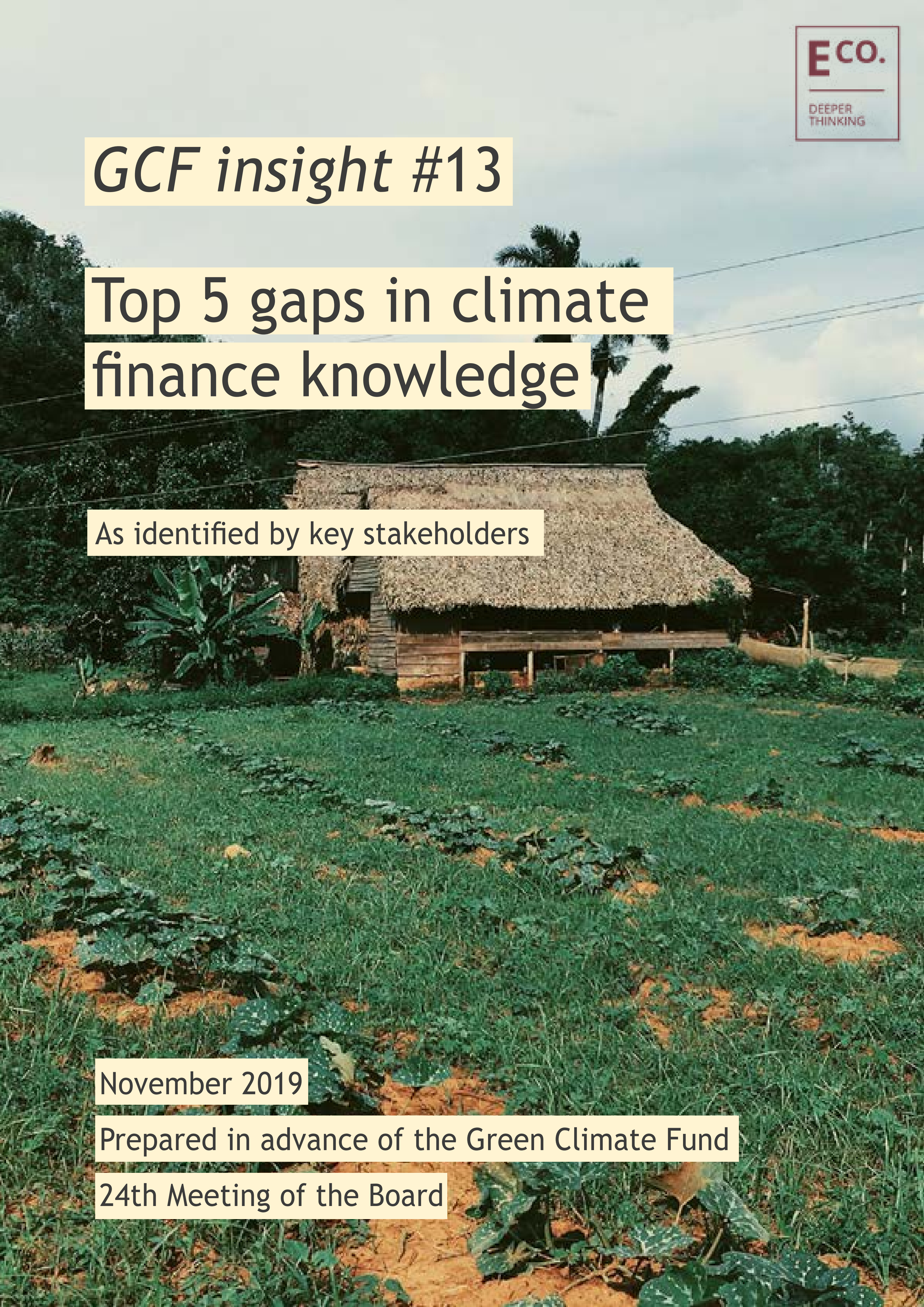


GCF insight #13

Top 5 gaps in climate finance knowledge

As identified by key stakeholders

November 2019

Prepared in advance of the Green Climate Fund

24th Meeting of the Board

GCF insight #13

Top 5 gaps in climate finance knowledge

GCF insight seeks to understand what's working — and what's not working — in Green Climate Fund (GCF) project development. These studies, conducted by E Co. consultants, spotlight the most topical GCF issues. This 13th edition explores the most significant knowledge gaps in climate finance as identified by key stakeholders and the resulting implications for the GCF.

Spotlight on climate finance knowledge

As the landscape of climate finance continues to evolve, the global discourse on its definition, mechanisms, and criteria remains a complex matter for most stakeholders. While significant progress has been made in disseminating information on climate finance flows, fund architecture and their limitations and on providing toolkits for scoping out climate finance opportunities to developing GCF Proposals, knowledge gaps persist - particularly for those stakeholders who should benefit most from accessing these funds.

Monitoring climate finance flows remains difficult, due to the lack of a universally agreed definition of climate finance itself. Moreover, benefitting from funding opportunities, requires an in-depth knowledge of project financing and donor requirements; an understanding of country specific needs; as well as insights into technologies and market dynamics.

