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INDEPENDENT EVALUATION OF THE GREEN CLIMATE FUND'S APPROACH TO THE PRIVATE SECTOR

Executive summary

September 2021

GREEN CLIMATE FUND

INDEPENDENT EVALUATION UNIT

Independent evaluation of the Green Climate Fund's approach to the private sector

EXECUTIVE SUMMARY

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ABBREVIATIONS

AE	Accredited entity
DAE	Direct access entity
DMA	Division of Mitigation and Adaptation
GCF	Green Climate Fund
GI	Governing Instrument
IAE	International accredited entity
IEU	Independent Evaluation Unit
IFIs	International financial institutions
LDC	Least developed country
MSMEs	Micro-, small- and medium-sized enterprises
NDA	National designated authorities
NDC	Nationally determined contributions
PSAA	Project-specific assessment approach
PSAG	Private Sector Advisory Group
PSF	Private Sector Facility
RFP	Request for proposals
RPSP	Readiness and Preparatory Support Programme
SIDS	Small island developing States
UNFCCC	United Nations Framework Convention on Climate Change
USP	Updated Strategic Plan

EXECUTIVE SUMMARY

A. INTRODUCTION

As an operating entity of the Financial Mechanism of the United Nations Framework Convention on Climate Change (UNFCCC), the Green Climate Fund (GCF) has the explicit mandate to contribute to the achievement of the ultimate objective of the UNFCCC make a significant and ambitious contribution to the global efforts towards attaining the goals set by the international community to combat climate change. The GCF will promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change, taking into account the needs of those developing countries particularly vulnerable to the adverse effects of climate change. To achieve this objective, the GCF has a clear mandate to catalyse climate finance, both public and private. The following five core provisions are discernible in the GCF mandate on the private sector:

1) Channel private finance, including catalysing finance
2) Country-driven approach
3) Geographical and thematic balance between adaptation and mitigation
4) Efficiency and effectiveness to promote participation of private sector actors
5) Support to enable private sector involvement in small island developing States (SIDS) and least developed countries (LDCs)

During its twenty-seventh meeting, the Board of the GCF requested the Independent Evaluation Unit (IEU) to undertake an independent evaluation of the GCF's approach to the private sector. This report presents the findings of that evaluation.

The evaluation team was guided by the GCF's Governing Instrument (GI), the principles established by the Board in the Evaluation Policy for the GCF, and the GCF evaluation criteria provided in the terms of reference of the IEU.[1] The evaluation was carried out from March to August 2021. All data included here, unless otherwise noted, are valid up to 15 July 2021.

Considering the GCF's mandate, the evaluation serves several objectives. The first is to assess the relevance and effectiveness of the GCF's approach to the private sector. The evaluation also informs the second performance review of the GCF, which will be undertaken in parallel but conclude later than this evaluation. In parallel, the GCF is developing a strategy towards the private sector, and this evaluation may be used to inform that strategy.

B. KEY FINDINGS AND CONCLUSIONS

Mandate of the GCF:

1) The Board has provided limited guidance to the GCF regarding the private sector approach. The Private Sector Advisory Group (PSAG) was effective, but its term has expired.
2) The Updated Strategic Plan (USP) provides a list of priorities related to the private sector but is limited in its strategic guidance, and these priorities do not necessarily translate into actions and incentives for the Secretariat.
3) There is a lack of clarity regarding how the GCF defines its private sector portfolio. The distinction between the Division of Mitigation and Adaptation (DMA) and the Private Sector Facility (PSF) is artificial, as both divisions can target similar outcomes. The distinction

[1] GCF/B.BM-2021/15

between divisions is unclear, not only to accredited entities (AEs) and countries but also to Secretariat staff, and limits cross-divisional coordination.

4) It is unclear if the GCF, in implementing its long-term strategic vision over the 2020–2023 programming period in the USP, intends primarily to be (i) a high-leverage fund that mobilizes the maximum quantity of investment for a given input of public resources, and/or (ii) a high-risk fund mobilizing and catalysing investments in high-risk and new and emerging markets (particularly, for LDCs and SIDS).

5) The USP does not explicitly or clearly define that the GCF's accreditation, programming capacity and pipeline development related to the private sector will be driven and informed by a "country-driven prioritization" of financial, capacity-building, and technology development and transfer needs.

