Workstream III: Operational Modalities
Sub-workstream III.1: Finance Entry Points
Scoping Paper

I. Introduction

A. Mandate

1. The COP in its decision 1/CP.16 entrusted the Transitional Committee (TC) with the design of the Green Climate Fund (GCF) to develop and recommend operational documents for approval by the COP at its 17th session. The TC at its initial meeting held in Mexico City on 28-29 April 2011, agreed to organize its work through four workstreams, including (i) Workstream I on Scope, Guiding Principles, and Cross-cutting issues, (ii) Workstream II on Governance and Institutional Arrangements, (iii) Workstream III on Operational Modalities, and (iv) Workstream IV on Monitoring and Evaluation. It also agreed that work under each workstream will be facilitated by two members of the TC, the Co-Facilitators. The Technical Support Unit (TSU) is providing support, under the guidance of the Co-Chairs and Workstream Co-Facilitators, by preparing background papers and organizing workshops and other consultations as requested.

B. Background

2. The decision 1/CP.16 provides key parameters for the operational modalities of the Green Climate Fund (GCF). 1/CP.16 decides that the GCF is to be designated as an operating entity of the financial mechanism of the Convention under Article 11.[1] The Terms of Reference for the Transitional Committee in Annex III to 1/CP.16 state that the TC should develop in its work "methods to manage the large scale of financial resources from a number of sources and deliver through a variety of financial instruments, funding windows and access modalities, including direct access, with the objective of achieving balanced allocation between adaptation and mitigation".[2] These parameters form part of the overarching framework for the work of workstream III on operational modalities.

3. The co-facilitators of Workstream III have subdivided issues into five sub-workstreams: III.1 Finance Entry Points; III.2 Managing Finance; III.3 Accessing Finance; III.4 Balance between Mitigation and Adaptation; and III.5 External Inputs on Operations. On 24 May 2011 the co-facilitators circulated a set of questions on sub-workstream III.1 inviting written submissions from TC members (annex II) and observer organizations. In addition, at the first technical workshop of the Transitional Committee (TW1), members and observers exchanged views on these questions. The co-facilitators proposed to synthesise these views in a scoping paper with the support of the TSU for discussion at the second meeting of the TC in July 2011.

C. Scope of the paper

4. The relevant TW1 discussion among the TC members, their representatives, and observers, as well as written submissions received, on Finance Entry Points is synthesized below in this Scoping Paper for discussion at the second meeting of the TC. This paper is intended to stimulate further discussions, allowing the co-facilitators to prepare and table a working paper outlining decision points on sub-workstream III.1 at the second technical workshop of the TC.

[1] 1/CP.16, paragraph 102.
[2] 1/CP.16, Appendix III, Para 1(c) and 1/CP.16 paragraph 99.

II. Modalities for contributions to the GCF

5. The linkage between the capitalization of the GCF and other processes dealing with sourcing climate finance, in particular the ongoing negotiations within the Ad-hoc Working Group on Long-term Cooperative Action under the Convention (AWG-LCA), was emphasized by members. In addition, members noted the report of the High-Level Advisory Group on Climate Change Financing (AGF).

6. In this context, members stressed the importance of remaining focused on the Terms of Reference for the Transitional Committee.[3] As such, members highlighted that the work of the Transitional Committee should focus on the types and forms of finance that could flow into the GCF as it relates to the design and characteristics of the GCF, including the process for managing finance contributions.

A. Types, forms, and design implications of finance contributions

7. Members underlined that the GCF will need to be able to receive multiple types of finance contributions, in multiple forms. Five main types of finance that the GCF may need to be equipped to receive were highlighted.[4]

8. Government contributions: the Fund should be able to receive finance from government sources. Moreover, members underlined that government contributions could, at least initially, make up a significant share of finance inputs to the GCF.[5]

9. International innovative mechanisms: the Fund should be able to receive different forms of innovative finance from international sources, such as a tax on financial transactions, a levy on aviation and shipping fuels (“bunkers”), a levy on existing and future mitigation market mechanisms, and use of special drawing rights (SDRs). It was noted that the TC may need to clarify precisely which mechanisms should be considered.

10. Non-government contributions: the Fund should be able to receive direct contributions from sources such as foundations and non-government organisations. Members noted that the TC should consider the challenges that might be encountered in receiving investments directly from the private sector, particularly from institutional investors.

11. Climate Bonds: the GCF could use bonds to bring in finance from capital markets (covered in section III of this scoping paper), although further consideration of this option would be needed.

12. Reflows within the Fund: the Fund should be structured to accept reflows from its own lending activities that could be reused within the Fund over long time scales.

13. In addition to expressing views on the types of contributions, members emphasised that the GCF should be able to receive finance in multiple forms. Three main forms were highlighted: grant finance, concessional loans, and investments. The TC may need to consider the relative importance of each of these forms of finance. It was also noted that the GCF may need guidelines on the level of “concessionality” required for concessional finance contributions.

---

[3] 1/CP.16, Annex III.
[4] Note that this does not imply that these will be the sources of finance for the GCF, but rather that the Fund may need to be structured to accept resources from these types of channels if they eventuate as sources for the Fund.
[5] Members requested the co-facilitators to develop a short note on initial capitalization scenarios for the GCF. This will be presented at the second technical workshop.

14. Members noted a relevant linkage with sub-workstream III.3 on the issue of leveraging finance from the activities of International Financial Institutions, UN agencies, the private sector, and institutions at the national level. Members noted the possibility of GCF funds leveraging additional resources from these entities through specific projects and programmes. However, a distinction was made between these leveraged resources and those resources that actually flow through the GCF.

15. Choices on the types and forms of finance contributions will have significant implications on other design issues within the GCF. Four particular issues were highlighted by members:

(a) First, receiving non-grant finance has implications on the fundamental characteristics of the GCF. In particular, the GCF would need to manage, or outsource, the process of receiving loan repayments. In addition, should the GCF receive finance in the form of loans from contributors (as is the case with some contributions to the Climate Investment Funds) there would need to be a clear process established for repayment.

(b) Second, the form of contributions has an impact on the subsequent form of disbursed resources from the GCF. For example, to provide substantial volumes of grant finance to developing countries the Fund itself must receive a substantial volume of finance in the form of grants. In this context, members underscored the need to keep the balance between mitigation and adaptation in mind when considering the form of contributions.

(c) Third, members highlighted a linkage between finance contributions and the thematic funding windows of the GCF.[6] Specifically, it was suggested particular finance inputs could be tied to windows within the Fund.[7] However, members pointed out this may have implications for achieving balance between adaptation and mitigation within the Fund.

(d) Fourth, a number of institutional implications of the type and form of finance inputs have been raised by members. Many of these focus on governance and how non-government actors, such as foundations, may need to be included within the GCF governance framework if they are to contribute to the Fund. The practices within the Global Fund to fight AIDS, Malaria, and TB were noted in this regard. This raises as additional linkage with workstream II.

B. Processes to mobilise funds

16. A key design issue considered by members is the process through which finance is raised. Members drew attention to the fact that different finance inputs to the GCF may require different fund mobilisation processes. In this context, members underscored the need to design processes that will ensure the predictability and sustainability of finance for the Fund. The responsibilities of Annex II countries to the Convention, particularly under Article 4, were highlighted in this context.

17. Two main mobilisation approaches emerged from members in this respect: 1) a replenishment cycle system, which could give predictability over programming timescales of several years; and 2) a system of continuous contributions, which could provide longer-term sustainability but also flexibility as new sources of finance emerge. Members suggested that these two approaches could work in parallel and complement each other to provide predictability over both shorter and longer timescales. The TC would need to give further consideration to this approach.

18. Members have suggested that a replenishment model would be suitable for government contributions, possibly over a cycle of 3-4 years. The TC may need to decide whether or not it

[6] Taken up under sub-workstream III.2.
[7] Note: this is taken up in the background note under sub-workstream III.2.

is within the TC's mandate to consider criteria for determining government contributions, and, if so, what the criteria might be.

19. For other potential finance inputs, such as international innovative mechanisms and non-government contributions, members proposed a continuous process for receiving funds could be used. It was noted that this would be needed to accept finance from future revenues from levies and taxes, as well as ad hoc contributions. In addition, it was highlighted that a continuous fund mobilisation process in addition to a replenishment cycle approach is needed so that new sources of finance can "plug in" to the GCF in the future.

20. In addition to these two processes for accepting finance contributions, the TC may need to consider how reflows from lending activities are accepted and re-programmed within the Fund.

21. The management of these mobilisation processes, including both a replenishment cycle and continuous inputs system, is also an issue to which the TC may need to give further consideration. In particular, there is a need for clarity on which elements of the GCF governance framework will play a role in this. It was noted that this could be determined by the GCF Board once clarity on institutional responsibilities within workstream II is further developed.

III. Methods to mobilise and leverage private sector finance

22. Members underscored that private finance should play a vital but supportive role in mobilising the needed resources to address climate change. Members made clear that the intention behind including instruments within the GCF to mobilise the private sector would be to supplement – rather than replace – publically-financed contributions with private money. It was highlighted that engaging private finance at scale is about using public contributions in the most effective ways possible to leverage much larger capital investment for achieving the Fund's objectives. The following sub-sections examine the two distinct approaches to this issue, the first being to directly source private financing into the Fund and the second being to mobilise private finance alongside GCF funding at the operational level.

A. Options to mobilise private finance directly into the GCF

1. Receiving direct private sector contributions into the GCF

23. While members stressed that the Fund should be structured to receive contributions from many types of sources, including the private sector, it is unclear whether or not the Fund should be purposefully structured as a public-private investment fund that would raise financing on commercial terms from the private sector. Views submitted suggest that structuring the Fund to receive private investment may be difficult. However, accommodating philanthropic contributions would not be difficult and could draw on the experiences of funds operating in the health sector.

2. Raising private sector contributions from the capital markets

24. The question of whether the GCF should raise funds from capital markets was highlighted by members. It was noted that many public finance institutions–including both national development banks and international financial institutions─are structured to source some or all of their funding requirements from the capital markets, usually through sovereign backed bond offerings. It was also highlighted that many levels of government, such as municipalities, access bond markets to raise financing for public projects, especially infrastructure investments. It was suggested that the question of whether to raise funds from the capital markets could be left to the GCF Board to decide.

25. However, caution was raised as to whether the GCF should take on the function of a financial institution by issuing bonds. It was suggested that this might 'crowd out' rather than 'crowd in' new funding and also raise issues of liabilities (i.e. who pays in case of default). When considering this approach, it may be important to clearly differentiate between borrowing by developing or developed country governments, borrowing by international financial institutions and borrowing by private industry. It was noted that care should be taken to ensure that the GCF does not increase the debt burden of already heavily indebted developing countries. Therefore, enabling the GCF to raise funds from the capital markets could be an option to consider even if, as members noted, the catalytic role expected from the GCF should also be achieved through leveraging and co-financing at the implementation level, especially through blending at the national level.

B. Options to catalyse private finance alongside GCF funding

1. Mobilising private finance at scale[8]

26. The issue of how the GCF can optimise the 'crowding in' of private finance at scale is seen as an important design consideration that may require specific approaches to governance structures, financing modalities, safeguards and results measurement9. However, further consideration from the TC may be needed on what is meant by crowding in private finance at scale. The issue of "scale" can include consideration of how to mobilise new financial actors, for instance pension funds, as well as consideration of new public-private financing instruments and modalities that could increase both the size of private commitments and crowding-in effectiveness of public commitments. However, "scale" can also imply transformational financial instruments, approaches that move beyond project-based financing to sector-wide financing programmes, or efforts that mainstream climate investment activity within the financial community.[10]

27. Members raised specific concerns in relation to engaging the private sector in adaptation financing. In particular, it was noted by members that private finance should not be counted towards the fulfilment of obligations under the Convention, especially insofar as adaptation is concerned. It was also highlighted that this would not preclude the use of private financing for adaptation, with members suggesting that GCF resources could be available on a grant basis to fund viability gaps or ensure minimum returns to make otherwise unbankable projects commercially viable.[11] Examples of private sector involvement in adaptation were highlighted, such as insurance.[12]

28. Consideration was given to the need to include a range of actors in promoting the engagement of the private sector. Members expressed the importance of involving both foreign and domestic financial actors. For the public sector, members noted the importance of the International Financial Institutions and UN agencies, and highlighted the importance of national institutions, in particular the activities of national entities.

29. Regarding the involvement of the private sector in the operations of the Fund, there may be a need to further consider the engagement of the private sector in the governance framework of the Fund, such as through a private sector focal point or an international business advisory panel.

[8] The questions posed focused on the leveraging of private financing, though incentives for mobilizing additional public financing also deserve consideration.
[9] Members stressed the need to engage the private sector within the TC process in this respect, and the workstream III co-facilitators are developing a private sector engagement strategy to support this.
[10] For instance through putting a price on carbon or providing other forms of revenue enhancement.
[11] Information on this topic is contained with the sub-workstream III.3 background note on additional information on financing instruments.
[12] Information on this topic is contained with the sub-workstream III.3 background note on additional information on financing instruments.

30. Regarding the involvement of the private sector in the design process of the GCF, members underlined the need for a structured dialogue with the private sector and a sharing of ideas to better understand the potential for, and limitations and conditions of, private sector involvement. Members recommended seeking private sector contributions and the inclusion of working sessions with investors and financiers focused on private sector issues.

2. Incentives to engage private sector

31. Members emphasised that climate change actions in developing countries often generate global public good benefits that are larger than the direct financial benefits to investors, so there may be a role for the GCF to provide incentives for addressing viability gaps. Incentives for private sector engagement can work by adjusting the risk/return profile of investments by reducing barriers to investment, lowering investment risks, or buying-down the costs of what is being financed.

32. Various specific options for using GCF funds to improve the risk-return characteristics of projects were proposed, including lowering development costs through technical assistance, lowering the cost of capital through equity and debt co-financing instruments, covering the incremental costs or financing the riskier aspects of investments, lowering risks through credit enhancement, insurance or other forms of guarantee, enhancing returns through 'results-based' funding mechanisms, market creation approaches (including futures and carbon markets), and efforts to access the capital markets. In addition, the importance of using direct policy measures to influence the risk/return ratio of private investments was highlighted.

33. It was noted that enabling environments are a key pre-condition for attracting private financing. On this basis, the GCF might assist governments in the development of policy and regulatory environments, and both governments and industry in the transfer and early deployment of technology. Capacity building can be an effective tool to address inefficient market outcomes and strengthening local institutions is an important step in this direction. The use of capacity-building funding to develop climate policy frameworks may yield significant longer term benefits. Members also stressed the need to firmly integrate GCF-supported investment activities within national priorities contained in nationally appropriate mitigation strategies and national adaptation plans.

34. It was suggested that the incentives implemented by the GCF should avoid three important risks of any public intervention: i) crowding out other funding already available, either public or private; ii) creating windfall gains to the private sector, whereby private corporations profit for doing little different to business-as-usual; and iii) creating a moral hazard for the national authorities insofar as they may be disincentivised from implementing actions to establish a sound investment framework in order to keep on benefiting from international public financing. Where GCF funds are being used to attract private sector projects, it was noted that transparent, competitive tender processes should be used, based on full life-cycle cost/benefit analysis.

