

**Workshop on the role of the Green Climate Fund in fostering
transformational change, engaging civil society and
leveraging the private sector**

Discussion note

**Geneva, Switzerland
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Introduction

1. The Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) entrusted the Transitional Committee (TC) with the design of the Green Climate Fund (GCF). The TC has 40 members representing world regions and constituencies and covering both climate and finance expertise. At its second meeting, held in Tokyo on 13-14 July 2011, the TC agreed to organize a workshop prior to its third meeting to have further interactions with representatives from civil society and the private sector and discuss how the GCF can play a prominent role in fostering transformational change and leveraging private sector engagement.
2. This workshop is organized as a half-day event to provide the Transitional Committee members with an opportunity to consider key concepts related to transformational change and options for leveraging the private sector. Presentations and interactions during the workshop will set the scene for discussions on these topics during the third meeting of the Transitional Committee taking place directly after the workshop.
3. The workshop will be structured in two distinct sessions. Transformational change will be discussed in the first half of the morning while thoughts on leveraging the private sector will be discussed during the second half of the workshop. Civil society engagement will be a common theme through both sessions.
4. Three discussion notes providing background information to support these sessions are here attached. The notes draw from submissions by TC members, observer input and literature reviews undertaken by the Technical Support Unit. The transformational change note presents elements driving transformational change and elaborates on the scope and design of the GCF to facilitate this change. The note on civil society brings out the benefits of engaging civil society in the design and implementation of the Fund and cites examples of how this has been done in similar funds. The private sector engagement note provides suggestions on how the Fund could mobilize private investment and provide a platform for private sector participation.

Part I Transformational change

5. This note provides background information aiming to support discussion at the ‘Workshop on the role of the Green Climate Fund in fostering transformational change, engaging civil society and leveraging the private sector’ to be held before the third meeting of the Transitional Committee (TC) in Geneva on 11 September 2011. The text is based on the submissions of TC members and observers, and literature review by the Technical Support Unit.

A. Introduction

6. The need for “transformational” or “transformative” actions to address climate change adaptation and mitigation is increasingly used in international discourse. However, there is currently no common definition of this term. The national and global implications of transformational change, and the means to monitor it loom as large questions. Complex and rapidly changing technologies, policies, and financial instruments are the ingredients of transformational change.

7. Transformational approaches to address climate change are imperative in both developed and developing countries. Fundamentally, this implies transforming production processes and consumption patterns, enhancing institutional capacities and adapting planning processes to enable low-emission and climate-resilient development pathways. The urgency of the challenge, and the need for green and inclusive growth more broadly, necessitates significant action as soon as possible.

8. Changing economic development pathways will entail costs and benefits, as well as, bring additional and new responsibilities for policymakers and societies. Transformational change presents new challenge and opportunities in adaptation and mitigation finance, technologies and policies. Ultimately, the promotion of transformational change has the potential to create an ‘international public good’ that many actors can play a role in delivering.

9. The following sections aim to explore the elements of transformational change for climate change with a view to analyze the operational implications for the Green Climate Fund (GCF). The note is structured as follows:

- The first section examines the Key Elements of Transformational change;
- The second section seeks to demonstrate the Role of Finance in Transformational Change;
- The third section describes the potential Scope, and Design Elements and operational implications relevant to the GCF to ensure transformative results; and
- The last section sets out the Key Questions for discussion.

B. Key elements of transformational change

10. While the concept of transformational change is still evolving in climate change discussions, there is a common understanding that holding average global temperature increase below to 2°C above pre-industrial levels, coupled with building through adaptation climate resilience, calls for a quantum shift towards more sustainable actions across all sectors in both developed and developing countries. This implies a large-scale shift of “green” economies towards more sustainable models. Future policies or activities aimed at development transformational change must be sustained over time and should be able to cope with projected adverse impacts, as well as the high degree of risk and uncertainty posed by climate change.

11. The challenge of accelerating and strengthening the process of achieving low-emission and climate-resilient development pathways calls for ambitious actions by policymakers, economic actors and the society as a whole. Strong political will and persuasive leadership are of paramount importance to overcome existing barriers and to

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catalyze efforts to make a change at scale beyond existing patterns, thus enabling a shift in economies and societal behaviour. Many developing and developed countries have launched initiatives to make this shift. The question is, how can such actions be universal, accelerated, sustainable and at the scale necessary to achieve global transformation?

12. The unprecedented nature, magnitude and complexity of global climate change may require actions that confront existing medium and long-term plans and economic models. To take up such a holistic challenge, the accepted boundaries of reasoning might need to be extended, both in space (what happens here has an impact elsewhere and needs to be taken into account) and in time (the long term shall carry much more weight when decisions are made).

13. The ability to predict and/or manage the future risks may also need to be questioned. Being able to better manage uncertainty, and not only risks, which are quantifiable by nature might in fact be a key element of transformational change strategies. This could imply complementing deterministic approaches with more inductive ones, and combining innovation and preventive approaches with precaution principles. As there is no silver bullet to address climate change, transformational change would also call for flexible portfolio approaches and decision reversibility. Periodic reviews to integrate new knowledge about climate change, shifts in the perception of the related challenges by all stakeholders, as well as the evolution of social limits for acceptable risks and uncertainties are prominent factor that confront decision makers. Innovative methods to monitor transformational change made would also need to be designed and implemented, as well as integrated into strategic planning.

14. The threat posed to all countries by climate change unfortunately has not generated enough pressure for a breakthrough in global climate change action. Although similar trends are observed in some countries, such isolated efforts must be mirrored at the local and country levels in a more systematic and coordinated manner in order to effectively drive the transformation of the concerned economies.

15. There are a number of components driving transformational change, both in developed and developing countries:

(a) Policy frameworks

16. International, national and local level policy frameworks may require transformation to enable an environment for growth of appropriate low-emission and climate-resilient activities. Strong institutions and capacity are needed to adopt and continuously implement long term climate strategies, embedded in social and economic development plans. Elements encompassing such a strategy might include specific public financing modalities, environmental, energy and building regulations, transparent and conducive investment laws, reduction of implicit subsidies for climate-risky behaviour and fossil fuels, conducive environment for stakeholder participation, including civil society and the private sector, in governance, decision making and implementation of climate change actions. A partnership between governments, the private sector and civil society is central to achieving transformational change. In addition, domestic policies and government interventions should ensure that the most vulnerable regions and people are priorities.

(b) Economic, technologic and infrastructure shifts

17. Business models and production modes may need to be adapted to better focus on long-term cycles including investments decisions, concomitant with countries' long-term climate change adaptation and mitigation and development goals. Industry should be encouraged to develop methods to manage increasing uncertainty and risk and find ways to mitigate greenhouse gas emissions. Innovations and new technologies have to be developed and transferred at scale also allowing developing countries to bypass outdated models. This may require addressing current barriers to technology development and transfer to and among developing countries. Incentives to build on national and international synergies should be encouraged. A low-emission (mitigation) and climate-resilient (adaptation) economy may have major impacts on energy systems, land-use patterns and agriculture, real

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estate development and retrofitting of buildings as well as national and global transport models. Finally, supporting climate friendly ways of energy production and energy efficiency, will avoid lock-in effects in technologies with high dependency on fossil fuels.

(c) Behavioural changes

18. The IPCC has shown that global climate change is largely caused by anthropogenic factors, resulting from development patterns that are not sustainable. Societal changes among constituencies and individuals may be crucial to facilitate positive results and impacts. This particularly calls for actions that reduce direct emissions of CO₂ from burning of fossil fuels including domestic energy consumption and transportation, and our indirect CO₂ emissions from the whole life-cycle of manufactured products.

19. Functional partnerships between governments, civil society organizations and the private sector are needed to identify transformational strategies and to ensure a sustained long term implementation of strategies. Private sector participation is required to develop and implement strategies, plans and actions. Enhanced participation of civil society organizations will help to secure transparency and accountability. In addition to economic and fiscal incentives, capacity building and country-wide educational campaigns need to be supported in order to transform societies.

