.

*Source: Vietnam presentation at CCAP IDEA dialogue.*

Developing county concerns and barriers with respect to mobilizing private finance include:

• **Lack of awareness, capacity, and coordination:** Governments tend to have longstanding experience working with public financing partners, including multilateral and bilateral financial institutions, as well as a strong understanding of public sector projects. However, government officials might be less familiar with approaches for mobilizing private investment. Climate change or environment ministries, which are often in charge of overseeing international climate finance programs, may not coordinate sufficiently with ministries of finance or planning, which tend to have greater financial expertise and experience with private sector approaches.

• **Perception of competing resources or greater burden:** Governments may be concerned that financing from IFIs or climate funds allocated to private sector activities will detract from resources available for public sector projects. For instance, an evaluation of the CIFs found that some
government partners viewed private sector initiatives as competing for resources with those from the public sector in a “zero sum game.” The CIFs assessment also documents misconceptions that MDB funds allocated to private sector activities will contribute to sovereign debt, when in fact no guarantee or borrowing is required of recipient country.

- **Ability to ensure alignment with NDC**: Public agencies may feel less able to control and manage public sector programs than private programs, and ensure private sector activities align with national priorities.

## Experience of Existing International Financial Institutions and Climate Funds

IFIs and climate funds have built a significant track record and body of knowledge on financing private sector activity and effective approaches to mobilize private investment. To understand this experience, lessons learned and gaps, CCAP reviewed a number of sources that take stock of and evaluate the climate-related activities of bilateral and multilateral institutions, particularly those targeted to the private sector, including:

- Independent, third-party evaluations
- IFI and climate funds’ own individual assessments and group reports
- External reports and evaluations by public and private-sector think tanks

Based on this review, we aim to distill key finding and conclusions, particularly those where there seems to be a consensus across multiple sources.

We find that common lessons and gaps can be grouped within three broad categories:

1) **Supporting readiness for investment**, through technical assistance and building national capacity.

2) **The provision of finance**, including financial instruments and the level of risk appetite to address risks, cost and capacity constraints faced by the private sector.

3) **The delivery channels for climate finance**, including the operations of IFIs and climate funds that support engagement with the private sector.

For each approach, the assessment points to a number of common lessons and remaining gaps.

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4 CIFs, 2011.
5 CIFs, 2011.
1) Supporting Readiness for Investment

Lessons learned
To promote a shift in global financial flows, national policies and institutions must create the right incentives for private investment in low-carbon activities. While addressing financing barriers is critical, it is often not sufficient to catalyze private investment. In many cases, the experience of IFIs and climate funds demonstrates that successfully engaging the private sector requires an integrated approach that combines direct project financing with broader policy and market reforms, capacity building, and technical assistance that can enhance the investment context.

To this end, three critical areas for support emerge: improving national and sector policy frameworks; strengthening the financial system; and supporting the development of a strong project pipeline through technical assistance.

Integrating project financing with broader policy and planning can support long-term investment. Over time, many IFIs have moved from a narrower focus on project financing to a broader approach that integrates climate action with national sustainable development priorities, and recognizes the importance of linking investments with broader market development activities.

The experience of IFIs and climate funds has shown that supporting policymaking efforts in line with national priorities can provide a foundation for longer-term engagement with key public agencies and

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**Chilean Association for Renewable Energies (ACERA): Creating a Market for Small Scale Renewables**

ACERA was established to level the playing field for non-conventional renewable energy (NCRE) in the country. Early barriers in the sector—particularly for small-scale developers—were addressed through a combination of:

- **Regulation** that provided a stabilized price and afforded purchase guarantees for qualified generators under 9MW;
- **Financing** for NCRE projects from national, bilateral, and multilateral sources; and
- **Information** generation through public studies (e.g. resource availability and grid impact) and information sharing that raised awareness of the benefits of NCRE investments.

The market for NCRE developed over time as “early adopters” demonstrated viability and prices became more competitive through subsequent rounds of bidding.

By combining policy and regulatory reform with project financing, Chile has been able to accelerate private sector investment in grid-connected and self-supply NCRE. The evolution of NCRE in Chile also highlights the importance of demonstrating the technical and financial viability of low-carbon technologies to give confidence to project developers and investors to enter into new markets.

*Source: Presentation from ACERA at CCAP IDEA dialogue.*
other domestic players, and support the development of private sector investment programs better-targeted to the country’s specific context and barriers.\textsuperscript{6,7} For example, the EBRD’s independent evaluation of its Sustainable Energy Finance Facilities found that prolonged policy dialogue with the governments of Ukraine and Kyrgyzstan was a key factor in developing successful renewable energy and energy efficiency programs.\textsuperscript{8} In the case of Kyrgyzstan, this dialogue helped build support among government partners initially weary of the intervention. In an effort to scale up non-conventional renewable energy (NCRE) in Chile, a combination of policy reforms, financing from national, bilateral and multilateral sources, and information generation and dissemination helped address barriers for small-scale renewable energy developers.\textsuperscript{9}

