

The Green Climate Fund

A Unique Financing Vehicle among International Organizations

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Abstract

Global efforts to prevent catastrophic climate change have given rise to international collaboration, including between developed and developing countries. However, contentious issues around accountability for and financing of climate action remain. Within this context, this chapter explores how the Green Climate Fund (GCF) has navigated these issues to build collaboration and to effectively fulfill its mandate to accelerate low-emission and climate-resilient development in developing countries. The first section of this chapter outlines where GCF fits within the international climate change regime, including underlying principles. Section 1.2 then reviews key provisions of GCF's Governing Instrument, including the composition of its Board and its financing sources. Section 2 of this chapter analyses the development of GCF's capital raising processes, from the initial resource mobilization to the transition to a formal replenishment process. This section also examines how the organization has sought to balance diverse needs, including the need for oversight with accessibility of funding. The third section examines GCF's resource mobilization policies in detail, to provide insight into how its unique mandate, governing structure and fundraising modalities are functionally supported and made operational. The fourth and final section concludes the analysis of GCF's financing modalities and provides an indication of potential future directions for GCF.

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1 Introduction***

The Green Climate Fund (GCF) is the world's largest dedicated climate change fund and its work is inherently connected to the intricate international politics in this field, as well as broader efforts to combat the effects of climate change. The impacts of climate change vary across regions, countries and populations, with many developing countries bearing the worst consequences with limited capacity to adapt.¹ Additionally, oversight of funds for climate change mitigation and adaptation is necessary to ensure effective results are achieved with integrity, transparency and accountability. Accordingly, GCF inhabits a space of compromise and collaboration, where these different needs must be recognised and balanced. This chapter will explore how GCF has sought to develop suitable policies to respond to this challenge and, in particular, how its representative governance has impacted this process. The first section focuses on the international climate change regime and how this has shaped GCF, particularly in relation to its governing structure. The second section explores the process and politics of GCF's first resource mobilisation and the transition to a formal replenishment. To highlight its unique legal framework, final sections of the chapter review GCF's resource mobilisation and relevant operational policies in detail.

1.1 *International Climate Change Regime and the Green Climate Fund*

GCF is established under the United Nations Framework Convention on Climate Change² (UNFCCC or the Convention). The Convention was adopted in 1992, entered into force in 1994 and now has almost universal membership with 197 country Parties. Its ultimate objective is the “stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system”. In the 2015 Paris Agreement, which was adopted in Paris at the 21st session of the Conference of the Parties (COP 21) to the UNFCCC on 12 December 2015 and entered into force on 4 November 2016, this goal was further refined to, amongst others, keeping the “increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature

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1 Intergovernmental Panel on Climate Change 2018, 9 para B.5.1.

2 United Nations Framework Convention on Climate Change (adopted 9 May 1992, entered into force 21 March 1994) 1771 U.N.T.S. 107 (the Convention).

increase to 1.5°C”.³ Achieving this goal and addressing the impacts of climate change requires a significant investment of resources. Assigning responsibility for financing climate action, and determining how to distribute those funds, is an ongoing issue in global climate change negotiations. In light of GCF’s role as a climate change fund, these matters are central to its governance, operations and other modalities.

The Convention provides guidance on apportioning responsibilities related to climate change action and finance. Article 3.1 of the Convention establishes that the principle of Common but Differentiated Responsibilities and Respective Capabilities (CBDRRC) should apply and that developed country Parties should be taking the lead on climate change action. Consistent with this principle, Article 4.3 of the Convention states that developed country Parties shall transfer financial resources to meet the costs incurred by developing country Parties in complying with their obligations under the Convention. This obligation is reiterated in Article 9.1 of the Paris Agreement, with Article 9.2 encouraging other Parties to provide voluntary support. Article 11 of the Convention also provides that there shall be a financial mechanism for the provision of financial resources on a grant or concessional basis. As GCF was entrusted as one of the operating entities of the financial mechanisms, Article 11 lays down the foundations of GCF’s accountability and governance structure.

1.2 *Governing Instrument of the Green Climate Fund*

The Conference of the Parties (COP), the highest decision-making body under the Convention, established GCF in 2010 at its 16th Session.⁴ A year later at COP 17, GCF’s Governing Instrument (GI) was approved, further defining the objectives and structure of the Fund.⁵ Pursuant to the GI, GCF’s purpose is to make a significant and ambitious contribution towards attaining the goals set by the international community to combat climate change, particularly the Paris Agreement goals. Further, within the UNFCCC framework, GCF is to promote the paradigm shift towards low emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change. Another crucial element from the GI are the principles which guide

3 Conference of the Parties (adopted 12 December 2015, entered into force 4 November 2016) U.N. Doc. FCCC/CP/2015/L.9/Rev/1 (the Paris Agreement).

