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November 1, 2022

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63<sup>rd</sup> GEF Council Meeting  
November 28 - December 02, 2022  
Virtual Meeting

Agenda Item 15

**GEF BLENDED FINANCE GLOBAL PROGRAM  
AND NON-GRANT INSTRUMENTS POLICY UPDATE**

**Recommended Council Decision**

The Council, having considered document GEF/C.63/12, *GEF-8 Blended Finance Global Program and NGI Policy Update*, approves the proposed GEF-8 Blended Finance Global Program and Policy Update. The Council also requests the Secretariat to work with the GEF Trustee to provide an annual report on blended finance expected reflows to be submitted at the second Council meeting of each year.

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## **INTRODUCTION**

1. This document establishes the GEF-8 Blended Finance Program strategy, guided by the approved GEF-8 Programming Directions and GEF-8 resource allocation decisions.
2. This document also provides policy updates for the GEF Non-Grant Instruments (NGI) Policy, last updated in 2014, referenced as GEF/FI/PL/2. That policy covered the GEF-6 and GEF-7 cycles and was instrumental in guiding innovative non-grant investments and mobilizing private capital into GEF's strategic priorities. This updated policy will be applicable upon Council approval, for all NGI activities approved during the GEF-8 period.
3. The proposed policy updates cover the following areas: (a) agency eligibility, (b) financial terms of the investments, (c) types of financial instruments, and (d) reflow reporting.
4. A Guidelines document for projects seeking financing under the GEF Blended Finance Global program will be developed after the GEF-8 *Blended Finance Global Program and NGI Policy Update* is approved by Council.

## **GEF-8 BLENDED FINANCE PROGRAM UPDATES**

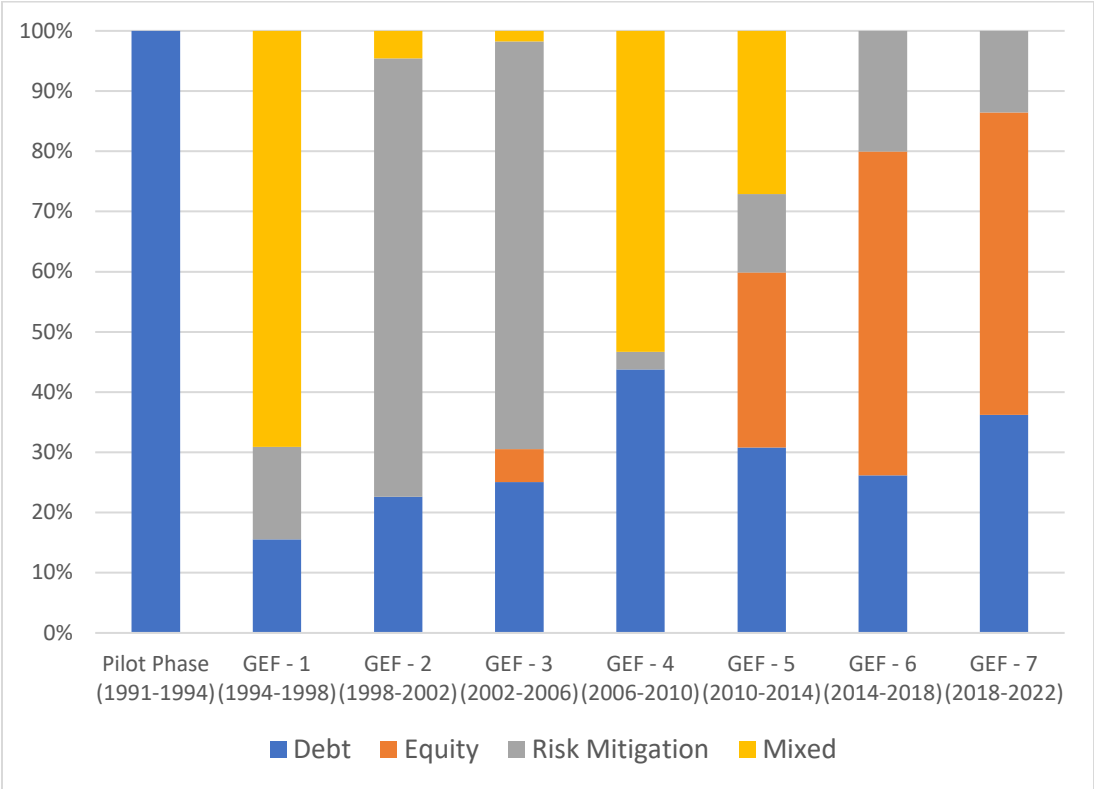
### **Background for Program Updates**

5. Under the GEF-8 Blended Finance Program, the GEF will continue to expand the use of blended finance to deliver global environmental benefits. The GEF work on blended finance has evolved from the early GEF cycles, resulting in a dedicated NGI window starting in GEF-4, receiving increasing support from Council in each subsequent GEF cycle and growing from \$40 million in GEF-4 to \$75 million in GEF-5, \$99 million in GEF-6, \$136 in GEF-7, and \$196 million in GEF-8.
6. The primary goal of the NGI window has been to expand private sector investment aligned with GEF strategic priorities and to create replicable business models and financial structures to accelerate private sector investment in the environment. The use by GEF Agencies of non-grant instruments such as debt, equity or guarantees (amongst other instruments) offers unique advantages for private investment since it enables the GEF to support innovation, and de-risk financial structures, to create adequate risk and return profiles for private investors to invest in the environment. Beneficiaries of the Blended Finance Program funding can be both the Private Sector and Public Sector entities.
7. In both GEF- 6 and GEF-7, the NGI projects have been increasingly adopting an integrated approach that brings together funding from trust funds and targets multiple focal areas. As the need for concessional financing for areas such as renewable energy and energy efficiency decrease over time, investments in "frontier areas" such as land degradation, international waters and biodiversity are growing from essentially zero in earlier GEF cycles to more than 60% in GEF-6 and GEF-7 NGI windows.