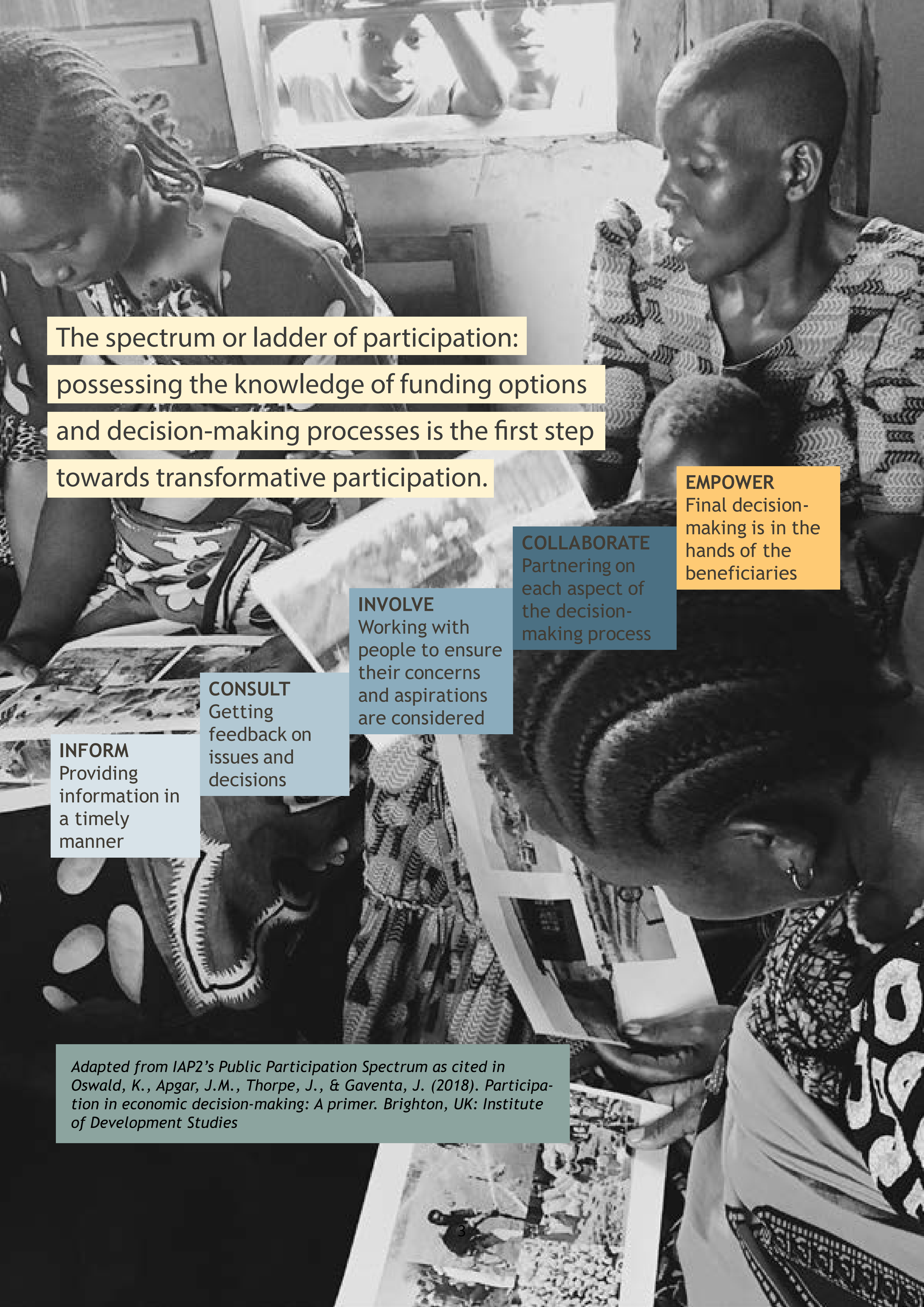
This report explores the main knowledge gaps in understanding climate finance, as identified by different stakeholder groups. We hope to shed light on key issues, necessitating further research; for better access to information; and for increasing access to climate finance.

Methodology

This report is based on findings from a study inspired by the Delphi Method, conducted by E Co. between August and October 2019.

This method, traditionally used in forecasting, relies on a panel of key experts to identify the most important themes in a subject area.
To identify knowledge gaps in climate finance, we surveyed experts from the **GCF Secretariat**, **international organisations** and **Accredited Entities** and **international consultants**.

We coded and analysed the responses of twelve experts to identify common themes regarding the greatest knowledge gaps in: understanding climate finance, its sources and mechanisms, and the challenge of complying with donor requirements.



The spectrum or ladder of participation: possessing the knowledge of funding options and decision-making processes is the first step towards transformative participation.

INFORM
Providing information in a timely manner

CONSULT
Getting feedback on issues and decisions

INVOLVE
Working with people to ensure their concerns and aspirations are considered

COLLABORATE
Partnering on each aspect of the decision-making process

EMPOWER
Final decision-making is in the hands of the beneficiaries

Adapted from IAP2's Public Participation Spectrum as cited in Oswald, K., Apgar, J.M., Thorpe, J., & Gaventa, J. (2018). Participation in economic decision-making: A primer. Brighton, UK: Institute of Development Studies

Who has what knowledge?