4 Conference of the Parties, ‘Decision 1/CP.16’ FCCC/CP/2010/7/Add.1 (2010).

5 Conference of the Parties, ‘Decision 3/CP.17’ FCCC/CP/2011/9/Add.1 (2012), 55–66 (the Governing Instrument).

GCF's work: GCF is to provide additional, adequate, and predictable financing to catalyse climate investment in both the public and private sphere, with balanced impacts in both adaptation and mitigation. In achieving these aims, GCF must be transparent, accountable, country-driven, while also promoting environmental, social, economic and development co-benefits and taking a gender-sensitive approach. To ensure GCF has the necessary tools to transform these important objectives into reality, the GI prescribes that GCF shall have juridical personality, legal capacity as necessary for its functions and privileges and immunities necessary for the fulfilment of its purposes.

The foundations for the governance structure and decision-making authority for GCF are set out in decision 1/CP. 16⁶ and the GI.⁷ Specifically, decision 1/CP. 16 requires that GCF be governed by a Board of 24 members, composed of an equal number of representatives from developing and developed country Parties, including representatives from Small Island Developing States (SIDS) and Least Developed Countries (LDCs).⁸ The GI also provides the Board with full responsibility over the funding decisions of GCF.⁹ The Board is supported by an independent GCF Secretariat which manages day to day operations and whose Executive Director (ED) enjoys only limited authority which has been delegated by the Board or as otherwise set out in the GI.¹⁰ This Board structure is extremely unusual amongst international financial institutions which generally, though not exclusively, leave a majority of Board seats for donors or funders. As a result, decision-making in GCF requires a balancing act between the different regional, financial and ideological interests on the Board. In particular, the collaboration and compromise between developed and developing party representatives has influenced many of GCF's core policies for receiving and distributing funds.

Another central aspect of GCF shaped by the GI is GCF's financing sources. As previously noted, GCF operates within the UNFCCC framework which requires developed countries to take the lead and transfer financial and technological resources to developing countries.¹¹ This is codified in the distinction between paragraphs 29 and 30 of the GI: Paragraph 29 mandates that the Fund will receive financial inputs from developed country Parties to the Convention, while paragraph 30 makes it optional for GCF to receive financial inputs from a

6 See note 4, [103].

7 See note 5, [11.C.1.9].

8 See note 4, [103].

9 See note 5, [11.A.5].

10 See note 4, [108]; See note 5.

11 The Convention 2015, Article 3.1.

variety of other sources, both public and private. Within these provisions, the GCF Board has authority to further define the parameters of raising capital. In this context, the representative governance on the Board reinforces the focus on ensuring developed countries fulfil their financing responsibilities under the international climate change regime while also striving for stringent financial oversight.

GCF is not the only operating entity under the UNFCCC's financial mechanism provision. The Global Environment Fund (GEF) is the other functioning operating entity and uses similar contribution-based financing, although it splits the funds between its five conventions.¹² The five conventions are respectively: The Convention on Biological Diversity (CBD), the Minamata Convention on Mercury, the Stockholm Convention on Persistent Organic Pollutants (PoP), the United Nations Convention to Combat Desertification (UNCCD), and the UNFCCC. UN agencies similarly rely on contributions. However, they receive a combination of assessed contributions and voluntary contributions. Multilateral Development Banks (MDBs) also fund projects similar to those in GCF's portfolio. In contrast to GCF, GEF and UN agencies, MDBs predominately provide finance through loans and raise funds in more varied ways, including leveraging their share capital and engaging with capital markets. As demonstrated, GCF is thus unique in its reliance on voluntary contributions for a single purpose.