8. Throughout, the GEF blended finance initiatives under the several NGI windows have successfully invested in highly innovative projects, generated Global Environmental Benefits (GEBs), while achieving high co-financing ratios with strong participation of the private sector. During GEF-6 and GEF-7, the co-financing ratio for GEF investments 18:1, which is more than double in relation to the average co-financing ratio for the overall GEF portfolio<sup>1</sup>. Furthermore, participation of private sector co-financing is 12:1, which is more than three times higher than in the general GEF grant programs/projects portfolio.

9. The GEF Blended Finance Program’s flexibility in offering different types of financial instruments originating from its dedicated window has proven to be key in achieving high co-financing ratios with high private sector participation. This flexibility was also key in supporting new and innovative financial structures and products. In earlier phases of the GEF, debt instrument including revolving fund and risk mitigation instrument was widely used but in the recent replenishment periods, equity investment are more widely used (Figure 1).

**Figure 1 GEF NGI portfolio distribution by financial product**



<sup>1</sup> Additional data on co-financing can be found in section 7 of the GEF Corporate Scorecards dated June 2022, December 2021, June 2021.

10. Improvements to the Blended Finance Program, first identified and approved by Council in the GEF-7 Programming Directions<sup>2</sup> will be continued in GEF-8. These include:

- (a) To enhance transparency, the GEF designed a competitive selection process to access the NGI window with clear selection and eligibility criteria published in calls for proposals.
- (b) Further, and as suggested by Council, the GEF formally established the Advisory Group of Financial Experts (AGFE) to assist the GEF Secretariat on aspects related to financial criteria, business model sustainability, additionality, risks, and potential for replication and scaling. The AGFE also provides advice to the GEF Secretariat on recent trends in blended finance and emerging areas that the Blended Finance Program could potentially target.<sup>3</sup>

11. Building on this experience and accomplishments, the GEF-8 resource allocation for the Blended Finance Program will enable GEF's largest ever NGI program at US\$ 196 million. As agreed in the GEF-8 Programming Directions, priorities for these investments will include:

- (a) The GEF will seek to support innovation at the forefront of investments in nature and climate: biodiversity, land degradation neutrality, climate-smart agriculture, and deforestation-free food systems, while integrating climate resilience, Nature-based Solutions, and adaptation. During GEF-8, we can expect more multi-trust fund projects that will deliver benefits aligned with the adaptation and resilience agendas.
- (b) Maintain and enhance GEF flexibility to financially innovate through new financial instruments, such as convertible instruments, contingent instruments linked to environmental performance, and additional de-risking instruments such as political risk insurance and liquidity facilities.
- (c) Work with Agencies to encourage SIDS and LDCs to participate in projects accessing the blended finance window.
- (d) Continue to support the structuring of new asset classes, investment and aggregation platforms to reach scale and issuance of securities in capital markets linked to nature or climate goals.
- (e) The maximum investment amount per project under the Blended Finance Program is US\$ 15 million but could exceed that amount in regional or global projects with high expected global environmental benefits and transformational impact.
- (f) Provide support for initiatives that result in better information for private investment in the environment through disclosure metrics, such as the Taskforce for Nature related Financial Disclosures (TNFD) or greening the financial system.

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<sup>2</sup> Enhanced transparency, the collaboration with the AGFE and other improvements were documented in GEF/C.55/12, GEF-7 Non-Grant Instrument Program (November 2018)

<sup>3</sup> Ibid, page 3.

- (g) Explore the use of thematic calls for proposals to attract more interest in priority areas of investment.
- (h) Support for underserved MSMEs or corporate value chains with a mission to support sustainability of their sourcing.
- (i) Enhance transparency, harness collaboration with MDBs, further streamline the selection process, build on the capacity and experience of individual Agencies with non-grant instruments, and encourage more MSPs.
- (j) Improve knowledge management including making the database of NGI projects accessible through the GEF website.

### **Enhancing partnership with MDBs**

12. In GEF-8, we will continue efforts with the MDBs to accelerate project preparation and processing of blended finance investments, attract underserved beneficiaries, and enhance social and environmental metrics and monitoring. In prior cycles, MDBs have experimented with various investment decision approaches to speed up investments on the ground while retaining oversight over non-fiduciary investment objectives, such as GEBs. In many projects, investments can be put to work more quickly when Agencies have flexibility in making investment decisions.

13. This flexibility can be used to delegate the authority for investments to the Agencies coupled with confirmation mechanisms to be used with the GEF Secretariat to ensure the achievement of environmental objectives and the overall objective of the project. GEF Secretariat could use existing mechanisms, which have already been approved by Council. For example, in GEF-5, a concurrence mechanism within the operational modalities for the Public Private Partnership (PPP) was designed and adopted by Council which provided flexibility to the Agencies to deploy GEF funding as project conditions materialized.<sup>4</sup> An increased delegation of authority also was tested with the Earth Fund which resulted in important benefits in the climate change mitigation arena and laid the foundation for the broader use of blended finance at the GEF and at the Agency level.<sup>5</sup>

14. During GEF-8, the blended finance program will seek proposals that feature enhanced flexibility, and integration of GEB validation mechanisms into standard operational modalities of blended finance projects.

### **Additional financial instruments**

15. In GEF-8, innovative approaches that support new capital markets projects and novel financial structures are expected to require performance-based instruments linked to the achievement of environmental goals, political risk insurance, or contingent and/or convertible instruments.

