CLIMATE INVESTMENT FUNDS

CTF-SCF/TFC.9/10/Rev.1
October 15, 2012

Joint Meeting of the CTF and SCF Trust Fund Committees
Istanbul, Turkey
November 2, 2012

Agenda Item 7

CIF AND THE EMERGING FINANCIAL ARCHITECTURE FOR CLIMATE CHANGE

PROPOSED DECISION

The joint meeting of the CTF and SCF Trust Fund Committees, having discussed the document CTF-SCF/TFC.9/10/Rev.1, *CIF and the Emerging Financial Architecture for Climate Change*:

a) recognizes and welcomes the progress that is being made on climate finance within the UNFCCC, including under the Standing Committee of the UNFCCC, and the Green Climate Fund;

b) requests the CIF partners, including countries, MDBs, the CIF Administrative Unit and observers, to share lessons and experiences from the CIF with those deliberating on climate finance within the UNFCCC and the GCF;

c) agrees to monitor developments in the elaboration of the operational procedures and modalities of the GCF so as to determine when it is timely and appropriate to give in-depth consideration to operational, financial and legal issues associated with the CIF sunset clause; and

d) agrees that the CIF could be a useful channel for providing additional finance to developing countries as the GCF's structures are put in place in the post 2012-period, and requests the CIF Administrative Unit to provide information to the committees on any decisions relevant to this issue taken at the eighteenth session of the Conference of the Parties to the UNFCCC in December 2012.

I. INTRODUCTION

1. At its meeting in May 2012, the PPCR Sub-Committee requested the CIF Administrative Unit to prepare a paper outlining questions and issues related to relationships between the CIF and the emerging climate finance architecture, in particular the Green Climate Fund (GCF), as a basis for discussion at the November 2012 joint meeting of the CTF and SCF Trust Fund Committees.

2. This discussion note presents a preliminary set of questions and issues to set the parameters for an initial discussion at the November 2012 joint meeting of the CTF and SCF Trust Fund Committees. Given both the political and technical complexities of this issue and the evolving international deliberations on climate finance, it is expected that further consideration of these and other strategic issues will take place at future CIF Trust Fund Committee meetings and that those continued discussions will be informed by the deliberations of other bodies outside the CIF governance structure, particularly those of the UNFCCC and the GCF Board.

II. BACKGROUND

3. A common objective of multilateral climate finance mechanisms is to provide streamlined financial support to developing countries to address climate change consistent with the provisions of the UNFCCC. In this context, both the CIF and other multilateral climate funding entities have been designed to include provisions to promote coherence and complementarity in delivery of financial support.

The Climate Investment Funds

4. The CIF were designed to provide scaled-up financing, through the MDBs, to initiate transformational change towards climate resilient, low emissions development. During the design of the CIF, governments emphasized the importance of generating lessons learned from delivery of climate finance investments at scale, including through piloting new delivery methods such as programmatic approaches. Governments underscored that the CIF would evolve within, and be responsive to, the context of the international deliberations on climate finance within the UNFCCC negotiations. In this regard, the CTF and SCF governance frameworks include the following provision[1]:

> "Recognizing that the establishment of the CTF/SCF is not to prejudice the on-going UNFCCC deliberations regarding the future of the climate change regime, including its financial architecture, the CTF/SCF will take necessary steps to conclude its operations once a new financial architecture is effective. Specifically, the Trustee will not enter into any new agreement with donors for contributions to the trust fund once the agreement providing for the new financial architecture is effective. The Trust Fund Committee will decide the date on which it will cease making allocations from the outstanding balance of the Trust Fund.

[1] CTF Governance Framework, paragraphs 53 and 55; SCF Governance Framework, paragraphs 56 and 58

Notwithstanding the above paragraph, if the outcome of the UNFCCC negotiations so indicates, the Trust Fund Committee, with the consent of the Trustee, may take necessary steps to continue the operations of the CTF/SCF, with modifications as appropriate."