“In the hands of the few: climate finance knowledge is available, but it does not permeate to the stakeholders that would benefit from it.”

This study begs the question: who has what knowledge? Which groups and stakeholders are knowledgeable about climate finance, and which ones lack essential information to access funding opportunities? The results from this study indicate an information access disparity. They highlight the knowledge gaps of those stakeholders who should, in fact, be benefitting from this information.

Gaps in climate finance knowledge perpetuate imbalances between the Global North/international entities and local project developers. These imbalances are reflected across the various funds’ unequal portfolios, as revealed in a recent performance review of the GCF.[1] The aforementioned performance review highlights how an unbalanced portfolio (82% of funding committed through International Accredited Entities) is failing to enable better access to the GCF. A focus on increasing access for Direct Access Entities (DAEs) should be a key priority for the Fund moving forward. Similarly, the Independent Evaluation of the GCF Readiness and Preparatory Support Programme[2] identified significant disparities between International Accredited Entities’ leading role and a lack of support to Direct Access Entities, which has not yet translated into pipeline development.

Furthermore, readiness Delivery Partners with Framework Agreements represent 50% of implementers of the readiness portfolio.[3] Due to lengthy and complex accreditation processes, local actors are discouraged to get involved, and DAEs often lack the capacity to understand and comply with GCF policies. In line with these findings, in our *GCF insight #12 on* Country Ownership, the majority of respondents (64%) cited low institutional capacity as the greatest barrier, followed by 15% who believe requirements of the GCF exclude national stakeholders.

When talking about knowledge and access to climate finance, information is the first step for engagement, meaning that those who benefit from the decision-making should be informed, consulted, and meaningfully engaged regarding funding decisions.[4] Climate finance should act as a catalyst for transformational change and it should build on the knowledge of thousands of actors and initiatives who are at the forefront of climate action. For their voices to be heard and for them to meaningfully participate in decision-making processes, access to climate finance knowledge is a first and fundamental step.

1. Forward-looking Performance Review of the GCF (2019)
2. Independent Evaluation of the GCF Readiness and Preparatory Support Programme
3. Of the 165 RPSP country grants (approved as May 2018) 89 of them are being implemented by DPs with Framework Agreements: UNDP, UNEP, GIZ, FAO, GGGI, CAF, and CCCCC.
4. Adapted from IAP2’s Public Participation Spectrum as cited in Oswald, K., Apgar, J.M., Thorpe, J., & Gaventa, J. (2018). Participation in economic decision-making: A primer. Brighton, UK: Institute of Development Studies- graph referenced on Page 3.

Top knowledge gaps
(by stakeholder)

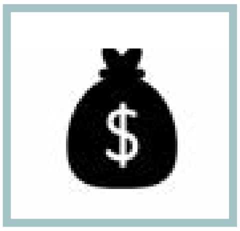
1. Climate finance fundamentals
2. Financial instruments & project finance
3. Private sector engagement
4. Local ecosystem, country context & policy frameworks
5. Trends, needs and best practices

Project developers & fund beneficiaries:

- Project finance tools and mechanisms, risks, financial sustainability, transaction costs
- Sources, fund architecture, difference from traditional development finance, fund requirements
- Accurate market trends, sensitivity analyses, sectoral analyses per technology

Market participants (eg. private sector, commercial banks):

- Availability of support mechanisms for technology providers, knowledge of commercial banks regarding investment opportunities
- Risk information, recurring issues with climate finance transactions
- Values, mechanisms and requirements associated with climate finance



Donors:

- Impacts of public vs private, sectoral and technology needs, best practices
- Understanding of climate risks and country risk profiles
- Understanding of local banking sector, country-specific risk profiles, business community needs

International community (CSOs, academia, media etc.):

- Definition, sources, fund architecture, actors active in climate finance (per technology and geography)
- Impacts of public vs private investments, sectoral and technology needs, best practices

Policymakers & governments:

- Policy frameworks to scale up investments, engaging with private sector
- Policy frameworks that promote climate investment
- Requirements for funding opportunities, sectors and opportunities under mitigation/adaptation

Top 5 climate finance knowledge gaps

FINANCIAL INSTRUMENTS AND PROJECT FINANCE **22**

CLIMATE FINANCE FUNDAMENTALS **20**

PRIVATE SECTOR ENGAGEMENT & MARKET TRANSFORMATION **17**

LOCAL ECOSYSTEM, COUNTRY CONTEXT & POLICY FRAMEWORKS **16**

TRENDS, NEEDS AND BEST PRACTICES **14**

with number of mentions by respondents

1

Climate finance fundamentals

What are the definitions, basic principles, and sources of climate finance?

One of the two most frequently mentioned themes in our research relates to a lack of knowledge regarding fundamental concepts in climate finance.

