1. **Task Force** Climate Change and Environment
2. **Title of the Policy Brief**

Promoting Southern actors' direct access to the Green Climate Fund to de-risk projects and raise additional climate finance flows

ALTERNATIVE TITLE (needs to be agreed by the T20 Secretariat)

Increasing climate finance flows through derisking mechanisms and Southern Actors/Financial Intermediaries' promotion – the Green Climate Fund case

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5. **Abstract :**

Both the 2020-horizon USD 100 billion mobilization for climate and 2025 renewed target remain elusive. Climate negotiations are heading for a deadlock. The largest among multi-lateral climate funds, the Green Climate Fund, targets "greater paradigm-shifting mitigation and adaptation impact". Analysing its role in structuring and scaling up climate financing, we focused on differentiating between various risk appetites.

To encourage private additional flows, the G20 should support the GCF's strategy of efficiently accrediting more Southern actors, becoming a facilitator of blended North-South-South public-private finance and an "educated risk-taking" Fund. This would defuse the climate negotiations crisis and accompany structuring climate finance.

6. **Key Recommendations** (100-250 words):

To stimulate the scaling up of climate finance, we recommend that the G20 engage with GCF's 2020 Updated Strategic Plan on capacity building, risk transfer instruments, and market creation:

(a) In coordination with the UNFCCC, through a regular G20-GCF dialogue (with both GCF's Board and Secretariat), the G20 should endorse GCF's newly defined objectives and accompany its programs in preparedness and capacity building of climate finance ecosystem stakeholders in Least Developed Countries, Small Island Developing States, and G20-neighboring countries. In this spirit, a dedicated dialogue platform should involve the B20 and T20, on innovative structuring of additional risk-taking and market creation, notably on adaptation.

(b) As ¾ of GCF funding still goes through Northern financial intermediaries, the G20 and B20 should proactively assist established national players from emerging G20-countries, and the Global South-relevant organizations which G20 members have a collaboration with, in becoming "Accredited Entities" (financial intermediaries) to the GCF.

(c) If the latter increasingly engage with Southern asset management funds, G20 countries' banks, bank-managed funds, incubators, and NGOs, the correlative local information plus risk-sharing would bring de-risking, additional private funding, and an extended project pipeline.

(d) The G20 should consider indirect financial support through very concessional re-insurance mechanisms (collateralizing public money) to scale-up proven models.

Several of these evolutions, current and potential, have gained international support, but in a piecemeal manner, rival across missions. G20's comprehensive endorsement would modernize global financial architecture through: (i) dis-intermediation from Development Finance Institutions; (ii) dynamization of Southern financial sectors; (iii) structuring climate finance.

7. **Challenge** (200-500 words):
Seeking "*transformative impact*" (in Paris Agreement parlance) or "*greater paradigm-shifting*" *(GCF) "through differentiated or incremental risk"* which is based on sound and fair economics involves three challenges — one intellectual, one of governance, one technical:

1. Alongside capitalizing on the current portfolio, how can risk positions be used to deliver scale?
2. On adaptation, how can financial instruments best be matched with various financial intermediaries?
3. How can operational windows be carefully designed to reach out to different actors while arriving at a "North-South" policy consensus on additionality?

As climate finance matures and refines, solving these challenges justifies the G20's support.

1. What and how to scale?

Since its initial 2016 Strategic Plan, the GCF has moved to mature partnerships with multilateral banks (see our statistical analysis below). The updated 2020-2023 programming wishes to "show how the risk appetite of GCF differs from other climate multilateral funds (in taking risks) – to support technology development and transfer, first loss positions or participation in higher risk tranches – to demonstrate the viability of innovative approaches and deliver scale".
This amounts to how best to use risk positions to deliver scale. Along with expanding development banks' current syndication model, literature suggests another promising route: more additionality can come through private entities accredited to the GCF if the latter provides "*the incremental costs of sustainability of projects",* the Private Sector Advisory Group of IFC stated (PSAG, 2014).
Our GCF portfolio analysis suggests **time is ripe to unlock this route** and *"crowd out opportunities, projects and priorities for the private sector".*

2. Which role for Southern financial intermediaries towards de-risking adaptation?

GCF's updated strategy links "*increased focus on new and innovative financing for adaptation*" with "*significantly increas[ing] funding channelled through direct access entities*". This reflects the bottleneck perceived in climate finance of scarcity in adaptation projects, which is in fact caused by 'adaptation' being an unstabilized financial category. It remains difficult to earmark the benefits of adaptation projects.
Gathering local expertise and private finance while clarifying accounting on additionality should be a priority to expand the adaptation project pipeline. The GCF portfolio analysis we conducted draws scaling routes for various actors and financial tools (grants, loans and equity as de-riskers, equity as catalyst of private funds, insurance). Incentivising national organisations to engage with instrument-focused project proposals, which would result in increasing both leverage and additionality towards adaptation, should stretch the envelope and build consensus.

