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December 18 – 20, 2018
Washington, D.C.

Agenda Item 09

GEF-7 NON-GRANT INSTRUMENT PROGRAM

Recommended Council Decision

The Council, having reviewed document GEF/C.55/12, *GEF-7 Non-Grant Instrument Program,* takes note of the implementation framework for the NGI Program. The Council also requests the Secretariat and the Trustee to provide an updated report on non-grant instrument reflows at the Fall 2019 Council meeting.

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BACKGROUND

1. This document provides an implementation framework for the GEF-7 Non-Grant Instrument Program (hereinafter referred to as "NGI Program"), including progress to date and next steps. The policy for non-grant instruments[1] from the GEF-6 period will continue to serve as the basis for the GEF-7 NGI implementation, while this document presents additional measures that are needed to support a more effective implementation of the GEF-7 NGI Program. Specifically, the GEF-7 Programming Directions[2] contains the following three elements, which will guide the Secretariat in the implementation of the NGI Program during GEF-7 by complementing the existing policy for non-grant instruments:

(a) Considerations related to measures under GEF-6:

- Further strengthen transparency in the implementation of the NGI;
- Ensure that the NGI investments address constraints revealed during the implementation of NGI under GEF-6, including to examine the cap as presently imposed on the size of NGI projects;

(b) Considerations related to the formalization of the ad hoc advisory group of financial experts for the purposes of supporting the NGI Program;

(c) Measures to enhance GEF Secretariat capacity related to the NGI Program.

2. An updated summary of the GEF-6 NGI Pilot is included in Annex 1. Annex 2 provides a copy of the policy on non-grant instruments.

GEF-7 NON-GRANT INSTRUMENT PROGRAM

Resource Allocation for the Program

3. The GEF-7 Replenishment established a window of USD 136 million for the NGI Program.

Further Strengthening Transparency in NGI Implementation

4. To further strengthen transparency in implementation of the NGI, more explicit financial criteria to avoid any potential subsidies to the private sector are clearly specified and are added to the criteria employed under the GEF-6 implementation.[3] Specifically, newly added criteria aim to ensure that implementation of the NGI program avoids subsidizing private sector entities and only provides the minimum amount of concessional funding needed

[1] See GEF, 2014, *GEF-6 Non-Grant Instrument Pilot and Updated Policy for Non-Grant Instruments*, Annex I. GEF Council document GEF/C.47/06.

[2] GEF, 2018, *GEF-7 Replenishment Programming Directions*. Document GEF/R.7/19.

[3] Existing selection criteria under GEF-6, as per paragraph 12 of GEF Council document GEF/C.47/06, *GEF-6 Non-Grant Instrument Pilot and Updated Policy for Non-Grant Instruments,* encourage proposals with the following elements: (i) Demonstrate innovative application of financial mechanisms and partnerships that may be broadly adopted and can be scaled up; (ii) demonstrate use of non-grant instruments in areas other than climate change; (iii) support innovative engagement of the private sector and public sector through innovative business models; and (iv) deliver high levels of co-financing.

to enable investors and enterprises to invest in projects that generate global environmental benefits that would otherwise not have happened. For projects with private sector recipients, an appropriate concessional rate of return on investment will be negotiated, which, consistent with the Agency's regular practices, must ensure a minimum level of concessionality, avoid displacing other finance, and catalyze other investments. The minimum level of concessionality is determined on a case-by-case basis, for each project proposal, and is validated by the Advisory Group of Financial Experts (see paragraph 7 below). These elements will be also continuously refined by the Group. The guiding criteria related to finance comprise:

(a) Equity criteria such as how the proposed structure compares to industry standards, the terms for fund management, proposed returns for the GEF, and whether credible project pipelines have been identified;

(b) Debt criteria such as terms and tenors for loan products and how these compare with commercial lenders in the subject area/country/region and to industry standards, whether the project team has adequate resources for project preparation, and how investment decisions will be made;

(c) Criteria related to risk products and other investment approaches, to determine why a risk product is preferred to equity or debt, whether the terms of the risk product including fees, tenor, default options and others, are adequate, and how they compare to industry norms, and if the proposed role for the GEF ensures that other players are not displaced; and

