The State of Climate Finance: the Private Sector and Climate Finance Readiness

Role of the Private Sector in Leveraging Climate Finance and the Private Sector Facility

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GREEN CLIMATE FUND

"The largest specialized climate fund globally"

Héla Cheikhrouhou
Executive Director

- Established by a decision of the COP to the UNFCCC at Cancun in 2010 (COP 16) to deliver developed countries´ pledge of mobilizing $ 100bn/yr by 2020 to combat climate change
- Governed and supervised by a Board of 24 members (equal number from developing and developed countries)
- Board´s decisions are taken by consensus of its members
- Day-to-Day operations of the Fund are executed by a Secretariat, headquartered in Songdo, Republic of Korea
- The Board is responsible for approval of funding strategies in line with the Fund´s principles
- The Secretariat has the responsibility to translate these strategies into project and programme funding decisions and funding agreements
- The Co-Chairs are the link between the Board and the Secretariat and their role is to provide guidance to the Secretariat on core strategic matters

GREEN CLIMATE FUND

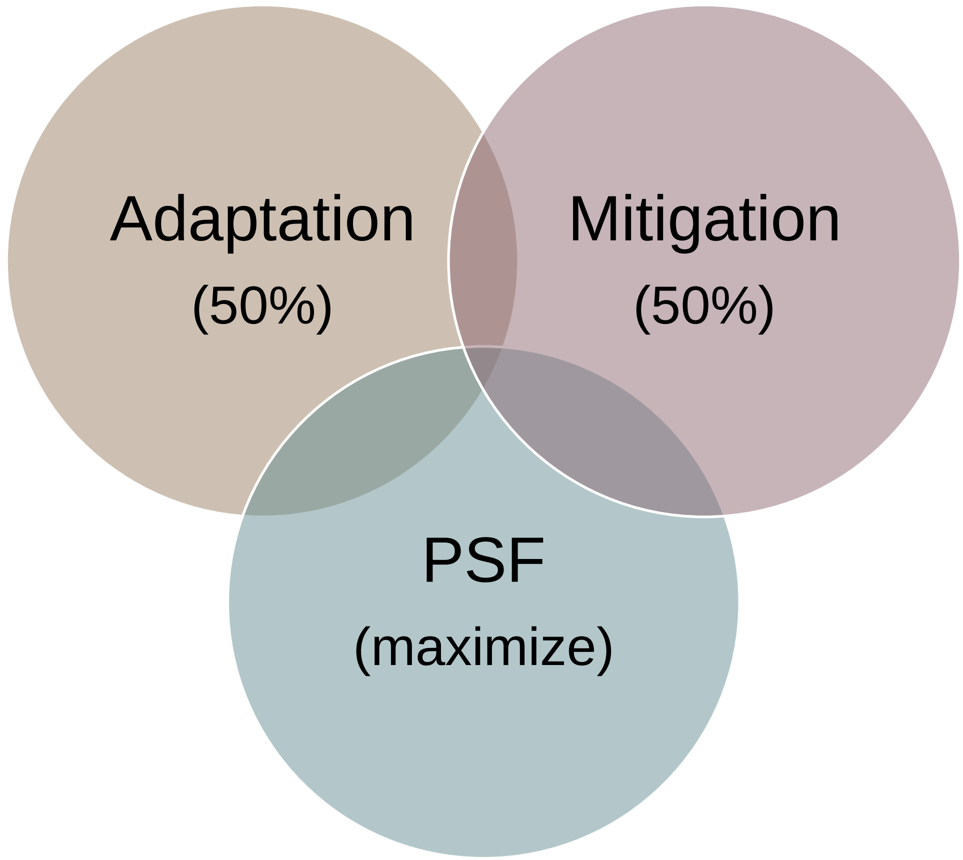
“The time has come to bring real scale to climate finance. We have no choice but to succeed”

Héla Cheikhrouhou
Executive Director

- The Fund will play a key role in chanelling new, additional, adequate and predictable financial resources to developing countries and will catalyze climate finance, both public and private, and at the international and national levels.
- The Fund wil channel its resources through accredited public and private implementing entities; to facilitate this process, an online accreditation system was launched last November
- Mode of access may be direct (through sub-national, national or regional entities) or through international international entities, including UN agencies, MDBs and international financial institutions
- Total contributions to the GCF reached $ 10.2bn since initial resource mobilization efforts started in July 2014, provided by 27 countries
- 70 developing countries have so far designated a national authority (NDA) or focal point as the governmental counterpart of the Fund
- Next step: turn pledges into contributions!