**Building the capacity of local financial institutions can help create domestic markets for low-carbon investment.** Domestic financial institutions have a critical role to play in promoting low-carbon investment. They are well-positioned to assess local market conditions and risks, lend in local currency, and finance smaller-scale projects that larger financial institutions avoid due to high transaction costs. For some IFIs, working through local intermediaries is an important part of their climate-related activity. This financing is often coupled with technical advice and capacity-building, including helping local financial institutions assess risks associated with climate-related investments, monitor and track operations, and conduct marketing. In this way, IFIs can help raise awareness among these local institutions and encourage them to lend in new markets, as well as mobilize additional private financing for projects through local actors.\textsuperscript{10} In its financing of energy efficiency programs, for example, the EBRD has found that the provision of energy audit expertise and other related skills has helped reduce the early hesitation on the part of local financial institutions to lend, and helped them identify a pipeline of suitable energy efficiency projects.\textsuperscript{11}

IFIs and climate funds have also found that partnering with local partners—who have a strong understanding of realities on the ground—can be an effective way to support domestic financial institutions. For example, the LGU Guarantee Corporation (LGUGC) has received support from IFIs for their programs in the Philippines, which provide guarantees and builds the capacity of local banks to lend to climate-friendly projects. The guarantees are more generous to begin, with the goal of reducing the need for subsidies and preparing local financial institutions to transition to market-rate financing over time. Key lessons from LGUGC’s experience include the importance of assessing the preparedness of partner banks and addressing gaps prior to program launch, designing programs that take into consideration industry-specific barriers faced by the target beneficiaries, and working closely with public agencies to ensure programs are consistent with government programs and regulation.\textsuperscript{12}

\textsuperscript{6} ODI, 2014.  
\textsuperscript{7} EBRD, 2016.  
\textsuperscript{8} Ibid.  
\textsuperscript{9} Presentation from Chilean Association for Renewable Energies at CCAP IDEA dialogue.  
\textsuperscript{10} World Economic Forum, 2013.  
\textsuperscript{11} EBRD, 2016.  
\textsuperscript{12} LGUGC presentation at CCAP IDEA dialogue.
Technical assistance and capacity building at different stages of the project lifecycle can promote a strong project pipeline. Scaling up private investment will require a strong and transparent pipeline of low-carbon projects that generate an acceptable financial return for private investors. The experience across IFIs suggests that early-stage project development support is vital to bring projects from concepts to finance-ready investments. Such support can help project proponents conduct feasibility studies and structure transactions in a way that addresses barriers and attracts private sector investment. However, securing early stage financing can be challenging. Various financing mechanisms have been piloted to support preparatory activities and mitigate early stage risks to help bring a project to financial close and attract additional investment. For example, IFC’s InfraVentures fund supports project development and provides early stage risk capital for renewable energy and other infrastructure projects.

IFIs and climate funds can also help accelerate private investment by supporting platforms that integrate project financing with technical assistance to address multiple risks and barriers faced by the private sector. A comprehensive approach can help overcome a range of obstacles—both financial and otherwise—tailored to the specific challenges of each sector. For example, through its integrated platform to promote Concentrated Solar Power (CSP) and other renewable investments, Morocco’s Agency for Sustainable Energy (MASEN) serves as an off-taker, shareholder and lender, as well as a provider of land needed for project development, standardized contracting, and technical assistance grants. Similarly, the Renewable Energy Performance Platform (REPP), managed by CAMCO Clean Energy and GreenStream, provides an integrated platform that targets key barriers to private sector investment in clean energy in Africa, including soft loans for project development, technical support for financial structuring, risk mitigation instruments and expertise, and results based finance to top up revenues.

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14 See http://climatefinancelab.org/idea/renewable-energy-scale-facility-resf/
15 MASEN presentation at CCAP IDEA dialogue.
16 CAMCO Clean Energy presentation at CCAP IDEA dialogue.
An Integrated Platform to Address Private Sector Barriers to Renewable Energy Investment in Morocco

MASEN was established to help advance Morocco’s energy national strategy, which includes increasing installed renewable energy capacity from 28% in 2009 to 52% by 2030 with a view to secure energy supply, increasing energy access, maximizing energy efficiency potential and integrating with regional markets. To achieve these targets, MASEN takes an integrated approach to promote private sector participation in CSP and other renewable energy projects. The institution addresses risks and barriers faced by private sector developers by serving in the following capacities:

- **Off-taker** in power purchase agreements (PPA) agreements with the project company,
- **Contract provider or manager** for water, roads, security, etc.,
- **Land provider** for project citing,
- **Shareholder** in the project company, and
- **Lender** by channeling financing from IFIs.

MASEN also structures institutional relationships (e.g. PPAs) and financial schemes (e.g. on-lending from IFIs) that lower transaction costs and risks for private developers. This in turn enables project developers, who are selected through a competitive process, to focus on offering technically sound and cost effective bids.