(d) Ensure that key criteria to avoid subsidizing the private sector are implemented, including, inter alia, that private sector recipients would not self-finance the initiative without GEF support, would not have the expertise to implement the project without GEF support, or would be unwilling to invest as project costs or risks appear higher than the benefits.[4]

Addressing Constraints Revealed during GEF-6 Implementation

5. The implementation of NGI under GEF-6 revealed several constraints related to market failures which NGI under GEF-7 may want to address. Specifically, there is a need to provide resources for aggregation due to small size of sub-investments; to meet needs for capacity building of developers, and the need to support pipeline development and leverage investments from capital markets. The GEF-7 NGI program will continue to support facilities that strengthen and sustain linkages between investors and project developers to provide seed capital, encourage project incubation and deal origination in frontier sectors such as marine plastics, sustainable agriculture, and blue carbon. An early success case is presented by the GEF-6 project on "The Coalition for Private Sector Investment in Conservation (CPIC)" which illustrated the benefits of facilities that can provide "one-stop-shop" services to project developers.

[4] See, for instance, DCED, 2014, *Demonstrating Additionality in Private Sector Development Initiatives. A practical exploration of good practice*. Donor Committee for Enterprise Development.

6. The funding cap for a typical project proposal is set at USD 15 million. The GEF-6 experience shows that this became a constraint in some projects. Accordingly, on an exceptional basis as needed, innovative projects with the potential for demonstrating impact at scale may request funding exceeding USD 15 million.

Advisory Group of Financial Experts

7. As in GEF-6, the Secretariat will utilize independent financial experts to complement the standard review process. The existing ad hoc group of financial experts will be formalized to assist the Secretariat in the technical and financial review, as per the GEF-7 Programming Directions. Experts serving in this function will be screened to avoid conflicts of interest and will be required to sign non-disclosure agreements. Specific terms of references for the formalized group of financial experts will include:

(a) Assist the GEF Secretariat in reviewing and selecting proposals for NGI, with a strong focus on the financial criteria stated above (see paragraph 4), as well as business model sustainability, risks, potential for replication and scaling;

(b) Provide advice to the GEF Secretariat on recent trends in blending finance and emerging areas that the NGI Program should target.

8. The proposed financial terms and expected reflows shall be presented in project documents for review by the GEF Secretariat and approval by Council. If currency risk is a consideration, the proposed approach and justification shall be documented in the project documents.

Enhanced GEF Secretariat Capacity

9. The Secretariat is in the process of recruiting one additional staff with expertise in the private sector and financial markets.

Application

10. Both full-size and medium-size projects are eligible for the NGI Program, following the regular GEF project review and approval cycle.

Promotion and Dissemination

11. Once approved, the GEF Secretariat will take steps to provide documentation of the NGI Program online and through various outreach and communication channels, including relevant events and meetings concerning relevant multilateral environmental agreements. The Secretariat will make a dedicated effort to enhance awareness about the NGI Program, including through outreach activities in connection with Expanded Constituency Workshops, National Dialogues, GEF Introduction Seminars and other activities.

Reflow Monitoring

12. The Secretariat will work with the Trustee to provide an update on non-grant instrument reflows at the Fall 2019 Council meeting.

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- GEF/FI/PL/02, *Non-Grant Instruments (October 30, 2014)*
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- GEF/C.54/19/Rev.03, *Summary of Negotiations of the Seventh Replenishment of the GEF Trust Fund (June 2018)*
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ANNEX 1: GEF-6 NON-GRANT INSTRUMENTS PILOT SUMMARY

1. Under the GEF-6 Non-Grant Instrument Pilot, The GEF approved a total of eleven (11) non-grant projects, using $99.4 million[5] in GEF funding and attracting $1,792 million in co-financing. Private sector co-financing was $1,362 million of the total co-financing.

2. Project proposals addressed focal areas of Climate Change Mitigation with 41% of the funding; Land Degradation with 29% of the funding; and Biodiversity with 16% of the funding. Multi-Focal Area projects represented 13% of funding and are expected to deliver benefits in Biodiversity, Land Degradation, Climate Change Mitigation, and International Waters. The Land Degradation investments are also expected to deliver Climate Change Mitigation benefits.

3. Regional coverage is showing application of the GEF Pilot in all GEF regions. Africa has four projects and 42% of the total funding; Latin America has two projects and 25%; Eastern Europe has one project with 14%; and Asia has one project with 6% of the total funding. Three projects have the potential for global investments using 12% of the funding.