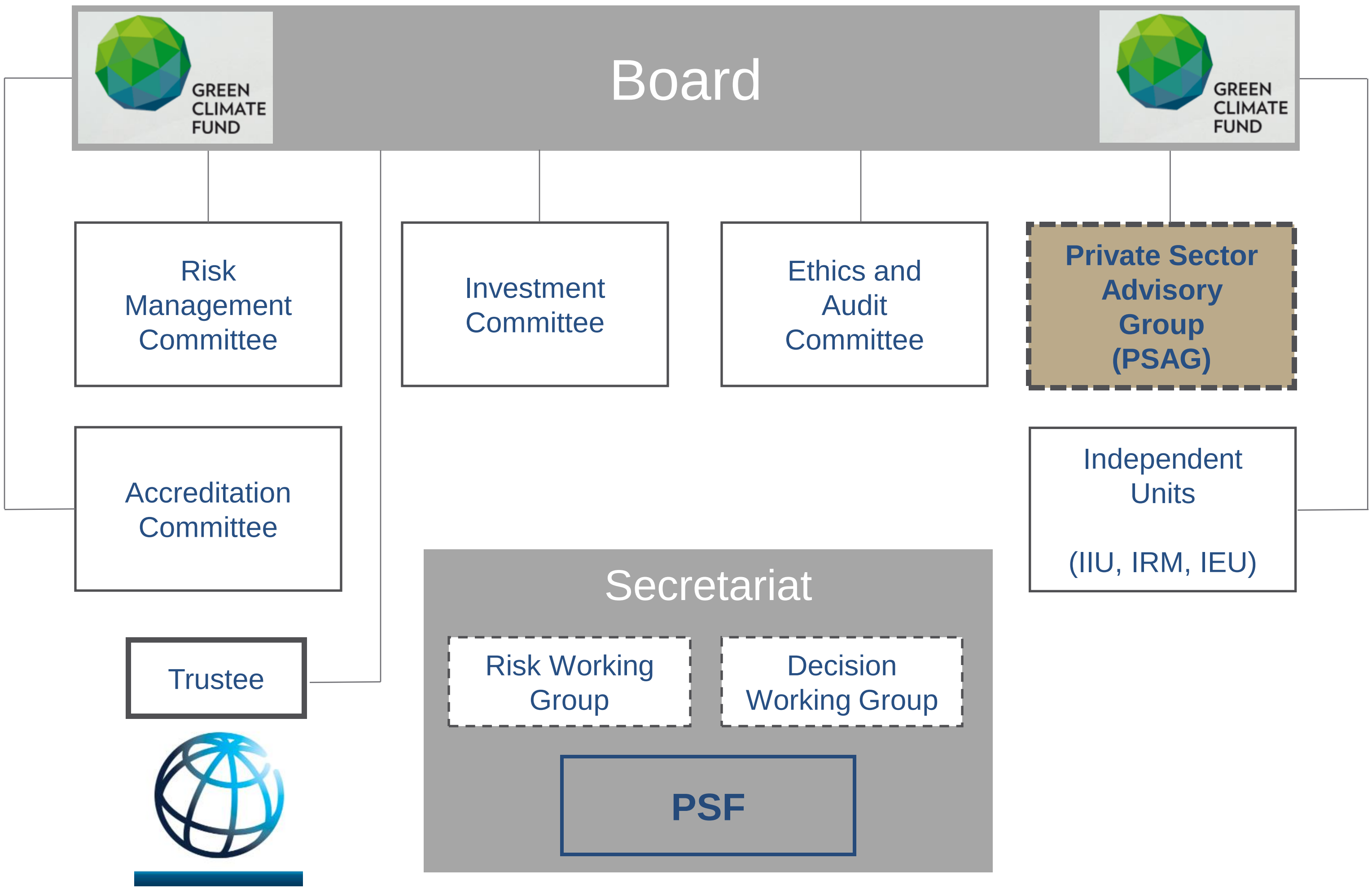
The GCF: Thematic Windows

- Afforestation, open space preservation
- Land use changes, relocation
- Infrastructure protection
- Building design
- Flood mitigation
- Emergency response
- Business continuity plans
- Community engagement



- Energy efficiency
- Renewable energy
- Combined heat and power
- Sustainable transportation
- Methane capture and use
- Industrial process improvements
- Carbon sinks