C. The role of finance

20. In order to facilitate transformational responses to climate change in developing countries, novel economic development models are required. Depending on national circumstances, multiple development pathways should be considered. The finance community can play three principle roles:

- Mobilize, catalyze and leverage public and private capital at both international and domestic levels from various sources is crucial to generate the volumes of finance needed to achieve the scale of transformation required;
- Promote and facilitate access to resources at scale and in a predictable and sustainable manner, to enable transformations in all countries, always considering and enhancing the potential for absorption;
- Generate synergies with overall growth and development priorities in ways that maximize the desirable transformational effects (i.e. long-term changes either to the national policies and institutional frameworks, to the national/sectoral investment climate, or to the risk-return profile of specific investments).

21. In each economic sector (i.e. mitigation, adaptation, and REDD+) a specific mix of financial instruments from a broad spectrum of options, both domestic and international, should be applied to reach the key objectives in relation to addressing climate change. Countries will need tailor-made finance packages that capture national development or poverty reduction strategies that have fully integrated climate actions as well as country-sector specific priorities.

D. Scope and design of GCF

22. As a part of a global portfolio, the GCF can be an important catalytic element of a global transformation process. If designed effectively, the GCF will be able to support a prominent shift towards low-emissions (i.e. mitigation) and climate-resilient (i.e. adaptation) economic and development pathways in developing countries.

(a) Key Activities

23. The GCF can play a transformational role both in terms of its adaptation and mitigation outcomes and in the way it is governed and it delivers climate finance. In the context of the key elements of transformational change described above, important activities for the GCF could include:

- Supporting programmatic sector-wide approaches for transformation in critical sectors such as energy (including security and efficiency), water, resources management, green

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technology and industries, green infrastructure and urban infrastructure. These large in-country sector-programmes could be designed to reduce technology, unfamiliarity and execution risks as well as facilitate the management of residual risk and uncertainty;

- Supporting the long-term development of national/regional climate strategies, including necessary capacities on how to design such strategies, analyses on impacts of low-emission and climate resilient investments on economic growth, employment, poverty reduction, trade, cross-country impacts and other factors, which become integral elements of national plans;
- Encouraging and supporting replicable and innovative models and prototypes that have the power to transform markets and production and/or consumption patterns;
- Leveraging national and international private sector involvement and capital at scale and reducing the risk-return profile over time for facilitating investments into low-emission growth and climate resilience.

(b) Governance and Delivery Systems

24. In addition to the transformational scope of activities the GCF could be transformational in its governance structure and its delivery system. Key elements in this regard are:

- Accelerating the shift to low-emission and climate-resilient development pathways by significantly and rapidly scaling up resource flows from developed to developing countries;
- Providing predictable and reliable base financing for the implementation of time slices of national climate strategies;
- Ensuring direct access to funding by developing countries;
- Be based on country ownership and country-led approaches;
- Engaging stakeholder mechanisms in the delivery process;
- Securing complementarities to existing activities;
- Transforming donor practices and coordination;
- Enhancing recipient's responsibility and accountability.
- Measuring transformation.

25. Criteria for measuring transformation are needed to both define the eligibility for GCF financing and to measure the impact of transformation. Setting up eligibility criteria and specific Monitoring, Reporting and Verification (MRV) systems remains a challenge. For example a direct in-country indicator to measure the impact on the global goal of 2°C target is questionable due to the multiple factors influencing GHG reductions, such as export/import patterns, economic growth, lacking baselines, the globalized and interlinked nature of economic systems, and the long term character of impacts. Innovative monitoring methodologies will be needed, so as to better measure what really counts, rather than only counting what is easy to measure. This may require revisiting the existing indicators and promoting multi-criteria analysis comprising quantitative but also more qualitative indicators. Despite these challenges, the criteria to assess the magnitude of transformational change could be characterized by process changes and outcomes achieved:

Criteria to assess process changes:

- Development and implementation of medium- to long-term climate strategies integrated in national development plans;
- Establishment and successful operationalisation of multi-stakeholder mechanisms for country-led strategies;
- Coherence of different policies and regulations to initiate shift in economic pathways;
- Transformed delivery systems.

Criteria to assess achievement of outcomes:

- Shifts in industry patterns, transport mix, construction standards, etc. towards low-emission, climate-resilient development pathways;
- Removal of structural and/or institutional barriers to low-emission, climate-resilient development;
- Leverage effects regarding private capital and other forms of investment;
- Generation of co-benefits (employment, energy access, energy security, etc.).

E. Questions for discussion

- Is the GCF as currently discussed by the TC members innovative and radical enough to catalyze finance at scale and enable transformational change? How can it be distinguished from existing funds?
- Does the current design of the GCF (governance, operation modalities and delivery systems) support the scale and absorption capacity needed to enable transformational change in developing countries within the next decade?
- How could programming by the GCF strengthen national capacity to address climate change and its impacts, including by mainstreaming capacity building into all GCF programming?
- How could funding prioritize programmes with sector-wide, regional or even economy-wide implications and activities with a long-term, sustainable and demonstrative / replicable potential?
- How could programming by the GCF transform the incentives faced by players in the market, notably by addressing risk and return imbalances, barriers to mitigation and low-emissions investment, and market failures, and by broadening and deepening private financial markets for this investment and related financial institutions?
- How can the GCF support countries in developing and testing innovative prototypes for low-carbon and climate resilient development with a potential to be replicated in different country systems? What would be required to allow for such innovations (e.g. in terms of risk levels or cost coverage)?
- The Fund needs to be a continuously learning institution and support ways to replicate best practices. What kind of structure is necessary to identify and replicate them? What elements for flexibility will be required to take on board lessons learned?
- Which kind of MRV systems could be designed and implemented to monitor and evaluate the transformational impact of the GCF?

Part II Engaging CSO for transformational change

26. This note provides background information aiming to support discussion at the ‘Workshop on the role of the Green Climate Fund (GCF) in fostering transformational change, engaging civil society and leveraging the private sector’ to be held before the third meeting of the Transitional Committee (TC) in Geneva on 11 September 2011. The objective of this note is to explore how the GCF can be transformational in its engagement with and through Civil Society Organizations (CSOs). The text is based on the submissions of TC members and observers, and literature review by the Technical Support Unit.

A. Introduction

27. The Decision CP.1/16 calls for the design of mechanisms to ensure stakeholder input and participation. Consequently, this has elicited a high level of CSO interest in the work of the Transitional Committee, including the potential opportunities to contribute to the design and implementation of the GCF. Members have also stressed the need for stakeholder engagement and have taken steps to ensure this engagement in the design process. The design of the GCF could enjoy greater support if it incorporates a systematic, comprehensive and targeted inclusion of the views of relevant stakeholder groups.

28. The need for the GCF to distinguish itself from, and add value to, existing funds has been emphasized by several TC members. Part of this distinction could come from ensuring that the Fund is transformational in the way it operates and in the impacts it achieves. A well-managed participation by civil society organizations, including groups representing vulnerable people, such as women and indigenous peoples, in the design and implementation of the GCF could contribute to the achievement of transformational change in developing countries. Also, the way that the GCF engages stakeholders, effectively harnessing their expertise, energy, innovation, commitment and passion in planning, implementing and monitoring funded activities can make it transformational.

29. While the Cancun Agreements have noted the need for stakeholder participation in the design and implementation of the GCF, it is important to identify:

- The nature of this participation and how the GCF can be transformational in the way it engages CSOs and other stakeholders;
- The value that CSO engagement will add to the achievement of transformational impacts in developing countries;
- The types of mechanisms that need to be designed to ensure effective stakeholder participation; and
- How CSO/private sector partnerships can be fostered to generate transformational impacts through GCF-funded activities.

