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ABOUT GCF

The Green Climate Fund (GCF) is the largest dedicated multilateral climate fund. It was set up in 2013 by the 194 countries who are parties to the United Nations Framework Convention on Climate Change (UNFCCC). It aims to deliver equal amounts of funding to limit or reduce greenhouse gas emissions in developing countries and to help vulnerable societies adapt to unavoidable climate change impacts.

The GCF's initial resource mobilisation in 2014 received pledges worth US\$ 10.3 billion. These funds come mainly from developed countries, but also from some developing countries, regions, and one city (Paris). As part of the ongoing replenishment of the GCF, 31 countries and two regions pledged to provide an additional US\$ 9.99 billion for the next four years (status: 30 Dec. 2020).

The GCF Secretariat is based in Songdo, South Korea. The fund is governed by a board of 24 members with equal representation from developing countries and developed countries. For more information, see: <http://www.greenclimate.fund>

GCF MONITOR

The GCF monitor reviews the progress of the GCF's efforts to respond to the challenge of climate change. Each edition analyses and briefly describes a unique topic selected because of its high importance at the recent Board meeting or other relevant event. The GCF Monitor is produced by the FS-UNEP Collaboration Centre of the Frankfurt School of Finance and Management.

Reflections on the Updated Strategic Plan

At its 27th meeting in November 2020, the Green Climate Fund (GCF) Board adopted the Updated Strategic Plan (USP). It sets out the overall mission, strategic objectives, strategic priorities as well as operational and institutional priorities for the 2020-2023 period (GCF-1).

The USP builds on the initial Strategic Plan of 2016. Since then, the context in which the GCF operates has evolved significantly. The Paris Agreement has entered into force and the GCF itself has matured: it has a substantial pipeline of projects and programmes, a large number of Accredited Entities (AEs) and a successful first replenishment has ensured the continued development of its activities. This GCF Monitor selects four aspects of the USP for further analysis based on their innovation and strategic relevance for successfully implementing the USP: 1) diversifying financial instruments; 2) prioritising the accreditation of entities; 3) making finance flows consistent with low-carbon and climate-resilient development; and 4) loss and damage. The recommendations section provides suggestions on how the Board could address these topics as it updates the Workplan for 2020-2023 during its upcoming Board Meeting in March 2021.

Key messages

- There might be a conflict between the diversification of financial instruments against the types and coverage of existing and new AEs in the short to medium-term. The GCF can address this issue through strategic accreditation and working with existing entities to upgrade their accreditation status.
- As countries move forward to tackle the climate consistency of finance flows (art. 2.1(c) of the Paris Agreement), it is essential for the GCF to reflect on its own supporting role for related activities. This includes how it may provide a more targeted support for transforming national financial sectors, from readiness and preparatory support (RPSP) to specific sectoral guidance and engagement of GCF partners, such as with requirements during reaccreditation that AEs demonstrate steps towards shifting their portfolios towards climate consistency;
- Although the GCF is already financing projects that directly or indirectly tackle loss and damage (L&D), this topic's inclusion in the USP allows for new proposals to take action on L&D more explicitly. The Secretariat now needs to effectively integrate L&D in future GCF planning through, for example, RPSP, sectoral guidance and development of country programmes.



Introduction

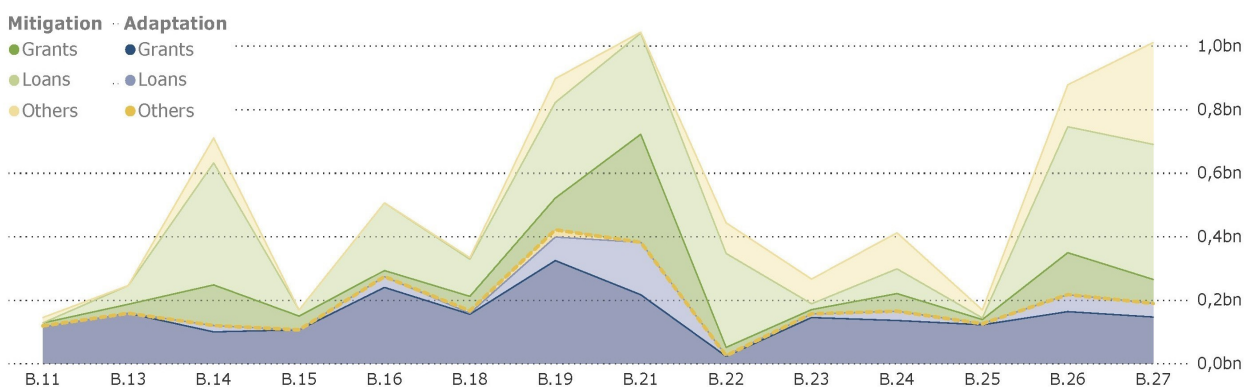
Building on its initial Strategic Plan of 2016, the Updated Strategic Plan (USP) offers high-level direction for the realisation of the GCF’s overall vision to promote the paradigm shift towards low-emission and climate-resilient development in the context of sustainable development and to support developing countries’ efforts to reach the targets set by the international community.