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<sup>5</sup> GEFIEO OPS5 Technical Document #13 Review of GEF Engagement with the Private Sector.  
<https://www.gefio.org/sites/default/files/documents/ops5-td13-gef-engagement-private-sector.pdf>

16. Performance based instruments such as performance-based grants can be efficient mechanisms to incentivize good implementation during the life of the project. These instruments are increasingly used in blended finance structures creating pay-for-results mechanisms as is the case in Impact Bonds or sustainably linked financial instruments<sup>6</sup>. Contingent and convertible instruments, and liquidity facilities can also act as powerful credit enhancements, which are necessary to attract private sector investments in projects where risk is perceived as too high for commercial finance alone.

17. According to research by World Bank's MIGA (Multilateral Agency Guarantee Agency), one of the major constraints to private investment in developing countries is political risk.<sup>7</sup> Political Risk Insurance can be used to protect private investments against the risks of breach of contract, currency inconvertibility and transfer restriction, expropriation, war and civil disturbance, and non-honoring of financial obligations. Innovative approaches for targeting investments to underserved MSMEs

18. MSMEs and entrepreneurs in the environmental sector face many layers of bureaucracy to attract investment. In GEF-8, the Blended Finance Program will collaborate with the Country Support Program (CSP) to identify new techniques and intermediaries such as fintech, crowdfunding, blockchain and other techniques to reduce the number of intermediaries and barriers to investment in these beneficiaries, including women-owned businesses and civil society.

### **Enhancing transparency and streamlined selection Process**

19. Starting in GEF-5, the GEF NGI windows introduced several innovative processes to encourage submission of innovative NGI projects and streamline approval. The following principles will apply for the GEF-8 Blended Finance window:

- (a) Blended Finance projects will be pre-screened by the GEF Secretariat through a competitive process announced through a bi-annual call for proposals, including selection and eligibility criteria. Submitted projects are also reviewed by the AGFE.
- (b) Projects identified as a result of this competitive process will be considered for a GEF Work Program in accordance with the GEF Project and Program Cycle Policy and GEF-8 Strategic Directions. The documents to be submitted for Council review are standard PIF/PFD projects with three additional annexes: a termsheet, a reflow schedule and a form describing the Agency capacity with non-grant instruments.
- (c) Following established procedure contained in the GEF Project and Program Cycle Policy, MSPs can be submitted and selected outside the bi-annual call for proposals to allow for additional flexibility.

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<sup>6</sup> Mainstreaming Results-Based Finance: Actionable Recommendations from USAID *USAID* (2016); Impact Bonds in Developing Countries *The Brookings Institute and Convergence* (2017)

<sup>7</sup> World Investment and Political Risk. World Investment Trends and Corporate Perspectives. 2014. MIGA



## Technical Assistance

20. Among the feedback received from Agencies from GEF-7 is that many investment projects can benefit from grant funding for targeted technical assistance<sup>8</sup>.

21. In prior cycles, GEF Agencies would often supply grants for technical assistance through co-financing. This effort, while workable, can often slow down project proposal development, delay submission, and reduce opportunities to work with new and underserved recipients.

22. In GEF-8, GEF Agencies will have the option to request a portion of the financing under the NGI window in the form of a grant for technical assistance by the executing partner or the implementing agency<sup>9</sup>. This type of technical assistance is different from a Project Preparation Grant (PPG) and tailored to achieve maximum benefit at minimal cost. In practice, this will mean the overall rate of return and reflows on the total project amount will be lower than if technical assistance was financed by co-financing. Additional details on technical assistance financing under the blended finance window will be provided in a Guidelines document for projects under this Blended Finance window.

## Encouraging Multi-Trust Fund (MTF) Blended Finance Projects

23. In the GEF-8 Blended Finance Program, specific efforts will be made to review and improve procedures to facilitate the funding of proposals from multiple GEF trust funds (e.g. the Special Climate Change Fund (SCCF) and Least Developed Countries Fund (LDCF).

24. In addition, opportunities for co-financing and strategic collaboration will be pursued with other trust fund partners including the Adaptation Fund, Green Climate Fund (GCF)<sup>10</sup>, Climate Investment Funds (CIFs) or other sources.

## Perspectives on Risk Appetite of the GEF Blended Finance Program

25. Some GEF-8 replenishment participants noted a preference for establishing a risk appetite of the GEF. A recent STAP paper has identified the benefits of developing a GEF statement and strategy for risk appetite to enhance the ability to identify and pursue innovative approaches with potential for scaling<sup>11</sup>. A Council paper on risk will be presented in 2023.

26. NGI investments, by definition, are used in projects with a high risk to return ratio, pursuing innovative efforts and enhancing engagement of the private sector to generate environmental benefits beyond “business as usual”.

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<sup>8</sup> Toward a Greener Global Recovery OPS7 IEO, January 17, 2022.

<sup>9</sup> The technical assistance portion is not expected to exceed 10% of the overall Blended Finance Program window. Each project requesting technical assistance financing will be subject to Council Approval.

<sup>10</sup> Long Term Vision on Complementarity, Coherence and Collaboration between the GCF and the GEF. Document GEF/C.60/08

<sup>11</sup> STAP. 2018. Innovation and the GEF.

[https://stapgef.org/sites/default/files/publications/STAP%20Innovation%20report\\_WEB.PDF](https://stapgef.org/sites/default/files/publications/STAP%20Innovation%20report_WEB.PDF)

27. Through the many years of GEF NGI investments, innovative approaches and lessons learned have helped the GEF support projects that balance risk and reward. Likewise, years of experience have helped the GEF avoid or mitigate the types of risk that undermine the delivery of project outcomes, such as:

- (a) Fiduciary risk during project implementation
- (b) Risks created in the relationship between the Implementing and Executing Agencies.
- (c) Risks due to the lack of strong mechanisms for monitoring GEF environmental benefits and management of reflows.