4. The Pilot included nine (9) full-size projects and two (2) medium-size projects. The full-size projects covered a full range of modalities, including five equity investments, two debt instruments and two risk mitigation instruments. The medium-size projects used debt instruments. Short summaries of each GEF-6 non-grant investment are provided below.

1. Equity investment in biodiversity (#9058). This Impact Investment in Support of the Implementation of the Nagoya Protocol on Access and Benefit Sharing (IADB) will support efforts in Latin America and the Caribbean to develop Small and Medium Enterprises (SMS) that are actively implementing the Nagoya Protocol. It will focus on 20 SMEs that are taking part in the production and valorization of genetic resources by means of research and development or that are part of value chains linking users and producers of these genetic resources. The investment will facilitate improved capacities for the valorization of genetic resources or commercialization of value-added products, effectively linking users and producers of these genetic resources. The project will bring on board the experience of the Union for Ethical Biotrade (UEBT). Under the non-grant pilot, GEF will invest $10 million and will receive an estimated risk-adjusted equity return of 13 percent-15 percent along with its principal. Reflows to the GEF trust fund will be confirmed at CEO endorsement; estimated to after the project is completed and fully returned within ten years. The project yields estimated benefits of 100,000 ha under improved management of landscapes and seascapes; 800,000 hectares under sustainable land management; and 2 freshwater basins with water-food-ecosystems security and conjunctive management of surface and groundwater.

[5] The GEF investment amount is USD 99.4 million; agencies fees are USD 9.1 million additional for a total utilization of USD 108.5 million.

2. Junior Equity for Renewable Energy (#9085). The Equity Fund for the Small Projects Independent Power Producer Procurement Program managed by the Development bank of South Africa (DBSA) will promote renewable energy supply in South Africa by small and independent power producers. Like the African Renewable Energy Fund (AREF), GEF funds are invested with the expectation of below-market return. DBSA will also create a securitization platform to help resell initial investments after the projects have begun power production. These two interventions help reduce capital costs for small-scale producers and attract private sector capital. The proposed investments will result in installation of close to 100MW of renewable energy, reducing approximately 260,000 tons CO_2e per year, resulting in an estimated 5 million tons CO_2e over an assumed average project lifetime of 20 years.

3. Junior Equity for Agro-Forestry (#9051). The Moringa Agro-forestry Fund for Africa, managed by the AfDB, will promote sustainable land management in production landscapes in Burkina Faso, Cote d'Ivoire, Kenya, Mali, Tanzania, Zambia, and Congo DR. The Fund will invest

in 5-6 scalable, replicable agroforestry projects that combine plantation forestry with agricultural elements to capture most of the value chain. The GEF has taken a junior equity position in the fund with an expected return of 6 percent. GEF's position helps lower risks for private sector investors who may be reluctant to consider land management projects on purely commercial terms due to for example long payback periods, lack no track record and uncertainty over product prices. The project also targets 79,000 hectares to maintain significant biodiversity and associated ecosystems goods and services, and more than 200,000 hectares of production systems under sustainable land and forest management. The project is expected to yield GHG emissions benefits of 9.5 million tons CO_2e.

4. Guarantees and Subordinated debt for Land Restoration (#9277). The Risk Mitigation Instrument for Land Restoration project managed by the Inter-American Development Bank (IADB) combines a GEF investment of $15 million with $120 million in co-financing to deploy innovative risk mitigation instruments to support public and private sector investment to restore degraded lands in Latin America. The private sector is increasingly seeking investments in the restoration of degraded lands as a means of bringing low productivity land into production. Such investments however, have longer payback periods and represent various types of high financial risk making them difficult to finance. GEF funds will be used to provide guarantees and subordinated loans, helping catalyze additional public and private sector investments by reducing perceived risk. The project will support land restoration and integrated natural resources management activities such as sustainable management for increased eco-system services; landscape regeneration; intercropping; shade-grown systems; high-value forest products; and silvo-pastoral systems yielding benefits on at least 45,000

hectares. The enhancements to carbon stock in these investments are estimated to yield emissions reductions of 4.5 million tCO_2e.