3. Modalities for aligning and blending GCF finance with private finance

35. Members noted that the private sector needs to be engaged at various levels throughout the project cycle, so as to optimize its participation and investment. It was recalled that there is a broad spectrum of donor-supported facilities to draw on regarding the promotion of private participation in infrastructure in developing countries. These infrastructure facilities address various obstacles to meeting this objective, including policy and regulatory settings and information asymmetries, project development and financing needs. Members also proposed to examine the policies that various countries have implemented to increase investment by the private sector.

36. Members highlighted a variety of approaches for combining GCF funds with private finance or other types of public finance. Both ‘parallel’ and ‘blended’ approaches were suggested as methods for using GCF funds to leverage private finance.[13] The use of concessional loans to soften the terms for borrowers was noted. Similarly, blending at the national rather than the multilateral level was highlighted. It was suggested that lessons can be learnt from these different approaches.

37. The linkages between mobilizing the private sector and the GCF’s thematic funding windows were noted. This linkage is addressed in sub-workstream III.2.

38. Members raised the importance of a link to the carbon markets. It was suggested that several possible linkages be explored, such as having financial complementarity between the mitigation actions funded by the GCF and the carbon markets. It was also suggested the TC could learn from the experience of the CDM monitoring, reporting and verification process.

4. Mobilising private finance in regions with poorly developed financial markets

39. Members drew attention to the problems developing countries with smaller financial markets face in attracting private sector investment, especially for adaptation. In particular, the difficulties of small island developing states and least developed countries was an issue of concern and members noted that greater public finance may be needed in these countries. The challenge of technology transfer for countries deemed too small by private technology suppliers was also highlighted.

40. Members noted that the GCF should support targeted capacity building or other measures to overcome these barriers. This issue relates to the equitable allocation of GCF resources among developing country Parties as well as to the effective use of GCF financing. It was proposed that the TC should provide clear guidelines for the GCF Board, which will need to consider how to incentivize private finance in regions with poorly developed financial markets, as well as how to design programs that improve regional distribution of financing. It was further suggested that the TC should engage with the private sector in order to determine and consider options in this area. A range of instruments exist today, for instance risk mitigation products that can enhance loans offered by domestic banks or foreign exchange hedging products that allow international lenders to finance projects in local currency.

41. As a means of improving the delivery of private finance in regions with poorly developed financial markets, it was suggested that the GCF could contribute to the improvement of ‘enabling environments’ in developing countries, including by assisting the development of the policy and regulatory environments necessary to attract investment and lower the risks of investing, and by strengthening the ability of financial market actors and of financial institutions in developing countries to identify, assess and structure financing for climate-friendly projects. The GCF could allocate funding (notably grants) for capacity-building actions to help these regions to establish sound investment frameworks for climate-resilient actions. Another possible means for facilitating access to the international financial markets would be to use GCF funding to blend or soften financing that countries source from other financing institutions.

[13] In the parallel approach, public and private actors cofinance specific projects, while in the blended approach, the actors pool their funds in a public-private fund or financing vehicle.

Annex I

Private sector consultations

In order to fulfill the mandate of the Transitional Committee, members have highlighted the need to seek private sector inputs to the GCF design process. This can be done at several levels, including seeking input from the private sector through a harmonized questionnaire (several private sector associations have offered to provide written inputs); TC members undertaking national level private sector consultations; and holding regional/sub regional consultations, subject to budget availability and with the assistance of donors, UN agencies, MDBs and/or private sector associations.

1. To assist these various engagement activities it is suggested that outreach efforts aim to address a number of key questions, as well as any others of relevance to local context. The co-facilitators will then synthesis all feedback received into a Private Sector Scoping Paper for consideration at TC3.

I. Introduction: Views of TC members on private sector engagement

2. Within the Transitional Committee (TC), there is a widely held expectation that the private sector must play a vital but supportive role in mobilizing the needed financial resources. Overall the views range from an urgency in outreaching to the private sector, to some expressions of concern regarding whether it's appropriate or even feasible to mobilise private finance for certain climate activities.

3. During the first workshop that took place in Bonn, as well through submissions on Workstream III - Finance Entry-Points, members of the TC have made several important observations, questions and proposals.

4. Members have observed the important role that the private sector can and must play within the GCF and the need for evolving a platform for private sector engagement on a sustained basis, both in the design of the fund and in its future operations. It is felt that this engagement must begin as soon as possible given the design implications involved. It is also widely felt that the GCF should be able to utilize a wide range of instruments and modalities as a means of mobilising financial resources from the private sector. It was also highlighted by some members that the approaches employed would need to ensure that all mobilised private sector resources are measurable, reportable and verifiable.

5. Although efforts to engage with the private sector are widely supported across the TC, some specific concerns have been raised particularly in relation to adaptation. Some members have suggested that private finance should only be engaged for mitigation related activities and that private finance should not be counted towards the fulfillment of the obligations under the Convention especially insofar as adaptation is concerned. Other members had differing views, noting that private financing for adaptation was occurring in some areas such as insurance and suggested some further analysis be undertaken on this topic. Another issue of concern raised by some members was the difficulties of small island states and least developed countries in attracting private finance.

6. A number of key questions have been raised, including: How can the GCF best use public funds to leverage private finance? What legal and technical arrangements will be needed to engage with the private sector? Should the TC restrict the nature of activities that can be financed through the private sector? For instance, what role, if any, should the private sector play in the area of adaptation? How to ensure that private sector resources are transferred towards low income and least developed countries? How would the GCF receive funds from the private sector and how would they be accounted for and MRVed? What lessons can be learnt from public private partnerships?

7. A number of possible proposals have also been made regarding the role of private finance in the GCF, including: interacting with the private sector through a focal point or an international business advisory panel; establishing a dedicated window for private sector financing; and underwriting risks and providing other forms of support to the private sector to allow them to move into regions and countries with low economic development or less developed carbon markets.

8. Even though the views expressed by TC members on the possible role that private finance should play in the design and operationalization of the GCF have not been conclusive, members recognize the need for two way communication and sharing of ideas. It is, therefore, vital that engagement with the private sector be initiated now and that TC considers views and proposals from the private sector as soon as is practically possible.

II. Questions for the Private Sector

9. *Opportunities*

(a) What opportunities do you see today for scaling up your organization's financing in climate mitigation and adaptation?

(b) What are the possible avenues for bringing private sector finance into the GCF, for instance through climate bonds raised on the capital markets?

(c) What are the opportunities for the GCF to support and leverage private sector investment in climate change mitigation and adaptation?

10. *Barriers*

(a) Risks*:* In relation to investing in climate change mitigation and adaptation, which commercial, technological and political risks do you see as most difficult to deal with? What risks are associated with the overall enabling environment? Which risks are better managed by the public sector and which by the private sector?

(b) Access*:* Is there a lack of long-term or other necessary financing for climate change actions in the markets you operate in? What are the reasons for this lack of access to finance?

(c) Economics*:* Do many climate sectors/projects you deal with lack financially viability? How are adaptation and mitigation projects different from a financial perspective?

(d) Other*:* What other barriers prevent you from financing climate projects?

11. *Responses*

(a) Risks: In what ways could the GCF most effectively help the private sector overcome risks to climate investments? Which sorts of risk sharing instruments could the GCF support, for example partial credit guarantees, local currency hedging, subordinated financing structures and other public-private instruments? What design elements should be considered for the GCF to ensure the most effective implementation of such instruments.

(b) Access: What options could the GCF consider to improve access to finance for climate actions, particularly for those most vulnerable to the adverse impacts of climate change, including Least Developed Countries and Small Island States?

(c) Economics: What are the options for the GCF to improve project economics and which do you feel would be most cost effective? What are the options for lowering the cost of capital for projects and what impact could they have on project economics? How could the GCF enhance or otherwise improve revenue streams?

(d) Other: What other actions could be undertaken by governments or supported by the GCF to improve the conditions for climate investment (e.g., project development support, institutional strengthening)?

12. ***Engagement***

(a) How could the GCF engage effectively with the private sector in developing and implementing instruments to support private sector climate investments?

(b) Would a dedicated GCF window for the private sector be useful? If so, how would this window operate differently to the rest of the fund?

(c) Of the current fund models (CIFs, GEF, Global Fund, etc), which ones are working well for the private sector? What concrete improvements could be implemented to increase private sector engagement in climate change action through the GCF?

Annex II

Views of members of the Transitional Committee on Workstream III: Operational Modalities Sub-workstream: Finance entry points

I. Submission by Ms. Vanesa Valeria D'Elia (Argentina)

General Remarks

As regards Climate Change Financing, Argentina understands that the principles enshrined in the United Nations Framework Convention on Climate Change (UNFCCC) should be preserved, especially those of equity and common responsibilities, but differentiated between developed and developing countries.

In this regard, it is considered that these historical responsibilities of developed countries should be the factor determining the distribution of the economic burden for implementing mitigation and adaptation actions in developing countries. Therefore, the starting point should definitely be the contribution made by developed countries, as was the case in the other operating entity of the Convention's financial mechanism (GEF).

We understand that public funding, private funding, and the carbon markets are essential to address climate change, but public funding should have a prevailing role over the other income sources.

The architecture of this Fund should be equitable and effective to ensure that the financial mechanism governance does not replicate the financial access limitations and under-representation of developing countries in International Financial Agencies.

In addition, Argentina understands that the Green Fund for Climate Change should take the necessary actions to guarantee the provision of new resources, additional to those of the Official Development Assistance (ODA) and will be so designed that it is seen as a major player across Climate Change financing funds. These resources should also be adequate, predictable and verifiable, with a balanced approach between adaptation and mitigation, thus ensuring the increase in access by all developing countries, including direct access.

Specific Remarks

In particular, we remark some elements referring to the questions raised by co-facilitators on item regarding incoming funds. However, we believe that the agenda for this first workshop could also include a further discussion on the complete work programme, as the proposal is not totally clear.

As regards the GCF governance, it should have an adequate legal capacity, with the necessary legal status (similar to the one agreed upon for the Adaptation Fund), making it possible to proceed expeditiously both to receive funds from the various sources suggested and to provide them. Thus, it is suggested that the elements in common with the Adaptation Fund should be studied so that the time required for the necessary proceedings can be optimised. Additionally, the Trust Agency (Word Bank) shall enter into an agreement with the GCF Board to align their functions with the operating guidelines set forth by such Board.

As far as incentives are concerned, given the volume required for the GCF to operate, a full and active participation of the private sector is fundamental, and all mechanisms contributing to that end should be explored. Therefore, it is important to engage the market mechanisms, Both taking advantage of the positive experience of the Kyoto Protocol and improving those aspects that limited the scope of such mechanisms, for example, by minimizing the bureaucratic interferences preventing a significant access to resources. It is also very important to take account of all projects, policies and programmes (including small scales ones or others more costly, risky or less attractive to the private sector) in all regions or countries, and assure country involvement in the development, definition, implementation and monitoring of project activities and operational guidelines for allocation and disbursement of financing, basing its work in partnership with national programs and policies and respecting country-led formulation and implementation processes.

In addition, the actions that various countries have implemented to increase investment by the private sector in the short term could also be explored. In that regard, we provide the example of Law 26.190: "National Development scheme for the use of renewable energy for electricity generation" (GENREN - Decree N° 562/09) in Argentina, which the main objective is to increase the power capacity through the generation of renewable energy. It establishes that within the period of 10 years, 8% of electricity consumption has to be supplied from renewable energy sources. The first tender had finished and soon will begin the second tender for the purchase of electricity from renewable sources.

We also provide the example of the Public-Private Partnership in Uruguay, which is in its last stages of parliamentary approval, and fully supported by all sectors of the political parties in the country. This partnership opens up the possibility for private parties to submit projects related to strategic areas and to participate in their execution, through an open and transparent selection process. This should be associated with a regulatory framework fostering investment, and at a global level, the necessary guidelines for its implementation should be set forth, perhaps creating a specific body in the GCF environment.

II. Submission by Mr. Ewen McDonald (Australia)

Australia appreciates the opportunity to provide initial feedback on issues to be considered in sub-workstream III.1 Finance entry points. We look forward to working with Transitional Committee colleagues, the Transitional Support Unit, observers and other stakeholders to further analyse and consider these issues and provide more substantive input as the work progresses. Australia will look to consult with domestic and international stakeholders over the coming months across the different workstreams to inform the consideration and ultimately recommendations of the Transitional Committee.

In all workstreams it will be important to identify areas of cross-over between workstreams and key areas for information gathering and analytical work to inform the considerations of the Transitional Committee. Value could be added to the consideration of a number of issues under this workstream by collating lessons learned and background on existing financing mechanisms, funds and entities, both in the climate change area and more broadly. The issues covered in this workstream also consistently point to the importance of obtaining the views and input of a range of stakeholders.

Modalities for contributions to the Green Climate Fund

1. In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?

Consistent with the Cancun Agreements, the Green Climate Fund should be designed to be able to accept a wide range of sources, both public and private. This will provide it with the flexibility to accommodate any decisions Parties reach on resourcing the Green Climate Fund under the UNFCCC and within national government considerations. Discussions on sources of climate finance will be progressed under the UNFCCC. The Transitional Committee could commission advice on the governance and legal capacity required in relation to each of these sources. We note that the report of the United Nations Secretary-General's High Level Advisory Group on Climate Change Financing (AGF) outlines a wide range of potential sources, which may be useful as input into the development of such advice.

If the Green Climate Fund is to achieve the ambitious scale of financing desired it will likely need the capacity to accept a range of funding modalities including grants, loans and investments. If the Green Climate Fund accepts loans, consideration will need to be given to the capacity and systems required to realise repayments. This would likely mean that the Green Climate Fund would require the capacity to provide loans or guarantees or invest loan amounts in activities which provide a return. Consideration will need to be given to the types of activities that may be suitable for loan financing rather than grant financing. This workstream should consider the range of potential funding modalities in relation to funding sources and map the resultant impacts on funding distribution (under sub workstream III.3 Accessing Finance).

The Climate Investment Funds currently accept a range of funding modalities including grants, loans and capital investment. A number of other funds only accept grants. The systems, capabilities, governance and legal capacity required for the Green Climate Fund to accept a range of funding modalities should be informed by reference to existing funds.

2. What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs of periodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?

In the consideration of the costs and benefits of periodic compared to ongoing funding receipt, the experiences of existing funds that utilise these different approaches (e.g. Global Environment Facility - periodic, Climate

Investment Funds - ongoing, World Bank - periodic and ongoing, Adaptation Fund - ongoing) will be a valuable and useful input. Key considerations are expected to include financial management implications, ability to harness investment opportunities as they arise, flexibility of the Green Climate Fund to respond to changes in the international environment, predictability of funding availability and fund resourcing implications (i.e. flat or 'seasonal' staffing profiles).

Australia supports the Green Climate Fund taking an active role in leveraging private sector investment, noting the findings of the AGF. In order to do this it is likely that the Green Climate Fund will require the ability to seek and leverage funding as opportunities arise.