2 How the Green Climate Fund Raises Capital

2.1 *Launching the Initial Resource Mobilization*

This section discusses the rationale surrounding the timing and nature of the first resource mobilisation effort by GCF. The Board decision for GCF to launch an ad hoc Initial Resource Mobilization (IRM) and transition later to a formal replenishment process was made at the Fifth Board Meeting, held in October 2013.¹³ By decision B.07/09 in May 2014, the Board confirmed that certain requirements relating to the Fund's capacity to receive, manage, programme and disburse financial resources had been met and that the IRM process should commence.¹⁴ The Board requested that pledges be received by November 2014,

12 Global Environment Facility 2019, 9–10.

13 Green Climate Fund, 'Decisions of the Board – Fifth Meeting of the Board' GCF/B.05/23 (2013), 12.

14 Green Climate Fund, 'Decisions of the Board – Seventh Meeting of the Board' GCF/B.07/11 (2014), 11.

with the acknowledgment that the process may extend beyond this date. To begin the IRM process, the Board also endorsed arrangements proposed by the Secretariat for the collective engagement of interested contributors.¹⁵ These arrangements included a series of meetings to assess the overall performance, as well as virtual communication between meetings as necessary; two technical sessions and a high-level pledging conference.¹⁶

2.2 *Themes and Priorities*

At the first and second meetings of interested contributors to the Initial Resource Mobilization Process, held respectively in June/July and September 2014, differing views emerged regarding GCF's financial policies as well as governance matters.¹⁷ These debates then carried over to the eighth Meeting of the Board and subsequent board meetings. The discussion on the policies for contributions at the eighth Board Meeting highlights some of the key contentious issues, including potential earmarking or targeting of financial contributions, proposed linkage between contributions and decision-making in order to incentivise more fundraising and the division of roles between the Board and Secretariat.¹⁸ Procedures for decision-making in the absence of consensus, a matter the Board was mandated by the GI to resolve, also remained a controversial issue for many years. Despite these tense negotiations, the policies for contributions for the IRM were eventually endorsed at the eighth Board Meeting,¹⁹ which paved the way for contributors to make pledges to the Fund.

Of note, the IRM Contributions Policy reaffirms that GCF would accept only the following types of contributions: (a) grants from public and private sources (noting that private sources would require the development of a separate policy); (b) contributions from public sources; and (c) concessional loans from public sources.²⁰ It was held that grants must "significantly exceed" loan amounts²¹ and limitations were set on the uses of loans, for example, they

15 Ibid.

16 Green Climate Fund, 'Arrangements for the first formal replenishment of the Green Climate Fund' GCF/B.21/30/Rev.01, (2018), 4.

17 Green Climate Fund, 'Outcome of the First and Second Meetings of Interested Contributors to the Initial Resource Mobilization Process of the Green Climate Fund' (2014) GCF/B.08/15.

18 Green Climate Fund, 'Report of the Eighth Meeting of The Board' GCF/B.08/46 (2014), [287]-[341].

19 Green Climate Fund, 'Decisions of the Board – Eighth Meeting of the Board' GCF/B.08/45 (2014), [22].

20 Ibid, Annexes XIX–XXIII.

21 Ibid, Annex XIX [III.10].

were not available for non-reimbursable uses such as to finance the administrative budgets of the Fund. It was also agreed that contributions in the form of loans or capital would be accompanied by a minimum grant contribution to the Fund to cover administrative costs²² and that loan contributions would also be accompanied by a grant contribution to cushion any non-performing loans.²³ Many of these core provisions have carried through to GCF's first replenishment.

2.3 *Pledges as Part of the Initial Resource Mobilization*

After finalizing the policies and other arrangements for contributions, the High-Level Pledging Conference was planned for 20 November 2014 in Berlin, Germany. Even before the Conference, however, almost USD 3 billion had already been pledged.²⁴ Twenty-one more countries, including four developing countries, pledged at the High-Level Pledging Conference, resulting in a total of the equivalent of approximately USD 9.3 billion.²⁵ Between the Pledging Conference and COP 20, there were additional pledges announced from Spain, bringing its total pledge to EUR 120 million, and Canada (CAD 300 million).²⁶ Further pledges were announced at COP 20, with some original contributors increasing contributions and other contributors pledging for the first time. Ultimately, the pledges amounted to the equivalent of approximately USD 10.2 billion and were received from 32 countries, including eight developing countries.²⁷ The final hurdle for GCF before allocating resources towards projects and programmes, was to reach effective commitment authority. This required 50 % of contributions pledged by November 2014 to be confirmed by fully executed contribution agreements/arrangements by the Secretariat no later than 30 April 2015.²⁸ In May 2015, GCF was confirmed to have reached the necessary threshold for commitment authority to become effective.²⁹ Resulting from the contributions from both developing and developed countries, this milestone highlights the collaborative approach of GCF.

22 Ibid, Annex XIX [IV.13(c)].

23 Ibid, Annex XIX [VI.25(f)(11)].

24 Green Climate Fund, 'Outcome of the First GCF Pledging Conference and Pledges as of December 31, 2014' (2015) GCF/BM-2015/Inf.01/Rev. 01, [I.2].