28. In GEF-8, the Blended Finance Program will continue to identify projects that balance risk and potential for high impact, informed by the broader GEF risk appetite discussion, the expert input of the AGFE, guidance from private sector experts and international financial institutions.

### **Reflow Reporting**

29. The potential for non-grant instrument investments to produce reflows has been a central tenet of the GEF NGI Program since it was first considered as a separate financing window.

30. Before the establishment of the country allocation system (RAF and then the STAR), reflows could be generated by any project using NGI, depending on the project goals and objectives. After the establishment of RAF and STAR, however, reflows from NGI projects were restricted to projects funded from a dedicated window.

31. As noted in the NGI Policy, reflows generated by STAR allocation investments in country projects and that are used as NGI to enhance private sector engagement, do not flow back to the GEF Trust Fund at the end of the project.

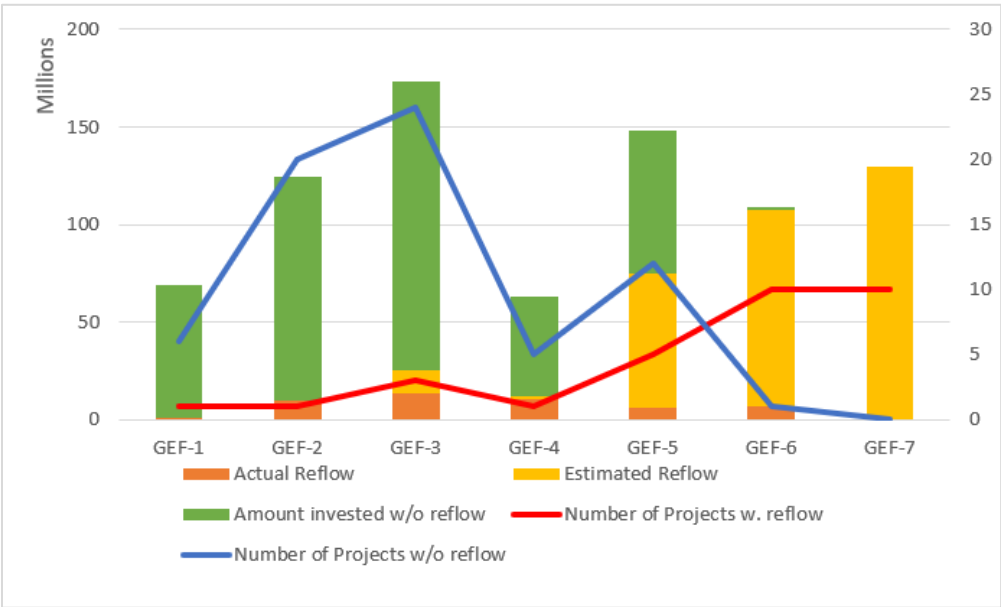
32. Practices and policies related to reflows, such as proposal content, reflow schedule, and reporting, have been covered in many Council documents, as noted in the References section. Since GEF-7, the GEF Secretariat submits to Council on an annual basis a report on expected reflows from NGI investments under the separate NGI funding window. Further guidance on reflows reporting is included in the updated NGI Policy.

33. On a quarterly basis, or alternatively at another frequency agreed with Trustee as per the terms of the Financial Procedures Agreements (FPAs) with Agencies, GEF Agencies commit to return actual reflows to the GEF Trust Fund. The Trustee then reports to the GEF Council on the amount of reflows received in its regular financial report of the GEF Trust Fund. On a yearly basis, and with a June cut-off date, the Agencies are required to report expected project reflows to the GEF Secretariat, so that the annual report in expected reflows can be submitted for the Fall Council. Justification of major changes in expected reflows, reflow schedules, and/or changes in the investment during project implementation are required to be included in this annual reporting exercise to the GEF Secretariat.

34. Since inception, the GEF Council has approved 101 projects with non-grant instruments with a total investment amount of USD 925.4 million and total co-financing of USD 8.7 billion. The majority are from the early GEF cycles, and most projects were not expected to generate reflows<sup>12</sup>. As documented in the yearly reflow papers submitted to Council, thirty-one (31) projects accounting for USD 339.1 million of GEF funding are expected to generate some level of reflows to the GEF Trust Fund. Five (5) of these projects are from GEF-3 and prior, and five GEF-7 projects are approved by the Council but not yet approved by the GEF CEO.

35. Most expected reflows are expected to be generated after the NGI separate set-aside was created in GEF- 4. Twenty- seven (27) projects are from GEF-4 through GEF-7, when specific set-asides for the use of non-grant instruments were established to help attract private sector investment, and with the expectation of reflows to the GEF Trust Fund. Several of these 31 projects have already generated reflows of USD 49.8 million with a total additional (remaining) expected reflow of USD 313.4 million as of June 2022 (Figure 2). The annual Update Report on Reflows to the GEF Trust Fund from the Non-Grant Instrument Portfolio<sup>13</sup> provides the additional documentation on this subset of GEF concessional finance projects, including distribution by geography, focal area, instrument type, and agency and annual reflow reporting provides more details.

**Figure 2 GEF NGI portfolio with reflow based on GEF Secretariat, Trustee and Agencies information**



<sup>12</sup> [GEF-6 Non-Grant Instrument Pilot and Updated Policy for Non-Grant Instruments](#), GEF/C.47/06, October 10, 2014, Annex 2-A GEF Projects using a Non-Grant Instruments, provides a full list of these early GEF projects using non-grant instruments.

<sup>13</sup> Reports to Council on Reflows were submitted for Council Review in 2021: GEF/C.61/Inf.13; in 2020: GEF/C.59/Inf.17; and in 2019: GEF/C.57/Inf.07.