3. Dedicated windows for scaling and for understanding additional risk

Supporting the non-bankable part of nearly-bankable projects is the route to enable adaptation to become structured similarly to mitigation. For adaptation, innovation in climate finance lies in reaching small-scale projects (Verdolini et al, 2017). The versatility of financial intermediaries accredited to the GCF is under-utilized, whilst it could contribute to supporting "small scale programmes that could be scaled up over time through aggregation into a single vehicle", as IFC suggested. We recommend considering GCF's action not through financial instruments but through established, specifically G20-backed, dedicated windows based on the intermediaries they work with.

8. Proposal (1,000-2,500 words):

Introduction: On scaling up to trillions in climate finance, de-risking, and public-private partnerships

"Contributing to shifting the wider financial flows managed by the private sector is key to realizing the scale of resources – in the trillions – needed to implement (...) climate strategies."
GCF Updated Strategic Plan 2020

Climate finance stands at a cross-roads, but the cup might be more half-full than usually thought: "*Similar to the progress in scaling up energy efficiency and renewable energy in climate change mitigation, private sector investments in adaptation are slowly growing, as risks, vulnerabilities and the business case for adaptation finance are better understood*", the PSAG (2018) stated.

The GCF aims to "*catalys[e] both public and private sources of finance at the international and national levels*" and claims a comparative advantage in *"being willing to take risks to unlock climate action and de-risk more conservative sources of finance".*

The GCF financing modality lies in the involvement of "Accredited Entities" (AEs), i.e. financial intermediaries, with a provision allowing "direct access" for developing countries (Direct Accredited Entities – or DAEs)[1]. This gives financial intermediaries from the South the potential to move climate finance out of the preserve of development banks. This must be regarded as an opportunity to create green development coalitions to disseminate and share local information, reduce the perception of risks and, hence, reduce the associated costs of capital.

Based on WRI (2017) report "The Future of the Funds", attention to multilateral funds' *operational and architectural reforms* to improve their ability to deliver low-emissions and climate-resilient development has grown. While the report points to great potential for the GCF, the recommended "emphasis on programmatic approaches and catalyzing systemic shifts" is to be taken more boldly than confining it to financing "non-bankable projects". We believe the GCF can skilfully fund non-bankable parts of larger "nearly bankable projects".
Compared to this report, our position provides an update integration of GCF's recent achievements (see 8.3) and recent literature on linking private finance and adaptation (8.2).
The G20, concerned with promoting public-private partnerships, should consider the GCF's potential to be impactful and transformative, especially for adaptation. Financing as a de-risking strategy can make large projects bankable in a public-private framework, hence our recommendations (section 8.1).

8.1. G20's opportunity in supporting the GCF as climate finance matures

8.1.1. De-risking to scale up: focusing on incremental risk segments

WEF estimates total annual *additional* investment needs in green infrastructure at about USD 700 billion annually, while The Climate Policy Initiative estimates USD 360 billion annually in current public and private climate investments, with developed country governments providing USD 10-20 billion per year according to their fast-start finance reports and OECD estimates. For adaptation alone, costs are estimated at between USD 280 billion and USD 500 billion globally per year by 2050 (Guha-Sapir, Santos and Borde, 2013 and UNEP, 2017), pointing to a need to leverage both private and public sector investments. GCF's Updated Strategy reflects this, aiming to "*catalys[e]*

[1] https://www.greenclimate.fund/sites/default/files/document/gcf-brief-direct-access_0.pdf

private sector finance at scale". Its goals include *"De-risking (...) to mobilize private sector resources at scale for climate investments in developing countries, including (...) adaptation"*.

Going beyond the 'donor-beneficiary' relation – Southern financial intermediaries and PPPs

GCF financing via Southern financial intermediaries is set to increase. This model requires relying not only on grants. The GCF Board (i.e. countries, including many G20 countries) should consider *"grants as first loss capital (credit enhancement and/or covering the risk premium required to make investments viable)"*, (PSAG, 2014). Bundling public-private finance can easily happen on mixed projects that target mitigation and adaptation. Rather than grants, loan and equity should be used as much as possible, especially when supporting climate-oriented local financial systems, green banks, markets and institutions. Equity as well as loans are equally good instruments used by a risk off-taker, but as there are usually fewer sources of equity for projects that might be eligible for GCF funding, this instrument should go to structuring projects, as into privately supported equity funds or debt funds. The GCF has opened this promising and potentially generalizable route to support equity or debt funds addressing nearly bankable projects on adaptation issues.