The Standing Committee on Finance under the Convention

5. In its decision 2/CP.17 the UNFCCC Conference of Parties (COP) established a Standing Committee on Finance. The Standing Committee is to assist the COP in exercising its functions with respect to the financial mechanisms of the Convention in terms of improving coherence and coordination in the delivery of climate change financing, rationalization of the financial mechanism, mobilization of financial resources, and measurement, reporting, and verification of support provided to developing country Parties.

6. The Standing Committee held its first meeting in September 2012. At this meeting the Committee developed a draft work plan to structure its work. This work plan will be finalized at the Committee's next meeting in early October 2012. A key function identified in the draft work plan is improving coherence and coordination in the delivery of climate change financing, including through dialogue and interaction with delivery channels outside the financial mechanism of the Convention. Such dialogue is intended to promote sharing of lessons learned and coherence among channels of climate financing.

The Green Climate Fund

7. The establishment of the GCF was agreed in UNFCCC decision 1/CP.16 in December 2010 in Cancun, Mexico. In 2011, an intergovernmental Transitional Committee designed the fund's governing instrument, which was approved in decision 3/CP.17 in Durban, South Africa.

8. In 2012, governments constituted the GCF Board and an interim secretariat. The first meeting of the Board took place in August 2012 and began consideration of the broad range of policies, procedures, and modalities needed to structure the fund. A second meeting of the Board is scheduled for October 2012.

9. During the initial negotiations on the design of the GCF, a central issue has been the relationship between the GCF and other climate finance institutions, both within and outside the Convention. The GCF Board intends to consider this issue during its design work.

10. There are a number of relevant references in the GCF's design documents:

UNFCCC Decision 1/CP.16 states:

"[The Transitional Committee will consider] methods to enhance complementarity between the Fund's activities and those of other bilateral, regional and multilateral funding mechanisms and institutions;"

> Paragraph 33 and 34 of the GCF Governing Instrument state:
> "The fund shall operate in the context of appropriate arrangements between itself and other existing funds under the Convention, and between itself and other funds, entities, and channels of climate change financing outside the fund. The Board will develop methods to enhance complementarity between the activities of the fund and of other relevant bilateral, regional, and global funding mechanisms and institutions, to better mobilize the full range of financial and technical capacities…"

III. KEY QUESTIONS AND ISSUES

11. As the CIF moves into full implementation, the UNFCCC bodies continue their work related to climate finance, and the GCF Board prepares the detailed operational design of the GCF, a range of key questions and issues related to the interaction between the CIF and the wider climate finance architecture can be considered.

Lessons Learned and Experiences

12. In line with its mandate and aims, CIF partners (including the CIF Administrative Unit, MDBs, and observers) are making every effort to share lessons and experiences with those deliberating on climate finance within the UNFCCC, in particular, with the Standing Committee on Finance and those considering the work program on Long-term Finance. In addition, the CIF Administrative Unit has engaged in constructive dialogue with the UNFCCC Secretariat to identify avenues and options for sharing CIF experiences with the Standing Committee. CIF partners, including MDBs, are now actively engaged in the work of the Standing Committee and UNFCCC discussions on climate finance more broadly.

13. In addition, should the GCF Board and/or Secretariat request, the CIF Administrative Unit and the MDBs are available to bring their experience to the GCF governing and technical bodies to inform the development of procedures and modalities for the GCF.

Near-term Considerations

14. At present the CIF remains the main multilateral vehicle for supporting climate change investment activities in developing countries. Given the urgency of achieving results in the area of climate-resilient low-emissions development, and the high demand from recipients, it is important to ensure continued support for developing countries from the multilateral system. This was highlighted by Parties and observers at the UNFCCC informal negotiating session in September 2012 in Bangkok, Thailand. Both verbal and written interventions, particularly from developing countries, underscored the importance of scaling up the volumes of climate finance post-2012 as well as access to these resources.

15. The GCF Board's draft work plan indicates that intensive design work will likely continue well into 2013, with pipeline development then taking place following the adoption of policies and procedures. To ensure continued support to investment activities, the CIF could provide additional or transitional finance to developing countries as the GCF's structures are put into place and thus act as a finance bridge post-2012. Given that the majority of resources that

have been pledged to date have been allocated by Trust Fund/Sub-Committees, additional resources would be required for this. Such activities could expand support in existing CIF recipient countries; expand support to new recipient countries and/or pilot new approaches.

