Inputs to the Updated Strategic Plan of the Green Climate Fund

April 2019

The Center for Clean Air Policy (CCAP) is pleased to respond to the Green Climate Fund (GCF) Board call for inputs on the update of the Strategic Plan of the Fund.

Background

The GCF initial Strategic Plan was endorsed by the Board at its twelfth meeting in March 2016. The Plan provided a vision for the GCF to promote a paradigm shift and support the implementation of the Paris Agreement. The Fund prioritized mobilizing funds at scale, taking on risk, piloting and scaling up innovative approaches, and deploying the full range of financial instruments at the Fund's disposal.

The Strategic Plan also provided elements for an action plan to implement the Fund's vision. The proposed action plan emphasized pipeline development, strengthening the Fund's proactive and strategic approach to programming, maximizing private sector engagement, and building adequate institutional capabilities.

In paragraph (e) of decision B.22/06, the Board of the GCF invited Board and alternate members, national designated authorities (NDAs), members of the Private Sector Advisory Group, active observers and observer organizations to submit inputs on the update of the Strategic Plan to the Secretariat by April 30th, 2019.

Prioritized Issues and Recommendations

CCAP has identified three issues that merit consideration in the updated Strategic Plan of the Fund. After briefly describing each of them, we propose "big picture" considerations to the Board and the Secretariat as to how these issues could be approached strategically, to be subsequently incorporated in the updated Plan.

In terms of the structure of the document, CCAP recommends that the updated version of the Strategic Plan includes goals, milestones, appropriate metrics, and a timeline to allow for tracking and measurement.

1) Improve How the Fund Measures Paradigm Shift

What is the Issue

The GCF has a distinct mandate to effect a "paradigm shift" toward low-carbon, climate-resilient development. The Fund's Measurement, Reporting and Verification (MRV) framework, however, currently lacks indicators and methods to measure transformational impacts at both the project and portfolio levels.

The GCF is in a unique position to lead a collaborative effort with climate finance users and providers on understanding and measuring transformation. The Fund's distinct mandate to effect a paradigm shift and engage the private sector, the volume of resources it manages, and its outreach capacity are assets that could serve the GCF in leading groundbreaking work at the forefront of measuring transformation at the transaction and portfolio levels.

Background

In its "Analysis of the GCF MRV framework", CCAP found that the GCF currently faces challenges in determining the impacts of its portfolio, for instance of how its investments contribute to achieve countries' Nationally Determined Contributions (NDCs) or longer-term low carbon, climate-resilient development goals. Similarly, it is unclear whether the Fund is helping to transform markets and shift financial flows towards climate-compatible investments.

CCAP has identified a number of challenges to assess the impact of portfolio-level GCF investments in effecting a transformation toward low-carbon, climate resilient development. These include:

- The absence of a definition of the concept of paradigm-shift and/or transformation toward low-carbon, climate resilient development.
- The absence of a counterfactual that allows comparing the changes that actually took place with what could have occurred in absence of the Fund's investments.
- Attribution issues that impede establishing the causality of complex change such as a paradigm shift. This is due to the ambiguous nature of the concept, which involves multiple changes over long periods of time.
- Difficulty identifying methodologies to assess and evaluate large scale impact beyond project- or program-specific changes.

Further, in its review of the Fund's Results Management Framework (RMF), the Fund's Independent Evaluation Unit (IEU) found that the RMF provides insufficient guidance on how, in the long run, projects are expected to contribute to a paradigm shift. Indeed, in CCAP's view, transaction-level impacts, such as high achieved leverage, do not necessarily indicate meaningful sector transformation or significant shifts of private flows to climate-compatible investments.

Other climate organizations have devoted efforts to measuring transformation prior to the GCF, such as the Climate Investment Funds (CIFs) and the NAMA Facility[1]. The scale of their operations and smaller number of beneficiary countries compared to the GCF, however, can limit the scope of their efforts and the potential to influence climate users and providers in the broader climate finance architecture. The GCF and its IEU are well positioned to be at the forefront of understanding and measuring

[1] For instance, the CIFs have aimed to advance work on measuring transformation through the CIFs' Transformational Change Learning Partnership, which brings together representatives from Multilateral Development Banks (MDBs), climate finance users and providers, and other stakeholders. The NAMA Facility, in turn, has also elaborated on the basis of the concept of transformational change, and has developed its theory of change around the concept.

transformation and shifting a paradigm, which requires for instance a deep understanding of the nonlinear, cross-linked causal pathways of emissions reductions and resilience enhancement.

Recommendations to Address this Issue in the Updated Strategic Plan

a. Aim to position the GCF as the leading institution in measuring transformation and paradigm shift toward low-carbon, climate-resilient development. This includes having the GCF Secretariat work with the IEU (based on the IEU's advisory and capacity support function) and other climate finance institutions to lead knowledge generation in measuring transformation beyond transaction-level impacts.
b. Ensure mandates related to the Fund's framework for managing for results and MRV system focus on improving how the Fund measures transformation (including methodologies and indicators beyond transaction-level impacts), for instance:
    - Whether GCF investments transform country-level decision-making and investments to achieve NDCs or other national policies.
    - Whether GCF investments are contributing to a market transformation and the shifting of private climate flows to climate-compatible investments.