Methods to mobilise and leverage private sector finance, both foreign and domestic

3. How can the GCF best 'crowd-in' private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?

4. How can the delivery of private finance be improved in regions with poorly developed financial markets?

Attracting and delivering private finance are two sides of the same coin. To provide finance, just as to deliver it effectively, private financiers will be seeking policy and regulatory settings that are conducive to investment and strong institutional structures to inspire confidence.

The Green Climate Fund can contribute to ongoing efforts in developing countries to improve the 'enabling environments', including by assisting the development of the policy and regulatory environments necessary to attract and lower the risks of investing in developing countries. Australia would support analysis on current work underway (see our response to question 5) and how the Green Climate Fund could build on this, including providing advisory services alongside investments or as discrete activities.

The design parameters of the Green Climate Fund will also strongly influence the scale of private finance that can be attracted and the impact such finance can have. Some key issues for further consideration are:

- Private sector representation in the Green Climate Fund governance and decision making: it may be important for institutions representing private finance interests to participate in the Green Climate Fund. Australia would welcome further analysis and discussion by the Transitional Committee on the form this could take (e.g. observer, participating observer, decision maker, serving on a purpose designed sub-committee) and the representatives that could participate (e.g. private enterprises, industry groups or international finance institutions such as the International Finance Corporation).
- Types of private finance: analysis on potential sources of private finance and mechanisms which have the potential to be leveraged would be useful to explore (e.g. venture capital funds, market capital and carbon markets).
- 'Parallel' vs 'blended' private financing: there are a range of existing climate change financing mechanisms to encourage private co-financing of Green Climate Fund investments ('parallel private financing') from which lessons can be learnt. In addition, further analysis of the possibility for the Green Climate Fund to implement investments financed by public and private sources ('blended private financing') will be a beneficial contribution to the work in this area. There may also be the potential to partner with private enterprises to implement Green Climate Fund investments which are financed by public and private sources.
- Identifying investments for private participation: existing climate change financing mechanisms have identified investments that may be attractive for private finance. Further investigation of the potential role for the private sector in identifying and submitting investment proposals to the Green Climate Fund

would be useful, including consideration of those which require additional public or concessional financing to be commercially viable.

5. Should GCF resources be deployed to raise funds from the capital markets, whether through bond issues or some other vehicle that could be considered to mobilize significant amounts of funding from institutional investors?

Deliberations on this issue would benefit from an assessment of the range of institutional funding sources and vehicles that could be mobilised for Green Climate Fund investments. Such an analysis should also consider the associated risks and benefits and implications for Green Climate Fund design, including its establishment as a legal entity.

6. How can the modalities of public-private engagement be optimised, including timing of engagement, aligning project cycles, pre-investment activities, linkages to the carbon markets and other operational issues?

In working to optimize public-private sector engagement, an analysis of barriers to public-private partnerships and other types of private sector engagement would be constructive. Targeted consultation with private sector entities will provide valuable input to identifying such barriers and the most appropriate approaches to optimise this engagement.

In addition, there is a broad spectrum of donor supported facilities to promote private participation in infrastructure in developing countries that may be instructive. These infrastructure facilities address different obstacles to meeting this objective, including policy and regulatory settings and information asymmetries, project development and financing needs.

Further exploration of the role of innovative finance (eg. advance market commitments) in Green Climate Fund investments could be a practical way forward.

There may also be a role for the Green Climate Fund to promote business innovation among small-medium enterprises to support the development and commercialisation of clean technologies.

III. Submission by Ms. Naoko Ishii (Japan)

1. We support the Co-facilitators' proposal to organize the work into five categories, and start from Finance entry points (sub-workstream I) and Accessing finance (sub-workstream 3) with additional comments below.

2. Following items could be added for TC members' consideration;

[Sub-WorkstreamIII.1: Finance entry points]

- What is the best way of financial management of GCF best serve the purpose of the fund? The review of strengths and weakness of financial management of existing financial mechanisms may help to crystallize the issue. For example, CIF allows donors to contribute in several methods, including, loans, grants and equities. There is mismatch between the way funds are collected and the way funds are delivered to recipients.
- There are many kinds of financing modalities to catalyze private sector participation. This includes financing incremental costs of investment, credit enhancement for risk mitigation, co-financing with private financiers, guarantee scheme, and accessing capital markets. In order to find the most effective way to catalyze private sector participation, we recommend to have working sessions focused on private sector participation by investors (private companies) and financiers (financial institutions).

[Sub-WorkstreamIII.2 and 3: Managing finance and Access finance]

- These topics of "Managing finance" and "Access finance" need to be discussed together with a discussion of effective and efficient corporate structure including governance and approving procedures. Effective and efficient delivery mechanism through (i) different funding windows, including direct access, and (ii) different type of implementing agencies is critical in designing GCF intuitional arrangement.
- Considering the methodology to deliver financing through different access modalities and different types of implementing agencies, including direct access, the study should explore options for efficient management, governance, procedures and corporate structure of GCF.

[Sub-WorkstreamIII.4: Balance between mitigation and adaptation]

- To consider the appropriate balance between mitigation and adaptation, we should learn from the current best estimate on the needs. In addition to the balancing of mitigation and adaptation, we should also consider a resource allocation methodology to countries and regions.

IV. Submission by Mr. Nick Dyer (United Kingdom of Great Britain and Northern Ireland)

This is a good set of TORs, which cover the main issues - the GCF structure and windows, private sector and direct access. We may later want to consider additional sub-workstreams if we conclude that there should be more windows than just private sector and direct access.

It is very helpful to see the timeline for this workstream which looks good with a couple of comments:

- Modalities for contributions to the fund - it will be difficult to take decisions about contribution modalities until we have a good idea about what types of instruments, products and windows the GCF will have. The task at this stage will be to determine the complete range of possible contribution modalities, and then later when we know the instruments we can pick appropriate contribution modalities from the list. So we will likely need to come back to this issue later in the year once we have a better idea of the function of the GCF.

- Private sector - I welcome the proposal to consider private sector so early in the process. Given the amount of work that Transitional Committee members and the Technical Support Unit will need to do on the private sector - and the importance of getting it right - I think it will be difficult to conclude the private sector discussion at the 2nd meeting in Tokyo. I suggest therefore that we plan to continue the private sector discussion in the 3rd Transitional Committee meeting.

As in workstream I, it would be helpful at this stage to set out what pieces of analysis the Technical Support Unit will be tasked to undertake:

- On direct access under sub-workstream 3.3, it would be helpful to consider how a direct access window in the Green Fund could be structured, building on lessons learnt from other direct access funding instruments. Other instruments to consider include the Adaptation Fund, the Global Fund for Aids, TB and Malaria (GFATM), MDB climate change PBLs, Poverty Reduction Budget Support, and results-based instruments such as Cash on Delivery.

- On sub-workstream 3.1, a lot of analysis has been done on private sector involvement in climate finance, and there are several institutions - including the MDBs - that already offer climate-related private sector products. The Transitional Committee can benefit from learning from these, and the design of the GCF will need to take them into account. I therefore suggest the Technical Support Unit is tasked to consider the following questions:

1. How can the private sector offer of existing institutions be enhanced and what role can the GCF play?

2. Building on the useful work undertaken to date, including by the UNFCCC Secretariat and the AGF, what new institutional and instrument approaches are needed to address gaps in the existing architecture that can quickly increase private finance at scale?

I would also welcome the opportunity to comment on terms of reference for any other work the Technical Support Unit is tasked to carry out under workstream 3.

V. Submission by Ms Marisa Lago (United States of America)

Modalities for contributions to the Fund

1. *In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?*

   U.S. Response: Ultimately, the Board will likely need to address technical issues on modalities for how contributions are made. The fund must be flexible enough to receive contributions from multiple sources, including developed and developing country governments and non-state actors. The fund must also be sufficiently flexible for contributors to be able to designate windows for their contributions. Contributions should be made on a voluntary basis. The fund should be structurally capable of receiving innovative sources of finance in addition to direct country contributions in various forms. Legal issues related to whether the GCF is able to accept funds from such a variety of sources should be referred to Workstream II.

2. *What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs ofperiodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?*

   U.S. Response: For direct contributions by governments, funding could be raised through multi-year replenishments.

Methods to mobilize and leverage private sector finance, both foreign and domestic

3. *How can the GCF best 'crowd-in' private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?*

   U.S. Response: The GCF must be designed to maximize private sector co-investment in as many areas as possible but being careful that this leveraging does not displace private funding. This will require engaging private sector stakeholders early and often throughout the development of the GCF. In particular, private firms with experience in infrastructure investment, project finance, and banking (which do not typically follow UNFCCC negotiations) should be encouraged to participate. The IFC, EBRD, and other governmental agencies that have experience with crowding in private finance should also be brought into the discussion. While the TC can provide broad guidance, it will be for the Board to structure windows to maximize private co-investment and also consider the value of creative approaches such as loan guarantees, equity fund investing, investment competitions, and pay-for-performance.

4. *Should GCF resources be deployed to raise funds from the capital markets, whether through bond issues or some other vehicle that could be considered to mobilize significant amounts offunding from institutional investors?*

   U.S. Response: The GCF Board should consider all sources of funding.

5. *How can the modalities of public-private engagement be optimised, including timing of engagement, aligning project cycles, pre-investment activities, linkages to the carbon markets and other operational issues?*

   U.S. Response: The private sector needs to be engaged at various levels throughout the project cycle, so as to optimize their engagement and level of investment. The fund board should engage regularly with the IFC, EBRD, private sector firms, and governmental entities that work on public-private sector investment and engagement as part of their mission.

6. *How can the delivery of private finance be improved in regions with poorly developed financial markets?*

   U.S. Response: The GCF Board will likely need to consider how to incentivize private finance in regions with poorly developed financial markets as well as how to design programs that improve regional financing. The GCF should first engage with the private sector in order to determine how best to proceed in this area.

VI. Submission by Mr. Tosi Mpanu-Mpanu (Democratic Republic of Congo) and Mr. Omar El-Arini (Egypt)

Issues related to sub-work stream III.1: Finance entry points A-

Principles

- *Africa bases the answers to the questions posted under Work stream on the following principles:*

1- Provisions of the Convention and the relevant COP decisions constitute the basis of, and provide a framework for our work in the TC. Therefore the work of the Green Climate Fund is under the guidance of the UNFCCC COP and based on the Convention.

2- The principles of Common but differentiated responsibility, respective capabilities, equity, as well as, the historical responsibility of developed countries in causing the current changes in the climate.

3- Funding for climate change should be scaled up, new and additional, predictable, sustainable and adequate. It shall be provided to developing countries, taking into account their urgent and immediate needs, especially those developing countries that are particularly vulnerable to the effects of climate change.

4- There is a clear relation between the financing needs of developing countries and the scale of funding that should be made available in a timely and country driven manner, and in a way that supports and facilitates actions of the developing countries as part of the global effort to face climate change.

5- Direct, easy and facilitated access to funding for developing countries should be guaranteed in any climate related finance to overcome current gaps.

6- An institutional process of evaluation and assessment of financial resources made available to developing countries, including identifying any conditionality to such resources is to be conducted under the UNFCCC, in order to ensure a facilitative and effective process.

7- A balanced disbursement of funds should be guaranteed. Criteria for balance should include geographical distribution and relative needs of different regions.

8- Ambitious mitigation commitments by developed countries are indispensible to secure an efficient carbon market, and it can be boosted by the voluntary mitigation actions by developing countries.

Modalities for contributions to the Fund

1. In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?

Forms of funding:

> **Initial/core funding should be provided from public sources through direct contributions from Annex II governments- as identified in the Convention-, such**

contributions will be based on an assessed scale following an agreed burden sharing scale between Annex II countries.

> **Other sources including direct contributions/ donations from the private sector, private individuals and foundations can also be accepted as supplementary sources for additional finance.**

> **The fund should have its legal personality and therefore capacity to receive and manage available finance (under the guidance of the COP).**

2. What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs of periodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?

> **An Assessed scale of contributions from Annex II for a replenishment period that can be reviewed periodically (every three to four years), should constitute the main source of funding. (Provides predictability and sustainability).**

> **An additional source could be a percentage from the Joint implementation and other similar instruments, and assigned percentage of the carbon market revenues in annex II countries, including from taxes or levies applied.**

> **There should be a minimum core budget of the fund, based on the assessment of the urgent and short term needs of developing countries related to climate change.**

Methods to mobilize and leverage private sector finance, both foreign and domestic

3. How can the GCF best 'crowd-in' private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?

> **Guarantees to private, co-financing, or develop rules on the basis of experience of Export and Import banks and other institutions that provide guarantees for local companies to export and /or invest in high risk countries.**

> **The fund can provide incentives for private sector, including using futures markets, or guaranteed carbon prices.**

4. Should GCF resources be deployed to raise funds from the capital markets, whether through bond issues or some other vehicle that could be considered to mobilize significant amounts of funding from institutional investors?

> **The issue should be considered by the fund's Board, in consultation with the Trustee of the fund, to determine whether a percentage of the resources may be deployed through capital markets.**

5. How can the modalities of public-private engagement be optimized, including timing of engagement, aligning project cycles, pre-investment activities, linkages to the carbon markets and other operational issues?

6. How can the delivery of private finance be improved in regions with poorly developed financial markets?

> **Guarantees, futures.**

VII. Submission by Mr. Manfred Konukiewitz (Germany)

Germany is strongly committed to the effectiveness of operational modalities for the Green Climate Fund (GCF). Therefore, results oriented financing, high accountability and a variety of funding resources and financial delivery mechanisms are crucial factors when designing the operational modalities for the fund.

A results-based approach is a prerequisite for the success of the GCF. A results-based approach should generally work towards incentivising the achievement of ambitious targets and indicators set up for a specific activity. However, the specifics of the different thematic areas need to be taken into account. In adaptation, increasing the resilience especially of the particularly vulnerable countries and communities is essential. In REDD+, emission reductions alongside biodiversity benefits are crucial. In mitigation, for example, the emission reductions that should be achieved and the transformational impulses of actions are key criteria. Elements of a results-based system could include inter alia independent review and monitoring processes, mid-term evaluations as a basis for releasing further tranches of funding

Sub-Workstream III.1: Finance entry points

Decisions on operational modalities need to be made in a wider context of size and scalability of possible public and private resources, including innovative financial resources (see German submission on Workstream I). Discussions on finance entry points should have strong connections with discussions on managing and accessing finance (Workstreams III.2 and III.3).

Finance entry points should be designed in a way to allow result oriented funding and make best use of mobilising private sector finance. To that end the Germany recommends a:

- two level funding system: Funds might be spent in a two level process: a fixed tranche and an result oriented bonus payment. The fixed tranche is aimed at securing general and continuous commitment to climate finance by the contributor. The bonus payment will be paid based on the absorption capacity, implementation speed, impact and results of investments according to pre-defined criteria. The bonus payment, which could be a grant or a loan, will have to be used to implement further projects or programmes as laid out in e.g. a low carbon development strategy.
- Grant and Loan funding: The GCF may accept grant funds and/or subsidized loan funds in order to better leverage the resources.

Sub Workstream III.2 Managing Finance

Ensuring ownership, accountability and financial discipline is a key element when providing direct access or access through MDBs, IFIs and other national or bilateral agencies.