6) The USP does not clearly set out that the GCF's balanced programming capacity and pipeline development related to the private sector will be driven and informed by the initial resource mobilization's overall outcomes, and through "country-driven prioritizations" of financial, capacity-building, and technology development and transfer needs and priorities.

7) The GCF does not place a strong focus on promoting participation of micro-, small- and medium-sized enterprises (MSMEs) in GCF activities in LDCs, SIDS or African States.

Lessons learned from the landscape of institutions:

8) Evidence from climate funds, international financial institutions (IFIs) and development banks underlines the critical need to focus on enabling environments if the aim is to "catalyse private finance."

9) Evidence from climate funds, IFIs and development banks indicates that access to a diverse range of funding instruments helps to engage and mobilize private finance. Lessons from these institutions and their use of funding instruments demonstrate the importance of flexible financing structures, the principle of "least concessionality", enhanced risk appetites, and innovative blended finance.

10) Evidence from climate funds, IFIs and development banks indicates that the GCF private sector portfolio is targeting the same themes and regions, suggesting limited use of complementarity and coherence.

11) Evidence from climate funds, IFIs and development banks indicates that efforts to finance the private sector, directly and indirectly, require promoting and respecting country-driven processes that set the priorities for private sector engagement.

12) Evidence from climate and development funds indicates that the capacity for MSMEs to engage in climate action is restricted by weak enabling environments, limited knowledge and awareness of investment opportunities, and inadequate financial products.

Business model of the GCF:

13) The choice of access modality is linked to the country-driven approach. However, evidence indicates that the GCF's accreditation process has faced challenges of strategic clarity, which limits the identification and selection of entities for country-driven, private sector projects.

14) The GCF accreditation process has provided a portfolio of diverse AEs. However, it has not yet resulted in a portfolio that is in line with the priorities and mandate of its private sector approach, taking into account dimensions of country ownership, local private sector involvement and supporting the needs of developing countries, particularly LDCs and SIDS. The pool of AEs from the private sector remains very limited.

15) The GCF's accreditation process is perceived as too lengthy and too cumbersome to secure the accreditation of private sector entities, especially for direct access entities (DAEs). The project-specific assessment approach (PSAA) is not expected to address these challenges.

16) The Readiness and Preparatory Support Programme (RPSP) has limited structural linkages with the private sector or PSF. The RPSP has had limited use to encourage the participation of the private sector and has provided limited support to catalytic actions and an enabling policy environment for the sector.

GCF private sector portfolio:

17) The GCF's approach to private sector project development is not effectively country driven, and hence not in line with the priorities of the USP. Country programmes are yet to be deployed to increase the country drivenness of the project pipeline. Multi-country projects have limited effectiveness in country ownership.

18) On average, a PSF project takes 228 days from funding proposal submission to Board approval, with additional time needed for execution and effectiveness. The process and duration are unattractive for the private sector and considered unpredictable, which presents significant barriers, even for large international accredited entities (IAEs).

19) Evidence suggests that while the GCF may be appropriately gauging the concessionality of its funding on a project-by-project basis, at the portfolio level, the GCF has employed a lower risk appetite than that contained in its mandate, and hence has provided limited levels of concessional financing overall.

20) The GCF's overall, portfolio-level use of financial instruments provides another indication that it is not targeting high-risk private sector investments.

21) The PSF portfolio is strongly focused on mitigation, predominantly targeting energy generation and access. This portfolio has had a modest contribution to developing countries' mitigation and adaptation priorities, with limited support for private sector engagement in LDCs and SIDS. While nationally determined contributions (NDCs) are broadly addressed, PSF projects alone are not sufficiently targeting the most urgent NDC priorities of countries.

22) The Project Preparation Facility is underutilized, while Requests for Proposals (RFPs) are not effective or efficient in serving the mandate of the GCF with regard to the private sector. Both RFPs focused on the private sector were not able to fully commit the allocated budget, primarily owing to challenges in the business model.

Results and impacts of the GCF private sector portfolio:

23) The GCF will be unable to credibly measure and report results of its private sector mandate due to two key challenges: (i) the integrated Results Management Framework does not provide a robust framework from which to measure the success – or not – of the GCF's private sector approach, and (ii) the GCF's private sector approach does not include explicit logic models to assign appropriate indicators.

24) The quality of annual performance reports varies, leaving the GCF with limited oversight over AEs' compliance, especially for multi-country projects.

25) There is limited oversight over the reporting of funded activity agreement conditions and their compliance.