## **GEF-8 NGI POLICY UPDATES**

### **Background for Policy Updates**

36. With the GEF-8 cycle and the launch of the GEF-8 Blended Finance Program, an updated NGI Policy is needed. The current GEF Non-Grant Instruments (NGI) Policy was last updated in 2014 as recorded in GEF/FI/PL/2. This GEF NGI Policy covered the GEF-6 and GEF-7 blended finance programs and was instrumental in guiding innovative non-grant investments. Changes in the GEF operating environment and lessons learned over the last eight years point towards the need for updates to the NGI Policy (GEF/FI/PL/2).

37. Policy updates cover the following areas: agency eligibility, financial terms, types of financial instruments, and reflow reporting.

38. The rationale for each proposed NGI policy update is provided in this Strategy Paper and below in the updated NGI Policy.

### **Agency eligibility**

39. Under current GEF NGI Policy, Section IX, Definitions, the ten GEF Agencies (three initial agencies and seven agencies from the first expansion in 2006) are listed as being eligible, but the eight agencies from the second expansion in 2011 are not mentioned.<sup>14</sup>

40. The policy update documents that all GEF Agencies are eligible to implement NGI resources, subject to the considerations noted below.

41. Under GEF-6-7 NGI Policy, GEF Agency eligibility is set forth in section VI, paragraphs 10-12. In brief, a GEF Agency was eligible to provide GEF concessional finance, if it can demonstrate the following:

- (a) Ability to accept financial returns and transfer from the GEF 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
- (e) A track record of financial returns from lending/financial arrangements.

42. For GEF-8, the NGI Policy will clarify that stricter requirements apply for GEF Agencies using non-grant instruments, with a higher degree of requirements to be applied under the Blended Finance Program.

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<sup>14</sup> <https://www.thegef.org/partners/gef-agencies>

43. Further, information received from Agencies from GEF-6 and GEF-7 indicate that certain types of innovative financial instruments for NGI may require additional expertise from the GEF Agency and its executing entities.

- (a) For GEF-8, the NGI policy will require Agencies to:
  - i. demonstrate capacity to perform investments with the type of non-grant instrument requested from the GEF;
  - ii. provide an analysis/assessment including financial, operational and legal considerations ahead of CEO Endorsement.
  - iii. Additional requirements on the suitability of the Agency such as co-financing and co-investment requirements, safeguards, strengthened due diligence, and strengthened reflow reporting by executing entities, among others, can be included in the call for proposals, or be specific to the design of individual projects.

### **Financial Terms**

44. A central tenet of GEF NGI funding is the principle of minimum concessionality. However, the GEF 6-7 NGI Policy does not establish the required conditions to satisfy this principle.

45. The recommended GEF-8 Policy adds clarity to this point, explaining that the concept of minimum concessionality is intended to avoid crowding out private sector investment. Therefore, it is understood to mean that private sector recipients of GEF NGI resources would not crowd-out other private sector actors. It also means that the project cannot be fully self-financed without GEF support, and hence that there is additionality in the funding provided by the NGI Program.

46. Reference to financial terms for public sector projects is updated to refer to ODA financial terms at the time of the project proposal.

- (a) As noted in the GEF NGI Policy and the GEF Blended Finance Strategy program, both public and private sector beneficiaries are eligible to be recipients of NGI investments by the GEF Agency/executing partner.
  - i. Rates of return and reflow schedules for private sector beneficiaries are negotiated by the GEF Agency to achieve minimum level of concessionality needed to achieve project objectives, and proposed in the project documents for review.
  - ii. Rates of return, maturity and reflow schedules for public sector beneficiaries are negotiated by the GEF Agency with terms and conditions consistent with terms and conditions applicable for agency financing in a given country at the time of project submission, and disclosed project documents for review.

## **Types of financial instruments and non-grant investment types**

47. Blended finance techniques and practices are constantly evolving and producing innovative approaches for nature-based solutions, climate finance, and other public/private financial solutions. Recent innovations have illustrated the potential for certain types of grants with the potential for reflows, such as performance-based grants, contingent grants, convertible grants and liquidity facilities. Political risk guarantee/insurance can also enhance private sector investments in most vulnerable countries by mitigating political instabilities.

48. GEF NGI Programs have over time supported a variety of non-grant instruments. The GEF-6-7 NGI policy classified these instruments into three main categories: (i) risk mitigation products; (ii) equity; and (iii) debt instruments. The existing policy also lists the common instruments in Appendix 1, while recognizing that innovative instruments can be considered for GEF projects even if they are not listed in Appendix 1. However, some clarifying language and additional descriptions of new types of financial instruments have been provided in the updated policy to include political risk insurance, liquidity facilities, convertible instruments and contingent instruments.

### **Reflow Reporting**

49. Agencies will be required to follow the template prepared by the GEF Secretariat, in coordination with the Trustee, for reporting on reflows on an annual basis. The reporting template, prepared by the GEF Secretariat, will be included in the CEO Endorsement letter for each project.

50. On a quarterly basis (or at another frequency as agreed with Trustee), as per the terms of the Financial Procedures agreements (FPAs), GEF Agencies are obligated to return reflows from projects funded through the Blended Finance Program to the GEF Trust Fund. The Trustee reports to the GEF Council on the amount of reflows received in its periodic financial report of the GEF Trust Fund.

51. On a yearly basis, and with a June cut-off date, the Agencies will report expected project reflows to the GEF Secretariat with the GEF Secretariat approved methodology.

52. The new GEF-8 policy includes several clarifications on reflows, including:

- (a) Reflows include both principal and investment remuneration (financial returns) from the NGI investments,
- (b) Project documents to be reviewed by the GEF Secretariat and submitted to Council consideration should present the financial terms and expected reflows. If currency risk is a consideration, the proposed approach and justification shall be documented in the project documents.
- (c) Actual reflows from every NGI project are required to be included in the GEF Agency's reports to the GEF Trustee.
- (d) Additional justification on changes in actual or expected reflows shall be requested as part of the annual reporting to the GEF Secretariat.