To that end the fiduciary safeguards clauses concerning liability shall apply for the trustee, the fund manager and the beneficiaries of the fund.

Further, all institutions, agencies and organisations, in particular domestic funding entities, eligible to manage or utilise GCF funds shall comply with internationally agreed fiduciary standards concerning:

a) Planning and appraisal standards for climate investments
b) Accounting standards
c) Audit standards
d) Internal control standards
e) Procurement standards
f) Monitoring and evaluation standards

An independent body (e.g. international chartered accountant) agreed upon by the TC member states shall assess all eligible organisations applying for GCF funds prior to the first disbursement and on regular basis during implementation of GCF funds.

Sub Workstream III.3 Accessing finance

a) Loan and grant blending platform: Within the GCF these platform links GCF grants and loans to loans committed by international, regional, bilateral, national and private institutions. These mechanisms are already successfully being used in other set-ups and have increased the volume and quality of development finance while ensuring a better coordination and effectiveness. In particular the following criteria can be fulfilled by a loan and grant blending platform:

> a high flexibility according to operational needs
> the determination of grant amount according to the type (mitigation, adaptation, REDD) and the size of the project requirements
> improving coherence, cooperation and coordination between different existing and new climate financing mechanisms
> attracting additional funding to combine with GCF means
> jointly meeting defined minimum standards and reporting obligations

b) Structured Finance: to increase private funding a window for structured finance products should be opened. This funding window will be aimed at structuring first loss pieces (grants), a mezzanine tranche (loans froms MDBs and IFIs) and a commercial tranche (loans from private sector), thus leveraging scarce grant funds.

c) Type of grants: GCF grants shall be used in flexible way allowing a tailor made utilisation depending on the type of climate investment and the region concerned. The following grant options (non-exhaustive) can potentially be used in the framework of the fund:

> Technical assistance and studies
> Direct Investment Grants
> Performance/bonus oriented grants
> Interest rate subsidies
> Loan guarantees
> Structured finance - first loss pieces
> Risk capital
> Insurance premi

VIII. Submission by Ms. Audrey Joy Grant (Belize) First submission of views from Belize, supported by Guyana

Workstream III: Operational Modalities Sub-

workstream III.1: Finance entry points Modalities

for contributions to the Fund

- The Fund should be designed to be able to accept a wide range of sources, both public and private, and to accept a wide range of funding modalities including grants, investments etc.
- The fund must be flexible enough to receive contributions from both state and non-state actors. Must have the flexibility to designate windows for earmarked contributions.
- In this regard, we support the establishment of windows for mitigation, adaptation and REDD plus.

Methods to mobilize financing and the processes and sources might be used to raise funding

- Attention should be given to the UN SG's Advisory Group on Finance report of November 2010. In particular, the following should be noted:

□ $2bn -$27bn could be raised from financial transaction taxes on foreign exchange,
□ $4bn to $9bn from maritime shipping levies.
□ $2bn to $3bn from aviation levies.
□ $3bn to $8bn from removal of fossil fuel subsidies.
□ $8bn to $38bn from auctioning carbon allowances.
□ New carbon-based public instruments and a carbon price in the range of $20 to $25 a tonne of carbon dioxide equivalent in 2020" are also seen as key elements.

- Public sources should constitute the primary source of financing. This should be effected through direct contributions from Annex II governments. Contributions should be based on an Assessed scale of contributions from Annex II Governments. A replenishment period that can be reviewed periodically should be agreed.

- A percentage from Joint implementation activities, and assigned percentage of the carbon market revenues in Annex II countries.

- Other sources from the private sector and foundations can provide supplementary sources.

Methods to mobilize and leverage private sector finance and incentives to engage the private sector.

- Should seek to maximize private sector co-investment. Can consider private co-investment loan guarantees, equity fund investments, guaranteed carbon prices among other things.

- The Fund should consider how to incentivize private finance in regions with poorly developed financial markets as well as how to design programs that improve regional financing.

- A carbon price, such as 20-25 per ton is critical to incentivizing private sector participation.

SubStream 3.3 Access modalities and finance
Thematic funding windows

- The Fund should be designed with three funding windows for a) mitigation, b) adaptation and c) REDD+.
- In mitigation, activities which can initiate transformational changes should be given priority.
- In REDD+, support should be given to results-based actions that are measured, reported and verified (phase 3).
- In adaptation, primary attention should be paid to small island and coastal low lying developing states.
- Support should also be given to integrated climate change approaches, such as low-carbon/climate-resilient development strategies.

Flexibility in the number of thematic windows.

- The Board should have the flexibility to add windows or sub windows for certain financial instruments (e.g. loan guarantees) or for access modalities (e.g. the private sector), and to facilitate speedy implementation of projects and programmes.

Balanced allocation between adaptation and mitigation

- Allocations between adaptation and mitigation should be balanced; recognizing that there are challenges to striking an exact balance, the Board should seek to strike that balance as far as feasible.

- In allocating adaptation funds, priority should be given to vulnerable small island and coastal low lying developing countries where livelihoods are at risk.

Direct access

- Simplified and direct access to financial resources with minimized processing time and transaction costs.

IX. Submission by Mr. Rob Stewart (Canada) Comments on the draft work plan for Work stream III: Operational Modalities

The work stream focuses on very important matters that will have a large influence over the design of the GCF. In advance of the first workshop, we have focused our comments on finance entry points but we may have further comments on the work plan ahead of the second meeting of the Transitional Committee.

I. Comments on issues related to sub-Workstream Finance entry points

The questions raised in this sub-works stream on finance entry points outlines key issues that will need to be addressed in the design of the GCF. Given the limited public resources available, the role of private finance will be critical in meeting the climate change financing needs.

There are several options for both the modalities for contributions and for methods to mobilize and leverage private sector finance. Canada's submission for the first workshop aims at highlighting some of these options and presenting examples of recent initiatives in climate finance. Given the importance of these questions, we would support further work by the TSU on the advantages and disadvantages of different options for contributions modalities and methods to mobilize and leverage private sector finance.

Modalities for contributions to the Fund

Canada supports a Green Climate fund that would be able to raise funds from a variety of sources, including effective mobilization of private finance.

Processes and sources to raise funding for the GCF

The processes to raise resources for the GCF will vary depending on the type of institution created. In a trust fund model, multi-year replenishment cycles or ongoing funding processes could be established. While a multi-year cycle would have the benefit of bringing some predictability within the replenishment cycles, each cycle would maintain some uncertainty in the amounts that will be pledged. By contrast, an ongoing funding process would bring predictability in the GCF's resources, but is unlikely at this stage to be politically feasible.

A model more similar to a development bank would see various funding windows established, with each window offering different financing terms, and possibly raising resources through different sources. Some windows could be self-sustaining while others could be funded through a combination of donor contributions and transfers from self-sustaining windows. This model would have the benefit of maximizing total mobilization of finance for any given level of public funding contribution.

The modalities for contributions to the Fund would need to be addressed in the legal instruments(s) that underpin the GCF.

Methods to mobilise and leverage private sector finance, both foreign and domestic

Private sector investment decisions are based on the risk-adjusted return expected from these investments, with the desired returns commensurate to the perceived risk of the investment.

Private sector investments in climate change can be leveraged by having public resources addressing the risk-return imbalance that often occurs in this sector by using diverse instruments - i.e., guarantees, insurance, equity, or having public investment covering the riskier portion of a project through concessional loans or grants, subordinated debt, etc.

Other instruments could be used by the GCF to raise private sector finance directly for its operations. For example, so-called "green bonds" have been issued by the World Bank, offer a fixed income to investors on the basis of investments by the institution in climate solutions.

How the GCF could raise funds from the capital markets?

The attractiveness financial products that would be issued by, or on behalf of, the GCF, would largely depend on the demonstrated climate change impact of projects supported and the capital structure of the institution issuing the instrument.

Therefore, either the GCF will need to have its own capital, which implies a number of institutional and legal capabilities of its own, or, there might need to be a way for capital at an existing institution to be used/increased with some ring-fencing for GCF activities, which will require a different set of arrangements to be addressed. The TC could consider both possibilities based on technical input provided by the TSU. For example, it may be useful for the TSU to undertake an analysis of the arrangements and governance structures in existing international funds that have their own capital or partner with other bodies to access capital.

How to improve the delivery ofprivate finance?

Because private sector investments tend to flow where policy and regulatory frameworks are stable, strong and transparent, additional capacity building may need to be provided to developing countries to assist them in their efforts to enhance the mobilization of domestic and international finance towards climate change projects, and to strengthen the ability of financial market actors and of financial institutions in developing countries to identify, assess and structure financing for climate-friendly projects, such as in the areas of energy efficiency and renewable energy.

Examples of Canadian initiatives leveraging private sector funding

As an illustration of how public institutions can be effectively used to mobilize private financing, two Canadian examples, one international, and one domestic, are provided in the Appendix to this document. These offer useful potential approaches and lessons learned which might be usefully analysed by the TSU.

Examples of Canadian approaches to mobilizing private investment

As part of its fast-track commitment, Canada provided the International Finance Corporation (IFC), a member of the World Bank Group, with $285.7 million to be used as concessional financing for a broad portfolio of clean energy projects in developing countries.

Canada's investments will support greenhouse gas abatement opportunities and will be deployed to catalyze private sector financing for clean energy projects. Canada will work with the IFC to track the amount of private investment directly mobilized by Canada's public finance investments, as well as the emissions reductions achieved.

IFC will provide concessional financing with Canada's funds in accordance with the principle of providing the minimum concessionality needed to catalyze a given project. The pricing and terms offered to private sector clients will be tailored to address the barriers identified for each case and "crowd-in" private sector investments that would not happen otherwise. Concessional finance will also be deployed with a view to maximizing long-term financial sustainability and market transformation.

Canada also provided $5.8 million in grant financing to support IFC's Advisory Services to help remove barriers to private clean energy investment and build technical expertise. For example, this grant financing will support advice to financial institutions to strengthen their capacity to identify, assess and structure loans to energy efficiency and renewable energy projects.

Canada's contributions are being managed by IFC's Financial Mechanisms for Sustainability group, which deploys donor funds on concessional terms alongside IFC investments, as well as provides grant financing for technical assistance and capacity building.

To be eligible to receive concessional or grant financing from Canada's contributions, a project must satisfy IFC's standard criteria and due diligence.

On the domestic side, Canada has also implemented initiatives aiming at fostering the development of clean technologies by providing funding to address funding gaps in the innovation chain. Sustainable Development Technology Canada (SDTC) is an arm's-length foundation established in 2001 to finance and support the development and demonstration of clean technologies on a not-for-profit basis. The SD Tech Fund, launched in 2002, supports late-stage technology development and pre-commercial demonstration projects (i.e., advanced beyond the research and development stage, but still unproven) that address climate change, air quality, clean water, and clean soil. The Government has provided SDTC with $550 million to date for this Fund.

To date, SDTC has completed seventeen funding rounds and allocated a total of $515 million to 210 projects. This amount has been leveraged with an additional $1.2 billion in funding from other project partners for a total project value of $1.8 billion. Of those contributions, some 83 percent come from private sources. Independent evaluation suggests that SDTC has successfully assisted promising technology companies to develop and demonstrate their products, and did not appear to be displacing or crowding out private funding.

X. Submission by Mr. Per Callesen (Denmark)

Initial thoughts and considerations from Denmark and the Netherlands on issues related to sub-workstream III. 1: Finance entry points

Modalities for contributions to the Fund

1. In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?

Public funding forms may include paid in capital or guaranteed capital. Systems, governance structures and legal capacities must comply with fiduciary standards. In order to ensure optimal alignment with private sector investors, private sector representation should structurally be able to meaningfully influence governance and investment decisions, via for instance representation in the Board.

See attached Annex for an example of joint public private partnership.

2. What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs of periodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?

Links to the general discussion on long term sources of financing. At this stage no a firm position on these issues. General guidelines are that funding mechanisms should comply with the following criteria:

- respect national budgetary rules;
- are consistent with sustainable public finance practices;
- are predictable;
- can be mobilized at scale.
- Closely linked to the polluter pays

Methods to mobilise and leverage private sector finance, both foreign and domestic

3. How can the GCF best 'crowd-in' private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?

Key to crowding in private finance is to intelligently use concessional funds to align the risk/return ratio of private investments in such a way that FDI is mobilized without creating unwarranted windfall gains accruing to private investors. Examples of possible instruments include: insurance products, guarantees, equity and debt financing, technical assistance, venture capital support and 'results-based' funding mechanisms such as advanced market commitments (AMC's). Additionally, the GCF should actively interface with providers of official export credits (ECA's).

4. Should GCF resources be deployed to raise funds from the capital markets, whether through bond issues or some other vehicle that could be considered to mobilize significant amounts of funding from institutional investors?

Yes, especially Green Bonds or Green NAMA bonds could be possible mechanisms to consider, as long as the risks for donor bodies (governments, foundations) are transparent and capped.

5. How can the modalities of public-private engagement be optimised, including timing of engagement, aligning project cycles, pre-investment activities, linkages to the carbon markets and other operational issues?

Intensive consultation with the private sector is required to answer this question. Means for private sector representatives to structurally and meaningfully influence the Fund's decision-making processes will be key to insuring that continuous coherence between public and private sector investors.

A key engagement modality with the private sector is the procurement process. The procurement rules and regulations of the GCF should be based on the principle of *life cycle procurement* including the full quantification of environmental and social externalities (positive and negative). Concretely this means that the winning tender should be the one where the costs/benefit ratio is optimized over the whole life cycle of the project meaning the original capital expenditure as well as operation and maintenance costs and the costs for responsible deconstruction, including externalities.

6. How can the delivery of private finance be improved in regions with poorly developed financial markets?

Close cooperation with 'regular' development agencies/programs is required in order to further develop and improve the general business and investment climate in developing nations.

Blending of private FDI with loans/grants of MDB's can help leverage risks. **Case: Example of public-private capital: Global Climate Partnership Fund.**

In 2011 the Ministry of Foreign Affairs of Denmark will invest $7 million in the equity tranche and the IFC $75m in the mezzanine and senior tranche of the Global Climate Partnership Fund (GCPF). The Fund constitutes a decisive part of the German Government's efforts to support climate change mitigation in emerging and developing countries by increasing energy efficiency and reducing greenhouse gas emissions in emerging and developing markets. In order to leverage an impact of public resources, the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU) and KfW Entwicklungsbank (The German Development Bank) have set up the Fund as a "Public Private Partnership" model, in which both provide equity capital to partly assume the economic risk associated with the Fund's investments. Deutsche Bank is also invested in the Fund and acts as its investment manager. Osterreichische Entwicklungsbank belongs to key contributors of the Technical Assistance Facility attached to the Fund. Using its innovative structure, transparent governance as well as the benefits of a private fund manager, GCPF targets to increase its volume from currently US$200 million to a volume of US$500 million - mainly out of private funding sources.