25 Ibid, [11.10].

26 Ibid, [111.13].

27 Ibid, [111.14].

28 Ibid, [IV.15].

29 Green Climate Fund, 'Fourth Report of the Green Climate Fund to the Conference of the Parties to the United Nations Framework Convention on Climate Change' GCF/B.10/08 (2015), [V.5.4.3.25].

2.4 *The Green Climate Fund's First Formal Replenishment ("GCF-1")*

One of the major factors influencing the move towards a formal replenishment cycle model was the predictability of funding – an underlying principle required by GCF's GI. During the years following the completion of the IRM, the COP was also active in urging the Board to “agree on the arrangements for the first formal replenishment process of the GCF as soon as feasible”³⁰ at COP 21 and to launch the replenishment process at COP 23.³¹ The COP also noted the importance of the mandate of GCF, particularly in the context of the Paris Agreement and the commitment of developed countries to mobilise USD 100 million per year for climate action.³² Linkages between the Paris Agreement and UN Sustainable Development Goals and Agenda 2030 have also been highlighted to emphasise the crucial nature of GCF's work.

Turning to the arrangements for the first replenishment process, the Board discussions returned to old debates concerning the balance between oversight and accessibility of GCF funds. Board discussions also considered the desired ambition of the replenishment, with developing countries especially looking for increased scale and potential targets to match the goals outlined under the UNFCCC. While targets did not ultimately form part of the replenishment arrangements, these discussions underlined the urgency and importance of GCF for sustainable development in many countries.

2.5 *Decision to Trigger the Replenishment*

In undertaking the replenishment process, one matter which remained consistent over the years was the proposed trigger for the replenishment. In the first meetings with Interested Contributors for the IRM process and Policies for Contributions to the IRM, held in 2014, there was agreement that the formal replenishment process should be triggered “once the Fund's cumulative funding approvals exceed 60 % of the total contributions”³³ and this number was reaffirmed in subsequent policies. At the twenty-first Meeting of the Board, practical issues with the trigger arose, as there were different potential methods for calculating the Fund's total contributions. Of particular note was the question whether or not to count the USD 2 billion of the pledged USD 3 billion which had not been confirmed by a fully executed contribution agreement. As a result, the decision at the Twenty-first Meeting of the Board³⁴

30 Conference of the Parties, ‘Decision 7/CP.21’ FCCC/CP/2015/10/Add.2 (2015), [10].

31 Conference of the Parties, ‘Decision 9/CP.23’ FCCC/CP/2017/11/Add.1 (2017), [17].

32 See note 31, [53].

33 See note 22, Annex XIX [I.1(d)].

34 Green Climate Fund, ‘Decisions of the Board – Twenty-first meeting of the Board’ GCF/B.21/34 (2018), [58].

to commence the formal replenishment did not reference the 60 % trigger, but instead noted the importance of replenishment in accordance with GCF's mandate and its increased capabilities to support low-emission and climate-resilient development.³⁵

Echoing the IRM, the first replenishment process was structured around two consultation meetings in April and August of 2019.³⁶ The actual Pledging Conference for the first replenishment was then held in Paris, France on 24–25 October 2019 and secured financing for a four-year period from 1 January 2020 to 31 December 2023. A total of 30 countries and one region (Wallonia of Belgium) pledged to GCF, including two representing developing countries (Indonesia and Republic of Korea).³⁷ Total pledges, including pledges made since the high level pledging conference, amounted to over USD 10 billion.³⁸ The legal arrangements which made this process possible are discussed in the sections below.

3 Legal Aspects of the Green Climate Fund's Fundraising

3.1 *Legal Authority and the Green Climate Fund's Fundraising*

The legal basis for GCF's authority to raise funds can be found in Articles 4.3, 4.4 and 11 of the Convention, Articles 9.1, 9.2 and 9.8 of the Paris Agreement and are operationalised in the context of GCF by paragraphs 29 and 30 of the GI. GCF's Board, with its representative governance, retains much of the authority over decisions which shape GCF's legal framework. Through a decision-making process originally based on consensus, now supplemented by a novel voting procedure adopted in July 2019,³⁹ the Board determines the basis on which GCF receives contributions. The Executive Director and Secretariat have limited authority to engage in this process, and their roles are predominately restricted to negotiating, accepting and signing agreements on contributions within policy parameters. In certain cases, despite the delegation of authority to the ED, the Board has approved certain contribution agreements which