Medium-term Considerations

The Sunset Clause

16. Paragraph 4 above sets for the provisions of the sunset clause. It is suggested that the determination by the Trust Fund Committees of the "effectiveness" of the new financial architecture, which would be the trigger for considering the arrangements associated with the sunset clause, should take into account discussions of the relevant UNFCCC institutions, including the Standing Committee on Finance, and/or the GCF Board. The CIF Trust Fund Committees should continue to exchange information with, and monitor developments in these institutions moving forward, so as to determine when it is timely to give in-depth consideration to the issues associated with the sunset clause. At such time, the Trust Fund Committees will also need to consider the operational, legal and financial issues that may arise from the sunset clause, taking into account the perspectives of the recipient countries, the contributor countries, Trustee, the MDBs, as well as other stakeholders.

17. Given that the GCF does not currently have the capacity to support climate investment projects and programs in developing countries, there may be a continued role for the CIF as the GCF develops its operational procedures and policies, funds readiness activities, and facilitates a pipeline of investment projects over the coming years. As noted above, within the UNFCCC fora there is growing discussion regarding the benefits of using existing multilateral institutions, such as the GEF, the Adaptation Fund, and the CIF, to continue channeling additional finance to developing countries, thus serving as a finance bridge post-2012.

Other Scenarios

18. The CIF governing documents provide for the option of continuing the operations of the CIF if the outcome of the UNFCCC negotiations so indicate. In this regard, the GCF governing instrument provides for its Board to discuss arrangements between itself and other funds to promote complementarity and coherence. It is expected that any discussions within the UNFCCC on the future operations of the CIF would be within the context of the evolving business model and detailed structure of the GCF, and information would be forthcoming from the GCF Board on this issue.

Related Questions for the CIF

19. These strategic questions and issues impact on other decisions on the operations of the CIF. If new resources were to be made available to the CIF in the near term as one pathway to ensure continued support for developing countries from the multilateral system while the GCF Board undertakes it design work, consideration would need to be given to the best uses of such resources.

20. At their May 2012 meetings, the CIF Trust Fund Committees/Sub-Committees deferred decisions on a number of issues related to the structure and operations of the CIF until they have further clarity on the future of the CIF. These issues included, in particular, addition of new implementing entities (such as EIB, KfW, and AfD, all of which submitted proposals to the meeting in May 2012).

21. Consideration would also need to be given to the model to be followed in allocating any additional resources. One option would be to apply the current model of developing country-based investment plans to new recipient countries that have expressed interest in participating in the CIF or to allocate additional resources to those countries that are already working with the CIF.

22. Another option would be to explore new ideas or approaches, taking into account the lessons learned to date in the CIF. These could lead to new targeted programs or new approaches to be piloted under the existing programs, as outlined in the annex.

23. The CIF Administrative Unit and the MDB Committee have received a range of proposals for new approaches and activities that could usefully be piloted/tested under the CIF while both maintaining flows of climate finance post-2012 and generating expanded lessons for the future financial architecture. These new approaches would make use of the established systems and structures of the CIF and build on its comparative advantages. These approaches all propose a somewhat different model for allocating future additional resources: either a different emphasis at the program level than the current CIF programs or a different approach for identifying and allocating funds to activities within programs.

24. The annex provides an indicative "sample" of some of the ideas that have been proposed. Should there be an interest in exploring any of these approaches, specific ideas and proposals could be further developed with interested contributor countries and eligible recipient countries, building upon the experiences and lessons learned since the CIF were first designed and taking into account the overall purpose and principles of the CIF and other on-going activities in the international system.