B. Benefits of effective engagement of CSOs in climate finance

30. Several existing financial institutions and vertical funds have reported some form of stakeholder involvement, including CSOs, in the programme cycle.¹ These engagements include their representation in decision-making organs of the funds, consultations during the project preparation and design as well as throughout project implementation, and participation in country level mechanisms to set the countries’ priorities as well as monitor implementation. The benefits of stakeholder engagement, including CSOs, in climate finance include:

- Their ability to implement projects and activities effectively as well as promote innovative solutions. They sometimes have better access to target audiences where they can mobilize support for projects, are able to promote better synergies and contribute towards more effective monitoring;

¹ See document TC-3/Inf.2 for more detailed review of stakeholder engagement in selected funds.

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- CSOs can lend greater legitimacy to global initiatives by bridging the gap between global or national decision-making and local implementation by translating local level experiences to inform and influence global policies and decisions for local implementation. They could contribute towards improving accountability, transparency, equity and effectiveness at all levels of decision-making and implementation;
- Several national and sub-national CSOs, in particular, have a good understanding of national circumstances, social networks, knowledge of institutional relationships, and a continued presence, which is sometimes needed to take advantage of opportunities for change, and to ensure long-term programme success.

C. CSO engagement in the GCF**1. Engagement in the design of the GCF**

31. The Transitional Committee is already engaging CSO's in the design of the GCF through the following means:

- ***Soliciting written contributions and/or comments:*** Stakeholder groups have thus far made written contributions to topics of interest to them. They have had the opportunity to contribute to or comment on draft outputs of the TC. To ensure a robust discussion of the substantive issues pertinent to the design and implementation of the GCF, the TC has created a clear channel for submitting written comments pertaining to the design of the GCF;
- ***Giving presentations in person:*** CSO representatives have been invited to give presentations in person at TC meetings and workshops. Having stakeholders present their views, opinions and contributions removes the element of passivity that is inherent in soliciting written contributions. Efforts have thus far been to ensure their being able to contribute to the TC meetings as well as create the space for them to dialogue with co-facilitators of the various workstreams;
- ***Consultations:*** Several consultations have been conducted directly by TC members and other relevant organizations and some of the reports of these consultations have been submitted for consideration by TC members. These consultations have been designed to create the space for stakeholders to engage with each other and with members of the TC on issues pertinent to the design of the GCF.

2. Engagement in operations of the GCF

32. The operations of the GCF could incorporate the principles of transparency and accountability. Accountability suggests ensuring a broad and equitable stakeholder participation and representation in the governance and implementation of the activities funded by the GCF; it could include a redress mechanism and other robust oversight standards and mechanisms. Transparency suggests publicly available information on the activities of the GCF, as supported by an information disclosure policy.

(a) Engagement in decision-making of the GCF

33. While Decision 1/CP.16 does not explicitly include civil society representatives on the board, the Terms of Reference for the design of the Green Climate Fund, listed in Annex III of 1/CP.16 calls for "mechanisms to ensure stakeholder input and participation." CSOs have requested the inclusion of civil society representatives from both the developed and developing countries as active members of the GCF board, where they can take the floor in meetings, suggest agenda items, and be active participants in all subcommittees, technical panels and workgroups.

(b) Engagement in implementation

34. It is widely accepted that a sense of country ownership is the cornerstone of effective development strategies. Financing for adaptation and mitigation to countries needs to be based on national level strategic development processes that are determined by national governments but designed and implemented with the engagement of civil society organizations and other stakeholders.

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35. The Green Climate Fund could provide for civil society and community-level participation in project implementation, including monitoring and evaluation. This may require the establishment of country coordinating mechanisms or frameworks, similar to those established by the Global Fund. Arrangements for these mechanisms may need to reflect national circumstances, while the Fund could ensure that each country's national-level strategic development process provides for full stakeholder participation and accountability to communities and other stakeholders.

36. To ensure that stakeholder participation is not treated as an add-on activity, it may be worth considering the need to develop a CSO Engagement Strategy, which could specify, inter alia:

- Modalities for full participation of civil society and other stakeholders, including local communities and marginalized populations, local governments, indigenous peoples, and parliamentarian in the development of national adaptation and mitigation strategies and planning processes;
- Participation of those same stakeholders in the implementation process;
- Reporting on that participation and on the extent to which the views of these stakeholders were reflected in strategies and implementation; and
- A monitoring and evaluation process of the implementation of climate finance that includes full participation of stakeholders.

D. CSO/Private sector partnership: The missing link

37. Transformational change cannot be achieved solely through isolated actions. Cross-sector collaboration and partnerships are increasingly required to generate transformational change. Effective partnerships between the government, the private sector and civil society organisations (CSOs) can help in achieving the required change.

38. While a 'watchdog' role is still being pursued among CSOs to force change in some circumstances, several CSOs are increasingly shifting from adversarial to collaborative approaches as a means of achieving greater outcomes and obtaining new sources of finance for their operations. With CSOs becoming increasingly important in society, partnerships may provide many opportunities for them to further their missions.

39. Partnerships between private sector and civil society organizations will allow actors to combine their capacities, expertise, resources, networks and comparative advantages in a way that adds value for each of them, and allow them to engage in areas and issues in which they would or could not engage on their own. In addition, the partnering process can provide the diversity and interactions that increase innovation and creativity; create new norms, rules and systems of international governance; and develop new business models that create 'blended' economic, social and ecological value to better address climate change.

40. While government/private sector partnerships are advanced through public-private-partnerships, the same cannot be said of CSO/private sector partnerships. As part of the transformational change agenda, the GCF could encourage and put in place mechanisms to support partnerships between CSOs and the private sector.

E. Empowering CSOs for transformational change

41. Few global financial institutions/ arrangements have managed to harness the full benefit of CSO engagement due to certain constraints. The TC may consider investing effort into addressing identified constraints and empowering CSOs to participate in the GCF at the national and sub-national levels. Critical elements of this empowerment could include inter alia:

- *A 'bottom-up' process of engaging CSOs, built up from the local to the national/global level.* This would go beyond improving horizontal, global-level CSO engagement, to improving vertical, "bottom-up" national and local-level engagement of CSOs in order to achieve the desired transformational impacts. This could be achieved

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by investing in national stakeholder networks (such as the GEF NGO Network). Sub-national members of this network could then regularly elect representatives for a fixed term, to represent them at national and global meetings (thus eliminating the current random selection of representatives), and to ensure the integrity of the network. This will also require putting in place strong accountability measures to govern the operations of the networks.

- ***Adequate resourcing for the accountability function of CSOs.*** A more formalized role for non-government actors in the GCF would undoubtedly need further investment. This investment could prove cost effective in the long run through improved local implementation of global goals.
- ***Direct participation of CSOs in project implementation.*** Many new and innovative approaches to tackling climate change (both mitigation and adaptation) arise from local initiatives through CSOs and other stakeholders. Many of these are either replicable and/or scalable, but face barriers because they are not yet recognized at the national level. Relatively small amounts of funding could encourage the growth of these activities until they find their place within broad, policy-based climate plans. One option would be to create a special funding mechanism to support small scale community projects that have potentials for scalability.
- ***Effective redress mechanisms.*** The GCF could also put in place an independent process to enforce mutual accountability (between the GCF, national governments and non-government actors). Such a redress mechanism could be set up at the national as well as global level. Three criteria to ensure the credibility and independence of a redress or appeals mechanism can be highlighted: **independence** (members should be chosen from outside the institution, and their budget should be independent and adequate); **public accountability** (the public should have access to every stage of the redress process) and **effectiveness** (the mechanism should have the authority to ensure that their recommendations are acted upon).
- ***Country coordinating mechanism.*** Proposals include the establishment of one overarching body which has oversight and coordination of all GCF-funded projects, in which civil society is represented. A multi-stakeholder mechanism that has national oversight could improve coordination and coherence of action as well as learning and replication which are fundamental to transformational change.
- ***Capacity Enhancement of CSOs.*** Many CSOs are not playing their full role due to a lack of capacity to do so. Resources could be included in readiness funding to enhance the capacities of CSOs to participate in the GCF.