35 Ibid.

36 Green Climate Fund, 'GCF First Replenishment (GCF-1): Replenishment Summary Report' GCF/B.24/11 (2019), [10].

37 Green Climate Fund, 'Status of Pledges and Contributions' (First Replenishment: GCF-1) (2019).

38 Green Climate Fund, 'Green Climate Fund exceeds USD 10 billion replenishment mark' (2020).

39 Green Climate Fund, 'Decisions of the Board – Twenty-third meeting of the Board' GCF/B.23/23 (2019), [16].

contained conditions which could be regarded as outside the policy on contributions. For example, the first contribution agreements to the GCF came in the form of loans from Canada and France and this established a precedent by which contributions could take form of loans to the GCF on concessionary terms and conditions.⁴⁰ Another case was the Board's approval of the contribution from Spain at the Twelfth Board Meeting. Spain requested that as condition of its contribution there should be a provision in the contribution agreement requiring that the Board must approve no less than four projects in any given calendar year in which the payment schedule fell, in order for the Spanish contribution to become valid.⁴¹ After some discussion, the contribution agreement was endorsed by the Board, and the ED stated that the Secretariat would continue to bring contributions containing special and novel provisions to the attention of the Board.⁴² However, the Board in general is reluctant to approve contributions which contain conditions. This runs contrary to the spirit of the UNFCCC and the Paris Agreement which require developed country Parties to make contributions to developing country Parties to promote a paradigm shift towards low emission and climate resilient pathways.

3.2 *From Whom Does the Green Climate Fund Receive Contributions and Why?*

This section explores how the underlying objectives and governance elements of GCF played a fundamental role in shaping its contribution policies. Due to the legal structure of GCF, GCF has no share capital, nor does it receive assessed contributions. At present, the GCF does not raise funds from the capital markets. Assessed contributions in the UN system, for example, are mandatory contributions made by Member States⁴³ in accordance with Article 17(2) of the Charter of the United Nations. Calculated based largely on per capita income, they are required from even the least developed countries. However, the unique mandate of GCF to facilitate the transfer of financial resources from developing to developed countries is at odds with requiring mandatory contributions from all country Parties and could undermine its critical objective. This distinctive objective means that GCF's main source of contributions is developed countries, as outlined in paragraph 29 of the GI.

40 Green Climate Fund, 'Decisions of the Board – Twelfth Meeting of the Board' GCF/B.12/32 (2016), [35].

41 Green Climate Fund, 'Report of the Twelfth meeting of the Board' GCF/B.12/33 (2016), [199]-[205].

42 Ibid, [203].

43 United Nations, 'Charter of the United Nations', (1945), 4(1).

However, the GCF resource mobilisation processes have attracted contributions from developing countries, indicating the collaboration and urgency at the heart of its work.

Theoretically, as per the Paris Agreement and paragraph 30 of GCF's GI, GCF may also receive financial inputs from alternative sources. The Policy for Contributions to GCF for the first replenishment therefore provides that, in addition to developed country Parties, GCF may receive financial inputs from:

- (a) Non-Parties to the Convention;
- (b) Public and private entities; and
- (c) Philanthropic foundations, among others.⁴⁴

In practice, obtaining Board approval and developing policies in relation to contributions received from alternative sources has been a drawn-out process. In July 2018, at the Twentieth Meeting of the Board, a document outlining policies and procedures for contributions from philanthropic foundations and other non-public and alternative sources was tabled in the agenda.⁴⁵ While some Board members indicated they felt the policy was already overdue, Board members from developing country Parties indicated a preference to keep the focus on ensuring developed country Parties fulfil their financial obligations under the Convention and the Paris Agreement. In light of the lack of consensus, the policy was not discussed during the Board meeting and will be considered by the Board at a later date.⁴⁶

Additional sources of funds for GCF may also include investment income earned on the balance of the Green Climate Fund Trust Fund and reflows from outgoing loans and other financial products, including interest and principal repayments, net of repayments to loan contributors, as well as returns on equity investments.⁴⁷ The Green Climate Fund Trust Fund was established at the 16th session of the COP to the UNFCCC, inviting the International Bank for Reconstruction and Development (IBRD), also referred to as the World Bank, to serve as the interim trustee of GCF.⁴⁸

44 Green Climate Fund, 'Decisions of the Board – Twenty-fourth meeting of the Board' GCF/B.24/17 (2019), Annex I section II.4.