The Fund targets sectors and regions with significant unlocked economic and environmental potential. By investing in GCPF, IFC follows its objective to enhance sustainable economic growth in these countries. The investment in GCPF is expected to have a considerable development impact and positively add to IFC's growing engagement in the clean energy sector in emerging and developing countries. Substantial amount af capital is required to mobilize the required capital to grow economies, while ensuring energy security and climate resilience. Innovative public private partnerships such as GCPF can be critical in order to raise the funds needed to accelerate climate change mitigation in emerging and developing countries. A key element is that the fund uses public finance to leverage private finance to provide loans to households and local firms in developing countries to investments in renewable energy and energy efficiency. The fund differentiates between the risk for public money and the risk for private money thereby creating an incentive for private investors to pay into the Global Climate Partnership Fund.

The reliability of energy supplies and global climate protection are two of the key challenges for the 21st century. Correspondingly, it is a central issue for the future for KfW Entwicklungsbank to promote wide-ranging investment in climate protection in developing countries and threshold countries. The public-private partnership concept on which this global climate protection fund is based, i.e. the cooperation between private and public investors, can play an important role in financing these investments.

GCPF's investments target to reduce energy consumption and greenhouse gas emissions by at least 20% compared to current levels. Initial focus countries of GCPF will be Brazil, Chile, China, India, Indonesia, Mexico, Morocco, South Africa, The Philippines, Tunisia, Turkey, Ukraine and Vietnam, but also LDCs are potential focus countries.

The Fund seeks to primarily finance local banks that engage in SME and residential finance and see sustainable energy financing as a promising product area, thereby supporting to improve living conditions and combat climate change.

XI. Submission by Mr. Manfred Konukiewitz (Germany)

Private Sector Input to the Members of the Transitional Committee
Workstream III A Discussion Note by Dr. Sabine Miltner, Group Sustainability Officer, Deutsche Bank/ Dr. Armin Sandhoevel, CEO, Allianz Climate Solutions GmbH

May 20, 2011

Although private capital is flowing into the climate change-related sectors, it needs to be significantly scaled up. At present, the scale of domestic and international private investment in climate-related activities in developing countries is seriously constrained by both activity specific and country-specific barriers that adversely affect the attractiveness of such investments, either in terms of the adequacy of returns or unmanageable risk.

Increased private flows to mitigation and adaptation activities in developing countries in 2020 will depend on the extent to which these investments become attractive relative to other opportunities.

The attractiveness of private investment will depend on three key factors:

- Firstly, the existence of an appropriate domestic policy framework and enabling environment, with transparency, longevity, and certainty ("TLC") of policy at its heart. This includes a functioning domestic financial sector, a system of land titles / deeds, the rule of law through the courts, the presence of project developers and existence of a project pipeline.
- Secondly, risk reduction mechanisms that address a series of real and perceived risks in the space. These include political risk, currency / FX risk, regulatory and policy risk, execution risk, technology risk, and unfamiliarity risk.
- And thirdly, the availability of revenue support and concessional instruments, which correct for externalities and can make climate-related investments more attractive than other opportunities.

International support can, and should, be brought to bear against each of these factors depending on the national context in question.

1. Appropriate domestic policy framework and enabling environment

As a precondition to any capital mobilisation, domestic conditions need to be conducive for investment. In many cases, autonomous domestic government measures can assist in bringing about a conducive domestic investment environment. These measures include:

- Environmental regulation, including pollution standards and regulations, public disclosure of information related to environmental impact, elimination of implicit subsidies for climate-risky behaviour, and improved sector governance and monitoring. Current status: variable across countries
- Energy regulation, including energy price reforms, elimination of fossil fuel subsidies, building efficiency codes, end use efficiency standards, efficiency certification / labels, power sector reforms, and improved grid access for renewables. Current status: variable across countries
- Regulation to establish the domestic financial sector, rule of law and land titles / deeds, the rule of law through the courts. Current status: variable across countries
- Establishment of an independent transnational arbitration court that is responsible to solve issues between e.g. investors and project developers. Current status: not existing

Beyond those measures that domestic governments can take themselves, there is a range of international support available. This includes:

- Technical assistance measures provided multilaterally through the MDBs or UN agencies, or bilaterally through bilateral finance institutions or technical agencies. Technical assistance can encompass individual measures, such as initial market studies, energy audits, wind mapping, feasibility studies, and facilitated licensing and procurement - and development of comprehensive low carbon development plans. Current status: exists but needs scaling up
- Development policy loans, which are increasingly being used as an integrating platform for climate change policy and programmatic initiatives. The report of AGF Workstream 7 noted that in the past two years, ten development policy loans with climate change components were approved by the World Bank's board. Current status: exists but needs scaling up

• Anchor investments from MDBs, bilateral development banks, and export credit agencies. These are desirable because the MDBs maintain a set of safeguards and other policy standards (e.g. fiduciary, procurement, environmental / social, consultation, disclosure) as well as post-Board supervision and quality assurance audits that reduce risks for commercial banks and other investors that are part of the financing package. Current status: exists but needs scaling up

Additionally there are some potential issues that have to be tackled with combined efforts of domestic governments, international support as well as the domestic and foreign private sector:

• Existence of a project pipeline, presence of project developers in country, domestic and foreign due diligence teams that can evaluate projects. Capacity building will be important to enable the GCF and investors to find sufficient suitable investment opportunities. Current status: exists but needs scaling up

2. Risk reduction mechanisms

Even with a conducive domestic environment, climate investments may not occur if risk management tools are unavailable, over-priced, or if risks are assigned to entities that are not well-equipped to manage them. A range of instruments are available to deal with these risks. These include:

• Policy guarantees, which include guarantees offered either by the host government or by bilateral or multilateral institutions. Current status: exists but needs scaling up
• Country and macro-economic risk insurance investments, which are available to investors, contractors, exporters and financial institutions involved in international transactions. Where commercial risk insurance is unavailable, it can be provided by public institutions such as MIGA and OPIC. Current status: exists but needs scaling up
• Foreign exchange risk hedging tools, including The Currency Exchange Fund (TCX) that was launched in September, 2007 by development finance institutions and commercial banks from European and African countries. Current status: exists but needs scaling up
• Loan guarantees from multilateral or bilateral institutions, which reduce the risk that a loan will not be fully repaid. Current status: exists but needs scaling up
• Facilities that establish local investment guidelines according to domestic policies and regulations and evaluate proposed projects to reduce technology, unfamiliarity and execution risks. Current status: exists but needs scaling up

3. Revenue support and concessional instruments

When risk-adjusted returns are not attractive, normally due to market failures, revenue support and concessional instruments can be deployed. These include:

• Advanced market commitments (AMCs), which make investments more attractive by ensuring investors upfront a minimum market demand and / or price for a product or service that meets certain specifications. Feed-in tariffs are a prime category of AMCs for renewable energy, but must be carefully crafted to avoid the erosion of political support (cf. Spain). Current status: embryonic
• Bilateral or multilateral investment grants, which can be used to address the carbon externality and other factors that are not adequately priced in. Current status: exists but needs scaling up
• Concessional debt finance, which lowers the cost of debt and is often drawn from multi-donor trust funds including the CTF, GEF, PPCR and SREP, as well as bilateral assistance agencies. Current status: exists but needs scaling up
• Equity and guarantees financed via grants. According to the IFC's Financial Mechanisms for Sustainability, equity and guarantees financed via grant funds can lead to a leverage of 1:20. Current status: exists but needs scaling up
• Donor-financed climate funds, which, from experience with the multi-donor Climate Investment Funds, show that every dollar of spending results in about $3 in private sector investment for sovereign guaranteed projects and $8.5 of private sector investment for private sector sponsored projects. Current status: exists but needs scaling up
• Grant-based technical assistance, which can assist the private sector in overcoming market-entry and start-up barriers. Current status: exists but needs scaling up
• Market based mechanisms like CDM or voluntary carbon markets (including REED) can be used to price externalities and can be used to increase returns and offset carbon emissions. Current status: exists but needs scaling up

Developing comprehensive strategies to unlock investment

Individual interventions can be used to build more comprehensive strategies to stimulate private investment. The instruments to be blended will depend on project characteristics and investor needs. These can include:

- For measures with negative net costs, but facing capital constraints, interventions like the IFC's China Utility Energy Efficiency Programme and the EBRD's Bulgaria Sustainable Energy Financing Facility have combined technical assistance and risk mitigation instruments to unlock significant investment. Current status: exists but needs scaling up
- For measures with modest costs, packages that combine instruments in scalable, replicable public-private fund structures have great promise. The Global Climate Partnership Fund, which was established by the German Environment Ministry and KfW, and has recently received an additional investment of $87 million from the IFC and Danish Foreign Ministry, is a promising facility to take this work forward. And Deutsche Bank's "GET FiT" programme is a comprehensive approach to create the on-the-ground capacity to deliver, aggregating capacity building with risk reduction and revenue support mechanisms. Current status: embryonic
- For measures with significant cost, grant-based funding, especially for R&D, should be prioritised for those measures that have the most potential for costs to come down over time as they scale. Current status: embryonic

Recommendations

- Areas marked as embryonic or with an identified need for scaling up should be tackled individually to make the GCF successful over the long term.
- An overall target should be to create investment opportunities with attractive risk adjusted returns that can compete with mainstream investment opportunities to attract private capital. Green Bonds are a good example of such an investment opportunity as they fit into existing (investment and financing) processes, complexity is low, they address the needs of private investors, can deliver attractive risk / return profiles and make mainstreaming possible.
- In designing the institution(s) that private investors will interact with and the packages of interventions that will be available to them, complexity should be avoided, as it is a deterrent to private investment.
- Transparency, longevity, and certainty ("TLC") should be at the heart of the institutional design of the Green Climate Fund.
- A cross-collateralized umbrella fund structure could be used to attract domestic as well as foreign investment. Domestic investors could choose to invest in their home country's subfund directly while foreign investors are expected to prefer investments in the umbrella fund due to higher diversification of risks. The umbrella fund would have the highest possible flexibility in its investment decisions and should be allowed to invest in / co-invest alongside existing climate funds and financing facilities.

XII. Submission by Ms. Bernarditas Muller (Philippines)

RESPONSES TO QUESTIONS ON ISSUES RELATED TO SUB-WORKSTREAM III. 1: Finance Entry Points

Submission by Bernarditas Muller, TC Member (Asia) June 5, 2011

ON QUESTIONS ON ISSUES RELATED TO SUB-WORKSTREAM : Finance Entry Points
TOR : Para.1 (c)

"Method to manage large-scale of financial resources from a number of sources and deliver through a variety of financial instruments, funding windows and access modalities, including direct access, with the objective of achieving balanced allocation between adaptation and mitigation."

- to address the historical imbalance of financing for adaptation under the Convention, as adverse effects continue to rise, both in frequency and intensity, causing untold damage to lives and the social and economic conditions of developing countries which contributed the least to the problem of climate change but which are the least able to cope with its adverse effects.

On questions 1 and 2: (Note that out of six questions, four are devoted to the role of the private sector, thus this questionnaire is completely imbalanced)

1. In line with the principles and provisions of the Convention, the basic source of financing for the GCF would be the public sector, through regular assessed contributions, taking into account historical responsibilities and whatever long-term goal would be agreed under the Convention.

Financing necessary for the achievement of the objective of the Convention would need to be determined regularly as the financing needs of developing countries would be directly linked to whether the mitigation commitments are going to be fulfilled. The adaptation needs would have to be determined through vulnerability assessments and scientific assessments of the action needed to address the adverse effects of climate change.

2. Other sources would be supplementary to this basic source of financing, such as voluntary contributions, both public and private, and other agreed sources such as a global tax on emissions.

3. The GCF Board would need to be endowed with legal capacity to enter into agreements to receive, and also to allot funds to other legal entities.

4. Predictability of funding, meaning its accessibility and not mere availability, can only be achieved through assessed contributions. Pledges could likewise be received from other sources, to be fulfilled at regular intervals to allow for long-term planning in climate change mitigation or adaptation projects.

5. Direct access is essential to allow for a balanced allocation of resources to mitigation and adaptation. Funding should be country-driven and demand-driven.

6. Direct access would also ensure equal access for all developing country Parties, thus allowing inclusivity and universality, contrary to some financing institutions outside of the framework of the financial mechanism under the Convention.

On questions 3 to 6- the role of the private sector and the use of market mechanisms

7. The use of market mechanisms should ensure environmental additionality, and not merely transfer of emissions through offsets. The use of market-based instruments should likewise be subject to the guidance provided by the COP.

8. Grants cannot be used to leverage loans, and loans cannot be offered as co-financing in order to access grant funding. These practices merely sink developing countries deeper into debt, and do not necessarily enable them to address climate change.

9. Sources of funding and uses of funding are the mainstreams of a Fund. Uses of funds should be determined by the users of these funds. This is what is meant by truly country-driven, demand-driven financing. Financial needs assessments, mechanisms for which already exist and are being used under the Convention, should drive the amount of funding necessary for the GCF to fulfill its objective.

10. All developing countries must have equal access to funds. Direct access would not only be cost-effective, but ultimately effective climate change financing. If one is looking at community-level implementation, in particular of adaptation, the grant instrument is the most obvious modality. Not generally considered "bankable" because they do not have collaterals, and adaptation activities are non-revenue generating, these potential implementors and the ultimate beneficiaries cannot easily access loan facilities, no matter how concessional. Private sector financing does not take this into account, and therefore must be enabled by their respective public sector, through regulatory mechanisms, such as incentives, to undertake such activities.

11. Private investments must internalize costs of the emissions arising from their investments, whether extractive industries or manufacturing, otherwise they will only exacerbate the problem of climate change instead of helping address it. Investments cause emissions that are "credited" to the host country of investments, and these are called "transfer emissions". In some cases, they also produce hazardous wastes for which developing countries do not have the capability for either disposal or recycling. All the costs for these should be added to the costs of investments made.

12. On "delivery of private finance in regions with poorly developed financial markets": It is not so much that countries have "poorly-developed financial markets" but that private sector financing, mainly profit-oriented, goes only to developing countries with developed financial markets. Thus, private finance is not suitable for climate change financing which is aimed at enabling all developing country Parties to meet the challenge of climate change and its adverse effects.

XIII. Submission by Mr. Sergio Barbosa Serra (Brazil)

1. Finance Entry Points
The Transitional Committee (TC) should be looking for design solutions to make the Green Climate Fund (CGF) operational by December 2011. Discussion on sources of finance should not take place under the TC, but under the AWG-LCA. The TC should, however, design and legally developed the CGF in a way that allows for different sources. The fund should be designed to take resources from a variety of sources, as mandated by 1/CP.16, in a streamlined manner. Members should be looking to the simpler solution/combination of solutions that will make the fund flexible enough to cope with future decisions by the COP.

2. Managing Finance
As it is consensus that the contributions of developed countries are going to be a source of finance, the TC should start looking at forms to operationalize the initial phase of the CGF based on this source. It should also consider the need for allowing for a periodic replenishment of the Fund by developed countries.

It is important that the CGF consider to what extent resources should be earmarked. Allowing earmarking by donors or by specific sources is bound to produce the imbalances we are trying to avoid, such as current imbalance between resources available to finance mitigation and adaptation actions.