Practical recommendation to the G20 on incremental risk and scaling-up

As the GCF has established its use of financial instruments (see 8.3), the G20 should collectively leverage its members' role in the GCF Board, as well as enter into a regular dialogue with the GCF, on the Fund's risk appetite and allocation.

The GCF should further consider funding a pooled guarantee mechanism for projects geared to Southern financial intermediaries — possibly in synch with MIGA. Indeed, since the GCF is not a bank, it has to collateralize all its guarantees. This instrument is barely used, though it should be central for addressing private sector adaptation project investments for instance, as a **learning process** towards *"educated risk"*. *Re-insurance* would serve as a pre-condition towards so-called *"incremental cost considerations"* of increasing climate impacts.

8.1.2. Enlarging the pipeline as climate finance establishes common standards: selective de-risking instruments for various financial intermediaries

Fostering Southern financial intermediaries should aim at providing both leverage and additionality to climate-related transfers and thus could help scale-up both climate change adaptation and mitigation in the Global South.

The case for continued syndication for nearly-bankable mitigation

Due to the decreasing cost of renewables, mitigation is now more commercially viable, with qualifications depending on segments (storage), or conditions (decentralised vs. centralised, off-grid vs. mini-grid or grid etc.). However, renewable prices themselves have in some markets fallen more than the equipment cost, and syndicating loans with local financial partners is a way to reduce risks. Here too, a limited, actionable G20-backed guaranteeing mechanism should be an available tool for scaling-up, with a simplified accreditation process for both project developers and willing private investors.

The case for private Southern funds/banks, Northern funds investing in the South

The GCF has started partnering with local investors in equity, such as CDG Capital in Morocco. The G20 should support the creation and generalisation of these national Accredited Entity-managed types of climate-geared equity or debt funds, and of green banks, especially regarding adaptation, thus offering a more effective use of financial resources.

Nonetheless, financial flows are still insufficient and should be mainstreamed, especially investments in private adaptation projects.

The case for Northern Banks' role

What differentiates international GCF accredited private banks from other Accredited Entities is that they are more oriented towards accompanying their established customers (large international infrastructure groups) than towards developing countries' needs. On these, concerned G20 countries should propose to share some of the non-financial risks, possibly in synch with the G20-Infrastructure Hub.

The case for consultancy and engineering companies

These non-financial organizations should become "delivery partners" in the GCF sense, to build on the shared knowledge around the GCF ecosystem.

Practical recommendation for the G20 on promoting Southern financial intermediaries

We recommend:

- Adding a GCF/Climate Funds know-how center to the G20 Global Infrastructure Hub and in link with B20
- Supporting co-financing in PPPs with Southern financial intermediaries
- Facilitating seed funding on mitigation and adaptation activities in Southern countries.

8.1.3. Being inclusive of small projects: LDCs, SIDS

The GCF should be able to massively mobilise guarantee instruments towards covering the initial investment risk in Small and Medium-Sized Enterprises, especially to invest in adaptation. This could be done by "*match[ing] larger companies with the MSME supply chains*" (PSAG 2018).

Practical Recommendation to the G20:

We recommend:

- Promoting aggregation and bundling (geographical and financial) to stretch the climate finance envelop towards LDCs and SIDS, thereby fostering additionality in the most ambitious sense
- Enhancing information transparency by promoting disclosure standards for environmental and climate risks, as the issue of small-scale actors in climate change has been a recurringT20 concern (see Verdolini et al, 2017)
- Cooperation between the T20 and the GCF, possibly in association with the G20-Africa initiative.

This could build practical knowledge to structure a real low-carbon shift in the developing world.

8.2. Literature

There is increasing debate on climate finance, especially regarding what kinds of financial flows should be counted and how these should be measured (Oliver et al., 2018; Weikmans & Roberts, 2019; Westphal et al., 2015).
Climate finance literature stresses that climate funds play a pivotal role in helping developing countries in climate mitigation and adaptation (Klöck & Nunn, 2019; Nakhooda & Norman, 2014; Scandurra et al., 2020; Sjöstedt & Povitkina, 2017). Pickering et al. (2017) argue that adaptation financing can support the most vulnerable countries, while mitigation financing can help developing countries to make the transition to low carbon economies.
However, greater mobilization of private capital is required. Government are facing restrictions on funding climate action, due to higher borrowing costs and rising debt burdens (Jobst & Pazarbasioglu, 2019). It is expected that the majority of future climate finance will continue to come from the private sector (Buchner et al., 2019).