5. Subordinated, concessional debt for energy efficient transport (#9047). The green logistics program managed by the European Bank for Reconstruction and Development (EBRD) will improve efficiency and productivity of freight transport in the black sea region by enhancing access to finance. GEF funding will provide subordinated loans at a concessional rate and security for investments made by the EBRD that promote energy efficiency and lower GHG emissions in the logistics sector. The availability of junior funding from the GEF will allow the EBRD to invest its own funds in projects that otherwise would be priced excessively, thus leveraging the EBRD's capacity to deliver energy efficiency solutions in the logistics sector in the region and to help clients to introduce energy efficient practices. With the GEF funding, co-financing investments should be well over $155 million during the project period. Subsequent follow-on investments are expected to rise to $250 million after the project is completed. Estimated greenhouse gas emissions reductions are 9.1 million tco2e.

6. Reimbursable grant for renewable energy (#9043). The AfDB/GEF project, Investing in Renewable Energy Project Preparation under the Sustainable Energy Fund for Africa (SEFA), will support the first of its kind reimbursable grant project preparation facility for renewable energy projects in Africa. Funding provided by the project preparation facility will be reimbursed as project developers received financing for successful projects. This allows the facility to remain sustainable over time and continue to fund additional project preparation investments. If this approach proves viable, it would lead to an expansion of bankable projects which would attract equity and debt financing, leading to faster development of low-carbon energy in Africa. Co-financing will come from the AfDB ($35 million), private sector project developers and debt investors in the eventual projects ($920 million). The project is estimated to provide reimbursable grants for at least 10 renewable energy projects, resulting in estimated emissions reductions of 3.5 million tCO_2e. Under the non-grant pilot, the GEF reimbursable grant will earn an estimated 2-5% on each project. The grants can be recycled back into the project preparation facility until the seventh year of the 10-year project. Reflows of recovered principal and interest to the GEF will commence after seven years and will be fully returned after 12 years. Additional reflow details will be defined by CEO endorsement stage.

7. Equity investment in sustainable fisheries (#9370). The CI/GEF project, The Meloy Fund: A Fund for Sustainable Small-scale Fisheries in Southeast Asia, will improve the conservation of coral reef ecosystems by providing financial incentives to fishing communities in the Philippines and Indonesia to adopt sustainable fishing behaviors and rights-based management regimes. This project will focus on the business aspects of the industry, such as ensuring market access, improving assets/equipment as well as providing technical assistance. The Meloy Fund will be the first impact fund focused entirely on community small-scale fishers in the developing tropics and will have a long-lasting impact by financing unbanked enterprises to acquire those fixed assets that will enable financial growth, job creation and resilience to economic shocks. Estimated global environmental benefits are improved management of 1.2 million hectares of seascapes. Co-financing of $35 million comes from the technical assistance provided by executing partners; foundations; investment and impact funds; and other private sector investors. Under the non-grant pilot, investments will be targeted to small and medium enterprises with expected tenors of 5-7 years and will be expected to earn between 10-15% returns, yielding an estimated gross internal rate of return of approximately 10.5% over the 10-year life of the fund. Additional reflow details will be defined by CEO endorsement stage.

8. Debt Aggregation for Energy Efficient City Lighting (#6980). The International Energy Efficiency Facility (iEEF), managed by the World Bank, is an example of a targeted intervention aimed a bridging the gap between institutional investors seeking exposure to real asset classes and the idiosyncratic investment needs related to increasing efficiency and bringing down carbon emissions in cities around the world. The iEEF will help aggregate energy efficient investment projects in cities around the globe, focusing first on conversion of traditional urban street lighting technologies to more efficient lighting emitting diodes (LEDs). Without aggregation, many projects would be too small for consideration by investors. Aggregation also helps cities with lower credit ratings to participate in a package that spreads the risk. Cities stand to not only reduce greenhouse gas emission benefits but realize budgetary savings. Once up and running, this facility could expand aggregation approaches to broader types of efficiency investments, such as building retrofits. Estimated emissions reductions are 1 million tCO_2e. (This project has not matured, and the World Bank anticipates the project will be terminated. Unspent funding will be reflowed to the GEF Trust Fund.)