2.1. Thematic Windows
Thematic windows can work as an important instrument to guarantee balance between mitigation and adaptation, as well as a means to guarantee finance to other relevant areas. As both mitigation and adaptation constitute broad areas of work, it can be expected that the Fund Board will want to create sub-windows/focal areas according to future discussion on programming and priorities. The creation of sub-windows/focal areas should be flexible, while the windows for mitigation and adaptation are to be permanent.

Two further permanent windows should be created: Technology Window and Capacity Building/Enabling Activities Window. Those windows are meant to guarantee financing to areas that would not usually find finance sources elsewhere, such as research and development of new technologies, demonstration projects, capacity building and other enabling activities that will allow countries to not only implement activities, but also access resources. Even though it is expected that some mitigation and adaptation activities will have a technology or a capacity building component, those two windows aim at financing activities that are not directly related with the implementation of specific activities.

The use of resources allocated in each window can be flexible, allowing for cross-cutting initiatives to use resources from different windows. . (The same paragraph was submitted to workstream I)

3. Accessing Finance
The CGF can consider using different financial instruments, but they should all offer facilitated finance. Grants should represent a significant part of disbursement. Also, the access to grants must not be conditioned to the combined use of non-grant mechanisms, such as loans.

3.1. Balance between operational modalities/financing instruments
When considering the use of non-grant mechanisms, due consideration should be given to the balance between resources available to each one. Grants mechanisms should be a priority.

3.2. Direct Access
Direct access must be widely used in CGF operations if the Fund is to contribute in a transformative way. Options to work directly with Governments, such result based payments, should be considered in addition to national agency accreditation processes. Even though some form of direct access should, in principle, be available in all areas, specific modalities, such as result based payments can be matched with the appropriate areas in a later phase, during a programming negotiation. (Similar paragraph was submitted to workstream I)

4. Balance between Mitigation and Adaptation
What constitutes an adequate balance is to be decided by the COP after due consideration of the needs of developing countries and scientific information. For ways of delivering such balance, see point 2.1.

5. External inputs
The board of the Fund could hold regular consultations with stakeholders. The board should be able to get adequate support from an independent and contracted secretariat.

XIV. Submission by Mr. Per Callesen (Denmark)

Workstream III – Operational Modalities

Denmark and The Netherlands appreciate this opportunity to provide input to the co-facilitators on this work-stream, please find our comments below. Additionally, we would like to thank the chairs, co-facilitators and the TSU for their efforts in facilitating the work of the TC. We look forward to closely collaborating with you and our fellow TC members in order to bring the TC's work to a successful result.

III.I Finance Entry Points

In our view, the discussion regarding the sources that will fund the GCF should be dealt with within the UNFCCC process. However, we do foresee that the funding will mostly come from public sources, either through paid in or guaranteed capital. However, it is key to then use these public sources as efficiently as possible for the realization of adaptation and mitigation projects. Therefore we envisage that a significant portion of this funding will be used to catalyze private investments in mitigation, but also, where possible, in adaptation measures.

Please refer to attached Annex for an example of joint public private partnership.

The Climate Investment Fund elegantly phrases the key concept on this issue by stating the following:

In the private sector, decisions to undertake new investments are based on the risk-return expected from the investment. If the risks are expected to be high, the return on that investment must also be commensurately high if the private sector is to engage in the project. [14]

In our view there are three main categories of instruments for mobilizing private capital. These are:

1. Reducing investment risk
2. Increasing bankability of projects by repackaging many small projects in such a way that they are attractive to larger investors;
3. Ensuring a climate friendly business environment of a country, including policies and measures that underpin investments in low carbon activities.

The Fund can play an active role in categories 1 and 2. Category 3 is more for 'regular' development agencies/programs as these also refer to generic policies in the field of, for example, good governance. In this context it is essential for countries to prepare coherent plans that specifies their aspirations on how to reduce carbon emissions.

Reducing investment risk

The key to crowding in private finance is to intelligently use concessional funds to align the risk/return ratio of private investments in such a way that FDI is mobilized without creating unwarranted windfall gains accruing to private investors. Examples of possible instruments include: insurance products, guarantees, equity and debt financing, technical assistance, venture capital support and 'results-based' funding mechanisms such as advanced market commitments (AMC's). Additionally, the GCF should actively interface with providers of official export credits (ECA's). In order to optimize these interfaces intensive consultation with the private sector is required.

Increasing bankability

Instruments such as the issuance of Green (NAMA) Bonds could be used to raise non project specific private investment capital for blending purposes as long as the risks for donor bodies (governments, foundations) associated with such instruments are transparent and capped.

III.2 Managing Finance

Systems, governance structures and legal capacities must comply with fiduciary standards. In order to ensure optimal alignment with private sector investors, private sector representation should structurally be

[14] CTF financing products, terms and review procedures for private sector operations, CIF, March 17, 2010

able to meaningfully influence governance and investment decisions, perhaps by having a seat in the board. Similar privileges could be considered for NGO's.

Regarding the amount of funding windows, we would favor keeping these to a minimum, preferably one for mitigation (including REDD) and one for adaptation. In our view having less windows allows for more efficient allocation of funds as the funds will then be assigned based on the merits of the program, project or fund in respect of agreed performance based criteria and not earmarked a priori for various thematic destinations. In this way we ensure that the funds are used in the most cost effective way.

We would encourage the GCF to fully utilize the finance delivery structures and existing networks and infrastructure of existing climate finance distributers, notably the national, regional en multilateral development and investment banks, when disbursing funds. It would be highly cost inefficient if the GCF would, for example, build up its own network of regional offices etc.

III.3 Accessing finance

We appreciate the background note that was drafted by the TSU for this topic. In our view the GCF should implement a broad range of instruments in order to best be able to cater to the type of activity being financed and its location. We believe that there will remain to be a role for traditional grant based financing, but in order to increase the chances of the fund having a transformational impact those instruments that most effectively mobilize private investment flows at scale without creating undue risks for the GCF or windfall profits for private investors should be emphasized. We would welcome an analysis of which types of instruments would best meet these conditions as well as their costs in terms of capital reserve requirements and administrative costs. The optimal tradeoff between these aspects needs to be found.

In promoting a country driven approach based on national development plans, direct access can be a key element. Direct access can be granted only if the quality of relevant fiduciary standards of the implementing/executing entities are fully guaranteed. It is essential to apply an open approach that allows for a range of types of organizations, including not least the relevant national institutions/entities. However, reflecting on the limited capacity of some government institutions, the global nature of the climate change issues and the important role of private investors, NGOs and private sector partners should also be considered when granting direct access, based on prior specified conditions.

III.4 Balance between mitigation and adaptation

The definition of "balance" should not be cast in stone for years to come. It will be crucial to have flexibility in the allocation. Allocation will be driven by both country-led programmes and plans that are put forward and guidance by the COP.

Both ambitious adaptation and mitigation actions will be crucial to foster low-carbon and climate resilience development paths. In order to avoid "crowding" out/competition between adaptation and mitigation, the setting of minimum volumes of finance allocated to each of them might be considered, which would provide some certainty but would also allow for flexibility.

Funding should be directed to initiatives where cost-effective results can be optained.

III.5 External Inputs

During the TC process we are of the opinion that both private sector and NGO's observers should be participate in the TC discussions in an interactive manner as well as being invited to provide written inputs.

Once the GCF is operations there should be means for private sector representatives to structurally and meaningfully influence the Fund's decision-making processes as this will be key to insuring that continuous coherence between public and private sector investors. Broad stakeholder engagement with the NGO community should be an integral part of policy making process within the GCF.

Other issues regarding private sector engagement

Life cycle procurement

Additionally an important engagement modality with the private sector is the procurement process. The procurement rules and regulations of the GCF should be based on the principle of *life cycle procurement* including the full quantification of environmental and social externalities (positive and negative). Concretely this means that the winning tender should be the one where the costs/benefit ratio is optimized over the whole life cycle of the project meaning the original capital expenditure as well as operation and maintenance costs and the costs for responsible deconstruction, including externalities.

MRV

Public bodies cannot be held fully accountable for private flows, therefore the same level of MRV stringency that should be applied to public flows should not apply to private flows. However, an indication of the types of public instruments implemented to moblise private flows and their expected leveraging ratio's should be part of the overall reporting process.

What get's measured get's done. MRV should not be seen as a last step in a financing process but as the first step. An MRV system plays an important role in incentivizing actions. Therefore the MRV system should be designed in such a way that it gives recognition and credit to those bodies that responsibly mobilize private capital.

Annex: Case: Example of public-private capital: Global Climate Partnership Fund.

In 2011 the Ministry of Foreign Affairs of Denmark will invest $7 million in the equity tranche and the IFC $75m in the mezzanine and senior tranche of the Global Climate Partnership Fund (GCPF). The Fund constitutes a decisive part of the German Government's efforts to support climate change mitigation in emerging and developing countries by increasing energy efficiency and reducing greenhouse gas emissions in emerging and developing markets. The Danish Government hereby contributes to a project initiated by the German Government.

In order to leverage an impact of public resources, the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU) and KfW Entwicklungsbank (The German Development Bank) have set up the Fund as a "Public Private Partnership" model, in which both provide equity capital to partly assume the economic risk associated with the Fund's investments. Deutsche Bank is also invested in the Fund and acts as its investment manager. Österreichische Entwicklungsbank belongs to key contributors of the Technical Assistance Facility attached to the Fund. Using its innovative structure, transparent governance as well as the benefits of a private fund manager, GCPF targets to increase its volume from currently US$200 million to a volume of US$500 million – mainly out of private funding sources.

The Fund targets sectors and regions with significant unlocked economic and environmental potential. By investing in GCPF, IFC follows its objective to enhance sustainable economic growth in these countries. The investment in GCPF is expected to have a considerable development impact and positively add to IFC's growing engagement in the clean energy sector in emerging and developing countries. Substantial amount af capital is required to mobilize the required capital to grow economies, while ensuring energy security and climate resilience. Innovative public private partnerships such as GCPF can be critical in order to raise the funds needed to accelerate climate change mitigation in emerging and developing countries. A key element is that the fund uses public finance to leverage private finance to provide loans to households and local firms in developing countries to investments in renewable energy and energy efficiency. The fund differentiates between the risk for public money and the risk for private money thereby creating an incentive for private investors to pay into the Global Climate Partnership Fund.

The reliability of energy supplies and global climate protection are two of the key challenges for the 21st century. Correspondingly, it is a central issue for the future for KfW Entwicklungsbank to promote wideranging investment in climate protection in developing countries and threshold countries. The public-private partnership concept on which this global climate protection fund is based, i.e. the cooperation between private and public investors, can play an important role in financing these investments. GCPF's investments target to reduce energy consumption and greenhouse gas emissions by at least 20% compared to current levels. Initial focus countries of GCPF will be Brazil, Chile, China, India, Indonesia, Mexico, Morocco, South Africa, The Philippines, Tunisia, Turkey, Ukraine and Vietnam, but also LDCs are potential focus countries.

The Fund seeks to primarily finance local banks that engage in SME and residential finance and see sustainable energy financing as a promising product area, thereby supporting to improve living conditions and combat climate change.

XV. Submission by Mr. Remy Rioux (France)

Submission on WORKSTREAM III. Operational modalities –sub-workstream II.1. Finance Entry Points

1/ In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?

The form of funding source will depend on the kind of fund we decide to design. These different models options should be further studied by the TSU in order to evaluate pros and cons of each of them.

However, as the CGF is established "*to support projects, programs, policies and other activities in developing country Parties*" and since "*funds provided to developing country Parties may come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources*", the GCF should be flexible and in the capacity to receive funding from a wide variety of sources.

As a multilateral fund, the GCF would need to be able to receive public contributions, either from innovative sources such as a contribution from international transport (so called *bunkers*) as recommended by the AGF report, which means the GCF should be able to receive such sources (such as the Adaptation Fund receives a share of proceed generated by the Clean Development Mechanism - CDM), **or from direct contributions**, which means that developed countries and voluntary developing countries should be able to pledge. Besides, if an international public source is established to fund climate actions in developing countries, the CGF should be able to receive this new source such as the Adaptation Fund receives a share of proceed generated by the Clean Development Mechanism (CDM).

In terms of governing system and legal capacity, if the GCF is designed as a banking institution with a significant initial capital, it should be under financial supervision, have a legal capacity and the voting right in the Board should be linked with the share of a member in the capital such as in the World Bank. If the GCF is designed as a Trust fund, it does not necessarily need to have a legal capacity: pros and cons of endowing the GCF with the legal capacity should be evaluated in the light of existing models (e.g. the GEF and the CIFs do not have the legal capacity).

The GCF should also be able to receive contributions from the private sector (individuals, financial institutions or foundations). It would suppose to create a specific funding window and specific institutional arrangements in order to provide the private contributors to the Fund with some views on the use of the funds.

2/ What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs of periodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?

Firstly, the processes are directly linked to the sources that would be used to fund the GCF. The Cancun Agreement does not give a clear and definitive answer to that question that will be discussed within the UNFCCC process, on the road to Durban. The G20 has also launched a process to feed the UNFCCC process, drawing on the AGF report. Therefore, until sources of finance are identified, it would be difficult to define the processes and sources that might be used to raise funding.

It appears that the process of funding will depend on the nature of the sources raised. For innovative sources of finance that could generate revenues partly or totally directly allocated to the Fund, only an ongoing funding would be possible. For direct budgetary and private contributions, both an ongoing and a periodic funding are possible.

Secondly, the processes and sources that should be used to raise funding would depend on the type of financial institution that the GCF would be. If the GCF has an investment program (i.e. if it expects returns on some of its operations), it would need an initial capital but it would generate ongoing revenues from the reimbursement of the loans issued. Periodic and/or ongoing funding could still be needed to replenish concessional/grant financing windows. If the GCF is only allocating grants, it would require either a periodic funding process if short term predictability is the priority or an ongoing funding process if flexibility for scaling-up is required.

3/ How can the GCF best "crowd-in" private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?

As climate is a public good, a public intervention to foster private investment in climate actions would be justified to address some specific market failures, notably the barriers that the private sector faces.

First of all, the use of capacity-building funding in order to develop an adequate climate policies framework may **yield significant longer term benefits.** Indeed, potential investors may have to face with the lack of sound climate investment policy frameworks in developing countries and difficulties to calculate and price risk for many climate-related projects in developing countries.

Besides, direct policy measures to influence the risk/return ratio of private investments may be needed since the risks are often perceived as being too high due to the combination of strong technological risks and developing country risk. Various policy instruments should be further analyzed to improve the risk-return profile of projects and otherwise leverage private finance flows including insurance products, public guarantees, equity capital, risk management/ sharing tools, advanced market commitments (AMCs) and other "results-based" funding mechanisms (for instance a public and private carbon Fund in the GCF mitigation window building on the experience of the FCPF), and concessional loans. **Whether the GCF will directly manage such financial engineering or not shall be examined in terms of governance implications, added-value and efficiency compared to existing financing institutions** that already manage such financial engineering.

The incentives implemented by the GCF should avoid three important risks of any public intervention:
i/ **crowding out effect** of other funding already available, either public or private , (notably the local entrepreneurship); ii/ **a windfall gain** for the private sector that would benefit from a reduction of risk unnecessary to trigger the investment; iii/ **a moral hazard** for the national authorities that would be prevented from implementing actions to establish a sound investment framework in order to keep on benefiting from international public financing.