26) It takes over 18 months for PSF projects to go from funding proposal submission to first disbursement. AEs' ability to monitor and report against their projected impacts is undermined

by delays in meeting the conditions for the effectiveness of PSF projects, due to changes in the baseline context.

The evaluation's overall conclusion is that the GCF has a clear and unique mandate to engage with the private sector within the context of its role as an operating entity of the UNFCCC. However, the GCF's private sector approach has been largely disconnected from this mandate. The evaluation has found that the GCF has failed to operationalize several provisions set out by the GI and UNFCCC Conference of the Parties decisions. The evaluation's conclusions are structured around five normative provisions.

Conclusion 1. Channelling financial resources and catalysing public and private climate finance.

The GI of the Fund stipulates that "The Fund will play a key role in channelling new, additional, adequate and predictable financial resources to developing countries and will catalyse climate finance, both public and private, and at the international and national levels." The GCF has successfully channelled new financial resources to developing countries. It has also leveraged large-scale co-funding from public and private sources. However, partly because the process for securing funding through the GCF is slow and highly unpredictable, which presents significant barriers to local private actors that cannot afford the risks and delays associated with accreditation and funding applications. A distinction needs to be made between catalysing finance and leveraging co-funding. However, the USP uses these words interchangeably and overemphasizes leverage ratios as a measure of the impact of private sector activities. The PSF, in turn, has focused on maximizing leverage in individual projects, rather than the catalysing of private finance for adaptation and mitigation activities more broadly. The catalytic effect of the PSF specifically is likely limited due to its low risk-appetite and lack of funding for the enabling environment.

Conclusion 2. Pursue a country-driven approach.

Article 9.9 of the Paris Agreement states that the GCF, as an operating entity of the Convention, should ensure efficient access to climate finance in the context of national climate strategies and plans. The GI states that the "Fund will pursue a country-driven approach and promote and strengthen engagement at the country level through effective involvement of relevant institutions and stakeholders."[2] Additionally, the GI stipulates that "the operation of the [private sector] facility will be consistent with a country-driven approach."[3] Despite this clear mandate to be country driven, the PSF has limited engagement with national governments to align spending on private sector projects with national climate strategies and plans. Under the PSF, project origination is driven primarily by IAEs, with limited country ownership.

Conclusion 3. Directly and indirectly finance private sector mitigation and adaptation.

The GI stipulates that the "Fund will have a private sector facility that enables it to directly and indirectly finance private sector mitigation and adaptation activities at the national, regional and international levels."[4] The PSF has directly financed several mitigation projects. These have primarily been implemented by IAEs and heavily weighted towards the energy sector. The PSF has provided very little direct finance for adaptation activities. It has also invested very little to indirectly finance private sector projects – for example, by supporting the upstream enabling

[2] FCCC/CP/2011/9/Add. 1., Decision 3/CP.17/, Annex I, paragraph 2
[3] Ibid., Annex V, C (2), paragraph 42
[4] Ibid., Annex V, C (2), paragraph 41

environment that indirectly results in private finance flowing to adaptation and mitigation activities.[5,6] GCF support for policy and regulatory reforms, technical capacity-building, readiness and the like is delivered primarily with limited targeting of or consultation with the private sector.

Conclusion 4. Promote the participation of private sector actors in developing countries.

The GI stipulates that "The facility will promote the participation of private sector actors in developing countries, in particular local actors, including small- and medium-sized enterprises and local financial intermediaries."[7] MSMEs are central to implementing several mitigation and adaptation actions that are commonly included in SIDS' and LDCs' national climate plans – for example, sustainable fishing practices, climate-smart agriculture, energy efficiency in buildings or small-scale manufacturing, and clean cookstoves. Deployment of these actions tends to require numerous small transactions in local currencies, which will likely be more efficiently deployed through local financial intermediaries, which in turn are likely to be DAEs. While several private DAEs have been accredited, almost no funding is flowing through them, and as a result, the PSF has not delivered its mandate to promote the participation of local private sector actors and financial intermediaries.

Conclusion 5. Support activities to enable private sector involvement in adaptation, particularly in SIDS and LDCs.