A first challenge is in defining climate finance. Though there exists no single definition of climate finance, the UNFCCC describes it as *'finance that aims at reducing emissions, and enhancing sinks of greenhouse gases and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts.'* Other key concepts such as adaptation, resilience, and paradigm shift potential are not clearly defined. Respondents highlighted that often beneficiaries have difficulties in discerning how climate finance differs from traditional development finance and humanitarian assistance.

Beyond definitions, respondents noted that many climate finance stakeholders may not have a full grasp of basic key concepts that are important to effective project formulation and investment. These concepts include defining the climate rationale for a project, explaining how the project impacts are additional to what would have otherwise occurred, understanding the various available options for mitigation and adaptation activities, and knowing which sectors are involved in climate finance initiatives.

Moreover, climate finance stakeholders may not have a full awareness of the various sources and the architecture of climate funds. Even where stakeholders can identify sources of climate finance, they may not know how to navigate accessing them. The cumbersome requirements for receiving funding further hinders stakeholders from understanding and accessing funding opportunities.

2

Financial instruments & project finance

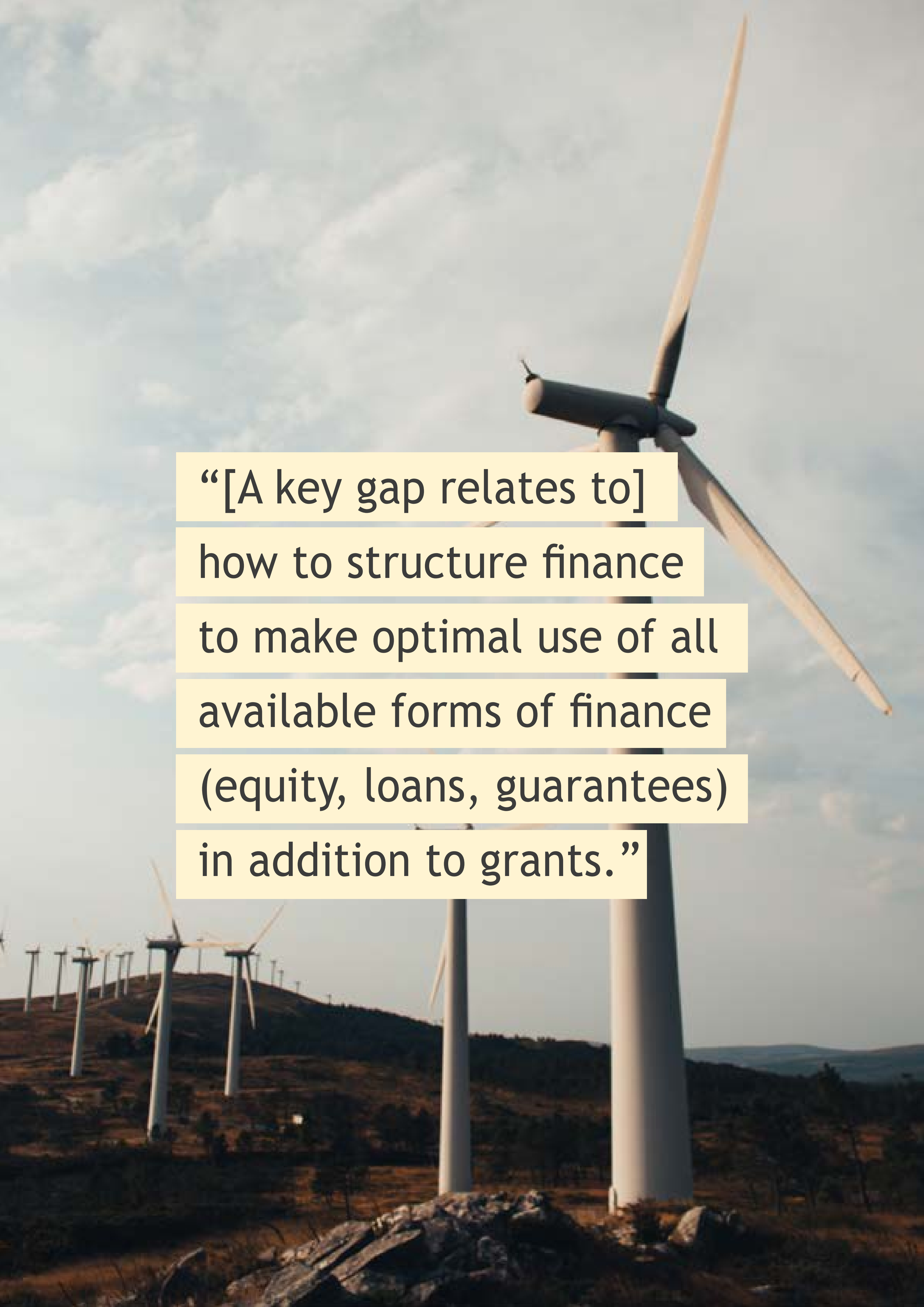
What financial instruments are available, and how can they be best employed?