To ensure a proper participation/engagement of the private sector, three complementary actions would be necessary: i/ **a structured dialogue** early in the project cycle and often during the implementation phase; ii/ **an appropriate participation of the private sector both within the GCF and on a national level**, by being involved into the definition and implementation of national climate policies; iii/**a role of commercial local banks** on national level to identify and implement some projects.

4/ Should the GCF resources be deployed to raise funds from the capital markets, whether through bond issues or some other vehicle that could be considered to mobilize significant amounts of funding from institutional investors?

When designing the GCF, we have to find the structure which, taking into account the existing other players, will maximize its impact on private finance, in order to best leverage public resources and to best put private actors on the path towards a sustainable private-based funding of the fight against climate change.

These two goals have to be kept in mind while looking at how the GCF could interact with institutional investors:

- it would probably be more useful **in terms of leverage** to have institutional investors co-financing a project with the GCF or contributing venture capital to a dedicated GCF window, rather than providing it with direct funding through a risk-free bond issue (where the GCF would just duplicate what is already done by MDBs or other AAA-rated issuers). GCF may also achieve greater and more effective leverage by providing the appropriate item (subsidy, guarantee, equity, loan or investment product) to make a project bankable, rather than through focusing on raising large amounts of risk-free resources (and then leaving open the question of the funding/hedging of the risky part of the projects).

But to **help drawing institutional investors toward climate finance**, one has of course to take into account where most of them stand now, very cautious (due to natural tendency to be risk adverse but also because climate finance is and will remain in the coming years exposed to important legal, technical and policy risks). It could then be useful to see if and how the GCF could have a dynamic approach towards these investors, attracting their interest first through products they are comfortable with and gradually leading them towards riskier products.**Therefore allowing the GCF to raise funds from the capital markets is an option to consider, alongside other interesting options. It should be noted that the catalytic role expected from the GCF could also be achieved at the level of implementing financial institutions**. A detailed costs-and-benefits analysis drawing on the experience from international financial institutions should be conducted and different options could be proposed.

5/ How can the modalities of public-private engagement be optimized, including timing of engagement, aligning project cycles, pre-investment activities, linkages to the carbon markets and other operational issues?

A link to the carbon markets would be essential in order to contribute to the emergence of a global price signal, which is the most efficient way to reduce CO_2 emissions. Several possible linkages should be explored:

- **a first possible linkage would be to have a financial complementary between the mitigation actions funded by the GCF and carbon markets.** Since 2009, France has been proposing the creation of a crediting mechanism that would be able to purchase international carbon credits (for instance from new market mechanisms that could be created) and create a public demand additional to the private demand of offsets in order to maintain the carbon price at a certain level. In order to ensure the environmental integrity, the credits acquired by the GCF would be destroyed afterwards.
- **another possible linkage would be to benefit from the expertise acquired by the UNFCCC in terms of monitoring, reporting and verification process (MRV) through the CDM.** As other MRV systems have been developed by development finance institutions (IFC, Agence Française de Développement, etc.), a comparative and qualitative analysis of these MRV systems would be useful.

6/ How can the delivery of private finance be improved in regions with poorly developed financial markets?

To improve the delivery of private finance in regions with poorly developed financial markets, **the GCF could exercise several functions among which:**

- **it could allocate funding (notably grants) for capacity-building actions to help these regions to establish a sound investment framework for climate-resilience actions;**
- **the GCF could provide financial products or grant financing to be blended with financing products managed by other financing institutions that would facilitate the access to international financial markets for these regions through specific incentives** (for instance insurance products, public guarantees, equity capital, risk management/sharing tools, advanced market commitments (AMCs)) in order to lower the risk that the private sector will encounter when investing in these regions and increase the financial viability of projects implemented in these regions. We could imagine that only the least developed countries and small island developing states would have access to some specific instruments.

XVI. Submission by Mr. Michael Adande (Gabon)

We fully contributions from Belize and Philippines on this workstream. Nevertheless, we would diverge from their view on focusing more on the usage of the funds rather than on the funding. There is no issue real issue in regards to the origin of the funding, private or public sector. Each of these can focus on different areas:

- **Private sector funding on mitigation, Redd+ and technology related windows**
- **Public sector funding on adaptation**

Sources of funds can be innovative and transformational.

XVII. Submission by Mr. Yaga Reddy (India)

India welcomes the opportunity to present views to the Transitional Committee for the design of the Green Climate Fund on various issues relating to the work of the Committee. Pursuant to the deliberations held in the first meeting of the Committee held on 28-29 April, 2011 in Mexico and the subsequent technical workshop held on 30 May – 1 June, 2011 at Bonn, Germany, India submits its views on the issues relating to the thrid work-stream i.e. operational modalities as follows.

Operational modalities

(i) Modalities of contribution

The GCF cannot decide or recommend the sources of revenues. But, it should have a clear vision of the modalities of contributions and the manner in which the resources are to be generated and channelled as per the provisions of the Convention. The modalities should reflect the reality of available funding sources, including the private sector funds and other instruments for generation of resources that may be applied by developed countries.

As per the the Cancun decisions, the work of the GCF is to decide the form of contributions while the sources are discussed and agreed upon in the AWG-LCA negotiations. The focus should be on deciding how the funds will be received from various sources with maximum efficiency and effectiveness so that the flows are predictable, measureable and verifiable. Relevance of the recurring, periodical or ongoing nature of the contributions to the optimal design of the fund should be examined and recommended.

Large and significant share of resources must come from public sources, irrespective of how they are generated and provided by the developed countries, whether through new or innovative instruments. This must be done in a manner that such instruments do not result in an incidence on any developing country or entity. Assessed contributions on an ongoing basis are the only efficient and effective way of imparting predictability to the fund flows required to meet the objectives of the Convention.

(ii) Access to finance

The GCF should be built on the principles of direct access to the Parties/Governments to the resources of the Fund. The access to the parties should be granted through the National Implementing Entity (NIE) which should have the role of coordinating and implementing a nationally appropriate development strategy for climate change.

Access of the private sector institutions or bodies to the GCF should be facilitated through the NIEs who should obtain resources from the GCF in accordance with agreed principles of accountability and provide to such private entities for in order to meet the objectives of financial mobilization and implementation of climate change related plan at the national level.

(iii) Eligible entities

The GCF should define the entities eligible to submit proposals and to receive, manage and spend financial resources. Eligible entities will typically be national legal entities formally nominated by the Parties. These could include official national entities, sub-regional or regional entities, multilateral implementing entities, and non-government entities. In all cases, the principal entity –a national agency that is officially appointed – would need to be approved by the Fund Board and satisfy certain basic fiduciary standards agreed collectively. Ultimately, the agreed entity will bear final responsibility for the overall management of the financed activities and for compliance with relevant financial, monitoring and reporting responsibilities.

(iv) Thematic windows

There could be a range of thematic windows for providing access to the GCF. There should be specific thematic windows for each of the four pillars of Bali Action Plan - adaptation, mitigation, technology and capacity building. The thematic bodies set up under the cancun decisions e.g. Adaptation Committee, Technology Mechanism, Forum for Response Measures, and such bodies may provide policy and techncial guidance to the GCF in matters relating to the projects/activities/programmes and thematic allocations. But, these thematic bodies of the Convention need not duplicate the function of providing resources for meeting the adaptation, mitigation, technology and capacity building related needs.

The thematic bodies set up under the cancun decisions e.g. Adaptation Committee, Technology Mechanism, Forum for Response Measures, and such bodies may provide policy and techncial guidance to the GCF in matters relating to the projects/activities/programmes and thematic allocations. But, these thematic bodies of the Convention need not duplicate the function of providing resources for meeting the adaptation, mitigation, technology and capacity building related needs. This function should be performed by the GCF on the basis of technical advice of its own technical panels and through its funding windows.

While private sector needs to be involved in implementation of sustainable development strategies, this need not happen at the global level through a specific window for facilitation of private sector access to the GCF. This should be encouraged through the national implementing entities. There are no goals at the global level to be internalized by the industry at the cost of public resources. This is a matter of national development strategy and such incentives or subsidies can be built into the public policies only if it is felt that they are the most effective and efficient way of achieving the sustainable development objectives at the national level.

(v) Eligibility for funding

The GCF should lay down the eligibility for funding and adopt clear approval processes. In each thematic area, eligibility criteria should provide clear guidance on the types of activities that are entitled to the provision of financial resources. These should be tailored to reflect the specific thematic area so as to target financing and facilitate access. Within each thematic area, eligibility criteria should reflect requirements of activities at different levels (e.g. project, programmatic and national planning levels). The financial resources will be required to enable developing countries to strengthen their efforts at the cross-sectoral and national level to integrate climate change into relevant economic and social development planning. The GCF should therefore support and enable activities at a range of different levels including specific concrete projects, larger overarching programmatic initiatives, and integrated national climate plans. Setting clear national objectives, and defining specific projects and programmes for funding should improve the access of the developing countries to the GCF resources.

(vi) Process of approvals

The GCF should adopt a streamlined approval process that will enable effective disbursement of financial resources. One key component is the distinction between small and large-scale activities, with simplified criteria and procedures for small-scale activities. During the intervals between the meetings of the Board, funding approvals can be made and communicated via mail or other media.

The GCF should ensure that all developing countries are eligible to receive financial resources for the implementation of measures relating to adaptation, mitigation (including forests), technology development and transfer, and capacity building, as well as for national communications. There should be no attempt to formally narrow the category of countries eligible for financing runs as it will run counter to the letter and spirit of the Convention. There can however be guidelines for consideration of the specific needs and concerns of countries in certain situations.

(vii) Private Sector Financing/mobilisation of resources

Cancun decisions recognise that the private sector will have a role in mobilization of resources. But their role is distinct. An engagement of private sector in the work of GCF should be seen in the context of the funding model agreed for the GCF as outlined in the other two work-streams-WS I and WS II.

Resources flowing through the carbon markets or private entities do not constitute provision of new and additional financial resources. Such flows are autonomous and cannot be directed by the GCF to meet incremental costs or full costs on a grant or concessional basis. There is no guaranteed or benchmarked price of carbon to be used as the reference for private sector flows. Hence, private sector resources or funds raised from market are not be treated as resources for the GCF.

The GCF should support national development plans for climate change through public institutions and involve private sector in implementation of such plans. The ideal way of involving the private sector is through the instrumentality of the national entities. This should take place not at the global level but at the national level. This is needed because the risks are to be borne ultimately by the sovereign parties or the nations and not by the GCF. The private sector investments must therefore follow the national priorities contained in a nationally appropriate mitigation strategy. The GCF design should permit and facilitate co-financing of projects through choices to be exercised at the national level and not mandated by the GCF.

Involvement of private sector in adaptation actions is possible provided the fund is designed in such a manner that resources are available to the national entities on a grant basis. It is not enough to design market related instruments such as crop insurance or aim at mitigation of emissions from land-use or agriculture. Viability gap funding used by all developing countries for supporting public private partnerships in implementing social and economic development projects is a more appropriate model for such involvement. In projects which are economically unviable, viability gap funding is used. Similar methods to assure minimum returns to the private sector can be adopted if the GCF is enabled to provide such resources to the national entities on a grant basis. Such resources can then be used by the national authorities at their discretion to support adaptation projects to the extent of viability gap. The key is how to get the government and its agencies to the process and activities.

XVIII. Submission by Ms. Naoko Ishii (Japan)

Workstream III (Operational modalities)

6. We recommend having working sessions focused on private sector participation by investors (private company) and financiers (financial institutions) to help understand how the GCF will best use its resources to mobilize private activities. As mentioned above, it is important to (i) understand what are incentives and barriers for private sector participation in the area of mitigation, adaptation and REDD+, (ii) analyze the types of private sector involvement and (iii) consider how we should reflect the private sectors' needs into the GCF operational modalities, especially windows and financial instruments. It will be desirable to hold this session during the Second Technical Workshop in September.

XIX. Submission by Mr. A. F. Elisai (Samoa)

AOSIS submission to the Transitional Committee
Work stream 3.1: Finance entry points
8 June 2011

1. **In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?**

2. **What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs of periodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?**

- Fund raising systems and processes for different sources of funds will differ depending on the actual contribution from each source, and how climate change funding will be accounted for.
- Therefore, the GCF should be designed with the flexibility to receive contributions from a wide variety of sources and to optimise allocation and accounting for different purposes. Appropriate modalities should take into account the structural inter-linkages between:

    a. Sources of funds – public, private, multilateral, bilateral, innovative;

    b. Form of financing - grants, concessionary or non-concessionary loans, equity investments, guarantees, insurance ;

    c. Activities to be funded - technology development, mitigation, adaptation, REDD+;

    d. Recipients – level of development, income, investment climate and vulnerability (to climate change) of countries

3. **How can the GCF best 'crowd-in' private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?**

- Broadly, private finance can be catalysed through a mix of public policies and revenue-enhancing, risk mitigation measures which will improve developing countries' investment climate.

- The GCF, in conjunction with other development institutions, can help to crowd-in private capital, by targeting market barriers of:

    a. Gaps in **capabilities** in financing, planning, managing and monitoring climate change mitigation and adaptation projects in host countries. Some of these projects could be very large in quantum, long-term in nature, or complex to structure (for example, linkages to carbon markets). There is therefore scope for GCF financing to be accompanied with relevant technical expertise and advisory services to host governments and local private sector partners.

    b. Initiatives to strengthen the **risk climate** for business and investments. Climate change projects require long-term commercial horizons, and hence a robust and predictable legal and regulatory framework. While the financing tools of GCF are not likely to directly influence the broader investment environment of host countries, there is scope for co-financing, risk mitigation (guarantees/insurance) and public policy coordination to stimulate investor confidence at the project level. This is especially so for markets where political risks are perceived to be high and capital markets weaker.

c. Improve **return expectations**. In public-private co-financing or investments, concessionary funding from the GCF can help improve return expectations for the private sector so as to make the investment proposition more compelling.

- A key priority in the design of the GCF should be to maximise the potential amount of private capital that can be leveraged with each public dollar, where appropriate. This is so that limited public funding can be channelled to areas that are less given to markets and commercial investment, such as adaptation projects and programmes in SIDS and LDCs.

XX. Submission by Mr. A. M. Al-Abdulkader (Saudi Arabia)

Saudi Arabia is pleased to share its initial views and concerns related to issues tackled under working stream III: operational modalities, and looking forward to work constructively with the other transitional committee members (TC) in a transparent, inclusive, and TC-driven process to further advancing the dynamics of designing the Green Climate Fund as mandated by Cancun Agreements.

I. Financing entry points:

1. A wide range of potential sources for the scaling up of new and additional financial resources has been identified including: a) public sources, b) private sources, and c) carbon market finance.

2. Public sources of the developed country Parties mainly **direct budget contribution** are the major source of the financial flows to the Green Climate Fund. Provided their substantive nature in financing the GCF, utmost priority should be given to develop modalities that would advance the accountability and predictability of the public sources of the developed country Parties.