45 Green Climate Fund, 'Policies for contributions from philanthropic foundations and other alternative sources' GCF/B.20/08/Rev.01 (2018).

46 Green Climate Fund, 'Report of the Twentieth Meeting of the Board' GCF/B.20/26 (2018), [59]-[122].

47 See note 50, Annex I [II.4].

48 Green Climate Fund, 'Agreement on the Terms and Conditions for the Administration of the Green Climate Fund Trust Fund', (2013).

3.3 *Legal Agreements/Arrangements for Contributions*

A pledge to GCF is a political commitment signifying a willingness to contribute funds. This statement must undergo an important conversion process in order to become funds which are accessible to GCF. GCF's funds are held in trust in accordance with the Amended and Restated Agreement on the Terms and Conditions for the Administration of the Green Climate Fund Trust Fund (Amended and Restated Terms and Conditions).⁴⁹ These provide that the World Bank (the Trustee) must establish and administer a Trust Fund to receive contributions from contributors in accordance with the terms of the contribution agreements entered into with the Contributors. The Standard Provisions Applicable to the Green Climate Fund Trust Fund (Standard Provisions)⁵⁰ also form part of the governing documentation for the trust arrangements, by outlining key definitions and detailing other aspects of how the Trustee may use the funds. In accordance with these terms and provisions, the Trustee may only administer the funds and assets which make up the Trust Fund in accordance with the relevant decisions of the Board of GCF or other designated person(s). This includes, for example, the policies governing the process by which the Trustee may receive and credit any return or reflow of funds to the Trust Fund.

A key legal requirement outlined in the Amended and Restated Terms and Conditions is that each contribution be formalised in a contribution agreement, executed by the Fund, the Trustee and the Contributor. The Contributor is authorized to make contributions to the resources of the GCF within the parameters set out in the GI. The Fund will not only receive financial inputs from country Parties to the Convention but also may receive financial outputs from a "variety of other sources, public and private, including alternative sources".⁵¹ The Standard Provisions provide that contribution agreements include all contribution agreements and arrangements, including loan agreements. Contributors may negotiate regarding the terms and form of their contributions. One illustration of this, particularly common for large contributions to GCF, is when a Contributor requests to formalize their pledge through the use of a non-legally binding contribution arrangement instead of a legally binding agreement. This requires the clauses and language used in the agreement to be tailored accordingly. The arbitration clause, for example, may be

49 Green Climate Fund, 'Decisions of the Board – Nineteenth meeting of the Board' GCF/B.19/43 (2018), [16].

50 Green Climate Fund, 'Decisions of the Board – Second Meeting of the Board' GCF/B.02-12/12 (2012), [9].

51 Conference of the Parties, 'Decision 3/CP.17' FCCC/CP/2011/9/Add.1 (2012), 55–66 (the Governing Instrument), [29]–[30].

modified and a disclaimer added to indicate that the document is an ‘administrative arrangement’ rather than a contractual agreement.

In fulfilling its role executing contribution agreements and managing GCF’s day-to-day functions, the GCF Secretariat is held to high policy and fiduciary standards.⁵² The policies, as decided by the Board, require having appropriate measures in place to prevent corrupt, fraudulent, and otherwise illegal practices, including the prevention of the use of Fund resources to finance terrorist activity. Similarly, the Secretariat is required to adopt best practice fiduciary principles and standards relating to anticorruption, countering of financing of terrorism, fraud, financial sanctions, embargoes and anti-money laundering, as well as such other fiduciary principles as may be identified by the Board as best practices.⁵³ These fiduciary principles and standards, including anti-money laundering and counterterrorism financing, are also imposed on entities accredited by the Fund via accreditation master agreements and/or arrangements with accredited entities.⁵⁴ Any allegations of violation of the relevant fiduciary principles and standards is to be reported to, and investigated by, GCF’s Independent Integrity Unit.⁵⁵

3.4 *Types of Contributions and Policy Conditions*

The terms and conditions under which these financial resources may be provided to the Fund are approved by the Board. The policies therefore reflect the priorities and compromises of the diverse governing caucus, as well as GCF’s operational needs. For example, there are a number of risks which GCF is exposed to as a result of its unique funding modality. Most notably, GCF’s contributions policies must account for risks such as unfulfilled pledges, underperforming loans and loss as a result of fluctuating exchange rates. In its most recent iteration, the Policy for Contributions to GCF for the first replenishment thus authorises and outlines the conditions for making contributions to the Fund while imposing protective measures. In accordance with the Policy for Contributions, contributions to GCF may take the form of grants, loans or capital payments and are authorised via contribution agreements/arrangements signed by the contributors, GCF and the Trustee.⁵⁶ While the Board has final