Participants agreed that the largest knowledge gap (22 mentions) exists for financial instruments and project finance. In line with these findings, project finance was identified as one of the main issues for developing GCF Funding Proposals (see *GCF insight #9*): the expected performance against investment criteria and the financing/cost information were considered the most challenging sections of the proposal development.

Project developers and local governments lack a general knowledge of project financing and its different tools, as well as an understanding of financial systems. Structuring project finance to optimise available forms of funding, such as distinguishing between grants, balancing debt and equity, guarantees and other mechanisms, is seen as an essential knowledge gap. The respondents identified sectoral ministries, such as ministries of Environment, to be lacking capacities to *'analyse existing cash flows, establish alternative business models, and a general understanding of [how] project/ programmes (both public, private and PPP) can be financed'*.

These knowledge gaps hinder the ability of project developers to attract investors and to ensure that concessionality levels are appropriately determined to secure sustainable financing solutions.From a donor perspective, the study highlights a lack of capacity and experience in assessing climate risks and a lacking in understanding the risk profiles of various countries. Project developers, on the other hand, often overlook financial risks. For example assuming that loan repayment rates will be 100% - this does not reflect the reality of investment vehicles. Similarly, currency risks are too often ignored and fluctuations over multi-year projects can have a significant impact on the profitability levels of climate finance.

Another important aspect of project financing is related to financial sustainability i.e. how the project performs after the donor intervention ends. Some respondents believe this to be a key knowledge gap from a project developer's perspective. Additionally, the need for market research, due diligence, and information to select appropriate interest rates are considered key to fill capacity gaps.



"[A key gap relates to] how to structure finance to make optimal use of all available forms of finance (equity, loans, guarantees) in addition to grants."

3

Private sector engagement and market transformation

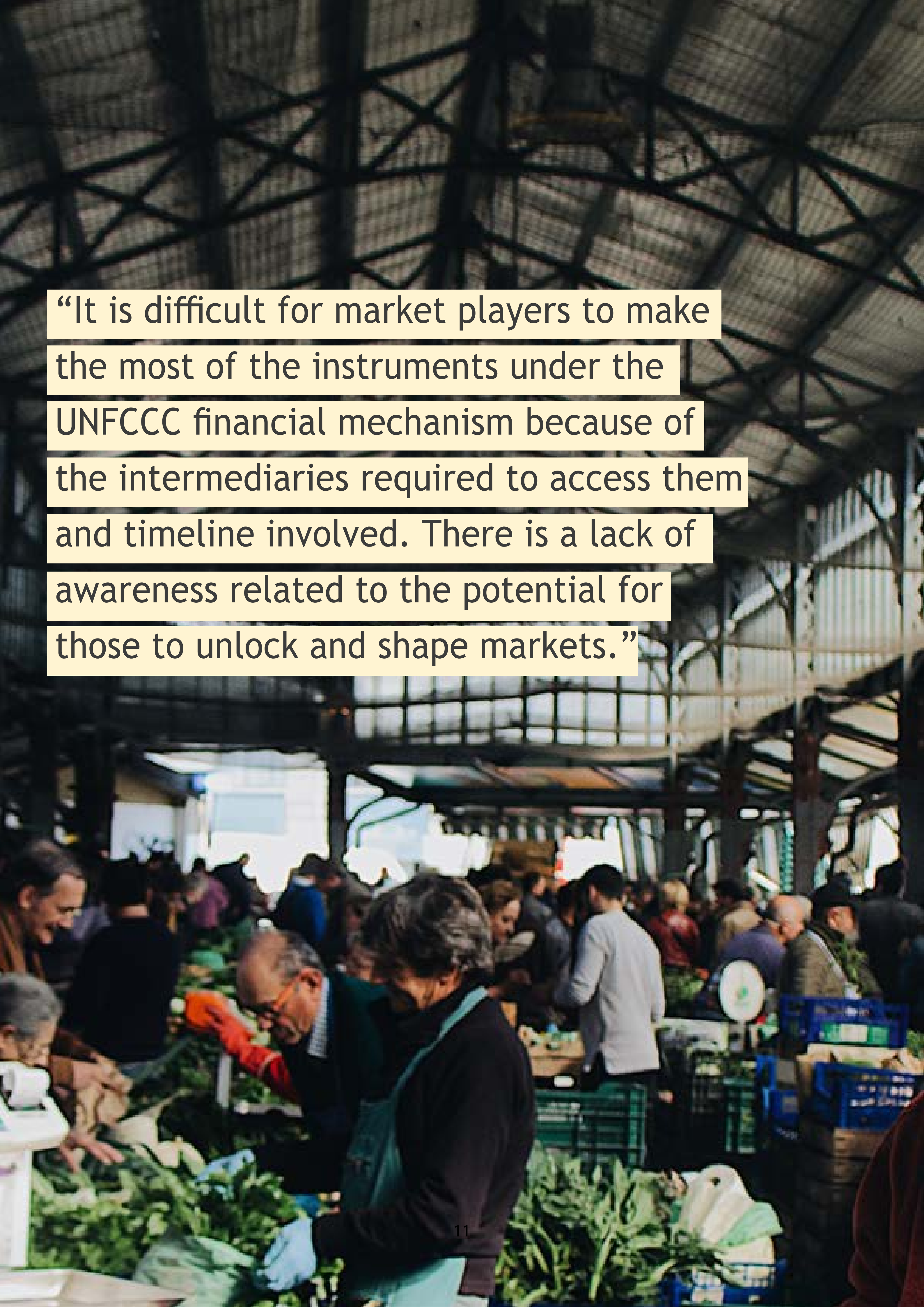
How can climate finance stakeholders interact successfully with the private sector in order to transform markets?