*Source: MASEN presentation at CCAP IDEA dialogue.*

**Remaining gaps**

**Project identification and development:** According to a recent survey of IFIs and investors, a lack of “bankable” projects is considered one of the major barriers to sustainable infrastructure investment. Preparatory support is often skewed toward projects that are further along in their development, as opposed to early-stage support to help identify and assess the best options (e.g. technologies, financing). This may be due in part to the relatively high risks associated with the early stages of project development. In addition, many developing countries are still in the process of undergoing a national planning process to convert NDCs into specific policies, measures and investment strategies. This can help identify priority infrastructure and financing needs in line with country goals, and help potential investors justify a commitment of resources to conduct market assessments and establish partnerships.

**Capacity of local financial institutions:** While many IFIs provide financing through local financial institutions, low-carbon investment is still hindered in many cases by a lack of familiarity and limited capacity of local financial institutions to structure project finance and assess risks and benefits of climate investments. In markets where clean technologies are less established, financiers and banks are often

hesitant to lend in what they consider unfamiliar and potentially risky areas. Strengthening the capacity of local financial institutions can be complicated and take time, but doing so will play a critical part of shifting local markets and aligning domestic financial flows with climate and development goals.

2) The Provision of Finance

Lessons learned
IFIs and climate funds have played a central role in providing financing and financial instruments that help reduce risks and boost returns to attract private sector investment in low-carbon projects. The experiences of IFIs and climate funds have found that:

**Flexibility in financing structure and instrument choice** can help IFIs channeling concessional funds address specific project risks and barriers that vary by country and sector, as well as match financial instruments to needs at different stages of the project lifecycle. This includes making available a wide-range of instruments, and allowing for flexibility in how they are deployed within a program (e.g., instrument choice and financing terms). For private sector programs in the CIFs, for example, MDB intermediaries propose parameters for the range of instruments and terms at which they can be offered to sub-projects within an overall program approved by the CTF Trust Fund Committee. An evaluation of the CIFs’ private sector interventions found this approach helped intermediaries to be responsive to specific market conditions and to deploy funds with fewer delays.18

“Least concessionality” can help minimize distortions in the market and avoid crowding-out private investment. Under the principle of least concessionality, IFIs and donors aim to set the level of subsidy embedded in the financing package at the minimum level required to enable the investment. While there is no exact methodology for determining minimum concessionality, many IFIs have adopted a broad definition that goes beyond low-cost loans to include loans with longer tenures or grace periods, equity with or without lower return requirements, and subordination structures or risk mitigation instruments that are priced below the full face value of the risks they cover. For the IFC, “minimum concessionality” is one of the several principles approved by IFC’s Board of Directors in 2012 as part of IFC’s approach to blending concessional funds, and is used to deliver a short-term subsidy to address specific barriers and risks in a way that minimizes market distortions. The IFC aims to provide concessional finance where a subsidy is justified by high costs or a strategic use, or where the subsidy can be tied to achievement of milestones.19 Well-designed programs support a transition to unsupported products and financial instruments, and there are already examples of markets where subsidies have been reduced over time. For example, the CIFs find that in some cases, the minimum subsidy requirement can be discovered through a competitive bidding process, or reduced through successive investments in the same markets over time.20

18 CIFs, 2011.
19 IFC presentation at CCAP IDEA dialogue.
20 CIFs, 2011.
De-risking instruments can play a pivotal role in catalyzing private investment. Even when subsidies in the form of concessional financing are not required or justified to induce private sector investment, real and perceived risks may serve as a major deterrent to private sector engagement. In fact, a recent survey of banks, equity providers and institutional investors conducted by the World Economic Forum found that legal, currency and construction risks act as the "top deterring factors" to investment in infrastructure in developing countries. Many IFIs have financial instruments at their disposal to address risk in climate-related investments, including guarantees, insurance products, interest rate hedging tools and currency swaps. In some cases, these instruments have been associated with significant private sector mobilization. In their evaluation of multilateral climate funds, for example, the Overseas Development Institute (ODI) finds the use of guarantees are linked with high levels of private sector co-financing. At the same time, the deployment of guarantees to date suggests they have been most effective in catalyzing private investment in more mature markets. This may be due in part to the fact that guarantees on their own do not make available the capital needed to catalyze investments in less mature markets where liquidity is constrained. Discussion with stakeholders suggests that patient and risk-inclined capital, including equity and subordinated debt, are often important elements in catalyzing investments in new markets and technologies.

Leverage is important, but not the whole story. Within IFIs' climate-related portfolios, private sector participation has generally been highest for established technologies and markets, as well as larger-scale interventions, such as utility-scale renewable energy projects. While IFIs should aim to invest strategically to mobilize high volumes of resources at scale, a focus on leverage alone can lead to underinvestment in certain sectors and new markets where such support could help bring them closer to market-readiness. Additionally, attaining high leverage does not necessarily mean achieving high levels of environmental or social co-benefits, and may be an indicator that the upfront subsidy was not needed.