F. Key questions for discussion

- What roles can CSOs play in achieving transformational change?
- What concrete systems at the local, national, and international levels should be put in place to encourage active and transparent engagement of CSOs in the GCF?
- How can CSOs best influence climate change policies and plans in their countries?
- How can a CSO/private sector partnership in the GCF be fostered and enhanced?

Part III Private sector engagement

A. Introduction

42. This note aims to help TC members consider how to make the GCF transformational in its engagement with and through the private sector. The note provides background information for the session on private sector engagement of the ‘Workshop on Transformational Change’ to be held in Geneva on 11 September 2011. The text is based on inputs received from the private sector, from TC members and from observers, and literature review undertaken by the Technical Support Unit.

43. The issue of how the GCF can mobilize private finance at scale is seen as an important design consideration that may require innovative approaches to the Fund’s governance structures, financing modalities, safeguards and results measurement. If the GCF is to achieve scale then consideration should be given to how to mobilize new financial actors, for instance pension funds, through new public-private financing instruments and modalities. These approaches should aim to increase both the effectiveness of public commitments at mobilizing private investment, and the scale of such investments, without crowding out what may already be happening locally without GCF support.

(a) Members have emphasized the need to engage the private sector during the GCF design process, and at the second TC meeting members encouraged activities to seek and compile private sector views on issues relevant to GCF design and to supplement these views with the expertise of the TSU.

B. Achieving transformation – catalyzing private sector investment at scale

44. Transformation is achieved through large-scale shifts away from business as usual. In climate change adaptation this can mean helping developing countries and companies to be proactive instead of reactive to climate impacts. For mitigation actions this can mean helping move markets towards a low-carbon growth trajectory. To achieve measurable transformation of a country’s private sector, change must occur at scale meaning widespread actions/interventions which become the new basis for business as usual.

45. With the exception of regulatory standards and controls, which require all firms within an economic sector to take a specific action in a given timeframe, most transformation begins with the actions of early market entrants who take risks in expectation of a financial return. Once these early entrants “prove a venture successful”, other private sector players enter a market more quickly. At times, however, the high risks of entering an unproven market, combined with uncertain returns, prevent any projects from happening. To catalyze market growth in these instances there is usually the need to rebalance the risk versus reward profile for early investors so that they achieve the minimum return needed to undertake the project. By strategically supporting a few early entrants and demonstrating success, future growth can occur at scale without the need for further subsidies²; however, once sector growth begins at scale, it is essential that financing be available to support such change.

46. Like technology developers or early adopters of new technologies (in both adaptation and mitigation), large scale investors such as pension funds, investment banks and/or investment funds face similar risk/reward decisions when investing in a new or unproven sector. By mitigating the risks for such investors, GCF has the potential to unlock private capital at scale to support transformational growth.

47. To achieve high impact, it is essential that the GCF address the barriers both for first movers and large scale investors. By addressing initial barriers to market entry new low

² Implementation of such approaches is best undertaken by national or international financial intermediaries with the market knowledge and skills necessary to negotiate, structure and aggregate such private sector focused interventions.

carbon and climate resilient sectors can start to grow and prove out early investments; by then helping to manage the risks of institutional investors, large infusions of private capital can be unlocked to finance the scale-up of proven climate sectors. However, unlocking private capital at scale, without catalyzing the projects in which they are to invest, will not lead to market transformation. Likewise, to catalyze sector growth, but not have the financing available to support such growth, would also not lead to market transformation.

C. Views from the Private Sector on GCF Design

48. The need to seek the views of the private sector on GCF design was raised by TC members, therefore, the questions listed in the annex to the note on Finance Entry Points (TC-2/WSIII/1) were sent out to private sector companies and associations, and used as the basis for consultations undertaken by UN agencies, MDBs and supporting organizations to secure further private sector inputs. The following is a summary of the inputs received. A full synthesis is annexed. The reports of these consultations and the direct submissions from the private sector associations are available on-line at the workshop web site.

On barriers to investment, the private sector respondents noted that:

- Elevated risks and uncertain returns are fundamental barriers to climate investment in developing countries, especially for early market entrants;
- Among the many risks involved, those associated with legal and regulatory uncertainty are among the most intractable;
- With regards to returns, climate-related projects are still not financially viable in many sectors, largely due to high costs and uncertainties associated with new technologies combined with the lack of clear market signals or a price on carbon;
- Lack of access to different forms of capital remains a barrier in many countries, with limited early stage risk capital financing and long-term debt financing cited as two areas of particular concern;
- Inadequate institutional capacities – technical and financial skills and experience in both public and private institutions pose additional barriers to investment, particularly in LDCs and SIDS; and
- These various barriers combine to create a challenging environment for low-carbon and climate-resilient investments in many countries and a general slow and costly state of climate-related sector development.

On the possible responses from the GCF, private sector respondents suggested that:

- Public resources can effectively leverage private capital by helping to improve the enabling policy and institutional environment in developing countries. The GCF should support both the development of enabling environments and enhance the governance and capacity needed to oversee and enforce regulations;
- A wide range of instruments should be provided, ranging from early stage project development facilities to help prepare investment opportunities; public-private funds to unlock equity investment; guarantees and credit-lines to shore up the availability of long-term debt financing; and results-based incentives such as feed-in tariffs, carbon finance and long term fee structures to address any residual gaps in financial viability.
- Demonstration programs should be supported to create market based track records and economies of scale that reduce the risks and costs of follow-on investments;
- Technology transfer should also be supported, both for adapting technology to local markets and for training the skilled workforce needed for deployment; and
- Public finance instruments in general should be designed according to local conditions, aligned to the on-the-ground needs and structured to ‘crowd-in’ private capital flows in a catalytic way.

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On the need to access private sector expertise in GCF operations, private sector respondents suggested that:

- The Fund Board should have both a mandate and the means to consult directly with the private sector; and that
- Such a private sector engagement mechanism could ensure that the Board gains inputs and expertise, particularly on relevant principles, governance, standards and terms needed to mobilize private sector resources to further GCF goals.

49. The following sections provide information on the different possible roles for engaging the private sector within GCF activities, as well as some examples of how this is being done today through existing funds, programmes and institutions.

D. Types of private sector involvement with the GCF

50. The private sector is often referred to as a single entity with a specific role in the GCF; however, the private sector is actually a heterogeneous group that could be engaged by the GCF in a variety of ways. This section describes the most likely and promising ways the private sector may engage with the GCF, starting from the highest level of investments directly into the Fund, followed by investment mobilized at the program and project level and finally other forms of private sector involvement in project implementation.

1. Opportunities for the private sector to invest directly into the GCF

51. In theory there are three main ways that private capital could come into the GCF at the Fund level: (i) through direct investments from private investors; (ii) through bonds sold on the capital market; and (iii) through philanthropic contributions from corporations, wealthy individuals or foundations.

52. Securing private sector investment directly into the GCF would require structuring the Fund in a way that both pays a market return and fully involves private actors in governance and operations. This would be difficult both from the return perspective, considering the need for the GCF to offer much of its support in the form of grants, and from the operational perspective, where private investors would want significant control over the use of their funds. It would consequently be difficult for the GCF to attract private investment into the Fund itself. Even Corporate Social Responsibility (CSR) investors that may be attracted to the climate benefits of GCF's investments would in most cases require a market level of return.