9. Blue Bonds for Fisheries Management (#9563). The World Bank/GEF project, Third South West Indian Ocean Fisheries Governance and Shared Growth project (SWIOFish3), will commit non-grant resources in partnership with the Government of Seychelles to support the issuance of Blue Bonds to attract private sector investment. The Blue Bonds proceeds will strengthen efforts to improve management of fisheries and coastal conservation at regional and national

levels and improve fish handling processes at targeted handling sites in the Seychelles. This approach is a unique blending of GEF non-grant resources into a recently approved project with the World Bank (PMIMS 9250), that accessed Seychelle’s BD STAR resources alongside with IW funds. Seychelles has pledged to protect 30% of its Exclusive Economic Zone by 2020 and initiated a Marine Spatial Planning exercise to serve as the foundation of its sustainable blue economy strategy. In parallel, Seychelles is also developing management plans for its near-shore fisheries, including the first fisheries management plan for the Mahé Plateau, with a view to progressively transition from an open access fishery to a more controlled fishery. However, the implementation of these two initiatives faces the risk of being underfunded. To supplement the financial flows needed, the Government of Seychelles will issue Blue Bonds (for an estimated total of $15 million) to finance this alternative scenario, in a landmark new kind of transaction that mobilizes capital markets to finance Seychelles' blue economy objectives. The GEF non-grant loan of $5 million will be used alongside an IBRD guarantee to lower the cost of the Blue Bonds. Co-financing of $32 million is expected.

10. Piloting Innovative Investments for Sustainable Landscapes (#9719). The UNEP/GEF medium-sized project on Piloting Innovative Investments for Sustainable Landscapes is supporting the *Tropical Forests and Agriculture Fund*, announced at Davos in January 2017, through a strategic partnership with the Norwegian government, the Sustainable Trade Initiative (IDH), and UN Environment. This project showcases additional cases and best practices on enhanced engagement of the private sector and public sector through innovative finance models that deliver protection and production benefits. The new Fund also involves several tropical forest countries and is supported by major food companies and international environmental NGO's. It is intended to trigger private investments in deforestation free agriculture in countries that are working to reduce their deforestation and forest and peat degradation.

11. CPIC Conservation Finance Initiative - Scaling up and Demonstrating the Value of Blended Finance in Conservation (#9914). This IUCN/GEF project will seek to improve the conservation and sustainable use of biodiversity by demonstrating innovative finance blending models to increase return-seeking private investment in conservation. Conservation investment currently faces several hurdles that significantly increase the risk and transaction costs relative to other impact investment opportunities. The key barriers preventing significant conservation investment are: 1) transactions are too small for institutional capital to flow into them; 2) project developers lack track record; most transactions are first-of-their kind; and 3) risk-return profiles do not meet investor needs. To overcome these barriers requires a set of durable transaction models that can be repeated and aggregated into "vanilla" financial

products, and a comprehensive approach to de-risking these projects. A blended finance approach that uses public and philanthropic funding to create conditions where private finance can then flow, modeled in part after successful approaches employed to catalyze investment in the renewable energy sector, is one highly-promising approach. This project will take advantage of the growing engagement of the Coalition for Private Investment in Conservation (CPIC), launched at the IUCN World Conservation Congress in September 2016, with the intent of increasing deal flow into global priority conservation projects. The core of the CPIC model is the development of investment blueprints that create models for investable conservation projects in five sectors: sustainable agriculture; coastal fisheries; coastal resilience; green infrastructure for water; and forest landscape restoration and conservation. The Rockefeller Foundation will, pending final approval, provide co-financing through grant support that will help project developers in the pre-investment phase to acquire capacity as well as providing technical advice. With the support of multiple partners, including Rockefeller; Credit Suisse; Cornell University, CPIC, this project should attract $100M in private sector financing and foster a new set of tools to facilitate expanded private investment in support of conservation objectives and programs. Estimated global environmental benefits include 10,000,000 hectares under improved management of landscapes and seascapes; 400,000 hectares under sustainable land management, and 300,000 tCO_2e emissions mitigated. Specific benefits will depend on the nature of the projects selected for investment. GEF investment will come from the $8 million non-grant investment with expected reflows to the GEF based on the investment returns of conservation projects funded with a focus on principal maintenance plus a small return.

POLICY: FI/PL/02

October 10, 2014

Annex 2: Policy - Non-Grant Instruments

(COPY OF POLICY FROM OCTOBER 2014)[6]

[6] See GEF, 2014, *GEF-6 Non-Grant Instrument Pilot and Updated Policy for Non-Grant Instruments*, Annex I. GEF Council document GEF/C.47/06.