To achieve scale, much of the financial leverage will have to come from the private sector. However, despite the availability of financial instruments that enable risk sharing in investments, projects submitted to the GCF Private Sector Facility (PSF) are predominantly focused on mitigation (2% of funding is for adaptation projects) and only 29% of co-finance in PSF projects is leveraged from private sector entities, leaving a large untapped market.

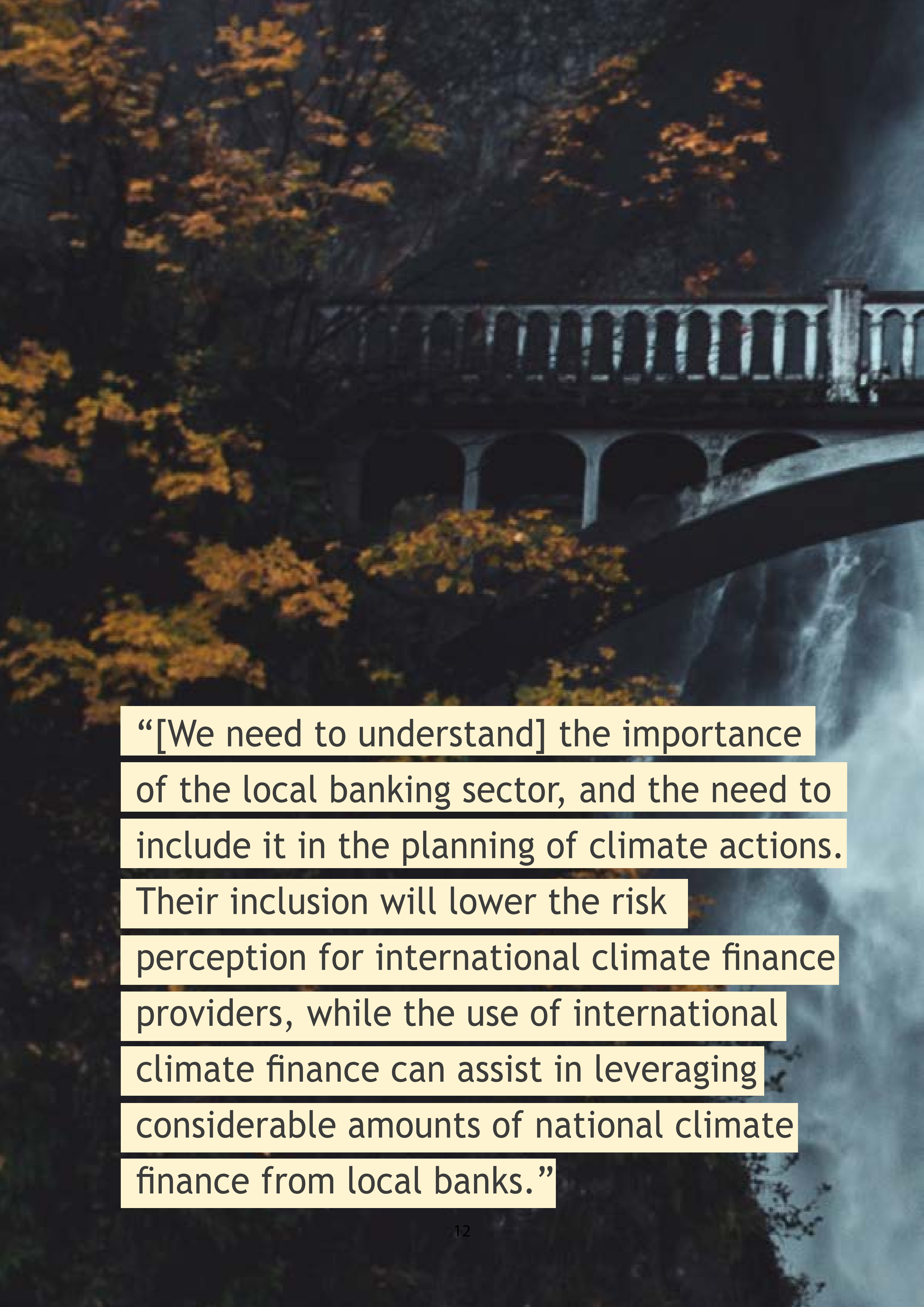
Aside from reputational issues associated with climate finance and its past failure to lead to market transformation, market actors such as commercial banks and other investors lack an understanding of values, mechanisms and risks associated with climate finance.