Learning on adaptation
Financing adaptation is a learning process, as it was for mitigation not so long ago. As stated by the PSAG (2018), "*rather than immediately assuming that adaptation is purely a social goods problem, there is potential for further development in private sector driven markets for adaptation (...). For example, when responding to (...) business disruption and operational risk (...), companies are indeed adapting to climate change*". Two options can be considered.

Consolidating towards transformational change
Given the diversity of climate funds, five of which fall within the institutional framework of the UNFCCC, there is literature (WRI, 2017) arguing that GCF should focus on driving transformational change by providing programmatic interventions **– to create markets, build capacities, and remove barriers to entry – that serve as precursors to longer-term mobilization of finance[i], mainly in the form of grants, towards projects that are not bankable. We consider it is only one of two options.**
As argued in 8.1 and as analysis in 8.3 supports, this is indeed one path that can be pursued given the GCF track record and the context of augmenting the number of DAEs. A complementary action within this approach would be to back private projects with technology transfer and grants for knowledge-sharing and project preparation, which can structure market creation, regulatory support, and pipeline development (Henry, Ruet, and Wemaere, 2017).

Additional risk, preparedness, and blended finance
The other main option involves "*blended finance (which) has been used with success in leveraging finance for climate change mitigation (should be used) to support engagement with the private sector in adaptation action*" (PSAG, 2018).
Our analysis (8.3) suggests blended finance can be anchored into GCF's current portfolio record to scale hybrid projects (mitigation+adaptation) or through supporting equity funds.

Focusing on projects type, not on ownership
These **two options** are distinguished in literature by the private vs. public character of the financial intermediary they mobilise. However, each window could have its own Private Sector Facility[ii]. Involving private actors can be to the benefit of Southern Public Organisations and Nationals Action Plans and no option is detrimental to any party. Ultimately, we wish to move the debate : the former option fits for un-bankable projects **as it focuses on market creation**, and the latter for nearly-bankable ones and focuses on **market development**.
If G20 countries are to participate in the newly replenished "GCF-1" Fund, the GCF should maximise impact in structuring climate-related projects in both adaptation and mitigation, and both approaches complement each other.

8.3 Analysis

"GCF takes educated risks – to support technology development and transfer, first loss positions or participation in higher risk tranches – to demonstrate the viability of innovative approaches and deliver scale."
GCF Updated Strategic Plans objectives

Thus far, the GCF is structured under two main "funding patterns": one which interacts with the public sector, and a smaller but equally promising "Private Sector Facility" (besides these, capacity building is a third, smaller one). These stand out as being quite distinct in terms of their economic rationale, the GCF financing instruments, project themes, and project ownership.

The first funding pattern mostly addresses adaptation projects (sometimes combined with mitigation), mainly through grants (mostly to poor IDA countries), and has so far been GCF's preferred funding tool. Our statistical analysis of the GCF portfolio shows that GCF grants are very strongly and positively correlated with international guarantees and international in-kind funds, but negatively correlated with national public guarantees and international open market funding. This suggests that the least bankable projects tend to receive grants from the GCF, which acts with a clear additionality rationale. In these projects, the GCF acts as leader in international and national syndications and is also able to complement regional programs with additional funding. The potential additional finance mobilized by GCF grants (leverage on grants), through their de-risking function, should be accelerated and their impact further increased based on gained experience.

The second pattern is targeted to projects that we would qualify as "nearly-bankable", as they are associated with higher risk than the average bankable projects. GCF funding can help increase bankability for such projects, which are funded with non-conditional loans or, to a lesser extent in the GCF portfolio, equity. This pattern is aimed at mobilizing private funding to obtain maximum leverage. Two finance pathways stand out for such so-called nearly bankable project: loans and equity.
- GCF loans are significantly and positively correlated only with international loans (+54%) (showing a focus on loan-to-loan leverage) and national public equity (+25%) (and support to national public equity). At the same time, they are significantly and negatively correlated with international equity (-48%) and national private equity (-19%), as project finance theory predicts on substitutability between loan and equity of a similar origin.

There is quite a high leverage of GCF loans on international loans, and GCF loans also tend to combine with national public equity, but not with international nor national private equity.
- GCF equity is significantly and positively correlated with national public loans (+11%) and especially with national private equity (+71%), as well as with international open market funding (+44%), but is significantly and negatively correlated with international loans (-24%), which suggests that GCF equity tends strongly to mobilise national private equity and also open market funding.

