Supercharging climate finance

Photography: Green Climate Fund

A new institution has been set up with an ambitious plan to help drive billions of dollars into cleaner, low carbon and climate-friendly investment, as **Mark Nicholls** reports

The world's response to climate change is, some say, set to trigger the first predictable industrial revolution, with massive innovation – and investment – deployed to de-carbonise the global economy.

Helping to finance that revolution will be a new international financial institution, the Green Climate Fund (GCF), which aspires to be at the centre of potentially hundreds of billions of dollars of so-called "climate finance".

The GCF – set up under the auspices of the UN climate change convention – has an ambitious mandate: to promote a paradigm shift in the economic development of the world's poorer countries, creating infrastructure that is low-carbon and better able to adapt to the effects of global warming.

And it is likely to be central to the climate change effort over the next decade. "In terms of international climate policies that will get money flowing on the ground between now and 2020, the GCF is pretty

much it," says Miles Austin, London-based executive director of the Climate Markets and Investment Association, a trade body that is one of several private sector associations currently accredited as an observer organisation to the GCF.

"The GCF has the promise to be a very powerful and well-funded service," says Lisa Jacobson, the Washington DC-based president of the Business Council for Sustainable Energy. "It could well become the leading source for climate mitigation and adaptation funding."

Moreover, the GCF has been founded with an explicit role for the private sector. Its governing principles, agreed at the UN climate talks in Durban, South Africa, in 2011, say 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".

"Private sector capital needs to be leveraged to deal with this problem," asserts Craig Ebert, a Los Angeles-based senior vice-president at ICF International, a technology and policy consultancy. "The question is, how do you get from here to there?"

The need for funding is enormous. The International Energy Agency forecasts that an additional $15.2 trillion of investment will be required, globally, by 2035 to address, or rather, mitigate, greenhouse gas emissions. Adaptation to a 2°C increase in average temperatures will cost developing countries alone $75-$100 billion a year, according to a 2010 World Bank study.

There is a broad consensus that poorer countries – which have contributed least to the build-up of greenhouse gases in the atmosphere – should be financially supported both to adapt to climate change and to offset the incremental cost of choosing low-carbon development over the fossil-fuelled paths trodden by industrialised countries.

So it is into this space that the GCF will step.

G-force: Songdo Smart City, South Korea (main picture) and the G-Tower (above) the GCF's new hq

Left to right:
Earth's diplomats – the GCF board in Songdo; Daedong Hwamyeong Bridge; delegates at the June GCF meeting; and Songdo at night

Since its creation in Durban, its 24-member board – which is comprised of 12 representatives from rich countries and 12 from developing countries – has been moving fast to set up its administrative and institutional framework.

"The board is well functioning, and it is ticking off the major deliverables," says Jacobson. "It is making good progress," agrees Austin. "There is a lot of goodwill around the table, and I am optimistic – I hope the momentum carries on."

Meanwhile, the GCF's interim secretariat is morphing into a full-time body, to be based in Songdo, South Korea, and in June, Hela Cheikhrouhou was named as its first executive director.

The respected Tunisian national joins from the African Development Bank, where she was director of the energy, environment and climate change department. Cheikhrouhou brings a crucial mix of multilateral and private sector experience – she was an investment banker at Citi for seven years – and she has focused recently on bringing together public and private finance to tackle development challenges.

The GCF is under pressure to move quickly – its mandate calls for a "fast start", and staffers, donors and recipient countries are all hopeful that it can begin disbursing cash next year.

"By the end of 2014 we should be in a position to seek calls for projects and programmes, from not only countries, but possibly also the private sector," says Farrukh Iqbal Khan, a GCF board member and Pakistani diplomat. "The fundamentals are coming together."

But the big question is just how much funding the GCF will receive – and where it will come from. At the Copenhagen climate talks in 2009, developed countries committed to "mobilising jointly $100bn a year by 2020" of climate finance for developing countries.

How close they come to that target, and how much of the money flows through the GCF, remain open questions. As to where the money comes from, developing countries want as much as possible to come in the form of aid from rich country governments. These, in turn, facing enormous economic and budgetary pressures, want as large a role as possible played by the private sector.

Austin says that donor countries have earmarked money that they are ready to disburse, but they first want the GCF's institutional framework to be agreed and to have clarity on exactly how the money is going to be used. Developing countries, meanwhile, want to know how much public money will be committed before deciding on the GCF's framework and precise mission.

"There is a circular argument around financial commitments," says Gwen Andrews, a vice-president at engineering giant Alstom and a private sector observer on the GCF board, representing the World Business Council for Sustainable Development. "It is

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The GFC board is made up of 12 rich countries and 12 developing countries

Tapping the capital markets

The volume of investment needed to tackle climate change is encouraging some creative thinking within the GCF board. At its last meeting, in Songdo, South Korea, in June, it cited a need to "mobilise funds at scale from, inter alia, institutional investors, such as pension funds and sovereign wealth funds", and it charged the secretariat with coming up with ways of doing that.