Annex: Examples of possible new 'thematic programs' under the CIF

1. The ideas in this annex are presented to stimulate discussion and feedback.

2. *Strengthening climate investment readiness/preparedness:* As the GCF Board works to design the operational procedures and systems for making the GCF fully operational, there is an opportunity for interested parties such as contributor countries, recipient countries, and MDBs, to collaborate in the framework of the CIFs to prepare in a strategic manner for future access to climate investment finance, including funding from the GCF. These preparatory and readiness activities could include:

   a) support to prepare or strengthen low-emission and/or climate resilient development strategies or plans, and strengthening in-country institutional arrangements, including capacities for coordination, fiduciary standards, and environmental and social safeguards; and

   b) support for the preparation of public and private sector investments (scoping, surveys, pre-feasibility assessments, environment and social assessments, economic analyses) to prepare a pipeline of investment projects that can be proposed by national, and where appropriate, regional entities for funding from the emerging climate finance.

3. *Targeting a specific technology*: funding could be directed towards promoting scaled-up investment in a specific technology, either to overcome identified bottlenecks or systemic risks, and/or to bring down costs through coordinated deployment. The program could be focused, for example, on a particular technology (such as geothermal energy, carbon capture and storage, or minigrids) which has the potential to contribute a significant share of clean low cost electricity supply in several low and middle-income countries. Funding through the program would provide risk capital needed for the MDBs to promote innovative investments to reduce risks, and a scaled-up level of funding should trigger sufficient investments by the CIF and other partners to bring down the costs of the technology by taking a portfolio approach across multiple countries and projects. Eligibility criteria for technology-specific thematic programs could be based on whether the proposed project or program had a high potential for transformation and long-term GHG reductions. Programs could be open to projects from both low and middle income countries. A technology-focused program could include incentives for financial innovation, leverage and private sector engagement

4. *An expanded approach to the management of transboundary resources:* The current country-based approach of the CIF has meant that it is not possible to address the climate smart management of transboundary resources. This is a cross cutting issue in all the CIF programs. For example, challenges in the management of transboundary natural resources, such as inland water bodies, forests, and coastlines, will be exacerbated by climate change, but these have not been addressed in the PPCR or the FIP. The variability in river flows, erratic precipitation levels, increasing temperatures and sea level rises will impact the sustainable use of these resources. In Africa, for example, more than 60% of the water resources are transboundary while transboundary forests cover approximately 21% of the African landscape. Providing new

resources to the PPCR or FIP to develop investment plans and implement projects under these investment plans in collaboration with countries sharing a transboundary natural resource could generate important lessons and results.

5. *Sub-regional or regional programs*: within CIF programs, such as the CTF and SREP, it may be beneficial to explore opportunities for sub-regional or regional programs that could effectively and efficiently address the objectives of the program through bringing together countries in close geographic proximity to promote renewable energy and energy efficiency improvements through technical collaboration and jointly developed investment programs and projects.

6. *Targeted funding for instruments that deepen the engagement with the private sector*: through the operations currently funded by the CIF and through the normal development activities of the MDBs, a number of financial instruments that could increase the engagement of the private sector in addressing climate issues have been tested but they are not yet widely and sufficiently used. Alternatively, other approaches, such as results based financing, need to be further tested to see how they can best be used to achieve climate finance objectives.

7. For example, over the last 15 years, many MDBs have tested, and in some cases standardized, their provision of first loss guarantees – sometimes called “risk sharing facilities” – to financial institutions (“FI”) for the purpose of incentivizing those FIs to develop and finance a portfolio of renewable energy and energy efficiency projects. These investments have been made with target local banking sectors, where market failures are most obvious and project sponsors are frequently unable to obtain economically viable debt financing. Concessional funding is provided to partially cover the first loss portion of a bank’s renewable or energy efficiency portfolio, and to reduce the overall pricing of the guarantee to the FI. This approach has been proven to leverage financial intermediary contributions, promote sustainability and develop financial and sustainable energy markets in beneficiary countries. This risk-sharing/guarantee financial product for renewable and energy efficiency lending has the potential to be “scaled-up” as a standardized product offered across a wide range of FIs, including local, multi and international banking institutions. Another model has been the use of concessional finance to provide high-risk capital in the establishment of funds dedicated to lending for energy efficiency and renewable energy, where the concessional contribution aims to provide security for private investment that will be raised at a later stage.