1. Diversifying financial instruments

The USP sets the strategic goal of ‘enabling countries and AEs to choose from a flexible range of financing instruments offered by the GCF’ (USP 2.2.11). This allows the GCF ‘to take risks to unlock climate action and de-risk more conservative sources of finance’. Diversification of financial instruments can help to promote a larger variety of projects, while having a multiplier effect on GCF resources towards its objective of achieving a paradigm shift. Financial instruments differ by characteristics such as repayments and risks involved in investing in them. Depending on the fiduciary standards of the proponent AE, the GCF can offer (reimbursable) grants, (sub- and senior-) loans, result-based payments (RBP), equity and guarantees. As illustrated in Figure 1, grants and loans are the primarily used instruments. Since the approval of the first funding proposal in B.11, the share of more diverse use of GCF instruments is slowly evolving in mitigation projects. While adaptation projects are primarily grant-financed, loans are cumulatively the main instrument used in mitigation projects.

A keyword when it comes to deploying GCF’s full range of financial instruments is ‘innovation’, which is consolidated as a direction for the USP period – i.e. in the context of GCF’s risk appetite (USP 4.2.19.c), of structuring innovative investments (4.2.20.b) and of deploying blended finance to test innovative business models in adaptation (4.2.23.e). The use of innovative instruments in complement to grants and loans increases the expectation of potential co-financiers to mobilise additional funds, thus improving the potential impact. It also produces a mainstreaming effect of GCF climate goals and standards through the engagement of new financial actors, besides performing a demonstration role to governments and private sector on novel set ups that can enable different types of climate projects around the world. A clear example would be the consolidation of innovative financing structures which can be replicated to crowd-in domestic and foreign direct investment into adaptation projects, broadening the range of financing options for different developing countries’ needs and contexts. The meaning of innovation depends on its context. What might be outdated in one country, sector or aim, might be innovative somewhere else. For example, while loans are standard for mitigation projects, a minor loan component to a grant-based adaptation project without considerable revenue streams might be highly innovative. Such a new component may, among others, enable the expansion in the number of beneficiaries or the involvement of other national actors in the project implementation. In terms of thematic focus, most adaptation projects have thus far used grants as the only financial instrument.

Figure 1: GCF funding volume over time by instruments



Note: Project funding volume has been disaggregated by adaptation and mitigation result areas and accumulated by board meeting. Because GCF result area contributions are differentiated only by mitigation and adaptation, cross-cutting projects have been proportionally split into mitigation and adaptation according to projects’ specification. *Grants* include Grants and Reimbursable Grants. *Loans* include Senior and Sub Loans. *Others* include Guarantees, Result-Based Payments and Equity investments.



In contrast, both mitigation and cross-cutting projects often use multiple instruments. Numerically, mitigation projects with two [three or more] instruments (n=19 [n=5]) have an average project size of USD 70m [98m], which by far exceeds the average project size of USD 50m for mitigation projects that only use one instrument (n=28). A deeper analysis is needed to clearly assess the drivers behind this observation.