Summary: This Policy (i) establishes the objectives for the use of non-grant instruments, (ii) defines non-grant instruments for the GEF, and (iii) sets forth the general principles and approaches for the use of non-grant instruments in GEF-financed projects.

Background: This Policy was approved by the GEF Council at its 47th Meeting on [insert date]. It replaces and supersedes the policy statements contained in Council Document GEF/C.33/12, *Operational Policies and Guidance for the Use of Non-Grant Instruments,* approved by the Council at its 33rd meeting in May 2008.

Applicability: This Policy applies to all non-grant instruments financed by projects or programs submitted and approved by the Council or the GEF CEO on or after the date of effectiveness of this Policy.

Date of Effectiveness: November 01, 2014

Sponsor: GEF Secretariat, Director for Policy and Operations

I. INTRODUCTION

1. This Policy establishes the framework for the use and management of non-grant instruments in GEF-financed projects and programs.

II. OBJECTIVES

2. The purpose of this Policy is to set out the principles for the GEF, working with its partners, to facilitate appropriate use of non-grant instruments as a means to inter alia: (a) enhance the effectiveness by leveraging substantial capital for targeted investments that support GEF's objectives; (b) strengthen partnerships with the private and public sectors in recipient country governments; (c) enable the GEF to demonstrate and validate the application of innovative and flexible financial instruments in projects for broader adoption; and (d) enhance the financial sustainability of the GEF through the generation of reflows.

III. INDICATIVE TYPES OF NON-GRANT INSTRUMENTS

3. A non-grant instrument in the context of the GEF is a mechanism to provide financing in a form that has the potential to generate financial returns, irrespective of whether such financial returns flow back to the GEF Trust Fund or not (see section V). Financial returns comprise funds or proceeds that are collected from the beneficiaries of projects/programs using non-grant instruments, including the original investment amount, principal, (excluding Agency fees), earnings or interest from the investment, dividends, proceeds from the sale of equity stakes, and repayment of original reserves and guarantee fees.

4. GEF projects/programs are designed with the appropriate type of non-grant instrument that best supports the goals of the project/program. The GEF Partner Agency submits projects/programs that include, but are not limited to, the following types of non-grant instruments, which are described in further detail in Appendix 1-A. The instrument names below are illustrative; the Partner Agency uses instruments and terms available under its policies and procedures:

(a) Credit guarantee (partial/full);

(b) Performance risk guarantee;

(c) Structured financing;

(d) Equity/investment fund;

(e) Revolving equity fund;

(f) Contingent loan;

(g) Concessional loan; and

(h) Revolving loan fund.

IV. FOCAL AREA ELIGIBILITY FOR NON-GRANT INSTRUMENTS

5. All GEF focal areas set out in paragraph 2 of the Instrument are eligible to use non-grant instruments.

V. REFLOWS

6. Reflows are the financial returns transferred to the GEF Trust Fund. For the purposes of the GEF Instrument (i) GEF financing is considered *GEF concessional finance*, if it is provided to a project/program that is expected to generate reflows to the GEF Trust Fund; and (ii) GEF financing is considered a *GEF grant* if it is provided to a project/program that is *not* expected to generate reflows to the GEF Trust Fund.

7. GEF grant finance (i) may be made available to any GEF recipient country provided that the recipient country meets the criteria under paragraph 9(a) or 9 (b) of the instrument; and (ii) may be provided by all GEF Partner Agencies in projects/programs using non-grant instruments.

8. GEF concessional finance for private sector beneficiaries may be made available to any GEF recipient country that meets the criteria under paragraph 9 (c) of the Instrument.

9. GEF concessional finance for public sector beneficiaries may be made available to any GEF recipient country that meets the criteria under paragraph 9 (c) of the Instrument, except that it may not be provided to an IDA country if that country is determined to be at a high risk of debt distress in accordance with the World Bank Debt Sustainability Framework (i.e., eligible to receive only IDA grants).