Remaining gaps

Minimizing concessionality: In our engagements, several experts have raised issues around whether the principle of least concessionality has been properly and consistently applied in order to avoid creating market distortions. For example, the low funding costs of multilateral institutions may lead them to price below commercial rates in specific markets, which could undermine incipient private financing channels. While many IFIs have good principles for the deployment of blended finance, putting them into practice has proven challenging. To this end, a group of Development Finance Institutions will come together in October 2017 to establish principles and guidelines for the use of blended finance in private

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23 WRI, 2012.
26 Whitley, Shelagh et. al., 2014.
sector proposals, and to agree on a coordinate approach in tandem with other bilateral finance work streams.\(^{27}\)

**De-risking instruments:** A number of assessments and expert discussions indicate existing risk mitigation instruments may fall short in addressing real and perceived risks faced by project proponents and investors on the ground. Deployment of guarantees is limited in part because IFIs allocate the same ratio of equity capital to backstop guarantees as they do for loans, even though guarantees do not draw on IFI resources until called and are less likely to be called than loans.\(^{28,29}\) Moreover, conversations with experts and studies suggest that borrowers and country parties may underuse risk mitigation tools due to a lack of understanding and familiarity with these instruments.\(^{30,31}\) While more can be done to scale up the use guarantees, experts note the need to scale up and enhance risk mitigation through the provision of risk capital (e.g. equity), subordinated debt instruments and early stage investments. Additional work is needed to understand in what contexts guarantees are most effective and where the provision of other instruments that help address risk may be better suited to leverage private investment.

**Local currency and interest rate risk tools:** Nearly all international debt and equity financing to developing countries is denominated in foreign currency, exposing these investments to currency risks.\(^{32}\) A lack of long-term local currency financing and foreign exchange risk hedging instruments means that many local project developers and companies are forced to borrow in foreign currency while the project generates revenues in the local currency. This places additional costs and risks on borrowers, particularly in less advanced markets. The challenges are greatest in the least developed countries, where macroeconomic and political risks are high and access to currency hedging is minimal. Some donors and financial institutions are developing approaches for long-term local currency financing and foreign exchange rate hedging, including local currency loans and swaps, and liquidity facilities. However, these services are often provided at a cost that reduces the overall viability of the investment and few have been successfully scaled up.\(^{33,34}\)

**Challenges for underserved countries and less advanced markets:** International climate support and, in particular, financing targeting high levels of private sector mobilization, has disproportionately gone to higher income countries.\(^{35,36}\) Similarly, efforts to mobilize private finance have been less successful for

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\(^{27}\) IFC presentation at CCAP IDEA dialogue.  
\(^{28}\) Humphrey and Prizzon, 2014.  
\(^{29}\) The World Bank, 2010.  
\(^{31}\) WRI, 2012.  
\(^{32}\) The Need to Reduce FX Risk in Development Countries by Scaling Blended Finance Solutions, 2017.  
\(^{33}\) CDKN, 2016.  
\(^{34}\) The Need to Reduce FX Risk in Development Countries by Scaling Blended Finance Solutions.  
\(^{36}\) WRI, 2017.
technologies and solutions that are less well-established. For example, a recent study finds that 95% of public climate finance for energy projects has gone to middle and high-income countries, and 50% has gone to utility scale projects, as opposed to 9% to decentralized energy.\textsuperscript{37} Barriers to promoting private sector participation in lower income countries and newer markets include real and perceived risks, under-developed domestic financial sectors and capital markets, and more limited national planning and project pipeline development. Within IFIs and climate funds, investments tend to favor large, lower-risk projects that can generate greater returns and leverage additional sources of capital more easily.

**Challenges for small-scale activities:** Barriers to scaling up the execution and financing for smaller projects in developing countries include high transaction costs and a lack of financing products tailored to small-scale investments. This has limited the deployment of distributed renewable energy solutions that can help enhance the resiliency of the energy system, particularly in urban areas, and overcome the challenges of an overburdened grid that many developing countries face, as well as increase energy access where grid extension is constrained. Similarly, financing for MSMEs remains limited due to lack of experience among project developers and local banks with respect to effective MSME financing approaches, and challenges associated with investing in business that are largely in the informal sector. Constituting 90% of firms in developing countries, these businesses have and can continue to play a growing role in accelerating access to certain types of climate solutions, including distributed renewable energy generation and energy efficiency.\textsuperscript{38,39,40}

3) The Delivery Channels for Climate Finance

**Lessons learned**

IFI and climate funds are playing an increasingly important role in supporting climate-related activities, and many took on more ambitious financial commitments ahead of the Paris Conference of Parties in 2015. As their role evolves, many institutions have taken steps to reshape their internal operations to promote the effective provision of climate finance.\textsuperscript{41} Their experience suggests that:

**Internal institutional drivers can enhance the impact of climate-related projects on private flows and promote institutional learning.** This might include making changes to internal governance and incentive structures through target-setting, instituting systems to track and measure progress, reviewing fee structures and timelines, and coordinatng across divisions. For example, internal governance structures can help IFIs adhere to the principle of minimum concessionality. To determine the appropriate support package for a climate-related project in the IFC, an investment officer negotiates with a separate blended finance team who has a mandate to provide the minimum subsidy possible to make the project viable. Establishing monitoring, reporting and verification (MRV) systems for climate investments can