Given the limited risk appetite that most institutional investors have – especially when it comes to infrastructure investments in less-developed countries – few observers expect them to be investing directly in GCF-supported projects or programmes. Instead, the expectation is that they come in with capital to free up the balance sheet of the GCF or the intermediaries it uses.

Andrews at Alstom suggests that the GCF or its partners might issue bonds or put together funds to allow private investors to provide finance to existing projects, effectively allowing more investment. "There is a real desire to bring something to the market that institutional investors will find attractive," she says.

"The Private Sector Facility could play a useful role in pooling or aggregating investments" to make them attractive to institutions, agrees Shally Venugopal, who leads the climate finance and the private sector project at the WRI. But she cautions that not all of the PSF money can come from investors, at the risk "of missing an awful lot of market segments". She notes that "institutional investors … are clearly more interested in emerging markets rather than poorer countries, simply because of the returns and scale."

a difficult issue, but the co-chairs are negotiating their way through it."

As well as government money, the GCF is also looking to the private sector for funding. This is part of the mandate of its Private Sector Facility – an explicit effort to engage private sector actors both as recipients of GCF funding and as a source of finance (see box, Tapping the Capital Markets).

In the past, multilateral institutions "haven't done a very good job of engaging with the private sector and mobilising the private sector", says Clifford Polycarp, a senior associate at the World Resources Institute, a Washington DC-based environmental think-tank.

In response, the PSF is charged with "addressing barriers to private sector investment" in adaptation and mitigation. This might be by building local capacity, helping local financial markets support low-carbon investment or reducing investment risk by underwriting demonstration projects, or by offering insurance products or partial guarantees.

But a huge amount still needs to be decided: exactly what sort of activities, programmes and projects the GCF and the PSF will support; what financial instruments they will use; and through which intermediaries they will operate.

"The ambition of the fund is clear," says one insider. "What is less clear is how we are going to get there. There is no one model that delivers the low-carbon paradigm shift required."

The kinds of support being discussed for the PSF include subsidising renewable energy generation through tariff support, providing country risk insurance for low-carbon investments, or offering guaranteed prices for carbon credits from qualifying projects.

Given its need to build internal capacity, it is expected that the GCF will initially operate through intermediaries. "Once the board has decided what it wants to do, it is likely to allocate a sum of money to intermediaries such as other multilaterals," says Austin at the CMIA. "Gradually, over time, it will move from a 'wholesale' to a 'retail model'."

Its governing instrument encourages it to use local enterprises, including financial institutions, and it is mandated to take a "country-driven" approach – that is, prioritising the needs of individual host countries rather than pursuing a top-down agenda.

In terms of the financial instruments it uses, the expectation is that the GCF will push the envelope. Developing countries historically favour traditional grants and concessional loans, but doing so "would leave a lot of opportunities on the table", says Jacobson at the BCSE.

"The board accepts that it will need to take some risk, so the GCF may well be more open to innovation than existing activities in this space," says Alstom's Andrews.

"This fund isn't going to be an ordinary fund, doing the same thing that others are doing. It has to be innovative, and it has a very difficult objective, to save the world from the catastrophic effects of climate change," says Khan. "To do that, it has to develop instruments that nobody else has thus far utilised."

It also promises to be innovative in its governance. An important concern for private sector partners is rapid decisionmaking. "The board won't have the capacity and skills, and won't meet often enough, to manage investment decisions," says Andrews. To that end, observers are watching closely as the board decides the composition and terms of reference of risk management and investment committees for the PSF.

But there is a "delicate balance" to be struck, says Polycarp at the WRI, between responsiveness and the checks and balances appropriate to a multilateral fund. "You don't want it to be hit by a big scandal or be called out for oversubsidising, for example."

"We have built up a lot of experience, through the [Clean Development Mechanism], the International Finance Corporation, the World Bank's Climate Investment Fund," says Khan. "Have we found that balance? No, not yet.

"At the start we won't be as fast as, perhaps, Goldman Sachs," he jokes, although he adds that, as the fund grows in experience and confidence, he expects decisionmaking to become increasingly speedy.

Now that the institutional framework is largely in place, the board will be deciding over the next 12 months exactly how it will operate – and these decisions will be of enormous importance to any private sector actor looking to develop or invest in climate-friendly infrastructure in developing countries, says Andrews. "It would really help for the private sector to show willing... and come forward with approaches that will help de-risk investments in these markets, and help advise how that will happen."

"My big concern is that the private sector isn't paying enough attention at the moment," says Jacobson. "It is not too late. There is an enormous opportunity over the next several months." m

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$100bn

Amount of climate finance developed countries committed to mobilising each year by 2020 for developing countries