52 See note 18, Annex 11.

53 Green Climate Fund, ‘Decisions of the Board – Eighteenth Meeting of the Board’ GCF/B.18/23 (2017), [8].

54 Green Climate Fund, ‘Template AMA: GCF Accreditation Master Agreement’ (2020).

55 Green Climate Fund, ‘Decisions of the Board – Twenty-Second Meeting of the Board’ GCF/B.22/24 (2019), Annex XIV.

56 See note 50, Annex 1 [IV.12].

authority over such matters, the ED has been delegated the authority to enter into contribution agreements which are consistent with applicable Board policies.

Reflecting their low level of risk and other respective benefits, contributions in the form of grants enjoy the greatest flexibility and may be used for any financial instrument (e.g., grants, concessional loans, equity, guarantees), administrative budgets, and the accredited entity fees. As a result of limitations on other forms of contributions, grant contributions must significantly exceed amounts contributed in the form of loans and capital.⁵⁷

Capital contributions may be used for financial instruments which are meant to generate reflows. Capital contributions may not be used to finance grants or administrative budget, unless the specific terms of such capital contribution allow for such use. Consequently, capital contributors are required to make a grant contribution to cover administrative budgets and AE fees, amounting to at least 10 % of the amount of the pledged capital contribution. Overall, it is recommended that aggregate capital contributions do not exceed 20 % of the total aggregated amount of pledges for the replenishment period, a threshold which may be reviewed in the future.⁵⁸ Both grants and capital contributions may be paid in the form of cash or promissory notes. The encashment of promissory notes will be based on an encashment schedule agreed between the contributor and GCF to ensure a predictable and reliable cash flow.

In relation to loan contributions, GCF prohibits cross-subsidization between providers of grants and providers of loans to ensure the financial sustainability of GCF. The use of loan contributions is also limited to the financing of loans on terms less concessional than the loan contributions and is unavailable for non-reimbursable uses, such as to provide grants or to finance the administrative budgets and AE fees. Similar to capital contributions, loan contributors are therefore required to provide a grant contribution to cover these non-reimbursable costs, in the amount of at least 10 % of the amount of the pledged loan contribution. Loan contributions from an individual contributor are also limited to 40 % of their total contribution, unless the grant contribution from that individual contributor exceeds the grant contribution provided in the previous resource mobilization period.

GCF's Policy for Contributions for the first replenishment provides protective provisions for non-performing loans which requires that losses from non-performing loans will be borne on a pro-rata basis by contributors whose contributions were allocated to loans. Fulfilling this condition requires GCF to

57 Ibid, Annex I, Section v.

58 Ibid.

model and monitor cash-flows. In addition, in accordance with the prudential debt limit considerations and principle of no cross-subsidization, a portion of the total grant contributions provided by loan contributors are held as a cushion for non-performing loans. The cushion for the first replenishment was set at 20 % of the total loan amount for the loan contributor.

3.5 *Other Potential Conditions on Contributions*

On numerous occasions the GCF Board has rejected proposals, primarily from developed, contributor country Parties, to attach additional conditions onto contributions and the use of GCF's financial resources. Since early Board meetings, proposals were made to link contributions and decision-making to encourage contributions and to allow the targeting or earmarking of contributions. At the Eighth Meeting of the Board, for example, an attempt to allow up to 20 % of total confirmed contributions to be targeted was removed prior to the Board's adoption of the Policies for Contributions for the IRM.⁵⁹ Decisions on policies perceived to be imposing new conditions on access to and use of GCF's financial resources have generally been unable to gain the consensus needed for adoption. However, there remain avenues through which country Parties condition, at least informally, the making of their contribution on certain policies being adopted. Noteworthy examples include the adoption of the decision-making procedures in the absence of consensus at the Twenty-third Meeting of the Board and the adoption of the Updated Gender Policy and Action Plan 2020–2023 at the Twenty-fourth Meeting of the Board, which are examined below.