\textsuperscript{37} IIED, 2016.  
\textsuperscript{38} CDKN and Dalberg, 2015.  
\textsuperscript{39} Amin, Amal-Lee, 2015.  
\textsuperscript{40} The World Bank Independent Evaluation Group, 2010.  
\textsuperscript{41} Bonnel and Swan, 2015.
foster greater impact. Initially limited to an annual review of a subset of projects, the EBRD’s MRV policy has evolved over time to become a comprehensive and ongoing and assessment across the EBRD’s investment portfolio with dedicated staff and budget.\footnote{Bonnel and Swan, 2015.} Doing so has helped shift attention toward climate investments and increase the volume of climate investments.

**Processes and procedures should be transparent, efficient and predictable.** Clear selection criteria and a transparent and timely process for approval and disbursement can attract private sector participation in climate projects. This clarity may be particularly important for climate funds working through financial intermediaries. Some have developed procedures for private sector activities separate from public projects that better align with private sector operations and timelines. In the CIFs, for example, separate operating guidelines for private sector proposals enable expedited approval timelines, and include specific criteria that lay out how financial sustainability, risk, and the effective use of concessional financing of private sector projects will be evaluated.\footnote{https://www.climateinvestmentfunds.org/sites/default/files/meeting-documents/private_sector_operational_guidelines_revised_oct2012_0.pdf}

**Remaining gaps**

**Internal incentives and governance:** Common gaps identified in this area include policies and accounting rules that deter the use of guarantees, investment policies that favor large-scale project and low-risk projects, a lack of a clear mandate and technical capacity to engage the private sector and for some institutions, a need for better coordination between private and public sector financing arms.\footnote{WRI, 2012.} \footnote{IIED, 2017.} \footnote{ODI, 2017.}

**Timeline, transparency and predictability of approval processes and policies:** In some institutions, overly complex and lengthy approval processes and lack of clear or consistent policies deter private sector investors. For example, an evaluation of the GEF’s non-grant instrument pilot finds that private sector project proponents consider selection criteria too vague and often unpredictably applied.\footnote{GEF, 2017.}

**Data collection and finance tracking:** In 2015, a group of multilateral institutions and the International Development Finance Club developed a set of common principles for climate mitigation finance tracking. However, there are remaining gaps with respect to data collection and monitoring of climate finance, particularly for direct private sector financing and mobilized private sector investment. This is due in part to restrictive information disclosure policies for private sector entities. However, without transparent and consistent information across funds, it is difficult to assess impact and capture lessons learned.

\footnote{Bonnel and Swan, 2015.}
\footnote{WRI, 2012.}
\footnote{IIED, 2017.}
\footnote{ODI, 2017.}
\footnote{GEF, 2017.}
The GCF Private Sector Facility

As it scales up operations, the PSF provides an opportunity to promote existing best practices and pilot new approaches that enhance private sector participation. Working through public and private sector accredited entities, the PSF enables the GCF to directly and indirectly finance private sector mitigation and adaptation activities. The Board of the GCF has put in place a number of policy levers that can help the PSF mobilize private investment, including:

- **Financial instruments:** The GCF can deploy grants, loans, equity and guarantees. Terms and conditions for non-grant instruments for private sector activities are determined on a case-by-case basis.48

- **Requests for Proposals (RFP):** In an effort to elicit innovative approaches to private sector participation, the GCF Board has set aside up to $500 million and $200 million for two pilot programs—the former aimed at “mobilizing resources at scale” and the later targeted to MSMEs—to be awarded through competitive calls for proposals. The first RFP under the MSME program was issued in July 2016, and three initial proposals have been subsequently approved. An initial RFP for mobilizing resources at scale was issued in May 2017. The RFP is open-ended in terms of sectoral focus and puts a strong emphasis on leverage and minimum concessionality to crowd in private investment.49

- **Risk management:** The GCF Board agreed on risk and investment guidelines that set methodologies and internal procedures for managing financial and non-financial risks. These include parameters for financial instruments deployed for private sector projects, which enable the Fund to take a first loss position and serve as the largest contributor in a tranche.50 The Board plans to strengthen other risk policies, including those related to credit risk management.

- **Programmatic approaches:** In addition to project-based funding, the GCF can support programmatic funding approaches at the national, regional or global levels. While guidelines for programmatic approaches have yet to be agreed upon, the GCF has already moved forward with programs that delegate investment decisions for specific sub-projects to accredited entities under an overall framework approved by the Board, as well as programs where initial phases are approved together with a funding allocation for future phases, subject to Board approval.

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48 This includes maturity, grace period, annual principal repayment, interest rate, and fees. For public sector projects, the Board has defined concessional and non-concessional terms for loans, while other non-grant financing instruments for public sector projects are determined on the case-by-case basis. See GCF Decision B.09/04.