53. There has been some discussion about whether the GCF might follow the lead of some other funds and expand its resources available for programming by borrowing on the capital markets. Such an approach may also be challenging for the GCF to realize. For the GCF to be able to sell bonds (i.e., to borrow) at attractive interest rates, the Fund would have to be rated highly by a rating agency; however, since such ratings are based on the risk an institution takes compared to the amount of capital it holds, the GCF would either have to refrain from taking the very risks it must take to achieve its objective of spurring market transformation, or it would have to hold a large part of its contributions in reserve (or receive additional government guarantees from contributor countries to back the bonds). Even if the GCF is able to borrow on the best market terms, it would not be able to raise funds cheaply enough to offer the sort of concessional loans and grants that are needed to catalyze and transform markets in developing countries.

54. There may be potential for the GCF to attract philanthropic funds if the GCF is structured in a way that the objectives of the contributor and the GCF can be aligned. There are some examples of philanthropic investments directly into global funds. In 2002, the Bill and Melinda Gates Foundation provided the seed capital for The Global Fund to fight HIV/AIDS, TB and Malaria. Typically, philanthropic investors require clear, agreed, eligibility criteria for the projects their money will support as well as a strong role in the governance of any investments made. This would probably require a ring fencing of the investments to be supported by the philanthropic contributor for specific issues, actors, and target beneficiaries (e.g., REDD+, adaptation, private sector projects, programs in poorest

countries and communities). The focus, structure and governance of the Fund are likely the biggest determinants of whether philanthropic investors will be attracted to the GCF.

2. Mobilizing private sector investment at the program and project levels

55. Although it may be difficult to bring private investment into the overall fund, there are many possibilities to engage private investors in program level and aggregated project level approaches as described in the achieving transformation section of this paper.

56. Public private fund of funds are an example of a program level approach where GCF funding could be used to mitigate the risks for institutional investors, thereby encouraging them to invest larger amounts into developing countries. Many examples of public private partnership (PPP) funds already exist at the national scale particularly for infrastructure and venture capital, and more recently there are global or regional PPP funds that can attract large institutional investors and enable investments across multiple countries. These include the Global Climate Partnership Fund (GCPF), the Green for Growth Fund, the Global Energy Efficiency and Renewable Energy Fund (GEEREF), and a few others. Box 1 summarizes the GCPF established by the German government with Deutsche Bank chosen as the Fund Manager.

Box 1: Program level strategy—leveraging private capital for low carbon investments through the Global Climate Partnership Fund

The Global Climate Partnership Fund (GCPF) is an innovative funding instrument that allows highly effective investments to be made in climate relevant projects in selected countries. This involves providing local financial institutions with credit lines, with which they in turn offer loans for investments in renewable energy, energy efficiency and the reduction of greenhouse gases.

In order to leverage their public resources, the German Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU) and KfW Entwicklungsbank (The German Development Bank) set up the Fund in 2010 as a tiered "Public Private Partnership (PPP)" that has different forms of capital taking different levels of risk within the fund. The fund blends together public funding from the German and Danish governments which is used as equity, the riskiest tranche, public funding from KfW and IFC funds which is used as mezzanine debt, the middle tranche, and private funding from the investment manager Deutsche Bank and other private investors which is used as senior debt, the lowest risk component but also eventually the largest share of the capital. In addition a Technical Assistance Facility, mainly financed by the OeEB (Austrian Development Bank), is attached to the Fund to help local financial institutions prepare projects for financing.

Using its innovative structure and the benefits of a highly-professional commercial fund manager trusted by investors around the world, the GCPF targets to increase its volume from currently US\$200 million to a volume of US\$500 million – mainly with private funding sources.

57. Other examples of possible program level GCF approaches could be supporting countries to put in place a sector wide feed-in tariff for renewable energy; a tax credit for energy efficiency improvements in buildings; or a long term fee structure for waste and water treatment facilities. These approaches would mostly mobilize private sector investment at the project level, but many projects at a time.

58. An example of an aggregated project level intervention in Mexico's wind sector is provided in Box 2. This approach is currently being tested under the Clean Technology Fund. Note that while this example is within a mitigation context, the approach is equally valid in adaptation sectors, for example, to catalyze the uptake of new irrigation technologies or seed crops by farmers adapting to climate changes.

Box 2: Project level strategy—investing in first movers as a means of catalyzing the wind market in Mexico

The Isthmus of Tehuantepec in the State of Oaxaca, Mexico, has one of the best wind resources in the world, with an estimated potential of 8,000 MW, but by 2008 only 88 MW had been installed through two public projects supported by the World Bank.

In November 2008, a new Renewable Energy Law was passed establishing a more effective regulatory framework and greater incentives for developers. Despite the new law and a favorable tariff structure, private sector projects were still not happening, largely due to significant additional costs and risks associated with being “first movers”, and a financial crisis which dried up access to capital.

Using funds from the Clean Technology Fund (CTF), the government of Mexico, along with the International Finance Corporation (IFC) and the Inter-American Development Bank (IDB) took a strategic approach to catalyzing and fast tracking Mexico’s private “selfsupply” wind market. The approach entailed supporting the first 2-3 developers to help establish a track record of performance and prove these projects could be profitable.

The first project, a 67.5MW wind farm developed by EDF Energies Nouvelles was unable to secure commercial financing and the financing package was closed with IFC, IDB, and the US Export-Import Bank. The second project, a 250MW wind farm developed by Acciona Energia, was able to attract commercial financing but still needed the support of MDBs to complete its financing package. For both projects, the CTF funds were structured in a subordinated position to fill the gap between senior lenders’ risk perceptions and what sponsors needed to receive an acceptable return. A third, 396MW wind farm is now being constructed by Macquarie under Mexico’s selfsupply framework; however, this time it will be fully financed by commercial sources.

The CTF funds demonstrated that private wind projects under Mexico’s self supply framework could take on more debt than was previously thought and helped to catalyze and fast track wind development even during a financial crisis. Today, the State of Oaxaca benefits from around 500 MW of installed wind capacity including projects under the private selfsupply framework and IPPs. A further 700 MW is expected to be commissioned by December 2011 and another ten projects totaling about 2000 MW is expected to come on line in later years.

3. Private sector as service providers and contractors

59. Private entities are also contractors, advisors and/or service providers. Such entities respond to fixed revenue procurement contracts and may be called upon to deliver and execute GCF-financed projects contracted either by the government or other private entities. It is important that the GCF considers, among others, the ability of potential implementing entities to employ fair, transparent, and merit-based procurement procedures in order to maximize the effectiveness of GCF funds to enable transformational impacts.

4. GCF link with carbon markets

60. Private sector engagement can also come in the form of carbon finance. In order to create synergy between funding from the GCF and financial flows from the carbon market, programs and projects that receive support from the GCF should not necessarily be precluded from the possibility to qualify for CDM, JI, or any new market mechanism under the UNFCCC. However, some members have expressed the view that carbon finance provided by Parties to acquire credits to help meet mitigation obligations under UNFCCC agreements should not be counted as leveraged financing amounts by the GCF and that it should not be counted towards the fulfilment of obligations contained in Article 4 of the UNFCCC.

61. The GCF could be used to support the development of carbon market programmers and projects under national action plans. This could be handled in a number of ways, including but not limited to:

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- Supporting the development of domestic carbon markets through advance market commitments which, inter alia, may provide an initial floor price until a fully operational system and market demand is established,
- Providing lending and risk mitigation services to projects and programs that have entered into emission reduction purchase agreements but have difficulty in securing the up-front financial resources to start and operate the project. This form of assistance may be particularly useful to entities in LDCs, SIDS, and other developing country Parties with limited access to commercial financing options, and
- Introducing new types of carbon credits in areas such as REDD+, CCS, and sectoral activities that could possibly be purchased in later years by buyers if and when relevant international, regional, national and sub-national systems are put into place. See Box 3 for an example of supporting REDD+ credits in Guyana. For such pilot schemes, the GCF should encourage the involvement of relevant experts and stakeholders in adopting appropriate validation and verification standards.

Box 3: Programme level strategy using carbon credits–results-based financing for REDD+ in Guyana

Guyana's low-carbon development strategy provides a model for how market-based climate finance could reduce emissions from deforestation and degradation in developing countries.