VI. GEF PARTNER AGENCY ELIGIBILITY TO ADMINISTER CONCESSIONAL FINANCE

10. A GEF Partner Agency is eligible to provide GEF concessional finance, if it can demonstrate the following:

(a) Ability to accept financial returns and transfer from the GEF Partner Agency to the GEF Trust Fund;

(b) Ability to monitor compliance with non-grant instrument repayment terms;

(c) Capacity to track financial returns (semester billing and receiving) not only within its normal lending operations but also for transactions across trust funds;

(d) Commitment to transfer reflows twice a year to the GEF Trust Fund;

And, in case of concessional finance for private sector beneficiaries:

(e) Track-record of repaid principal and financial returns from private sector beneficiaries to the GEF Partner Agency.

And, in case of concessional finance for public sector recipients:

(f) Track-record of lending or financing arrangements with public sector recipients; and

(g) Established relationship with the beneficiary countries' Ministry of Finance or equivalent.

VII. Financial Terms for Concessional Finance

11. For non-grant instruments with private sector entities, the GEF Partner Agency designs and negotiates non-grant instruments to ensure minimum concessionality in order to avoid crowding-out of other sources of financing while achieving the project/program objectives.

12. For non-grant instruments with public sector beneficiaries, the GEF Partner Agency utilizes terms comparable to IDA.

VIII. Monitoring, Reporting and Management of Reflows

13. At the time of project proposal submission, the GEF Partner Agency indicates a timeline when all investments are to be completed and an indicative schedule of reflows. At the CEO Endorsement Request stage, the GEF Partner Agency specifies the non-grant instrument term and an updated schedule of reflows. The schedule and amount of reflows is consistent with the applicable terms of financing under the relevant project/program proposals approved by the Council and/or the CEO.

14. Each GEF Partner Agency is responsible for receiving and monitoring financial returns in accordance with its own financial management policies and procedures applicable to such financing activities.

15. Each GEF Partner Agency, in accordance with its own policies and procedures, seeks to recover outstanding balances, recognizing that the risk of non-payment by a beneficiary can reduce reflows. The GEF Partner Agency maintains documentary evidence of its efforts to recover outstanding balances and provides a sound audit trail for the purpose of reporting to the Council, as appropriate.

16. Pursuant to the provisions of the Financial Procedures Agreement entered into between the GEF Partner Agency and the Trustee, the following procedures apply to the management of reflows by the GEF Partner Agency to the GEF Trust Fund:

(a) The GEF Partner Agency receives and holds the financial returns arising out of non-grant instruments, including investment income accruing thereon, in a designated account until such financial returns are transferred to the Trustee as reflows;

(b) All actual reflows, including investment income as noted above, are transferred to the Trustee at least twice a year, or at a frequency agreed between the Trustee and the GEF Partner Agency;

(c) The GEF Partner Agency informs the Trustee about reflows, on a quarterly basis, or at another frequency as agreed between the Trustee and the GEF Partner Agency, of (i) the financial returns received during the reporting period; (ii) the

date of such receipts; (iii) the project to which the returns are associated; and (iv) the total investment income earned on the balance of the account during this same reporting period;

(d) All reporting from the GEF Partner Agency to the Trustee is in writing; and

(e) The GEF Partner Agency maintains supporting documentation which may be requested by the Trustee as needed.

17. The Trustee assigns all reflows received to the GEF trust fund.

IX. DEFINITIONS

18. The terms used in this directive have the meanings set forth below:

19. **Executing Agency:** A GEF Executing Agency is an entity or agency that receives GEF funding from a GEF Partner Agency in order to execute a GEF project, or parts of a GEF project, under the supervision of a GEF Partner Agency. It may also be referred to as a "project executing agency".

20. **GEF Agency:** Any of the 10 institutions that were entitled to request and receive GEF resources directly from the GEF Trustee for the design and implementation of GEF-financed projects and programs as of November 2010. They include the following organizations: the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the Food and Agriculture Organization of the United Nations (FAO), the Inter-American Development Bank (IADB), the International Bank for Reconstruction and Development (World Bank), the International Fund for Agricultural Development (IFAD), the United Nations Development Programme (UNDP), United Nations Environment Programme (UNEP), and the United Nations Industrial Development Organization (UNIDO).

21. **GEF Partner Agency:** Any of the entities eligible to request and receive GEF resources directly from the GEF Trustee for the design and implementation of GEF-financed projects and programs. This category includes both the ten *GEF Agencies* and *GEF Project Agencies*.

22. **GEF Project Agency:** Any of the institutions that the GEF has accredited to receive GEF resources from the GEF Trustee for the design and implementation to implement GEF-financed projects and programs apart from the ten GEF Agencies.