49 See http://www.greenclimate.fund/documents/20182/730867/GCF_Request_for_proposals_to_Mobilize_Funds_at_Scale.pdf/2de47aea-8cde-477f-ad1e-1507b49ef901

50 See GCF Decision B.17/12
• **Readiness and project preparation support:** The GCF can also support national planning and policy development, capacity building and project development through its Readiness Program and dedication Project Preparation Facility (PPF).

The GCF has approved 11 projects through the PSF totaling approximately $1.2 billion of GCF support. To date, 94% of PSF funding has gone to energy generation and energy access and the majority has been put forward by international accredited entities.\(^{51}\) Three large-scale programmatic proposals have been approved that finance clean energy activities across multiple countries by the EIB, Deutsche Bank and EBRD.

In their Work Plan for 2017, the GCF Secretariat has prioritized the development of a “strategy and roadmap” for the PSF, which will involve an assessment of where the PSF can be “unique, complementary and additional” to existing climate flows, with a view to develop a business plan.\(^{52}\) In addition, the Board will consider a number of policy decisions that will impact private sector operations, including further development of the risk management framework, a review of the terms and conditions of loans, and revisions to the proposal approval process and further development of selection criteria for projects and programs.

At the GCF Board Meeting in July 2017, the Board considered the results of the Secretariat’s analysis of barriers to private sector investment and recommendations from the Private Sector Advisory Group, which will be integrated into the future work of the PSF.\(^{53}\) The Secretariat’s paper and CCAP’s assessment identify a number of the same on-the-ground barriers, including national policy and regulatory barriers, the need for greater technical assistance, the capacity of local financial sector, and limited risk-mitigation instruments for climate-related projects. CCAP’s analysis can help further this work and inform the development of the PSF’s work plan by taking stock of the current landscape of climate finance in order to identify strategic opportunities for intervention that address key gaps and scale up effective approaches.

**Recommendations for Mobilizing Private Climate Finance**

Our review of the interests of developing countries and the experience of multilateral and bilateral institutions points to a number of opportunities to enhance private sector investment in support of NDC implementation. Overall, these institutions, in their mobilization of private sector finance, should aim to drive action and build capacities in areas that are not already being served by existing support channels. To this end, IFIs and climate funds should look to increase their current capacity and appetite to take on risk, including making significant upstream investments to improve enabling environments and build project pipelines, encourage domestic private institutions to participate in new areas of climate-friendly investments, and support the development of bankable projects.

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\(^{51}\) As of April 2017

\(^{52}\) See GCF/B.16/21/Rev.01, *Work programme of the Secretariat for 2017 and adjusted administrative budget*

\(^{53}\) See GCF/B.17/03. The Private Sector Advisory Group consists of private sector representatives from developed and developing countries, and provides inputs to the Secretariat and Board on the Fund’s private sector operations.
lending, advance innovative financial instruments and de-risking tools, and help create “new” markets – whether in countries with the lowest level of private sector development, or in underserved sectors in more mature economies. For activities with relatively lower risks, IFIs and climate funds can focus on accelerating action, including by expediting access to proven climate solutions where these solutions are not yet deployable at market-rate terms.

To this end, we identify five key priorities for IFIs and climate funds, and propose a set of near-term implementation opportunities for each, including potential approaches relevant for the GCF.

1) Strengthen support for project identification and development
In many cases, the lack of a strong pipeline of bankable projects, and not a lack of capital, is the main barrier to private sector investment. Creating this pipeline often requires policy and regulatory changes to create favorable conditions for low-carbon investment. In addition, securing the support needed to prepare high-quality projects can be challenging, particularly for upstream policy planning and early-stage project development, and small scale projects where transaction costs are high.

IFIs and climate funds are well positioned to support the development of strong project pipelines, including by supporting national governments to develop long-term policies and investment strategies that consider the role of private sector investment, anchored in a country’s NDC goals. IFIs and climate funds should also scale up and expedite access to project preparation support and help address early-stage risks to attract financing at the beginning of the project lifecycle. Comprehensive platforms that integrate project financing with technical assistance can help address multiple risks and facilitate investment by the private sector. IFIs and climate funds can support these kinds of “one stop shops” at the national level (e.g. Morocco’s MASEN), or through in-house project preparation facilities that offer private sector developers financial expertise, technology advice, and access to finance.

In the case of the GCF, the Fund can offer countries support through its Readiness Program for the development of long-term investment plans that help countries identify their best options for engaging the private sector. The Fund can also scale up the provision of support for project development through the PPF, expedite access to these resources and ensure sufficient funding is made available for early-stage project development. However, project preparatory funding must be channeled through accredited entities, leaving private sector developers without direct access to early-stage funding. To increase private sector participation and promote innovation, the GCF should consider establishing a project preparation vehicle for private sector proposals that is accessible to a wider set of entities, including those looking to partner with GCF accredited entities or those intending to seek accreditation. More generally, the PSF should consider how it can encourage private sector entities not yet accredited to the Fund to bring forward robust ideas.