At the heart of the strategy is a climate finance mechanism, the Guyana REDD+ Investment Fund, which is structured as payment for forest climate services. Guyana sells avoided deforestation credits at US\$5 per ton of CO₂. Payments are then used as public finance in, or to catalyse private finance for, low-carbon investments.

It is estimated that Guyana will generate US\$350 million of climate services during the period 2010-2015. The Government of Norway has stated its intention to pay for US\$250 million worth of these services, based on an independent assessment of results achieved. Once the final US\$100 million is committed, the Government of Guyana will work to create the world's first national-scale forest climate services scheme.

62. The GCF Board would be expected to determine the appropriateness of using GCF funds to support the carbon market, and it should be cautious not to "crowd out" public and private buyers under the UNFCCC or other international, regional, national, and sub-national schemes. Where GCF funds may be used to purchase voluntary carbon credits for the purpose of stimulating early market development, if the same credits are later purchased by public and private buyers, the GCF and/or its accredited implementing entity should receive such payments as reflows, whenever appropriate.

E. What a private sector window or facility could look like

63. The TC is yet to determine the exact ways in which the private sector engagement can be integrated with the GCF structure. Some members are of the view that the private sector's role should be integrated across thematic windows, while some have proposed that a separate facility or a window be created (hereafter referred to a window). If a separate window or facility for the private sector is established, the objectives of such a window or facility would be to: (i) maximize the potential of attracting private contributions to the Fund or the activities it supports; (ii) incentivize recipient country governments to support projects that are not typically within their role or scope of experience but which contribute to the objectives of their climate change programs; and (iii) provide the most effective institutional structure possible to ensure efficient approval and supervisory processes and strategic decision making on private sector matters. A private sector window/facility could help to align the structure of the Fund to the fundamental requirements and characteristics of private sector actors.

64. Because of the many special considerations needed in structuring effective engagement with the private sector, the single largest factor affecting GCF's level of private capital mobilization may well be whether the Fund has a separate private sector window/facility. Of course, establishment of such a facility would encompass a number of elements which TC members would need to consider. What a private sector window/facility

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could look like within the GCF would need to be constructed based on at least three key considerations:

- **Structure and governance:** The window or facility would need its own “sub-governance” structure (“committee”) which reports to the Board. Such a committee could have delegated decision powers or simply recommend decisions to the GCF Board. The committee could be staffed by individuals (attached to the Secretariat or as a panel) nominated by the GCF Board who have the skills, experience and background to effectively assess private sector proposals and recommend strategic decisions on private sector matters. While all programs/projects to be funded through the private sector window/facility would be assessed by the private sector committee, such programs would still have to demonstrate how they fit within national climate change strategies and complement any government implemented programs to ensure appropriate coordination.
- **Institutions Eligible to Access the Fund:** Entities eligible to receive GCF financing could include national or international organizations capable of coordinating, implementing, supervising multi-project interventions, including public and private financial institutions, funds and supporting organisations.
- **Scope and Eligibility of Fund Investments:** Clear criteria would need to be established up front which align the interests of government and non-government GCF contributors towards target investments (in terms of strategy, scope, size, operational modalities, risk exposure, etc.) Supported programmes could include regional and global programs capable of addressing cross border barriers and/or the scale/risk diversification needs of international investors, and attract investments into smaller markets.

F. Supporting private sector engagement in Least Developed Countries and Small Island Developing States

65. Although many of the basic requirements for mobilising the private sector in the Least Developed Countries and Small Island Developing States remain the same as in other developing countries, these regions have specific additional challenges that will need to be addressed by the GCF if the private sector is to play a role in helping these countries realise their national climate strategies.

1. Barriers to Investment in LDCs and SIDS

66. Many of the barriers to private sector engagement in LDCs and SIDS relate to the lack of technical skills and experience within the sectors most affected by the need to adapt and mitigate. The skills gap manifests itself in at least three ways. Within governments, the lack of expertise and experience slows the development and implementation of policy and regulatory instruments creating uncertain environments for investment. Within industry, the lack of expertise prevents private developers from translating promising opportunities into new goods and services or bankable projects ready for financing. And within the finance community, a lack of familiarity with climate technologies can prevent local banks from effectively assessing the climate-related projects that come their way. Limited flexibility of internal lending policies is often an impediment to sector development, leading to high collateral requirements and other terms and conditions that limit access to capital.

67. Technology transfer issues can also be more challenging to deal with in LDCs and SIDS, due particularly to the smaller scale of markets. However the challenges are often similar to those soft costs already described, such as a lack of skilled technicians needed to service a technology as opposed to the hard costs of upgrading a technology to a country’s local conditions. For financiers, generating a pipeline of high quality projects is often considered to be more critical than the question of availability of a certain technology.

68. Poor project economics are also often a more significant concern in LDCs and SIDS than in other countries. Lack of market scale and high first mover barriers can increase significantly the cost of introducing new technologies.

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69. Access to financing is a much greater challenge in these countries. Lack of risk capital is a major problem, as is the lack of long term lending needed to amortise long life assets such as renewable energy projects. Many LDCs and SIDS still have to gain a “critical mass” of climate-related market experience. As a consequence, technology and project specific risks, or risk perceptions tend to drive up financing costs and requirements for collateral.

2. Responses – How the GCF could lower barriers to investment in LDCs and SIDS

70. Any increased use of climate mitigation and adaptation technologies in LDCs and SIDS can be expected to contribute to lowering technology costs and helping to bring financing costs down. Increased investment activity will generate learning effects to further technology application as well as to ease access to financing. Efforts to assist the engagement of the private sector in LDCs and SIDS should focus primarily on:

(a) Supporting first movers and measures to leverage their early involvement into broader sector growth; and

(b) Achieving critical mass by aggregating markets in different ways.

71. One way of aggregating market demand is through regional and global programs that can diversify the sovereign and market risk among several countries in ways that make investments in LDCs and SIDS more attractive to the private sector. Supporting early market entrants financially and through capacity building helps to develop and strengthen the domestic private sector.

72. The following are some suggested special approaches for encouraging first movers in LDCs and SIDS:

- Direct financing of pilot investments with targeted debt and equity instruments;
- Project development and transaction cost sharing facilities to generate pipelines of bankable projects;
- Seed investment facilities that finance early stage project developments;
- Risk sharing approaches that spread the risks amongst those best able to manage them, including governments, insurers, investors, banks and project developers;
- Public sector capacity building that catalyses improved policy and institutional frameworks;
- Private sector skills development that assists commercial financial institutions and industry actors in developing new climate relevant products and business segments and in establishing project evaluation and appraisal procedures for climate technologies.

73. Box 4 describes some existing initiatives aimed at supporting project development and lowering the transaction costs of early investments. Whichever approaches are used in a country, maintaining a continuous feedback loop between the GCF, the national government and the private sector is critical for ensuring sufficient information flow and to further understanding how the public and private sectors can work together to achieve climate-related goals.

Box 4: Mobilizing private investment through project development and transaction cost sharing facilities

First mover climate projects in LDCs and SIDS often have higher development and transaction costs which can prevent private sector engagement even for projects that are economically viable. A number of publicly funded development facilities have therefore been aiming to share and lower these costs using a range of approaches.

One approach is project development companies, entities with an explicit mandate to develop projects, usually providing the equity financing and additional expertise needed to undertake all the preparatory steps to financial close. The Norwegian funded SN Power and the multi-donor funded InfraCo are two example infrastructure development companies,

although neither purely focus on climate projects. A similar approach for business ventures is match funding which for example is being employed in Singapore through the SPRING Startup Enterprise Development Scheme.