Structure of the Fund



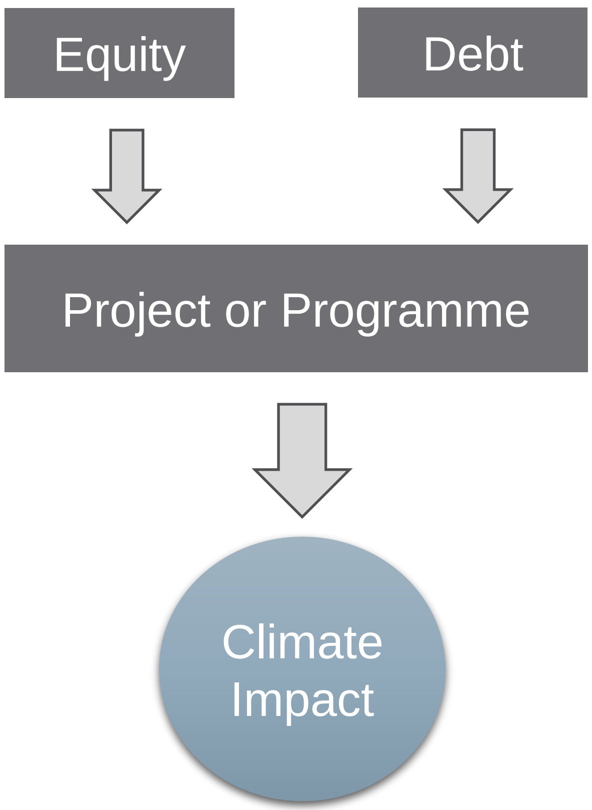
The PSAG: What is it?

- The Private Sector Advisory Group was established as a panel of the Board in accordance with the Rules of Procedure of the Board contained in the Governing Instrument
- It consist of 10 international experts, 5 from developing countries and 5 from developed countries
- In addition, there are 4 representatives of the GCF Board: 2 from developing countries and 2 from developed countries

The PSAG: Role and Functions

- The role of the PSAG is to make recommendations to the Board on the following issues:
    - How the Fund, including its Private Sector Facility (PSF), should engage the Private Sector in order to catalyze, mobilize and leverage flows of private climate finance in developing countries and make best use of the knowledge on best available technologies
    - The design and application of the Fund´s policies, procedures and financial instruments as they relate to engagement with the Private Sector
    - Engaging the Private Sector in climate-resilient development, particularly in Africa, and in adaptation activities at national, regional and international levels
    - Promoting the participation of Private Sector actors in low-emission and climate-resilient development in developing countries, small island developing States and least developed countries, in particular local actors, including small –and medium sized enterprises and local financial intermediaries
- The PSAG will also provide recommendations and advice to the Risk Management Committee and the Investment Committee

Private Sector: What qualifies as a Private Project or Programme?



- Private Sector Activity
  - Equity (or capital) owned by privately held company exceeds 50%
  - Equity owned by a non-sovereign SOE (e.g. SOE operating in a foreign country) exceeds 50%
- Public-Private Partnership
  - An investment involving both the government (or its SOE) and private investors
  - Generally governed by a partnership agreement (e.g. concession)
  - Operated through an SPV
- Grey Area
  - How to count quasi-equity, guarantees?

The Private Sector Facility: What is it?

- The Fund will have a private sector facility (PSF) that enables it to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international levels.
- The operation of the PSF will be consistent with a country-driven approach.
- The facility will promote the participation of private sector actors in developing countries, in particular local actors, including small –and medium-sized enterprises and local financial intermediaries. The facility will also support activities to enable private sector involvement in SIDS and LDCs.
- The Board will develop the necessary arrangements, including access modalities, to operationalize the facility.

The Private Sector Facility: General Principles

- The PSF must:
  - not crowd out other sources of financing
  - leverage private sector financing rather than replacing it (“crowding in effect)
  - make the private sector go where it wouldn´t go on its own
  - focus on local actors, SMEs, local intermediaries and investors in SIDs and LDCs
- The Fund´s approval process for the private sector must:
  - adapt to the faster decision cycles of the private sector
- The Fund´s financial products, after the initial start-up phase, must
  - be similar in nature to those offered by the private sector
    - Equity, quasi-equity
    - Senior debt, sub-debt
    - Guarantees, insurance products, swaps

The Private Sector Facility: Financing Instruments

- The Fund will initially provide financing in the form of grants and concessional loans to approved climate change projects and programmes through implementing entities
- Other modalities, instruments or facilities may be used subsequently, as approved by the Board (i.e. equity or quasi-equity, guarantees, insurance products, sub debt, swaps, etc).
- Grants and concessional loans will be tailored to cover the identifiable full or incremental costs of the investment necessary to make the project viable.
- Grants provided by the Fund might be –on a case-by-case basis- either with or withour repayment contingency.
- Number of concessional loan types to be decided by the Board:
    - One type of loan
    - Two types of loans: high and moderate concessionalty (most likely)
    - Three types of loans: high, moderate and low concessionality
- Manner by which interest rates are determined to be decided by the Board:
    - Based on the Fund´s cost-of-borrowing (most likely)
    - Based on market rates