The GI states that the "Fund will strive to maximize the impact of its funding for adaptation and mitigation, and seek a balance between the two, while promoting environmental, social, economic and development co-benefits and taking a gender-sensitive approach."[8] Additionally, the GI states, "The [private sector] facility will also support activities to enable private sector involvement in SIDS and LDCs."[9] Despite the mandate to balance investment between adaptation and mitigation, the PSF has provided very little funding for adaptation projects at all. The PSF's support for private projects in SIDS and LDCs has focused on directly financing mitigation projects, despite the fact that the countries are recognized under the UNFCCC as highly vulnerable to climate change. A key challenge to financing adaptation projects is to show that they can be profitable and generate revenue streams. Overall, the GCF has had limited results with regard to investments in an enabling environment for private sector adaptation, channelling sufficient finance via DAEs, or exhibiting sufficient risk appetite to achieve its mandate to enable private sector involvement in adaptation in LDCs and SIDS.

C. KEY RECOMMENDATIONS

Based on the above findings, the evaluation has a number of recommendations for how the GCF can better align its private sector approach with its mandate.

Recommendation 1: The Board and the Secretariat may wish to clarify that the GCF is a high-risk fund that aims to catalyse investment in transformative adaptation and mitigation

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[5] Jessica Brown and others, *Estimating Mobilized Private Finance for Adaptation: Exploring Data and Methods* (San Francisco and Paris, Climate Policy Initiative and Organisation for Economic Co-operation and Development, 2015). Available at *https://climatepolicyinitiative.org/wp-content/uploads/2015/11/Estimating-mobilized-private-finance-for-adaptation-Exploring-data-and-methods.pdf*
[6] Jessica Brown and others, *Improving the Effectiveness of Climate Finance: A Survey of Leveraging Methodologies* (San Francisco, Climate Policy Initiative, 2011). Available at *https://climatepolicyinitiative.org/wp-content/uploads/2011/11/Effectiveness-of-Climate-Finance-Methodology.pdf*
[7] FCCC/CP/2011/9/Add. 1., Decision 3/CP.17/, Annex V, C (2), paragraph 43
[8] Ibid., Annex I, paragraph 2
[9] Ibid., Annex V, C (2), paragraph 43

projects, rather than only a high-leverage fund that aims to maximize the quantity of co-investment.

strategic short-term

In line with the GI, strategically determine which private sector actors the GCF will target[10] and identify and adopt the appropriate modalities for engaging them.

operational long-term

Accordingly, determine and foster ambitious targets for private sector engagement in all GCF result areas. Develop and scale solutions by sharing new tools, methods, technologies and innovation to achieve these targets, such as systems for results management, including by drawing lessons from comparable climate funds[11].

operational short-term

Adopt a policy on concessionality to require project proposals to systematically assess wider market conditions to determine the private sector's appetite to bear identified risks, the additionality of the GCF finance proposed, and the level of concessionality required to make the project viable. As part of the internal guidance of the GCF on how the policy on concessionality will be applied, indicate that project proposals should only be approved if they demonstrate that GCF finance is targeting identified risks that the private sector is not willing to bear. Where the additionality of the GCF's support is weak, do not undertake any engagement.

operational short-term

Develop and adopt metrics and reporting for measuring the catalytic impact of interventions that do not focus narrowly on leverage ratios, and ensure adaptive management of the project.

operational long-term

Target the private sector portfolio towards higher-risk transformative projects that involve early stage technologies or business models that are not commercially viable, or towards geographies that are high risk due to high interest rates, weak regulatory frameworks, lack of capacity and the like, even if that means funding projects primarily through grants or highly concessional terms that are potentially loss making.

Recommendation 2: The Secretariat should enhance the speed and transparency of GCF operations to align with private sector needs for efficiency and predictability.

operational short-term

Streamline the accreditation process, and thus operationalize the USP priority (Section 4.4, Paragraph 26, Letter B).

operational short-term

Streamline the project approval process, and thus operationalize the USP priority (Section 5.1, Paragraph 29, Letter B).

[10] For instance, actors may range from fishers and farmers, MSMEs, to international banks, heavy industry and/or corporations.
[11] See the Global Environment Facility's Private Sector Strategy for early lessons for targets on catalysation and measurement of results.

operational short-term

Clarify the overall objectives of the PSAA and whether it is intended to address private sector needs. Accordingly, adjust the piloting of the PSAA.

operational short-term

To ensure transparency and accountability, consider using an online tracking system, published average response times for decisions, and incentives to Secretariat staff for rapid processing, among other things.