Some approaches are trying to specifically target transaction costs. For example a soft loan facility approved by the CDM Executive Board at COP15 is being set up to finance the costs associated with preparing CDM projects in countries with few registered projects to date. Two current examples of CDM project preparation facilities are the UNEP/ Standard Bank managed African Carbon Asset Development Facility and the UNDP managed MDG Carbon Facility. Meanwhile UNEP, ADB and AfDB have been jointly running a Seed Capital Assistance Facility that works through private equity fund managers to share clean energy project development and transaction costs.

As well, various coaching, mentoring and advisory programmes have also been focusing on the enablement of project developers in the low carbon sectors including for instance the Climate Technology Initiative's Private Finance Advisory Network.

While a growing number of programmes are today attempting to address these early stage costs and barriers, their scale and scope remain quite modest as compared to the transformational needs of LDCs and SIDS, and developing countries more broadly.

G. The Role of the Private Sector in Adaptation

74. The private sector has an active role to play in adaptation, but whether the private sector will finance adaptation projects, implement adaptation projects, or both will depend on whether the impacts from climate changes will have a positive or negative impact on their businesses. When the impact has a public cost or benefit, the government will necessarily need to finance adaptation interventions. The role of governments will therefore be to discern between climate impacts on private interests versus public interests and i) provide the information and incentives needed to maximize private financing when possible, and ii) minimize the cost of private sector implementation of adaptation for publically financed projects.

1. When will private companies finance adaptation projects?

75. Many companies are unaware of the impact that climate changes will have on their businesses; however, when companies know that there is an impending threat, or if such a threat can create an opportunity to generate revenues, the private sector will invest in adaptation projects. For example, information on climate impacts which were given to private port operators in Colombia incentivized them to invest their own capital to strengthen their ports and marine terminals. Likewise, hotels would make necessary investments to protect their shoreline if climate impacts threatened their future business. Where there are potential gains, the private sector may also step in to finance and drive technological innovation. For example this can include the development of useful and affordable products for use by local communities such as cheap water purifiers/tablets, mosquito repellent devices, flood protection devices, drought resistant crops, and ICT hardware/software for early warning systems. Given the significant threat to a country's economic base, the government has a critical role in gathering and disseminating information on climate threats, especially at the sectoral level. By disseminating such threats to private businesses, governments will maximize the likelihood that private companies will invest to protect their businesses.

2. When might private companies need incentives to invest?

76. There may be times when private companies understand there are climate threats but prioritize other investments, or don't have the ability to undertake the investment. For example, a farmer may be aware of the impact of droughts on his business in the future but may prioritize an investment in productive equipment such as a tractor over irrigation technology. Some companies may want to make a climate related investment but not be able to access credit because financial institutions are unwilling to lend. The GCF may have a role in such cases to provide incentives to demonstrate the benefits of climate investments

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and catalyze future investment. For example, if early market adopters could be supported to test new seed crops or irrigation technologies in agriculture, the success of such investments, especially after the first drought, could incentivise future market entrants to invest without additional subsidies. A similar approach could be taken with financial institutions to incentivize them to increase access to credit for climate investments. This approach would best be implemented by institutions with the ability to strategically aggregate, structure and negotiate several early mover projects.

77. When the benefits or threats of climate impacts will not be borne by private interests, the government will need to finance such projects. For example, if roads along a shoreline need to be upgraded and the benefits of such an investment do not accrue to a private company, the cost of the upgrade will need to be borne by the government; if however, the cost of the upgrade could be offset by private revenues from tolls, a private company may be willing to finance the project.

3. The role of insurance in adaptation

78. Insurers protect individuals and businesses against climate risks to assets, human well-being, loss of income and third party liability, among others. Insurance companies, through the cost of their premiums, have a significant role to play in adaptation by influencing the behaviours of people and companies towards positive adaptation. For example, if insurance companies charged farmers utilizing efficient irrigation technologies a lower premium than farmers who did not use such technology (because the negative impact on a farm's operations would be expected to be reduced in times of drought), this could incentivize faster uptake of the new technology. Likewise, if insurance premiums were lower on buildings that are better built to withstand hurricanes, this could have a very positive influence on the destructive capacity of extreme weather conditions in a country. To the contrary, if insurance is simply provided to cover losses due to climate impacts, without mitigating the risks and potential impacts of such climate events through a change in behaviour, insurance would effectively support the continued high risk behaviour. Two innovative insurance solutions, one at the local level and the other at the regional level, are highlighted in Text Box 5.

79. Another important consideration is how to develop insurance solutions for climate risks that may be too large, uncertain or unviable commercially, even once mitigated through a change in behaviour. In such cases, the public sector may need to be the main risk carrier or consider partnerships with the insurance industry.

Box 5: Innovative insurance products for adaptation

The Horn of Africa Risk Transfer for Adaptation (HARITA) project provides weather index insurance for smallholder rain-fed farmers in Ethiopia. The initiative is a partnership between Swiss Re, Oxfam, the Ethiopian Government and a local NGO. As one of the largest reinsurance companies in the world, Swiss Re is one of the pioneers in the development of weather risk insurance. A pioneering effort in India in 2004 reached more than 350,000 smallholders. In 2008, partnering with the World Bank and the government of Malawi, Swiss Re developed a derivative product to help protect Malawi against drought-related shortfalls in maize production.

Around 85% of all Ethiopians depend on agriculture for their livelihoods and their harvests and incomes are already threatened by drought. To address this problem, Swiss Re and its partners developed a risk management package that enables farmers participating in a government social safety net scheme to pay for weather risk insurance premiums by contributing their own labor to community projects that reduce risk, including irrigation, soil improvement and composting. In the event of seasonal drought, insurance payouts triggered automatically by low rainfall enable HARITA farmers to afford the seeds and inputs necessarily to plant in the following season.

The Caribbean Catastrophe Risk Insurance Facility (CCRIF) is a public-private partnership designed to limit the financial impact of hurricanes and earthquakes for 16 Caribbean

governments. Established in 2007, the Facility provides short-term liquidity (within 2 to 3 weeks) to participating governments when the policy is triggered by a catastrophe, such as the 2010 Haitian earthquake. The Facility uses a parametric mechanism or index to determine the potential future risk and trigger a payout whenever a predefined modeled loss level is exceeded. By pooling the risks of its members, CCRIF serves as a risk aggregator and can provide insurance coverage for otherwise mostly uninsured catastrophe risks borne by sovereigns. CCRIF member states decide on the level of coverage for each peril insured and the actual pricing of the insurance is based on a quantification of risk based on data analysis. Besides considering public-private approaches to capitalizing CCRIF type instruments, another area for public support could be in improving the quality and accessibility of data which would allow insurers to price their coverage more accurately and at lower cost to governments.

H. Key issues for TC consideration during the workshop discussion

80. To achieve its goal of generating transformational impacts, including market transformation, the GCF will use grants (capacity building support, results based mechanisms) and potentially non-grant instruments (highly concessional loans, guarantees and equity) to encourage private sector players to enter climate-related sectors that would not otherwise materialize under a business-as-usual scenario. GCF-supported actions may include addressing the risk/cost barriers that inhibit lenders and investors as well as private companies willing to put capital at risk in such projects (e.g., renewable energy developers, farmers investing in new irrigation technologies, or home owners investing in green houses). By using its funds to take risks that other investors cannot, the GCF has the potential to unlock significant amounts of private capital to help achieve its objectives.

81. Of the wide range of private sector issues that TC members must consider in GCF design, the following four have emerged through submissions as the most critical.

- Should the GCF have a private sector facility (or window) and, if so, how would it operate?
- Does the GCF need to employ special procedures for projects or programs involving the private sector, whether or not they are funded through a private sector facility or windows?
- How could the GCF support private sector engagement in LDCs and SIDS?
- How could the GCF best access private sector expertise to enhance the effectiveness of the Fund's operations?

82. TC members are invited to consider these questions as part of a dialogue with private sector representatives.

Annex

Consultation feedback - Views from the private sector on GCF design

1. The need to seek out the views of the private sector on GCF design was raised by members at both TC1 and TC2, based on which the workstream III co-facilitators proposed the following approach be undertaken:

'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.'

