Workstream III: Operational Modalities
Sub-workstream III.3: Accessing Finance
Scoping paper: Financial instruments and access modalities

I. Introduction

A. Mandate

1. The COP in its decision 1/CP.16 set up the Transitional Committee (TC) for 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, acting as Co-Facilitators. The Technical Support Unit (TSU) is providing support, under the guidance of the Co-Chairs and Workstream Co-Facilitators, by preparing background notes and organizing workshops and other consultations as requested.

B. Sub-workstream III.3: Accessing finance

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 contained 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, along with the rest of Annex III, form part of the overarching framework for the work of workstream III on operational modalities.

3. At the first technical workshop of the TC (TW1), the co-facilitators of workstream III proposed subdividing 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. The co-facilitators, with the support of the TSU, also tabled a background note on sub-workstream III.3, particularly focussed on financing instruments and access modalities. During TW1 the co-facilitators invited discussion and comments on the background note.

4. The relevant TW1 discussion among the TC members, their representatives, and observers, as well as written submissions received, on financing instruments and access modalities 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 on sub-workstream III.3 at the second technical workshop of the TC.

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

II. Synthesis of views on sub-workstream III.3: Accessing finance

A. Financing instruments

5. Members have identified the need for a range of financing instruments within the GCF in order to ensure it is able to perform at a large-scale and support multiple types of activities in developing countries. In this regard, members discussed the co-facilitators' background note on various financing instruments used in both climate and wider development finance. Instruments that have been highlighted in submissions include a range of equity and debt financing approaches, guarantees and insurance, and results-based approaches such as subsidising interest rates, advanced market commitments and feed-in tariffs.

6. It was noted that this suite of options should be assessed by the TC with a view to determining which groups of instruments may be most applicable to the GCF. Caution was expressed that any instruments employed should not crowd out other funding already available, either public or private, or create windfall gains for the private sector.

7. It was recognised that to provide the volumes of finance required to make the fund transformational, the GCF would need to employ a range of financing instruments. It was highlighted that grants will play a prominent role within the GCF. In addition, the use of non-grant financing instruments for particular activities was underscored. Further clarity is needed on the respective roles of grant and non-grant instruments within the Fund. The importance of grant finance for both adaptation and capacity development and readiness activities has been underlined. More broadly, the use of grants for building enabling environments, including regulation, to attract further private and public finance was stressed. Discussions on non-grant instruments focussed on the role of both concessional and non-concessional loan finance.

8. The importance of using financing instruments in a catalytic manner to leverage both private finance and other sources of public finance was emphasised. Examples exist on using grant finance to leverage concessional loan finance within Multilateral Development Banks (MDBs) and International Financial Institutions (IFIs), such by the Climate Investment Funds, as a method to increase financing volumes. In addition, examples exist on blending of grants and loans at the national level by various national institutions. Using grant finance to build enabling environments at the national level to catalyse further public and private finance has also been a major tool for generating finance, including domestic private finance within developing countries. It was underlined that these approaches have a role to play in the Fund, and in this regard, the TC may consider asking the GCF Board to develop specific delineations.

9. Clear synergies between discussion on financing instruments and issues under consideration in workstream II, as well as on the overall design and business model of the GCF and its implementing partners, have been highlighted.

10. Overall, it was noted that the TC needs to develop a greater understanding of typical uses of different financing instruments, building on information already contained within the background note on instruments and modalities circulated ahead of the first technical workshop. For instance, there is a need for information on how instruments can be combined, particularly within public-private partnerships, and on the typical delivery channels for different instruments. The co-facilitators have begun to compile this information in the background note on further information on financing instruments.

11. The need for further background information on how financing instruments aimed at the private sector could be used for adaptation activities was also highlighted. It was suggested that the involvement of the private sector should be aimed at increasing volumes of finance for adaptation, in addition to traditional government grant contributions. Case studies

are available where avoided losses through adaptation activities have promoted private sector investment in increasing resilience. Members have also noted the importance of regulation in climate-proofing private sector investments. Additionally, insurance was noted as a possible instrument, although members emphasised the need to keep in view the costs of premiums for developing countries within existing programmes.

12. In terms of next steps on financing instruments, it was highlighted that the TC should provide the overall parameters for what instruments could be employed by the GCF with some guidance on the types of activities that could be delivered using each instrument. However, the GCF Board, once constituted, could also be tasked with defining precise details in this area, including the specific rules determining use of instruments in different windows.