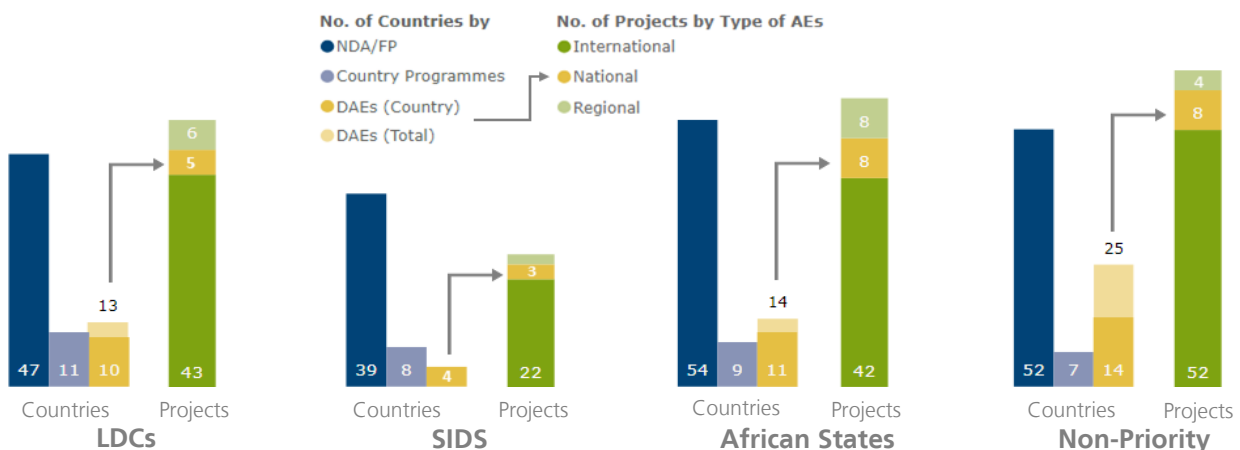
When pursuing the USP-mandated diversification of financial instruments as a means to achieve project diversification and innovation, the GCF might face some challenges from its own processes, such as accreditation-related categories. The majority of AEs that submit adaptation proposals are accredited only for basic project management and grant award, without the option to apply for on-lending and/or blending (for loans, equity and/or guarantees). Out of the 20 DAEs with at least one approved project, only seven have the fiduciary standards to access funds through guarantees and equity. For international AEs, this number is 11 out of 22. This reflection on the current accreditation status of AEs adds an important element to the discussion of diversifying instruments, which goes beyond the consideration of the nature of the project (e.g. adequacy or not of non-grant instruments in adaptation result areas). It is also crucial to address how the option of using various instruments may be sufficiently provided by the GCF to different countries and AEs.

2. Prioritising accreditation of entities

To date, the GCF has accredited 103 entities (41 international, 13 regional, and 49 DAEs), with diverse status of accreditations, track records, type of accreditation and areas for project implementation. Building on the characteristics of the GCF country-driven approach, the USP states that the GCF business model will include a 'more strategic approach to accreditation' and aspires to a 'sufficient coverage across regions [...] and financial instruments'. The development of AE participation can be considered as key to ensure that 'all countries have coverage and choice of AEs' (USP 4.4.26.a).

Figure 2 shows the number of countries with an NDA or Focal Point (blue bar), with a Country Programme (purple bar) and with National DAEs in the country (yellow bar), highlighting the distribution of access across the GCF's priority countries (SIDS, LDCs, African States) and non-priority countries. Per country, the SIDS have the lowest number of DAEs, but nevertheless they have a relatively large number of projects. SIDS' total number of four DAEs have implemented three projects, which represents a high share compared to other priority regions. African States, on the contrary, have a larger number of DAEs (14 DAEs in 11 countries), but a relatively low number of active projects (n=8) by those DAEs.

Figure 2: Country participation and access to GCF resources



Note: Numbers on LDCs, SIDS, and African States are partly overlapping, since several countries belong to more than one group. In total, 147 countries designated a NDA/FP (blue bar), of which 52 are non-priority countries and 95 are LDCs, SIDS, and/or African States. In total, 26 country programmes are available (purple bar). In case there is more than one DAE per country (e.g. Senegal has two DAEs, Centre de Suivi Ecologique and La Banque Agricole), it is only counted as one (dark yellow), Total number of DAEs (n=49) is shown in lighter yellow and numbered in black font in case of deviation from country number. Regional DAEs (n=13) are not mapped in the regional breakdown because of unclear country coverages. Project database based on 159 projects (up to B.27) (right bar). Grey arrow connects number of national DAEs with their respective total number of projects

Non-priority countries have the largest number of DAEs (25 DAEs in 14 countries), but this has not resulted in a higher share of projects (n=8) being implemented by DAEs. These insights demonstrate that access to and choice of AEs, rather than coverage, are key to move forward. A country-driven and strategic choice of AEs can ensure access to different financial instruments, attending different priorities and project specificities, while ensuring a faster and impactful deployment.

Since a large share of DAEs has been accredited so far only to provide grants (see Section 1), the USP goals of focusing more on DAEs and using more diverse instruments might be conflicting. We advise how to address this issue on the recommendations' section below.

3. Shifting financial flows

As one of the three objectives of the Paris Agreement, the goal of making finance flows consistent with low-carbon and climate-resilient development (art. 2.1(c)) has been explicitly included as part of the USP. While measures to address art. 2.1(c) are still developing globally, a few consolidated understandings can provide initial guidance on how the GCF can support developing countries' efforts.