2) Address Origination Challenges for a Balanced Portfolio

What is the Issue

The Fund's mandate to effect a paradigm shift allows it to take greater risk in order to achieve greater impact. The GCF, however, continues to fund a considerable number of "plain vanilla" projects that do not necessarily align with the Fund's ambitious mitigation and adaptation objectives, or may not necessarily require GCF's highly concessional financing to occur.

The Fund's portfolio for both the public and private sector is currently imbalanced in terms of result areas, financial instruments, and its transformation and paradigm-shift potential. Challenges with proposal origination are likely a substantial contributing factor to this.

Background

CCAP's prior research of private sector-oriented climate finance portfolios of large Development Finance Institutions (DFIs) in a sample of 36 GCF recipient countries showed that they are significantly skewed toward energy. Estimates of DFIs financing by financial instrument also showed portfolios are heavily focused on hard currency debt. Similarly, the GCF portfolio (public and private projects/programs) is also skewed toward energy (energy generation and energy efficiency), while transport, forestry and land use, and ecosystems and ecosystem services are notably underrepresented. Private adaptation projects are also relatively few in the portfolio. Hard currency loans are also overrepresented in the portfolio, with equity and guarantees being underused by GCF AEs.

These findings suggest the projects brought to the GCF by large DFIs are similar in sector prioritization and financial instruments to those financed through other sources. This could indicate that the GCF concessional financing is not necessarily used to finance the most innovative, riskier projects that need risk mitigation or subsidy the most.

Further, the most recent risk dashboard of the Fund showed that international entities have received 86% of the resources allocated by the Fund. Regional entities, in turn, have received 6% of the funding, and national entities have been allocated 8%. This suggests that even when direct access entities are successful in getting accredited to the Fund, they have limited opportunities to exercise their role as fiduciaries compared to international agencies and DFIs. If the purpose of accrediting direct access entities is addressing country needs more directly and contributing to country ownership, at least on a percentage basis, the updated Strategic Plan could address whether this goal is met through the existing business model.

CCAP's recent research suggests the Fund's portfolio is mostly supply driven. AEs are incentivized to prioritize projects within their pipelines over those from external sources. Consequently, highly innovative ideas that could benefit from the Fund's concessional finance may be turned away by AEs if they are not aligned with their own sector priorities and risk inclination.

Recommendations to Address this Issue in the Updated Strategic Plan

a. Revise the Fund's approach to project origination. This would require considering the merits and shortcomings of the accreditation model and whether AEs are acting as fiduciaries to the Fund to, for instance, catalyze innovation, support technology development and deployment, and facilitate access to the Fund from local actors such as micro, small, and medium enterprises (MSMEs), bottom of the pyramid, and private sector actors.

b. Consider additional ways to originate projects/programs. These could include:
   - Work through special-purpose entities whose business model could be facilitating access to the GCF for non-accredited actors, without a competing internal pipeline. Although CCAP is unaware of whether an entity like this exists, the Fund could consider the trade-offs of supporting the development of, or incentivizing, entities with an exclusive fiduciary role, including through identification of such entities through competitive tendering or selection.
   - Road test direct investment for specific areas of the Fund such as the Private Sector Facility (PSF).
   - Have the Fund serve a more proactive role upstream through readiness funding and supporting governments in developing a pipeline of projects and programs.
   - Work with NDAs to promote the accreditation of key local financial institutions or development banks with the capacity to act as fiduciaries, and facilitate access from local actors to the Fund.
   - Support national AEs in developing a strong GCF pipeline aligned with the GCF Country Programmes.

3) Take More Risk to Achieve More Impact

What is the Issue

The Fund currently deploys mostly hard currency loans[2]. Entities in developing countries (i.e. partners at the domestic level, public agencies at the national or local level) are exposed to exchange rate risk when borrowing from the GCF. Proposals' revenue streams are usually defined in local currency, but GCF loans are deployed in hard currencies.

Background

CCAP's research, reflected in the "programming scenarios" document developed prior to the twenty second meeting of the Board in February 2019, identified the absence of affordable, low cost debt in local currency as one of the gaps to developing strong financial ecosystems in developing countries.

The GCF programming scenarios document noted that the Fund can move toward shifting funding at scale by "taking on more project and portfolio risk to crowd in private finance, including by facilitating financing in local currency […] to ensure that the GCF plays a complementary, impact-oriented role within the wider climate finance architecture".[3]

From research conducted by CCAP in a sample of 36 developing countries, we learned that a number of stakeholders at the domestic level, including ministries of finance, identified exchange rate risk as a barrier to seek funding from DFIs or climate funds such as the GCF.

Lending in local currency would be a concrete way in which the Fund can take risk strategically and broaden its paradigm shift potential to catalyze shifts in financial flows in accordance with Article 2.1.c of the Paris Agreement.

Recommendations to Address this Issue in the Updated Strategic Plan

a. Provide a mandate to the Secretariat of the Fund to develop the capacity to finance primarily in local currency, working as appropriate with outside providers of currency risk hedging to complement internal risk management capacity.

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

[3] Strategic Programming Scenarios, page 32