## REFERENCES

- GEF/C.41/09/Rev.01, *Revised Strategy for Enhancing Engagement with the Private Sector* (November 10, 2011)
- GEF/C.42/Inf.08, *Operational Modalities for Public Private Partnership Programs* (May 4, 2012)
- GEF/C.47/06 GEF-6, *Non-Grant Instrument Pilot and Updated Policy for Non-Grant Instruments* (October 28, 2014)
- GEF/Fl/PL/02, *Non-Grant Instruments* (October 30, 2014)
- GEF/C.49/04/Rev.01, *Future Directions on Accreditation* (October 15, 2015)
- GEF/C.51/03, *Annual Portfolio Monitoring Report* (October 7, 2016)
- GEF/C.52/Inf.06/Rev.01, *Guidelines on the Project and Program Cycle Policy* (June 9, 2017)
- GEF/C.55/06, *Policy on Access to Information* (November 21, 2018)
- GEF/C.55/12, *GEF-7 Non-Grant Instrument Program* (November 27, 2018)
- GEF/OP/PL/01, *Project and Program Cycle Policy* (December 20, 2018)
- GEF/C.57/Inf.07, *Update Report on Reflows to the GEF Trust Fund from Non-Grant Instrument Portfolio* (December 16, 2019)
- GA/PL/02, *Minimum Fiduciary Standards for GEF Partner Agencies* (December 19, 2019)
- GA/PL/04 *Policy on Access to Information* (December 20, 2018)
- GEF/C.59/Inf.03, *Guidelines on the Project and Program Cycle Policy (2020 Update)* (July 20, 2020)
- GEF, *Guide for Understanding and Accessing Blended Finance* (December 2, 2020)
- GEF/C.59/Inf.17, *Update Report on Reflows to the GEF Trust Fund from Non-Grant Instrument Portfolio* (December 7, 2020)
- GEF/C.61/Inf.13, *Update Report on Reflows to the GEF Trust Fund from Non-Grant Instrument Portfolio* (December 1, 2021)
- GEF/C.57/Inf.07, *Update Report on Reflows to the GEF Trust Fund from the Non-Grant Instrument Portfolio* (November 26, 2019)
- GEF/C.59/Inf.17, *Update Report on Reflows to the GEF Trust Fund from the Non-Grant Instrument Portfolio* (November 17, 2020)
- GEF/C.61/Inf.13, *Update Report on Reflows to the GEF Trust Fund from the Non-Grant Instrument Portfolio* (November 17, 2021)



## **Non-Grant Instruments Policy**

Updated January 1, 2023



**Applicability:** This Policy applies to all non-grant instruments under GEF projects and programs approved by the Council or the GEF CEO under the Blended Finance Program window and focal area resources on or after the date of effectiveness of this Policy. It replaces and supersedes the policy statements contained in Council Document GEF/FI/PL/2, Policy - Non-Grant Instruments, approved by the Council at its 47th meeting on October 10, 2014.

This policy applies to all uses of non-grant instruments, whether financed through the Blended Finance Program, or through country STAR allocations and non-STAR resources. Certain requirements of the policy are specific to projects with the expectation of reflows to the GEF Trust Fund, further elaborated below.

**Date of Effectiveness:** January 1, 2023

## **I. INTRODUCTION**

1. This Policy establishes the framework and requirements 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 : (a) enhance effectiveness by leveraging substantial capital for targeted investments that support GEF 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 an instrument that provides financing in a form that has the potential to generate financial returns from the original investment or has the potential for principal repayment, irrespective of whether such financial flows are returned to the GEF Trust Fund. Non-grant instruments can be used under the Blended Finance Program (former NGI program) or used under the STAR allocation, IW or CW focal areas (see section IV for further details).
4. Financial returns are proceeds that are collected from the remuneration for using non-grant instruments, including interest income (for debt instruments), premium (for guarantees and insurance), dividends (for equity investments), proceeds from the sale of equity stakes or other assets (capital gains), other earnings and repayment of reserves. Principal repayment refers to the original amount of GEF funding invested in a given project.
5. GEF projects/programs are to be designed with the appropriate type of non-grant instrument that best supports the goals of the project/program. The GEF Agency submits projects/programs that include, but are not limited to, the following common types of non-grant instruments, which are described in further detail in Appendix 1. The instrument names below are illustrative; the Agency uses instruments and terms applicable under its policies and procedures:

- a. Credit guarantee (partial/full);
  - b. Performance risk guarantee;
  - c. Political Risk Guarantee/Insurance
  - d. Liquidity Facilities
  - e. Structured finance;
  - f. Debt instruments;
  - g. Equity/investment fund;
  - h. Contingent instruments-performance based instruments;
  - i. Convertible instruments;
6. Other types of non-grant instruments not listed in this list may be developed through innovative approaches and can also be considered for GEF projects as long as they comply with the characteristics described in paragraphs 1 and 2 above.

#### **IV. REFLows**

7. When a project uses GEF financing under the Blended Finance separate financing window, reflows are transferred to the GEF Trust Fund and include principal repayment and investment remuneration (interest rate, return, premium, etc.). When a country uses STAR allocation amounts for a project/program deploying a non-grant instrument, potential reflows are not expected to be returned to the GEF Trust Fund and will remain available to the beneficiary country making such use of their STAR allocation. For the IW and CW focal areas, reflows shall be returned to the GEF Trust Fund if the project/program benefits private sector recipients; if the project beneficiaries are public sector recipients, the potential reflows are not expected to come back to the GEF Trust Fund.
8. In accordance with the GEF Instrument: (i) GEF financing is considered *GEF concessional finance*, if it is provided for 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 for a project/program that is not expected to generate reflows to the GEF Trust Fund, such as project elements funded using Country STAR allocation.
9. Reflows may be lower or higher than expected at the outset of a project/program. GEF Agencies are responsible for closely monitoring projects and are required to report and manage reflows as described in Section V of this Policy.