2) Strengthen domestic financial institutions
Enhancing the capacity of domestic financial institutions to finance climate activities can create domestic markets for low-carbon investment. The evolution of local financial institutions can be complicated and take time, and many will need support to overcome barriers. While a number of IFIs
and climate funds channel financing through domestic financial institutions, greater efforts can be taken to enhance awareness and technical skills needed to invest in climate-friendly activities. Key areas for assistance include improving capacity to assess the benefits and risks of climate-related investments, helping to structure climate investment vehicles and adopt new business models, and sharing of best-practices and tools to monitor and evaluate climate investments. In addition, IFIs could provide financial instruments that encourage domestic financial institutions to scale up climate investments, including risk-sharing facilities and guarantees for bank credit lines.\textsuperscript{54} In general, support programs should be rolled out with sufficient staff resources, monitoring and oversight and time to ensure these skills and tools are successfully transferred to domestic financial entities.

Through its direct access modality, the GCF enables national or regional entities to receive and manage climate funds directly. However, only 11 out of the 43 proposals approved by the Board have been from direct access entities, and out of these, 2 from private sector entities.\textsuperscript{55} The GCF should look to expand support for institutional capacity building and pipeline development to private sector direct access accredited entities and those looking to partner with accredited entities. In addition, the GCF can encourage or require international and regional accredited entities to offer a capacity building component for domestic financial partners, and/or allow national entities to take “ownership” of a program as it rolls out.

3) \textbf{Enhance risk appetite}

Many IFIs and some climate funds have the mandate to use a wide-range of risk mitigation instruments to unlock investments in low-income countries. This includes guarantees, insurance and other credit-enhancement mechanisms, as well as equity financing and subordinated debt. However, more can be done to mitigate risks faced by project developers and private investors in making low-carbon investments.

Risk capital (e.g. including equity), subordinated debt and long-term loans can play an important role in lowering risks while incentivizing high performance by project proponents. In some cases, these instruments may be sufficient to catalyze private investments that generate commercial returns, lessening the need for below market rate loans to the private sector that can lead to market distortions.

Addressing currency risk also has a high potential to accelerate climate action and strengthen local markets. Expanding the use of guarantees instruments that bear currency risks is one option. IFIs can also consider supporting the scale-up of currency risk hedging instruments through strategic partnerships with special purpose funds – for example, the collaboration between IFC and special purpose swap dealer, TCX, to provide long-term foreign exchange risk products—or through partnerships with donor countries that leverage institutional investor funds.\textsuperscript{56}

\textsuperscript{54} Granoff et al. 2017.
\textsuperscript{55} As of June 2017
\textsuperscript{56} The Need to Reduce FX Risk in Development Countries by Scaling Blended Finance Solutions, 2017.
Guarantees have the potential to address specific risks deterring private investments. IFIs should consider revising equity capital allocation requirements that limit the deployment of guarantees. IFIs can tailor guarantees to better meet climate-specific risks; for example, guarantee facilities for energy efficiency investments or to insure against losses in the case that a renewable energy project underperforms. In capital-constrained markets, guarantees may be more effective when coupled with subordinated funds or other kinds of risk capital.

In general, IFIs and climate funds should look to align their policies and operations — including risk management and investment policies — to take on higher levels of risk. At the same time, funders can uphold high standards by using competitive processes to encourage innovative proposals and identify entities that have the fiduciary and technical capacity to effectively implement higher-risk programs.

To fulfill its vision as a risk-taking institution, the GCF Board should aim to enhance its ability to take on and effectively manage higher levels of risk, including by further developing its financial risk policies and enhancing the internal risk management capacity of the Secretariat. To date, RFPs issued through the PSF have been largely open-ended within a broader thematic area (e.g., Mobilizing Funds at Scale and MSMEs). Instead, the PSF can launch more targeted RFPs that address specific risks to private sector investment. For example, the PSF can tender a specific risk mitigation instrument (e.g., early-stage equity, foreign exchange tools, or first loss facilities) and select the bidder that can develop that instrument to deliver the greatest climate and sustainable development impact at the most competitive terms.

4) Target underserved countries and markets
International climate finance has disproportionately benefited higher income developing countries, as well as more established, lower-risk sectors and technologies. However, IFIs and climate funds have a critical role to play in creating new opportunities in countries and markets where alternative sources of support are absent or inadequate. For example, a concerted effort may be needed to mitigate real and perceived risks and pilot new approaches in less traditional sectors for climate investment, such as agricultural. In the provision of financing, IFIs and climate funds should ensure flexibility in financial instrument and the concessionality of financial terms in order to respond to the specific country and market contexts and risks.

The GCF is meant to promote transformative action where it otherwise would not occur. To this end, the PSF can consider designing pilot programs and RFPs that elicit innovative ideas to address specific markets, technologies, or geographies not currently being adequately addressed by existing sources of financing. The Board should also consider how to apply investment policies and adjust approval processes to account for country and market context.