Overall, we find this latter window to be a promising way towards very desirable "additional de-risking", and the 2020-2023 programming should seek to expand this window from mitigation to adaptation by better segmenting the risks in it. Within this approach, we find that pilot projects of supporting (equity or debt) funds, should these also address adaptation in a complementary fashion to mitigation, are a promising way of scaling-up while rightly allocating project and risk ownership. The two patterns above set the stage that makes us suggest thinking about a further differentiated two-window organization. Since grants mobilise 48% of total GCF financing, loans account for 38%, and equity for 8%, the current portfolio strategy seems mature for the GCF to acknowledge and allow for those two windows.

The possible optimized role of each type of accredited entity is specified in the Appendix.

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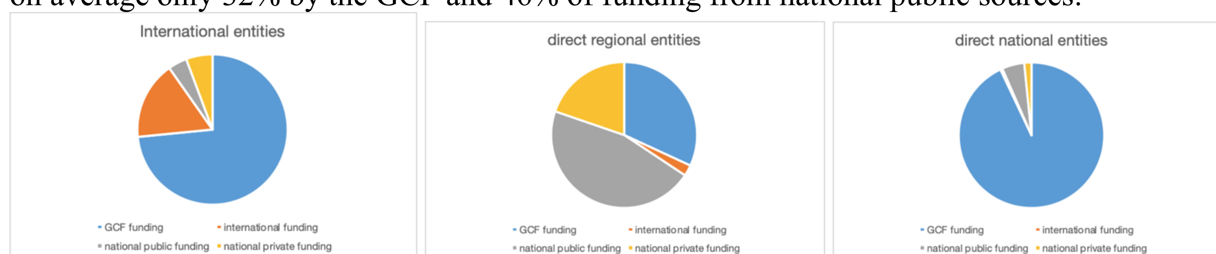
Appendix

Analyzing the GCF portfolio structure

1. By Accredited Entities: sponsor project to the GCF

Projects sponsored (brought to the Board) by international entities (101 projects) vastly outnumber projects from direct regional (10 projects) and direct national (17 projects) entities.
The average GCF share in funding for these three types greatly differs by type of funding source: GCF-supported projects by direct national entities on average get 93% of their total received finance from the GCF itself; GCF-supported projects by international entities also get on average a majority funding from the GCF, with 73% of the total funds; projects by direct regional entities get on average only 32% by the GCF and 46% of funding from national public sources.



2. By project theme

Of the total number of projects, 46% target climate change adaptation, 28.1% target mitigation, and 25.8% target a combination of both. 61% of the projects touch on the public sector and 39% on the private sector.

3. By GCF financing instruments

Grants mobilise 48% of the total GCF financing, loans account for 38%, equity for 8%, guarantees for 2%, and 4% are result-based instruments. As a comparison, the GEF only provides grants, the World Bank only loans. Further work has already been undertaken to foster the use of prudential instruments through partnerships with leading international guarantee institutions. This multi-instrument approach is a differentiating attribute for the GCF within international development finance institutions.
Total syndication (measured in number of projects) by theme is distributed between different accredited entities as follows:

Theme	Accredited entity: International	Regional	National
Mitigation	28	4	4
Adaptation	46	3	10
Cross-cutting	27	3	3

4. By mobilised external finance

The GCF updated strategy claims to channel "new, additional, adequate and predictable financial resources to developing countries" to "catalyse climate finance, both public and private". Along with developed country donors, financial inputs may come from "a variety of other sources, public and private, including alternative sources", such as "public finance, development bank instruments, carbon markets, and private capital".
The current structure of the GCF portfolio has been analysed through a statistical model in search for the most evident funding patterns, in terms of financial instruments, objectives or themes (mitigation, adaptation or cross-cutting), ownership of receiving structure, and type of intermediary,

with the aim of identifying possible funding patterns with different economic rationales (leverage/additionality) associated with the various degrees of concessionality of funding tools.
This portfolio analysis helps us build two categories:
1. Non-bankable projects, grant-funded, with low leverage, but with high potential for mobilising other concessional sources of finance such as international guarantees and international in-kind funds. This category includes projects that tend to target adaptation (and cross-cutting projects) and to be associated with public ownership.
2. Nearly-bankable projects, which are either loan funded, with high leverage on international loans and national public equity; or to a minor extent equity funded, in which case they are likely to mobilise national public loans and national private equity. This category includes projects that tend to target mitigation and to be associated with private ownership.