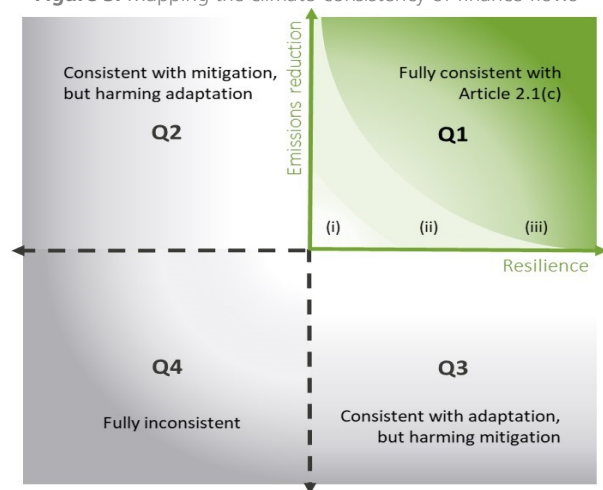
Traditionally, climate finance has channelled investments to the real economy, requiring the production of benefits – 'additionality' – to climate objectives. While still central for climate action, the committed role of finance as a means for creating climate additionality in developing countries is now complemented by a new and broader financial objective. Article 2.1(c) innovates by highlighting the big picture and pointing out to the need of a global transformation, which should involve the consistency of all finance flows. .

Figure 3 illustrates the entirety of global finance, with Q1 representing the particular climate consistency of finance flows. Finance can be understood as 'consistent' when it flows to activities: **(i)** with no effects (neutral) or only indirect positive effects (co-benefits) to climate objectives; **(ii)** specifically targeted at producing climate benefits (mitigation and/or adaptation); or **(iii)** with a significant transformational characteristic. 'Inconsistency' to art. 2.1(c) refers to any finance flow focusing only on mitigation (Q2) or adaptation (Q3) which produces detrimental effects to the other climate objective, and finance that

harms both climate objectives (Q4). Ultimately, the Paris Agreement signals that all finance harming at least one climate objective (Q2, Q3 or Q4) should progressively cease its harmful role, then becoming climate consistent (Q1). Finance flows into climate consistent activities (Q1) with a transformational characteristic (iii) acquire a particularly relevant function in this direction. They can re-orientate flows away from inconsistent activities (Q4), exert pressure to bring inconsistent activities (Q2, Q3, Q4) to consistency or boost larger scale benefits for climate objectives.

Given the GCF's objective of promoting a paradigm shift, all its funding to developing countries should already strive to support, at least in theory, activities with a transformational characteristic (within the dark green area of Fig. 3). That did not change with art. 2.1(c). However, by underlying the focus on 'finance flows' as an agreed means, art. 2.1(c) created the need of measures particularly targeted at transforming the financial system. The USP consolidated the GCF's role in supporting the alignment of finance flows to countries' climate plans and strategies. It reflected art. 2.1(c) by recognising the role of the private sector and the need to support climate oriented financial systems, green banks, markets and institutions (USP 4.3.22.a). Actions should include the capacity building of local private sectors, NDAs and AEs (4.3.22.a) and the support to climate investment capabilities of national financial institutions, the possibility of using the GCF accreditation process to effect an additional alignment of financial flows and options to explore partnerships with long-term institutional investors (4.3.23.b)

Figure 3: Mapping the climate-consistency of finance flows



Source: adapted from Cochran and Pauthier (2019) and Jachnik, Mirabile and Dobrinevski (2019).



The explicit involvement of the broader GCF ecosystem complements the implicit action that already exists in the GCF portfolio and project pipeline. For example, even without mentioning art. 2.1(c), some approved projects already support the transformation of national financial systems, either by focusing on local financial institutions (FP095 and FP149) or by facilitating access to finance for populations financially affected by climate impacts and risks (FP061). Moving forward, GCF's support to developing countries should include more targeted activities that explicitly focus on the climate consistency of national financial systems, such as with the improvement of finance-relevant climate information (e.g. sectoral definition of climate consistency; climate disclosure standards and norms) or projects that particularly seek to re-orient finance flows (e.g. climate-focused capacity building and peer learning, support to the inclusion of climate considerations to financial regulation, development and deployment of financial instruments, etc.).