B. Access Modalities

13. It was emphasised that access modalities should promote wide and equitable access to the GCF and avoid restricting access for developing countries that have specific circumstances. In this regard, it has been stressed that countries should be able to access a range of modalities simultaneously, including both multilateral and direct access.

14. National climate and development plans, including Low Emission Development Strategies (LEDS), Nationally Appropriate Mitigation Actions (NAMAs), and National Adaptation Plans (NAPs), were highlighted as a critical tool in this respect. Such plans could be the basis for "country programmes" within the GCF, whereby approval is granted to a single, sequenced county programme within which a range of activities are outlined. Specific access modalities could then be used for particular activities within the programme. Members noted that such an approach would help ensure that activities, whether multilaterally or nationally implemented, would be country-driven, follow national development priorities, include national stakeholders, and add up to a coherent, transformational package at the national level.

15. It was underscored that use of these country programmes could be a way to simplify approval processes within the Fund; approval of a country programme with agreed activities could eliminate the need to approve individual projects–a task that could then be devolved to implementing partners (whether these be national mechanisms/institutions or multilateral partners).

16. In terms of delivery channels, it was emphasised that the TC should agree on the initial use of both direct access and multilateral modalities, taking into account the importance of country systems and institutional arrangements in effective and equitable delivery of GCF resources.

17. ***Direct access***: Direct access was highlighted as an important element in ensuring the GCF is transformational. It was underlined that the TC should look carefully at the range of models currently in operation within both climate and development finance to ensure that a direct access modality within the GCF performs at the required scale with adequate standards in place. A number of issues were stressed as being important:

(a) First, consideration should be given to expanding the range of institutions that can participate in direct access. The TC may choose to look beyond the accreditation of only single domestic institutions for project implementation. For instance, the TC could consider the inclusion of line ministries, national central banks, and other institutions at the national level, as well as private sector actors. The use of regional organisations could also be considered, since such institutions can offer a balance between direct access and economies of scale for smaller countries such as Small Island Developing States (SIDS). A general response among members to the need to expand the institutions involved in direct access is the importance of having an in-country coordination mechanism. This was highlighted for two reasons; first, to ensure coherence at the national level among multiple implementing institutions, and, second, to ensure that appropriate institutions are utilised for specific types of activities (e.g. performance-based activities). The country coordination mechanisms of the Global Fund to fight AIDS, Malaria, and TB were highlighted by members in this regard.

(b) Second, the need to move from only project-based direct access to programmatic and sectoral scales. In particular, the relatively high transaction costs for national institutions to access project-scale finance and the need to increase scale were highlighted. In addition, the need to explore performance-based approaches within a direct access modality was noted.

(c) Third, sound fiduciary management and the presence of functioning, robust institutions are essential to the integrity of a direct access modality. Given the important of fiduciary standards, some countries will require institutional strengthening through national-level capacity building before they are able to operate and scale up direct access under the GCF. The TC may consider the value of providing GCF resources for capacity building in this area.

(d) Fourth, and more broadly, the need to ensure coherence with direct access provisions under other climate change funds was highlighted.

18. ***Multilateral Access**:* It was suggested that multilateral access will, at least initially, be a core modality within the GCF. In this regard, it was stressed that the GCF must ensure that all developing countries have access to a wide range of types of assistance from the multilateral system and not be restricted in their choice of partners. A variety of types of implementing institutions were considered important in this regard, including Multilateral Development Banks and UN agencies.

19. It is also important to underline the importance of national coordinating mechanisms to support and facilitate direct access and that such mechanisms could coordinate the GCF-funded activities of multilateral agencies in-country. In addition, members expressed the view that multilateral and direct access should function in a more independent fashion, with country programmes guiding activities at the Fund level.

20. It was also noted that the TC needs to decide on a process for establishing multilateral access modalities. In this context, two options were suggested: One, TC could give guidance on this issue. Two, the Board, once constituted, could use an accreditation process.

III. Further work for sub-workstream III.3

21. Members listed further background work needed to inform the work and decisions of the TC on workstream III.3. In particular:

(a) Information on how the private sector can support adaptation;

(b) Information on the instruments that can support public-private partnerships;

(c) Information on direct access, including forms and experiences;

(d) Information addressing points 1 and 2 is contained in a second background note under workstream III.3, and information addressing point 3 is contained in a third background note, jointly under III.3 and workstream II. These notes are being circulated in parallel with this scoping paper.