Recommendation 3: The Secretariat should take measures to ensure that private sector projects are country owned. Access to the GCF should be informed by a country-driven approach, directed and prioritized by the NDC gap analysis.

strategic short-term

In operationalizing strategic priority 4.1 of the USP, ensure that the accreditation of private sector entities and programming of private sector projects are also informed by country programmes.

strategic long-term

At the request of countries, provide the means to include the private sector in multi-sectoral planning on financing the implementation of NDCs, national adaptation plans and other national climate plans[12].

strategic long-term

Promote strong alignment between national climate strategies and GCF private sector projects, and request that national designated authorities (NDAs) define the types of private sector projects that will be supported by the GCF in their countries, including in country programmes.

operational short-term

Following a critical review of the current experience with RFPs, consider using an RFP for NDA-defined critical projects for the private sector.

operational short-term

Go beyond the use of no-objection letters to ensure country ownership, especially for private sector projects. Ensure the engagement of NDAs, not just during project approval but throughout the life cycle. In the case of multi-country projects, once countries are selected the same process should apply.

Recommendation 4: The Secretariat should create institutional and organizational structures that operationalize direct and indirect finance for private sector activities.

strategic short-term

Clearly articulate whether it is the DMA, PSF or another part of the GCF that has the institutional responsibility and strategic priority to provide technical support and funding for the enabling environment for private sector adaptation and mitigation.

strategic long-term

Revise the GCF Readiness Strategy to ensure the following:

– Structural linkages are built between the GCF’s private sector priorities and the RPSP.

[12] Previously recommended by PSAG (GCF/B.20/12)

- The RPSP includes appropriate objectives and outcomes for supporting the enabling environment for private sector adaptation and mitigation.
- Funding is carved out for supporting the enabling environment for private sector adaptation and mitigation, in line with country climate priorities, as outlined in their NDCs. The following are examples of projects that support the enabling environment:
  + Technical support to governments for the policy and regulatory reforms required to scale up private sector adaptation and mitigation
  + Funding for local industry bodies and associations to work with governments to design locally appropriate policy and regulatory frameworks for adaptation and mitigation
  + Training of local financial institutions, including microfinance institutions, in financing adaptation and mitigation activities to unlock finance in local currencies
  + Knowledge creation and peer-to-peer learning among private businesses regarding climate risks and solutions, and improved access to and use of climate data, analysis and projections, which in turn will help to improve private sector decision-making in relation to adaptation

Recommendation 5: Set out as a strategic priority for the GCF to channel finance to MSMEs, exploring access modalities and appropriate instruments for decentralized adaptation and mitigation actions.

operational short-term

Consider the mechanism and modality through which MSMEs can access GCF finance, recognizing the differentiated needs of targeted MSMEs vis-à-vis AEs.

operational long-term

Provide readiness support to accredited local and national intermediaries to build their capacity to channel finance to MSMEs through appropriate instruments for implementing decentralized adaptation and mitigation actions.

operational short-term

Stratify the simplified approval process specifically for private sector needs, with a focus on local actors to increase the efficiency and predictability of access to financial resources[13].

Recommendation 6: The GCF Board and Secretariat should expand the focus on financial instruments and GCF support specifically to enable private sector investment in adaptation, particularly in SIDS and LDCs.

operational short-term

Enhance GCF institutional and organizational capacity on adaptation, and review investment criteria, monitoring templates and indicators for adaptation and cross-cutting projects. Align adaptation investment criteria and indicators with

[13] The IEU previously recommended that the Secretariat take a tailored approach to the private sector and include a separate sub-strategy for attracting the private sector within a future SAP modality/modalities strategy. See: GCF, *Independent Assessment of the GCF's Simplified Approval Process Pilot Scheme, Final Report* (Songdo, South Korea, Independent Evaluation Unit, 2020).

Intergovernmental Panel on Climate Change definitions of adaptation, vulnerability, climate risks and exposures[14].

operational
short-term

Consider financial innovations tailored to needs and context.[15] Increase the GCF's risk appetite to experiment with financial instruments and business models that can help improve the economics of private sector adaptation or cross-cutting projects.

operational
short-term

Design Secretariat-level KPIs that support private sector projects in SIDS and LDCs.

[14] As previously recommended by PSAG (GCF/B.20/12), the GCF may allow for SIDS and LDCs to involve the private sector in the development and implementation of national adaptation plans and enhance peer-to-peer learning on private sector adaptation projects.
[15] As previously recommended by PSAG (GCF/B.20/12), some activities may include weather-indexed crop insurance and catastrophe risk insurance, resilience bonds, dedicated green/blue bonds and innovative financing for ecosystem-based management.

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