The Private Sector Facility: Terms and Conditions of Grants and Concessional Loans

	Currency	Service fee	Commitment fee	Interest rate	Maturity	Grace period
Grants	Major convertible currency	0.50 per cent of grant amount up front	Up to 0.75 per cent on undisbursed balances	Grants without repayment contingency: no reimbursement required[1] Grants with repayment contingency: terms adapted to the required concessionality of the project or programme		
Highly concessional loans	Major convertible currency	0.50 per cent annually on disbursed amounts	Up to 0.75 per cent annually on undisbursed amounts	Based on cost-of-borrowing terms of loan-type contributions received plus a margin that covers credit risk	Up to 40 years	Up to 10 years
Moderately concessional loans	Major convertible currency	0.50 per cent annually on disbursed amounts	Up to 0.75 per cent annually on undisbursed amounts	Based on cost-of-borrowing terms of loan-type contributions received plus a margin that covers credit risk	Up to 25 years	Up to 5 years

[1] Except in cases of corruption or other non-compliance with fiduciary standards.

Six Criteria for Private Sector Funding
How can a NAMA project qualify for GCF funding?

Impact / Result Potential	• Potential of the programme / project to contribute to the achievement of the Fund´s objective and results area • Climate-related impact • Sustainable development impact
Paradigm Shift Potential	• Degree to which the Fund can achieve sustainable development impact beyond a one-off project or programme investment through replicability and scalability • Systemic change towards low-carbon and climate-resilient development pathways
Needs of the Beneficiary Country	• Financing needs of the beneficiary country, or fewer available funding sources • Absence of alternative sources of financing • Income levels of affected population

Six Criteria for Private Sector Funding
How can a NAMA project qualify for GCF funding?

Country Ownwership	• Beneficiary country ownership of capacity to implement a funded project or programme: • Existence of national climate strategy, like NAMA, NAP, NAPA or similar • Coherence and alignment with existing climate policies • Capacity of implementing entities or executing entities to deliver
Economic Efficiency	• Benefit-cost ratio: impact per US dollar delivered by the Fund: • Cost-effectiveness • Amount of co-financing measured as total financing mobilized per USD of GCF financing provided • Alignment with industry best practices
Financial Viability	• Financing soundness of activity • Project or programme financial rate of return (net of subsidy element) and other financial indicators exceed predefined benchmarks or hurdle rate

How to promote participation of local private sector actors?
The Fund´s role in addressing key barriers to private sector investment

Information-related market failure	• Use of concessional resources to assist developing country actors in overcoming the information gaps in terms of available technologies, resource availability (e.g. geothermal resources, energy savings potential), financing opportunities, etc.
Weak or shallow financial markets	• Use of additional financial instruments • For small actors, such as MSMEs, tailored approaches –e.g. providing concessional resources deployed through accredited intermediaries- would be more appropriate

How to promote participation of local private sector actors?
The Fund´s role in addressing key barriers to private sector investment

Capacity Constraints	• To be addressed by the provision of project development and capacity-building grants to provide project assistance and build the capacity of private sector actors in developing countries • It includes financial support for project or programme preparation, development advisory services and targeted training, and will enable project sponsors to develop bankable climate change projects
Transaction Costs	• Transaction costs that are not the result of the Fund´s intervention can be offset through the Fund´s concessional financing terms, which are better than market terms and thus make the project or programme financially viable • The Fund´s own transaction costs shall be addressed through a streamlined approval process adapted to the private sector´s project development cycle

Example of Financial Instruments to help de-risk low carbon investments for the Private Sector

Barrier	Risk	Mitigation Instrument
Weak domestic capital markets / lack of financial infrastructure	Limited access to capital at the right cost impacts revenue flow and profitability	• Concessional loans: senior and subordinated debt/loans provided at concessional rates and/or extended maturities • Equity and/or quasi-equity
Weakly scoped energy projects due to lack of human capital	Longer Project development period resulting in crowding-out of private investors	• Grants for technical assistance and capacity building
Project specific	Failure to achieve project completion	• First loss partial guarantee
Lack of coherent, long-term predictable and stable political and regulatory framework	Unrewarded exposure to political and regulatory risk discourages private sector investment	• First loss partial guarantee • Insurance products (eg: political risk insurance, sovereign risk insurance) → complex to deploy

Thank You