3. On the other hand, private sources and carbon market finance are important sources of fund. Yet, they are rather not reliable nor predictable sources of fund

4. Private sources are complementary in nature to the public sources. it is not possible to commit private finance flows ex ante, given that they are driven by investor demand, which is itself a function of available investment opportunities, capital availability and the quality of the policy environment.

5. Carbon market finance is a controversial instrument that has been debated for its predictability and practicality as follows:
   5.1. It is a determinant of market forces and price fluctuations.
   5.2. It mixes rights and obligations by diluting the financial commitments of the developed country Parties, and imposing additional economical and financial burdens on developing country Parties.

6. It is crucial that any incidence on developing country Parties for any given source should be covered fully by the developed country Parties as stated in Article 4.7 of the Convention.

7. The type of funding received by the GCF as legally binding commitments from the governments of the developed country Parties, mainly, **direct budget contribution**s should be in the form of grants and concessional loans, with the level of concessionality being determined based on clearly defined criteria.

II. **Managing finance:**

1. Modalities on how to spend financial resources efficiently is critical to build a reciprocal trust between developed and developing Parties which in turns would initiate a conducive platform to mobilize long-term finance.

2. Building a reciprocal trust would require spelling out a vision and a discreet plan of action that shall ensure specifically:
   - 2.1. Ownership of developing country Parties.
   - 2.2. Predictability of long-term funding commitments.
   - 2.3. Modalities of private sector contributions, and accountabilities for these contributions.
   - 2.4. Responsiveness to the challenge of climate change and response measures.

3. Provisions of financial resources mandated under Articles 4.1, 4.3, 4.4, 4.5, 4.8, and 4.9 in accordance with Article 11 of the Convention are key issues of the UNFCCC and shall be dealt with ONLY through the UNFCCC and NOT through any other institutions such as the G20, World Bank etc.

XXI. Submission by Mr. Bruno Oberle (Switzerland) on questions to be discussed under WS III - sub-work stream 1 (finance entry points)

Modalities for contributions to the Fund

1. *In what form might funding sources be received and what systems, capabilities, governance and legal capacity does the fund require to receive these if the fund accepts contributions from: Governments; the Private sector; Private individuals and Foundations? What additional systems would be required if grants, loans, capital investments or other funding modalities are accepted?*

The GCF should be design to be able to attract and accept contributions from a wide range of sources – both from governments (developed and developing countries) and from non-government actors (business, foundations, individuals, etc.). The thorough analysis contained in the Report by the UN Secretary General's High Level Advisory Group on Climate Change Financing (AGF) and the experience of the Climate Investment Funds which operate with a variety of funding modalities (grants, loans, capital investments) should be used as a reference when designing the sourcing modalities of the GCF.

2. *What processes and sources might be used to raise funding? If there is a regular process for raising funds, how would such a process be managed? What would be the comparative benefits and costs of periodic compared to ongoing funding receipt? What systems would the Fund need to manage different processes that may be used for receipt of funding?*

To begin with, raising funds for the establishment of the GCF may be operated through pledging sessions. As the GCF might probably have a variety of funding modalities (loans, guarantees, equity and grants) returns on investment must be taken into consideration for potential sustainable financing. Further on, the GCF board may need to examine if a regular process for raising funds will need to be established (e.g. through replenishments). In addition, the process of raising funds should be elaborated in such a way that the public and private sector and civil society can join.

Methods to mobilize and leverage private sector finance, both foreign and domestic

3. *How can the GCF best 'crowd-in' private finance at scale, including foreign and domestic sources? What incentives may be provided to engage stakeholders, especially the private sector both at the national and international levels?*

The business environment needs to be conducive ("the main business of business is business"). A solid regulatory framework will be essential to build the necessary confidence, stability, and predictability to attract private sector finance. In order to design the GCF so that it attracts private finance, the Transitional Committee should engage in a structured dialogue with the Private sector to better understand the potential, limitations and the conditions of private sector involvement. The Transitional Committee should build on lessons learned, especially in the context of MDBs (such as IFC and EBRD which have a solid expertise in this field), on how to get sustained and at scale private sector involvement in climate finance.

4. *Should GCF resources be deployed to raise funds from the capital markets, whether through bond issues or some other vehicle that could be considered to mobilize significant amounts of funding from institutional investors?*

No option should be excluded ex ante. However, the option of raising funds from the capital markets will depend on a number of conditions, i.a. on the legal status of the GCF, its regulatory framework in general, its performance etc. In addition, the pros and cons of whether the GCF itself - or its "implementing agencies" - should deploy resources to raise funds from the capital markets will need thorough consideration by the Board of the GCF.

5. *How can the modalities of public-private engagement be optimized, including timing of engagement, aligning project cycles, pre-investment activities, linkages to the carbon markets and other operational issues?*

6. *How can the delivery of private finance be improved in regions with poorly developed financial markets?*

See answer to question 3. Successful models of public-private-partnerships can serve as inspiration on how to design programs which lead to the expected results on the ground and generate the appropriate revenue stream. However, the engagement of the private sector is not a goal in itself, but rather a way of getting all hand on deck which can contribute to solve the climate change induced challenges.

XXII. Submission by Mr. Nick Dyer (United Kingdom of Great Britain and Northern Ireland)

The Green Climate Fund: Financing Windows – A UK Perspective

As set out in our submission "*The Green Climate Fund: Framing the Challenge – A UK Perspective*" the existing climate finance architecture is not configured to deliver finance at the right scale or responsiveness, with the right geographical coverage, on the right terms or with sufficient leverage to substantially help developing countries shift onto lower carbon, climate resilient development paths.

The structure (form) of the Green Climate Fund should be designed to maximise its effectiveness and efficiency at delivering its objectives (function). This may require a structure that includes several distinct funding windows, which would need to be configured in a way that best:

- Supports the establishment of a coherent sets of instruments
- Enables a strategic allocation of resources including a balanced allocation between adaptation and mitigation as appropriate
- Permits an efficient and cost-effective management structure
- Enhances complementarity between the Green Climate Fund and other funding mechanisms and institutions

There are several ways in which the Green Climate Fund could be divided into windows. 1/CP.16 states both that the fund will use 'thematic funding windows' (para 102), and that it will have 'a variety of funding windows' (Appendix III, para 1c). Possible structures to consider include:

A thematic structure could comprise mitigation, adaptation and forestry windows. This would have the advantage of easily allowing a balanced allocation between adaptation and mitigation and might fit well with other funding mechanisms. But it might result in replication of instruments between windows and may therefore be neither as coherent nor as efficient as possible.

A geographical structure would have a window for each region. Each of these windows could in turn be structured in a way that is most suitable for the region it would serve. Such a structure would allow a coherent approach locally but may result in replication of functions in the different regions.

An instrument-based structure would group financial instruments and access modalities together into windows such as direct access or private sector. Each of these windows would then operate globally and across themes. This approach would support the creation of coherent instrument sets, but ensuring a balance between adaptation and mitigation would be challenging.

Hybrid structures, that combine two or more of the options above are also possible. For example, an instrument/thematic hybrid structure could have some instrument windows covering the full range of themes, while others could be broken down into thematic sub-windows.

We recommend that the Transitional Committee considers the pros and cons of each of these approaches to structure, as well as possible hybrid structures, before deciding which structure to recommend for the Green Climate Fund. A short background paper by the Technical Support Unit elaborating these options would be useful to frame our discussions.

The Green Climate Fund: leveraging private finance – a UK perspective

As set out in our submission "*The Green Climate Fund: Framing the Challenge – A UK Perspective*" the existing climate finance architecture is not configured to deliver finance at the right scale or responsiveness, with the right geographical coverage, on the right terms or with sufficient leverage to substantially help developing countries shift onto lower carbon, climate resilient development paths.

The Green Climate Fund is likely to need several financing modalities and instruments if it is to increase significantly the scale, responsiveness, coverage, terms and leverage of the climate change architecture and have the biggest possible impact on coherence, impact and results.

<u>The role of private sector in climate finance</u>
The private sector already plays a key role in climate financing – the UNFCCC Secretariat (2007, updated in 2008) estimates that it accounts for up to 86% of current investment into low carbon infrastructure. Moreover, private finance is likely to be of crucial importance if we are to meet the financing challenge of up to $200 billion additional annual investment required by 2030 (International Energy Agency). The key role of private finance in stimulating investment into low carbon growth and adaptation has been most recently highlighted in the work carried out by the High Level Advisory Group on Climate Change Financing (AGF).

But private finance will not flow to where it is most needed unless the perceived and real barriers to private investment are overcome, including information asymmetry, technology and policy risks. Provision of public subsidy and intervention in a way which helps overcome those barriers can leverage private finance at a scale many times the size of the original public investment.

Investment by the private sector is not limited to increased financing and carbon abatement. Evidence suggests that investment by the private sector also brings significant developmental co-benefits, in terms of increased energy access, jobs, know-how, financial infrastructure development, and wealth creation.

<u>Current initiatives to leverage private finance</u>
Significant efforts are already underway to mobilise private finance flows. The multilateral development banks (MDBs), for example, currently invest around $20 billion in climate change related investments, leveraging a total investment of some $50 billion. Donor resources through mechanisms such as the Climate Investment Funds have helped MDBs address market failures and increase private sector leverage by allowing them to use public finance in innovative and catalytic ways. Individual donor programmes aimed at piloting results based financing, public-private partnerships and other initiatives have contributed towards increasing financial flows from the private sector through targeted use of public finance.

<u>The role of the Green Climate Fund</u>
Despite advances in leveraging private finance achieved by the current initiatives, the scale of the challenge is such that significant gaps in the international climate finance architecture remain. Specifically, the scale of private finance flows needs to be increased; the efficiency with which private finance is leveraged and terms on which support is provided needs to be improved; and the range of public finance mechanisms aimed at helping overcome private investment barriers needs to be broadened.

Including private sector instruments in the Green Climate Fund does not mean replacing publically-financed contributions with private money. Rather it is about how to use those donor contributions in the most efficient and effective way that leverages much larger capital investment and channels it towards achieving the fund's objectives. The Green Climate Fund has the potential to do this by:

- Delivering at **scale**: where appropriate, public financing can be used in a way which maximises private finance leverage;
- Ensuring **responsiveness**: efficiency of access to public financing mechanisms will be key to unlocking the potential of significant private investment;

- Offering a **broad range of instruments**: in order to help overcome the barriers to private investment (such as information asymmetry, technology and policy risks) with comprehensive, coherent coverage across themes and geographical locations;
- Building capacity and supporting in-country **regulatory reform**: private investment cannot be scaled up in isolation. The fund could facilitate the regulatory reforms that will in turn mobilise the necessary flows of private finance.

The Transitional Committee has the opportunity to design a Green Climate Fund that unlocks private capital at large scale by ensuring that, where appropriate, the value of public finance channelled through the fund is maximised by catalysing private finance. This will both help tackle climate change and will deliver significant developmental co-benefits. We recommend that the Transitional Committee considers how the Green Climate Fund could be designed to achieve this. Building on the useful work undertaken to date, including by the UNFCCC Secretariat and the AGF, an analysis paper by the Technical Support Unit covering the following questions would help inform our discussions:

1. How can the private sector offer of existing institutions be enhanced, and what role could the GCF play?
2. What new instruments or institutional arrangements are needed to address gaps in the existing architecture that can increase private finance at scale, and what role could the GCF play?

The Green Climate Fund: Direct Access – A UK Perspective

As set out in our submission "*The Green Climate Fund: Framing the Challenge – A UK Perspective*" the existing climate finance architecture is not configured to deliver finance at the right scale or responsiveness, with the right geographical coverage, on the right terms or with sufficient leverage to substantially help developing countries shift onto lower carbon, climate resilient development paths

The Green Climate Fund is likely to need several financing modalities and instruments if it is significantly to increase the scale, responsiveness, coverage, terms and leverage of the climate change architecture and have the biggest possible impact on coherence, impact and results.

<u>How has direct access been applied in international cooperation?</u>

The aim of direct access in international cooperation is to maximise responsiveness and impact by increasing the level of country ownership and alignment to countries' priorities, reducing transaction costs, and creating stronger accountability. Direct access instruments have been used to respond to needs in specific sectors (such as disease-specific vertical funds or sector support programmes) and across a range of sectors to achieve broader results. Direct access has contributed to:

- empowering partner countries to define and own their poverty reduction priorities and plans
- improving responsiveness to needs and financing partner government plans relatively quickly
- focusing policy dialogue on concrete results and essential reforms and engendering better partnerships between donors and partners
- encouraging a culture of control and accountability: emphasis on internal checks and balances, external oversight and transparency has helped make direct access funding more accountable both to donors and citizens
- delivering good value for money, particularly when the mechanism includes features such as performance/results based financing or involvement of the private sector

There is evidence that funds using forms of direct access are helping achieve these benefits. For example:

- The second evaluation of GAVI Alliance (2010)[15] found that GAVI has successfully supported country ownership, country financial planning, strengthened systems and accelerated countries' introduction of life saving vaccines, together with low administrative costs and high efficiency.
- A similar evaluation of the Global Fund for Aids, TB and Malaria (GFATM)[16] found that it plays an important role in the global development architecture and fully merits the continued support and collaboration of the diverse array of development actors involved in the fight against HIV/AIDS, TB, and malaria.
- The 2006 Evaluation of General Budget Support[17] concluded that overall budget support has had clearly positive impact, especially on ownership, harmonisation, alignment, results and accountability.

What is the experience of direct access in climate change?

The Adaptation Fund provides an example of a form of direct access for climate change and is now accrediting National Implementing Entities, MDBs have made policy-based loans for climate change, and the GEF has recently agreed to pilot a form of direct access. However, the use of country systems and direct access is currently at the early stages for climate change finance relative to other international assistance.

The role of the Green Climate Fund

The Transitional Committee has the opportunity to design a Green Climate Fund that builds on the direct access experience in climate change and broader international cooperation, and is responsive, empowering, and accountable, builds partnerships, and delivers results with excellent value for money. We recommend that the Transitional Committee considers how direct access could be incorporated into the Green Climate Fund to help achieve this. An analysis paper by the Technical Support Unit that builds on lessons learnt from direct access funding instruments (including the Adaptation Fund, the Global Fund for Aids, TB and Malaria (GFATM), the Global Alliance for Vaccines and Immunisation (GAVI), multilateral development bank climate change policy-based loans, Poverty Reduction Budget Support, and results-based instruments such as Cash on Delivery) and considers how these lessons might be applied to the Green Climate Fund would help inform our discussions.

[15] CEPA with Applied Strategies, "Second Gavi Evaluation: Gavi Alliance", 13 September 2010. http://www.gavialliance.org/resources/GAVI_Second_Evaluation_Report_Final_13Sep2010.pdf

[16] The Five-Year Evaluation of the Global Fund to Fight AIDS, Tuberculosis, and Malaria, *Synthesis of Study Areas 1, 2 and 3,* March 2009. http://www.theglobalfund.org/documents/terg/TERG_Synthesis_Report.pdf

[17] IDD and Associates, "Evaluation of General Budget Support: Synthesis report", May 2006. http://www.oecd.org/document/33/0,3746,en_21571361_34047972_44005921_1_1_1_1,00.html