Appendix 1-A: Descriptions for Common GEF Non-Grant Instruments

1. This Appendix updates and clarifies the GEF descriptions for non-grant instruments, which were first established in GEF Council Document GEF/C.13/Inf.05, *Engaging the Private Sector in GEF Activities*, April 22, 1999, and further explicated in Council Document GEF/C.32/07, *Use of Non-Grant Instruments in GEF Projects: Progress Report*, October 25, 2007.

2. There exists a vast variety of non-grant instruments encompassing a range of sophisticated, innovative financial instruments. For convenience, these instruments are often grouped into three main categories: (i) risk mitigation products; (ii) equity; and (iii) debt instruments. The following descriptions provide a helpful guide for the types of non-grant instruments that are likely to be used in GEF projects. Other types of non-grant instruments which may be developed through innovative approaches can also be considered for GEF projects.

Risk mitigation products

Credit Guarantee/Partial Credit Guarantee

3. Credit guarantees are a commitment to reimburse a lender if the borrower fails to repay a loan. The credit guarantee balance is not invested but held in reserve and only paid out if a borrower fails to repay.

4. In partial credit guarantees, the GEF provides a guarantee for a pre-defined portion of a commercial loan, sharing the rest of the risk of potential losses with the lender and other investors. This facilitates the availability of commercial loans and increases the attractiveness of the respective loan terms. By extending the maturity of commercial loans for projects, partial credit guarantees can provide improved cash flow during project life. However, they do not address risks that jeopardize cash flow, but rather provide an overall enhancement to the project's economics by covering general credit risk during a particular phase of the project.

Performance Risk Guarantee

5. A performance risk guarantee is like a credit guarantee, only in this case the guarantee fund is used to help compensate project partners if the project fails to deliver expected cost-savings (i.e., through energy efficiency improvements). This performance guarantee provides lowers the risk of default, encouraging local lenders to provide debt funding at attractive rates for the project.

Structured Financing

6. This is a mechanism that layers GEF funding, usually at concessional terms or in a junior position, as part of an overall investment package. The ability of the GEF funding to be junior, and therefore more risky, allows other investors to be senior, providing them with more predictable returns. In the event of a partial default, senior investors would be repaid first, with the GEF and other junior partners potentially receiving no repayments.

7. This mechanism is very close in end goal to a partial risk-sharing facility, however, in this model the GEF funds are invested, rather than held in reserve.

Equity

Equity/Investment Fund

8. Investment funds are for-profit, private sector, environmental funds that receive grant and/or non-grant funding from GEF. The objective is to provide commercial or quasi-commercial financing to subprojects through a fund manager, with a possible financial return on capital. Investment funds leverage GEF financing to mobilize a larger pool of commercial capital to invest in eligible projects, utilizing debt or equity instruments as appropriate.

Revolving Equity Fund

9. A revolving fund establishes a mechanism that offers equity investments that are repaid to the fund as the project matures and generates income. If the project is not successful, the investment is fully or partially forgiven and not repaid. The revolving funds are designed to invest in a portfolio of projects anticipating that successful projects will enable reflow to the fund, therefore allowing the fund to sustain operations well after the original GEF project may be completed.

Debt instruments

Contingent Loan

10. A contingent loan differs from a contingent grant in that a loan is treated as debt and therefore has a higher repayment priority than the converted grant. A grant is treated as project equity or an asset unless another arrangement is negotiated. A contingent loan is repaid on a similar schedule and with similar interest to other loans. Similar to the contingent grant, it could be forgiven if the project fails.

Concessional Loan

11. A concessional loan refers to loans provided at below-market rates. These are also called “soft loans.” The availability of the concessional loan could be contingent upon participation of other commercial lenders to achieve co-financing and leveraging of non-GEF funds. Contingent or concessional loans would likely supplement (and probably be subordinate to) other project debt.

Revolving Loan Fund

12. A revolving fund establishes a mechanism that offers contingent loans that are repaid to the fund as the project matures and generates income. If the project is not successful, the loan is fully or partially forgiven and not repaid. The revolving funds are designed to invest in a portfolio of projects anticipating that successful projects will enable reflow to the fund, therefore allowing the fund to sustain operations well after the original GEF project may be completed.