#### **V. MONITORING, REPORTING AND MANAGEMENT OF REFLows**

10. For projects using non-grant instruments with no expectation of reflows to the GEF Trust Fund (i.e., using STAR allocation), the GEF Agency documents in the project proposal submission the type of non-grant instruments to be used, and the planned disposition of any remaining financing at the end of the project. Monitoring, reporting, and management of the project meets applicable GEF M&E requirements.

11. For projects using non-grant instruments with expectation of reflows to the GEF Trust Fund, each GEF Agency will seek to return the expected reflows as determined in the project documents, and in accordance with its own policies and procedures, recover outstanding balances, recognizing the risk of non-payment by a beneficiary can reduce reflows, including the loss of principal. The GEF Agency will maintain documentary evidence of its efforts to recover differences in expected reflows and document such differences, during the yearly submission of Expected Reflows to the GEF Secretariat or, on an ad-hoc manner as appropriate.
12. Pursuant to the provisions of the FPA between the GEF Agency and the Trustee, the following procedures apply to the management of reflows by the GEF Agency:
  - a. The GEF Agency receives and holds the financial returns arising from non-grant instruments, including principal and investment income accruing thereon, in a designated account until such financial returns are transferred to the Trustee as reflows with a periodicity agreed under the FPA;
  - b. All net reflows, including principal, investment income, and unused balances from completed, terminated, or canceled projects, are transferred to the Trustee at least twice a year, or at a frequency agreed between the Trustee and the GEF Agency;
  - c. The GEF Agency informs the Trustee about reflows, on a quarterly basis, or at another frequency as agreed between the Trustee and the GEF 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 Agency to the Trustee is in writing; and
  - e. The GEF Agency maintains supporting documentation which may be requested by the Trustee as needed.
13. Each GEF Agency will provide a summary report on NGI projects under implementation and/or still generating reflows, including actual and expected reflows, to the GEF Secretariat on an annual basis. Justification of major changes in expected reflows, reflow schedules, and/or changes in the investment during project implementation are required to be included in this annual reporting exercise to the GEF Secretariat.<sup>15</sup>

## **VI. COUNTRY ELIGIBILITY**

14. GEF non-grant instruments may be used in any GEF recipient country provided that the recipient country meets the criteria under paragraph 9(a) or 9 (b) of the Instrument. Eligible beneficiaries of concessional finance in the public sector or the private sector shall be located in any GEF recipient country that meets the criteria under paragraph 9 (c) of the Instrument.

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<sup>15</sup> The GEF Secretariat should be informed major amendments to NGI projects consistent with the GEF Program/Project Cycle Policy.

15. Financial intermediaries may be located in countries other than a GEF recipient country, subject to Agency policies and procedures, and provided the final beneficiaries (recipients of GEF financing) are located in a GEF recipient country.
16. GEF concessional finance may not be provided to a public sector beneficiary in 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 at the time of approval of the GEF financing.

**VII. FOCAL AREA ELIGIBILITY FOR NON-GRANT INSTRUMENTS**

17. Resources from all GEF focal areas set out in paragraph 2 of the Instrument can be used as non-grant instruments.

**VIII. GEF AGENCY ELIGIBILITY TO ADMINISTER NON-GRANT INSTRUMENTS AND CONCESSIONAL FINANCE**

18. A GEF Agency is eligible to administer projects using non-grant instruments if it can demonstrate the following:
  - a. Ability to monitor compliance with non-grant instrument repayment terms;
  - b. Capacity to track financial returns (semester billing and receiving) not only within its normal operations but also for transactions across trust funds;
  - c. Experience and positive track record with the use of non-grant instruments.
19. For concessional finance (i.e projects under the Blended Finance Global Program), a GEF Agency must further demonstrate:
  - a. Ability to receive and account for financial returns and transfer such returns from the GEF Agency to the GEF Trust Fund;
  - b. Capacity to perform investments in the type of non-grant instrument to be used with GEF funding;
  - c. An analysis of the investment/due diligence for GEF investments ahead of CEO endorsement;
  - d. Additional requirements on the suitability of the Agency such as co-financing, co-investment requirements, additional safeguards, strengthened due diligence, and strengthened reflow reporting by executing entities. These may be included in the call for proposals, or be specific to the design of individual projects.
  - e. Commitment to transfer reflows to the GEF Trust Fund as agreed under the FPA;
20. In case of concessional finance for public sector recipients, additionally, the Agency will be required to demonstrate:
  - a. Track-record of lending or financing arrangements (other than grants) with public sector recipients; and
  - b. Established relationship with the beneficiary countries' Ministry of Finance or equivalent.

## **IX. FINANCIAL TERMS for NON-GRANT INSTRUMENTS**

21. For non-grant instruments with private sector entities, the GEF 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.
22. For purposes of this policy, minimum concessionality means that recipients of concessional finance would not fully self-finance the initiative without GEF support and would not have the full expertise to implement the project without GEF support. Documentation and justification for minimum concessionality will be required in each proposal for use of non-grant instruments.
23. Both public and private sector beneficiaries are eligible recipients of NGI investments by the GEF Agency or executing partner.
  - a. Rates of return and reflow schedules for private sector beneficiaries are negotiated by the GEF Agency to achieve minimum level of concessionality needed to achieve project objectives.
  - b. Rates of return, maturity and reflow schedules for public sector beneficiaries are negotiated by the GEF Agency with terms and conditions consistent with terms and conditions applicable for agency financing in a given country at the time of project proposal.