Similarly to the conclusions of the Forward-looking Performance Review of the GCF, our study finds that private sector actors hold a perception of long timelines and a lack of predictability in project appraisal and GCF decision-making. There is *'a mismatch between [donor] requirements for application and what the business community is used to and is willing to do'*. On the other hand, climate finance providers fail to understand the importance of the local banking sector and they lack knowledge of country-specific risk profiles, resulting in high perceived risks and reluctance on both sides.

This study identified missed opportunities for leveraging the private sector and achieving market transformation when project developers lack understanding of the role of different market players, such as financing through households and private companies (e.g. for energy efficiency improvements), contributions from local banks and the role played by subsidies. A lack of dialogue between retail bankers and project developers has been mentioned by several respondents as one of the causes leading to failed engagement of the private sector. Additionally, respondents identified a key knowledge gap as to how *'activities and instruments supported by public money can most cost-effectively mobilise private investment'*.



"It is difficult for market players to make the most of the instruments under the UNFCCC financial mechanism because of the intermediaries required to access them and timeline involved. There is a lack of awareness related to the potential for those to unlock and shape markets."



"[We need to understand] the importance of the local banking sector, and the need to include it in the planning of climate actions. Their inclusion will lower the risk perception for international climate finance providers, while the use of international climate finance can assist in leveraging considerable amounts of national climate finance from local banks."

4

Local ecosystem, country context and policy frameworks

How can we ensure climate finance engages local stakeholders and is sensitive to country context, needs, and policy frameworks?

This study identifies the understanding of local ecosystems and country-specific arrangements as one of the main issues related to climate finance knowledge.
From a project developer's perspective, failing to account for the country context when designing an investment vehicle and ignoring local market developments can lead to challenges during project implementation. Project developers often lack capacity to design proposals that promote local ownership; build capacity of local stakeholders; and those that include local actors (e.g. local banks) in planning processes. In this regard, our previous study identified that issues with engaging stakeholders were linked to staff capacity and lack of funding.

An in-depth knowledge of local ecosystems and the need for *'insight and on-the-ground representation'* is seen as a required step for project developers and investors. However, often developers lack capacity to distinguish issues related to investments in a specific country and ignore the local developments (e.g. NDCs, legislations, regional political drivers) that are crucial for successful projects and for ensuring country ownership.

Respondents highlighted the limited knowledge of policy actors and developing country governments with streamlining policies that enable climate finance, as well as regulatory frameworks that scale-up climate investments and crowd in the private sector.

5

Trends, needs and best practices

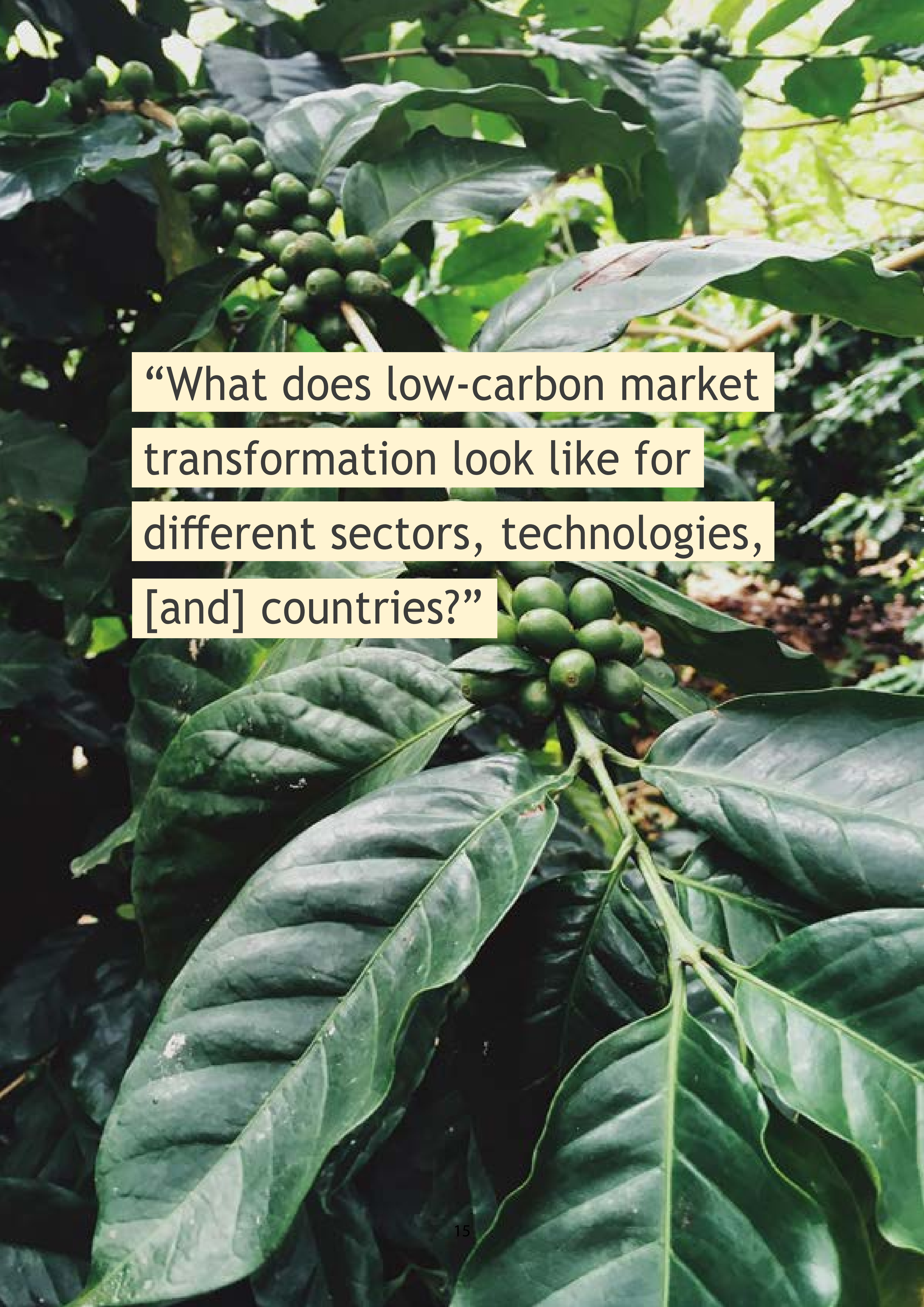
How might we use research and analysis to provide important information to stakeholders and improve climate finance practices?