4. Loss and damage

Over the last decade, loss and damage (L&D) associated with climate change impacts has become an increasingly important topic at the UN climate negotiations. The GCF, however, never had an explicit mandate on L&D until the recent guidance that followed from the UN climate negotiations in Madrid in December 2019 (UNFCCC, Decision 12/CP.25). The guidance invites the GCF 'to continue providing financial resources for activities relevant to averting, minimising and addressing loss and damage in developing country Parties, to the extent consistent with existing investment, results framework and funding windows and structures of the GCF, and to facilitate efficient access in this regard' (Decision 12/CP.25). The Updated Strategic Plan includes similar wording.

[Kempa et al. \(2021\)](#) demonstrates both that the institutional set-up of the GCF already offers broad opportunities to integrate action on L&D into its projects and that the GCF is already providing finance, mostly grant based and particularly to avert and minimise L&D. Almost a quarter of the GCF's approved projects explicitly mentions L&D, with 16% linking L&D to their main project activities. However, improvements should be considered: in particular in terms of increasing activities that explicitly address L&D and of enhancing access (see Kempa et al., 2021).

Recommendations

The USP succeeded to advance important issues relating to the improvement of the GCF business model and managed to reflect topics that are increasingly key for climate action. However, with less than three years remaining of the First Replenishment Period (GCF-1) covered by the USP, it is crucial that both the Secretariat and the Board are consistent in integrating such USP innovations as part of their current working agenda and into the relevant policy reviews and updates.

Diversifying financial instruments: the diversification of financial instruments must be particularly reflected in the update of terms and conditions of the GCF's instruments and the policy on concessionality. The topic should also be taken up in other key policies, such as the GCF support to adaptation, the review/update of the Board's 2020-2023 Workplan, of the Readiness Programme and Strategy 2022-2023 and of the incremental and full cost methodology.

Prioritising accreditation: actions should be taken by the Secretariat to improve the capacity of potential and accredited entities, while aiming to increase the number of AEs proposing projects. This requires the issue to be taken up in the Review of the Secretariat capabilities to implement the USP (in particular relating to capacity needs) and the Financial plan to manage the commitment authority for GCF-1. Considerations on access and entity choices should be reflected on policy updates such as on the updated accreditation framework, including the PSAA, as well as the policy guidelines on the programmatic approaches. It is also crucial that they are addressed in the next review and update of the Readiness Programme and Strategy 2022-2023.

Considering that a large share of DAEs has so far only been accredited to provide grants, the USP goals of focusing more on DAEs and diversifying instruments might be conflicting. The GCF has at least three options to address this issue:

- Active support so regional and direct AEs can expand their fiduciary standards in relation to instruments, project size and geographic coverage. For example, readiness and preparatory support can help to (re-)accredit and/or broaden the accreditation status of DAEs;

- Continued accreditation of new DAEs and/or ensuring that more accredited DAEs become project implementers. NDAs should be involved in a more proactive and strategic consideration of DAEs against country climate needs and strategies, as well as accreditation-related issues.
- Advances on the Project-Specific Assessment Approaches (PSAA) could offer opportunities to deploy a wider range of financial instruments while enabling the work with new national and regional entities.

Shifting finance flows: Among the range of activities that may lead to a paradigm shift, art. 2.1(c) highlights the necessity to also address the transformation of financial systems according to countries' climate strategies.

- This should be centrally reflected by the GCF in the updated Readiness Programme and Strategy for 2022-2023, the review of the Private Sector Facility modalities & strategy, and the updated Accreditation Framework (i.e. expecting a climate progress/shift on AEs' portfolios in their re-accreditation).
- Investments to transform the financial sector can impact any or all the GCF's eight results areas, but the financial sector itself is not captured in particular by any sectoral guidance. Given its relevance and specificities, a financial sector-focused guidance should be seriously considered.
- GCF Support to Adaptation might reflect how to engage and support the adaptation-focused transformation of national financial systems.

Loss & damage: As the first steps, the Secretariat must work on how to reflect L&D considerations in funding proposals and country programmes, as well as consider ways to include L&D in sectoral guidance. This should be reflected

in the Secretariat's 2021 work programme and budget. An explicit approach to L&D should be also integrated in the update of the Readiness and preparatory support. If these do not sort effect within this funding period, more far-reaching options could be considered in the context of a more comprehensive, strategic and extensive discussion by the Board on the role and niche of the GCF in relation to the funding of the whole breadth of L&D measures (Kempa et al., 2021).

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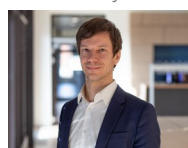
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