## **X. Definitions**

24. The terms used in this Policy have the meanings set forth below:
25. **Project Executing Entity:** An organization that executes a GEF Project, or portions of it, under the supervision of a GEF Agency, including national or sub-national government agency, civil society organizations (CSOs), private sector entities, or academic institutions among others. For Non-Grant Instrument projects, eligible executing entities will also include financial intermediaries.
26. **GEF Agency:** An institution approved by GEF Council as eligible to request and receive GEF resources directly from the GEF Trustee under the terms of an FPA and on behalf of an eligible recipient for the design and implementation of GEF-financed projects.

## **Appendix 1: 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), Council Document GEF/C.32/07, *Use of Non-Grant Instruments in GEF Projects: Progress Report* (October 25, 2007), and further explained in FI/PL/02, *Updated Policy – Non-Grant Instruments* (October 10, 2014).
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.
3. Blended finance practices are constantly evolving and producing innovative approaches for nature-based solutions, climate finance, and other public/private financial solutions.

### **Risk mitigation products**

#### *Credit Guarantee/Partial Credit Guarantee*

4. Credit guarantees are a commitment to reimburse a lender/or bond issuer if the borrower/issuer fails to repay a loan/bond. The credit guarantee balance is not invested but held in reserve and only paid out if a borrower fails to repay due to general credit risk. The reflows of the guarantee consist in a premium (remuneration) and the uncalled/recovered amount of the guarantee.
5. In partial credit guarantees, the GEF provides a guarantee for a pre-defined portion of a commercial loan/bond issuance, sharing the rest of the risk of potential losses with the lender and other guarantors. Guarantees are credit enhancements that improve the financial terms and conditions of loan or bond terms. The reflows of the guarantee consist in a premium (remuneration) and the uncalled/recovered amount of the guarantee.

#### *Performance Risk Guarantee*

6. A performance risk guarantee is similar to a credit guarantee, but the risk covered is not a credit risk but the performance of an underlying technology/project. In this case the guarantee is used to help compensate project partners if the project fails to deliver expected cost-savings (i.e., through energy efficiency improvements) due to the lack of performance of the technology used.

#### *Political Risk Guarantee/Insurance*

7. A political risk guarantee/insurance provides financial protection to investors that face the possibility of loss due to political events. It protects against the possibilities such as expropriation, political violence, breach of contract, the inability to convert local currency and repatriate it, sovereign debt default, and acts of terrorism and war. Political turbulence can cause assets to decline severely in value or to be destroyed or confiscated and lose value together. This instrument reduces the risk of doing business in countries with above-average levels of political instability that threaten their assets and their ability to operate smoothly. The reflow of this instrument is composed of a premium and the non-used or recovered guarantee.

### *Structured Finance*

8. This is a financial structuring approach 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 exposed to higher risk, 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 funding and other junior partners potentially being subordinated in repayment to more senior participants.
9. This mechanism is very close in end goal to a partial risk-sharing facility, however, in this model the GEF funds are invested by the Agency or an agent thereof, rather than held in reserve. The reflow of this investment depends on the financial structure and usually includes a financial return and principal repayment.

### *Liquidity Facilities*

10. Liquidity Facilities are financing instruments that are used to cover cash shortfalls in project finance, structured finance and other capital markets transactions that are used as credit enhancements that reduce the probability of default or severity of default of a given project. The reflow for this investment consists in a fee for available funding under the liquidity facility and principal repayment, when applicable.

## **Equity**

### *Equity Investment in Funds or Financial Vehicles*

11. Investment funds are for-profit non-bank financial intermediaries that receive investments from GEF Agencies (or agents thereof) using GEF funds, and other investors to then redeploy the financing in projects that generate GEBs with a potential financial return. The equity participation gives ownership to the investor and provides patient capital to the investee. Investment funds leverage GEF financing to mobilize a larger pool of commercial capital to invest in eligible projects, utilizing debt, guarantees or equity instruments as appropriate. Equity investment can also occur in financial vehicles where the GEF is not a majority holder.

## **Debt instruments**

### *Concessional Loan*

12. A concessional loan refers to a loan provided at below-market interest 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.

Concessional loans are likely to be structured in subordination to senior debt so as to take higher risks than other project debt. Subordination means that the loan supported (or made possible) by GEF financing will have lower priority of repayment in case of default.

### *Revolving Loan Fund*

13. A revolving fund establishes a mechanism whereby the GEF investment is 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.

## **Convertible and contingent instruments**

### *Contingent Instruments*

14. A contingent grant is a grant that is kept in reserve in order to pay a beneficiary for achieving an outcome that may or may not happen in a determined period of time in the future. An example of contingent grants is a performance-based grant that is paid if certain environmental outcomes are achieved with the activities of a project/intervention at a given date. The future payment acts as an incentive for a transformative change, and the GEF Agency would only pay if the global environmental benefits are achieved through the project activities. The reflow that may or may not be paid back in this case is the principal of the grant (with no financial return).
15. 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 contingent grant. A contingent loan is repaid on a similar schedule and with similar interest to other loans and may have an interest rate or coupon tied to it to reflect borrowing costs. The loan can become a grant if certain conditions to achieve environmental goals (agreed in each project) are met.

### *Convertible Instruments*

16. A convertible instrument is a financial instrument (equity, loan, guarantees) that may convert into a grant if certain environmental outcomes are achieved with the activities of a project/intervention. Since the product has the potential to generate reflows (financial instrument return) it is classified as a non-grant instrument at inception.
17. A convertible grant may convert into another financial instrument (equity, debt, guarantees etc) if some environmental or financial triggers occur. Convertible grants usually imply a discount rate (more favorable terms) on the pricing of the new non-grant instrument it is converted into. The reflow in this case comes from the potential return that a convertible grant may result in, if converted to a financial instrument other than grants.