A fifth theme identified by respondents relates to the need for accurate analysis and research to understand trends, stakeholders' needs, and best practices related to climate finance. This type of information is necessary during the project development phase, at the policy formulation level, and to strategically guide future climate finance flows.

At the project development level, stakeholders need to understand how to accurately analyse market trends in order to devise business models, to run sensitivity analyses, and to ensure the financial sustainability of a project.

At the policy level, stakeholders need to understand how policy change can promote climate investment and market transformation, allowing for a crowding-in of the private sector. This includes data on sectoral and technological needs in a given country context.

At the overall systems level, there is a need for research to inform various stakeholders in their climate finance decision-making. Best practice studies should be conducted through appropriate project financial models and tools, policy and legal frameworks, and market transformation approaches. Research should also explore short, medium, and long-term trends in climate finance, overall sectoral and technological needs, and the impact of public vs private climate finance.



"What does low-carbon market transformation look like for different sectors, technologies, [and] countries?"

Looking ahead

This report highlights the need to fill knowledge gaps of different stakeholders engaging in the climate finance landscape. The study identifies needs for additional research, such as best practices for sectoral investments and for legal frameworks to scale-up climate investments, and for dedicated capacity building of different stakeholders.

A first step forward relates to the development of knowledge-sharing platforms to match donor needs and beneficiaries. For example, the recently developed GCF Climate Investment Platform aims at bridging some knowledge gaps by decluttering the financial landscape and offering a matchmaking support service for developing countries.

In our experience, key issues facing project developers include understanding what constitutes a paradigm shift; in adaptation projects - integrating climate impacts into problem and objectives analysis; and other challenges related to understanding funding opportunities with the GCF. E Co. aims to address these knowledge gaps through bespoke capacity building trainings designed to meet the needs of participants.

Moving forward, we will explore the identified key themes with dedicated GCF insight issues. We aim at capturing a range of voices from Accredited Entities, local stakeholders, governments and market players to identify their most pressing needs, in terms of climate finance knowledge. As the climate finance landscape quickly matures, and in light of the recent success of the GCF first replenishment, we are working towards ensuring that universally increased knowledge of climate finance will be a first completed step towards more inclusive access to climate funds.

Learn with us at E Co. institute

E Co. institute is the new training arm of E Co. consulting and is run by our expert project formulation specialists. E Co. institute builds on our lengthy experience developing low-carbon, climate-resilient projects & programmes and the specialist training workshops we've conducted across the globe. We aim to build greater capacity amongst organisations worldwide seeking to deepen their knowledge of climate funds and develop skills in unlocking climate finance.

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11: Simplified Approval Process (SAP)

10: Stakeholder engagement & Country ownership

9 : Proposal development

8 : Gender mainstreaming

7 : The Private Sector Facility

6 : No-objection procedures

5 : Co-financing: Stakeholder perceptions

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Photos on Pages 1, 3, 15, 17 & cover image are credited to Silvia Emili.

About this report

We are grateful to the respondents of this study for their contributions and insights. This report is an initiative of E Co., emerging from work we are doing to develop low-carbon, climate resilient projects. E Co.'s team of consultants designed and conducted all interviews and prepared this report. E Co. has conducted this research independently and is not affiliated with the GCF, the GCF Secretariat or donors. The views expressed in this report are those of the authors and do not represent those of the GCF. Nothing in the interviews or any information or material relating thereto shall be construed as implying any official endorsement of or responsibility on the part of the Green Climate Fund.

About E Co.

We are a UK-based consulting company with a long track record in low-carbon, climate-resilient project formulation. We believe that the GCF can make a substantial and lasting change in the world, and we are doing all we can to help it do that. As a consulting company, we are leading the way and we are happy to share the lessons with the GCF community to make all GCF projects better. We would love to hear your thoughts on this edition of *GCF*

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