5) Replicate and standardize proven climate approaches
A number of climate solutions have proven successful in many contexts, but still face barriers to wide- scale deployment. For example, although large-scale renewables are already commercially available in many markets, they face barriers when faced with traditional utilities. Small-scale renewables and
energy efficiency approaches face higher transaction costs and are less familiar to investors, despite being cost-effective. Given their mandates and track records in investing in new markets, IFIs and climate funds are well-placed to accelerate access to proven climate approaches where they are not yet deployable on market-rate terms. Technological advances, standardization of products, new business models and the evolution of financing tools present an opportunity to develop a comprehensive toolkit of solutions to promote the replication of proven approaches in many contexts, particularly in clean energy and energy efficiency solutions.

Standardization should focus on processes—for example, through a menu of options or a defined series of steps—as opposed to a “cut-and-paste” approach. This should be carried out in the context of a bottom up, country-driven approach that enables countries to select relevant elements based on their national context and priorities, adjusting financing terms to reflect local conditions.57

To help meet the objectives of the Fund, the GCF Strategic Plan identifies the development of “replicable approaches and potentially standardized products” to accelerate deployment of proven approaches. More recently, the PSF highlighted the nascent stage of programmatic approaches in the GCF as a key barrier to scaling up private sector investments.58 The PSF can work with accredited entities to develop programmatic, replicable offerings that provide regulatory support to governments and a suite of technical solutions, business models and financing tools to private sector developers, vendors and investors.

57 See CCAP working paper, Accelerating Access to Proven Climate Solutions.
The following table presents key recommendations and near-term implementation approaches described above, as well as suggests additional considerations. These are categorized within the three broad approaches to mobilizing private finance identified in the paper—supporting readiness for investment, the provision of finance and the delivery channels for climate finance.

Table 1: Recommendations and near term implementation opportunities for IFIs and climate funds to mobilize private finance

<table>
<thead>
<tr>
<th>HEADLINE RECOMMENDATION</th>
<th>NEAR TERM IMPLEMENTATION OPPORTUNITIES</th>
<th>THE PROVISION OF FINANCE</th>
<th>THE DELIVERY CHANNELS FOR CLIMATE FINANCE</th>
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<tr>
<td>1. Strengthen support for project identification and development To enhance the volume and quality of the pipeline of country-driven projects</td>
<td>Support the development of long-term national plans grounded in NDCs to articulate investment needs and priorities Establish and channel significant resources to project development, including facilities that integrate technical assistance with financing</td>
<td>Deploy financial instruments to mitigate risks and attract early-stage financing (e.g. early-stage equity)</td>
<td>Simplify processes to access climate finance readiness and project development resources</td>
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<tr>
<td>2. Strengthen domestic financial institutions To develop local markets for low-carbon investment</td>
<td>Build capacity of local financial sector to assess the benefits and risks of climate-related investments, structure climate investment vehicles and adopt new business models, and use best-practices and tools to monitor and evaluate climate investments</td>
<td>Design and deploy tailored financial instruments that encourage domestic financial institutions to make climate investments (e.g. risk-sharing facilities and guarantees for bank credit lines)</td>
<td>Increase staffing and operational capacity to engage with domestic financial institutions</td>
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<td>3. Enhance risk appetite</td>
<td><strong>To crowd in private investment and promote long-term sustainability without subsidy</strong></td>
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<td></td>
<td>- Build awareness among borrowers and country parties about options and use of risk mitigation instruments</td>
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<td>- Scale up the provision of risk-bearing and patient capital with equity finance, subordinated debt and long-term financing</td>
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<td>- Support currency risk facilities through strategic partnerships (e.g. IFC and TCX’s Long-Term Foreign Exchange Risk Management instrument)</td>
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<td>- Consider how to effectively deploy guarantees, including combining with subordinated funds in liquidity-constrained markets</td>
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<td>- Consider revisions to IFI accounting rules that limit guarantees (e.g. capital reserves requirements)</td>
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<td>- Align risk management and investment policies to take on greater levels of risk</td>
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<th>4. Target underserved countries and markets</th>
<th><strong>To lay the groundwork for greater ambition over time</strong></th>
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<td>- Support upstream policy and financial market reforms and national planning</td>
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<td>- Ensure flexibility in financial instrument choice and concessionality of terms to respond to market barriers</td>
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<td>- Design RFPs to target markets and geographies not currently being adequately served by existing sources of financing</td>
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<td>- Adjust investment criteria (e.g. more flexible co-financing criteria), and introduce simplified approval processes</td>
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<th>5. Replicate and standardize proven climate approaches</th>
<th><strong>To accelerate access to proven climate solutions</strong></th>
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<td>- Standardized technical tools, legal frameworks, business models, RFP templates, and other investor materials to reduce transaction costs and promote best-practices</td>
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<td>- Develop standardized financial offerings that address common barriers to deployment of proven climate solutions</td>
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<td>- Streamline approval processes for standardized offerings</td>
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