Finance Entry Points Scoping Paper (TC-2/WSIII/1)

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2. Between TC2 and TC3 the questions listed in the annex of the note on Finance Entry Points were sent out to private sector companies and association, and were used as the basis for a number of consultations undertaken to secure further private sector inputs. The reports of these consultations and the direct submissions from the private sector associations are available on-line at the workshop webpage. The following is a brief synthesis of the views contributed during this process.

(a) Opportunities for private sector investment

3. Financiers noted steadily rising interest in various climate-relevant sectors in developing countries, with investment trends supporting this view. For many countries, the overall challenge is not necessarily a shortage of capital, but rather a need for enabling policy and institutional conditions to make projects that help to achieve adaptation or mitigation goals bankable. Getting the risk/reward profile right for investments that open new markets for mitigation or adaptation technologies or other such transformational actions – along with a significant increase in the pipeline of investment opportunities – will be needed to attract pools of capital at scale.

4. Domestic financial institutions in many countries are not seen as lacking funds, but they generally have not yet developed experience managing the range of risk issues that must be dealt with in non-traditional markets associated with energy efficiency, renewable energy and other areas of mitigation investment. Consequently they are often reluctant to support even commercial technologies in some instances for which they have little familiarity. For adaptation investments, private sector involvement is at an earlier stage, but the private sector has an equally important role in generating innovation – particularly by converting technologies into useful and affordable products for local communities.

(b) The barriers – What prevents the private sector from investing

5. There was a repeated message from the private sector that elevated risks and uncertain returns are fundamental barriers to climate investment in developing countries. A stable, attractive and competitive risk-return profile of climate investments is a prerequisite to mobilize private sector capital – an investor must see that money is to be made with a reasonable degree of risk. With regards to returns, it was pointed out repeatedly that climate-related projects are still not financially viable in many markets. This viability gap is largely due to high costs and uncertainties associated with new technologies combined with market distortions in the sectors they are trying to enter, but it is also partly due to difficulties in accessing affordable financing.

6. There was general consensus about the importance of predictable, stable and transparent policy environments as a critical determinant of an investments risk/return profile. Private investors see the various risks associated with legal and regulatory uncertainty as among the most intractable. A range of other risks can also pose challenges, including both real and perceived technology risks, revenue risks associated poor creditworthiness of utilities or other partners, and currency devaluation risks associated cross-border financing. The risk of natural catastrophes is another significant concern in all countries, especially relevant to certain types of adaptation investments. Technological and commercial risks can often be managed through specific instruments (e.g., contracts, guarantees, warranties, or insurance), although in some countries these are still lacking. Commercial approaches to mitigating natural catastrophe risks, such as drought, are poorly developed in many developing countries and suffer from both a lack of reliable historical data and absence of reliable medium and long-term forecasting tools. Technology risk solutions are often obstructed by weak information on costs, performance and market-proven track records.

7. Lack of access to different forms of capital is certainly a barrier in many countries. Banking sectors in LDCs are particularly weak in providing the long-term financing needed by infrastructure projects. Even when debt financing is available, it is usually offered at rather expensive rates and terms, which drives up project costs, lowering their economic viability. Also, when available, long term finance is often in foreign currency, thus requiring the borrower to manage a foreign exchange risk. Risk capital is also generally lacking, in part due to limited opportunities for investors to eventually exit their successful ventures through trade sales or stock market listings. Lack of early stage project financing is also a challenge, since

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few investors are prepared to engage in projects at the pre-permitting stages. For smaller investments, although many advances are being made in the area of microfinance, there is a weak availability of household or microenterprise scale financing for low-carbon and climate-resilient technologies.

8. Absence of expertise was also highlighted repeatedly as a barrier to scaling-up investment, particularly in LDCs and SIDS. Private developers and utilities in these countries lack the expertise and experience to translate project opportunities into bankable investments. For projects that do manage to come forward for financing, their reception amongst domestic financial institutions is usually tepid due to their own lack the expertise and experience in assessing such technologies and projects.

9. The above barriers combine to create a challenging environment for low-carbon and climate-resilient investments and a general slow state of climate-related sector development in many countries with low volumes and high costs. This leads many financiers to conclude that these sectors, although interesting, are not ready for scale-up, at least not for some time.

(c) The response – What GCF could do to mobilize private investment

10. A range of views were expressed on possible roles for GCF in helping shift flows of private investment towards low-carbon and climate-resilient projects and approaches. There was general agreement that public resources cannot effectively leverage private capital without helping to improve the enabling policy and institutional environment in developing countries. On the other hand, some financiers noted that creating the right enabling environment could take many years—even decades—in some countries and suggested that public finance be used initially to balance out institutional shortcomings.

11. It was highlighted that public finance mechanisms need to be designed according to local conditions, aligned to the on-the-ground needs of the beneficiary and structured to ‘crowd-in’ or complement private capital flows rather than competing with such flows. Such actions should exit quickly once a new market has been opened or a technology proven, so as not to ‘crowd-out’ the very private investment that GCF seeks to induce.

12. There was particular interest in guarantee instruments to address a variety of risks. For long-term infrastructure investments, it was suggested that public guarantees should be used to help mitigate political, legal, credit and local currency risks. In this way, the GCF could help overcome fundamental early stage barriers that prevent investors from entering certain markets. Credit/performance guarantees could be particularly effective in helping projects secure bank financing, though sector-wide risk-sharing instruments may be more suitable for creating broad-scale enabling conditions for low-carbon technology deployment. Besides loan guarantees, cash grants and various forms of concessional financing are also widely used today to help de-risk projects, and this experience can be built upon and amplified by the GCF. For adaptation investments, it was suggested that many risks can be ‘mutualised’ across multiple projects, or in the case of natural disasters, even across borders such as in the case of the Caribbean Catastrophe Risk Insurance Facility.

13. One approach to attracting private capital highlighted was through possible GCF encouragement of and participation in investment funds, created as public-private partnerships with a tiered risk sharing structure that has the junior tranches publicly financed and the senior tranches privately financed. Through intermediaries, GCF would become an equity partner, with any net returns generated to be reinvested.

14. There was a general recognition that the fund will need to balance several different objectives, including for example: ensuring a minimum level of support to all countries and countries; ensuring clear and an efficient access procedures are established means to directly access the fund; and seeking to maximize the use of limited resources through co-financing arrangements, public private partnerships and investments in private sector funds.

15. Many respondents identified the use of delivery-related incentives – such as advanced market commitments and feed-in tariffs – as effective approaches to creating conditions for the financial viability of targeted investments. Besides directly buying down the cost of a technology, such revenue support mechanisms can help lower the cost of capital, making bank

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debt more affordable in local financial markets. Fiscal credits, tied to income or revenue taxes, could also be used to reach scale in some markets, complementing risk-sharing instruments.

16. Many stakeholders have also highlighted the need for the GCF to mobilize and make the best use of the full range of existing development banks and financial institutions (national, regional and international) to carry out as implementing entities the necessary financial engineering for these public-private arrangements. This includes national and regional development finance institutions, which could play a key role in mobilizing their capital base and providing the necessary public finance instruments (for instance by blending GCF and other domestic and international resources with their own) to foster private sector investment. Implementation of GCF funds through such institutions could also help align private sector interventions with national strategies and priorities, and, reciprocally, encourage governments to provide policy certainty and directional clarity to the private sector.

(d) How the GCF could engage private sector expertise in its operations

17. A common understanding across the private sector community was that GCF should have both a mandate and the means to consult directly with both civil society and the private sector. This could be accomplished through advisory panels or the appointment of private sector representatives on Board sub-committees, so that the Board gains inputs and expertise, particularly on relevant principles, governance, standards and terms needed to mobilize private sector resources to further GCF goals. This would be bundled into a GCF private sector engagement mechanism.