The Board is mandated by paragraph 14 of the GI to develop decision-making procedures in the absence of consensus. For some Board members, obtaining agreement on these decision-making procedures had been a priority for years. As a result of this, during the IRM, attempts were made to make the approval of decision-making procedures in the absence of consensus a required condition for contributions. However, this position was strongly rejected on the basis that contributions should be strictly unconditional. Nevertheless, concerns around the perceived governance gap persisted and re-emerged as a significant issue in the lead up to the first replenishment. In July 2019, significant progress was made at the Twenty-third Board Meeting when the procedure on decision-making in the event that all efforts at reaching consensus have been exhausted was adopted.⁶⁰ Consultations on the first replenishment were then

59 See note 21, [296]-[324].

60 See note 44, [16].

held in August of the same year, during which another ongoing policy matter, the importance of which had been emphasized by contributors, was raised; namely, the need to update GCF's gender policy. A successful pledging conference for GCF's first replenishment was held in October 2019, demonstrating strong and continued confidence in the Fund's ability to fulfil its mandate.⁶¹ The following month, at the Twenty-fourth Meeting of the Board, the Board ultimately adopted both the Policy for Contributions to the Green Climate Fund for the first replenishment⁶² and the Updated Gender Policy and Action Plan 2020–2023.⁶³ Considering prior difficulties to gain consensus on both the decision-making policies and gender policy, the timing of their adoption, and the proximity to the first replenishment pledges, is noteworthy.

Another method through which contributors seek to exert soft influence over the use of GCF's financial resources is through accompanying letters, setting out priorities regarding the use of contributions. Recent examples include the letter of 3 July 2020 from the Government of Japan, regarding Japan's pledge of up to USD 1.5 bn.⁶⁴ In the letter it outlines four key expectations of Japan, namely, that GCF will promote infrastructure-related projects, further promote adaptation financing, enhance application of wide-ranged knowledge and expertise of climate change in GCF projects and realise balanced geographical representation in the composition of GCF Secretariat staff. By way of another example, in a letter dated 9 October 2020, the United Kingdom confirmed its additional contribution of GBP 1.44 billion and emphasised its keen interest in GCF taking all reasonable and adequate steps to tackle sexual exploitation, sexual abuse and sexual harassment.⁶⁵ It must be noted that these letters do not carry legal weight and the Board retains authority with regard to the financial decisions of GCF. However, as an entity relying on voluntary contributions, there is an incentive for the Board to consider the views of contributors.

3.6 *The Green Climate Fund's Commitment Authority*

GCF's commitment authority is calculated by reference to the total amount of available resources in the form of cash and promissory notes in the Trust Fund, which are yet to be committed by GCF. As a result, the commitment authority of GCF varies based on receipt of funds and promissory notes and

61 Green Climate Fund 'Pledging Conference for GCF's First Replenishment' (2019).

62 See note 50, [19].

63 Ibid, [39].

64 Green Climate Fund 'Contribution Arrangement with Japan (GCF-1)' (2020), 7–8.

65 Green Climate Fund 'Contribution Arrangement with the United Kingdom (GCF-1)' (2020), 6–9.

commitments. Based on the tracking by GCF, as part of risk management, it is expected that there will always be sufficient commitment authority available in the Trust Fund to meet GCF's obligations and support funding decisions. In the unlikely event that GCF has insufficient commitment authority, there is a policy to prioritize how the funds will be committed and transferred.⁶⁶

3.7 *The Green Climate Fund's Risk Management*

The inevitable financial risks faced by GCF as a result of its funding structure are acknowledged in its policies dealing with the different types of contributions GCF receives. Managing these risks has always been a priority for GCF, as evidenced by the fact that the financial risk management and investment frameworks were one of the eight essential requirements for the IRM to proceed.⁶⁷ Risk policies have continued to be updated since this time, to provide appropriate buffers and protect GCF's interests and resources.

The first specific risk managed by GCF worth noting is liquidity risk, which refers to the possibility of having insufficient available cash in the Trust Fund to meet payment obligations of GCF. Liquidity concerns would arise, if GCF's cash position was lower than its scheduled or unscheduled payment obligations at any point in time. The mechanisms implemented to manage this risk require GCF to commit only available cash and promissory note deposits, not amounts based on pledges. In addition, GCF closely monitors the risk of non-payment and set aside a financial reserve from the funding available for the minimum liquidity requirements as determined by GCF's risk management framework. The Fund's liquidity risk appetite in the Risk Appetite Statement requires GCF's liquidity reserve (on any day) to be sufficient to sustain GCF's net funding requirements for at least one year.⁶⁸ The Risk Appetite Statement aims to provide guidance on: overall level of risk that GCF is willing to take on, types of risk to be monitored, and qualitative appetite statements and quantitative metrics in the day-to-day operations of specific business units.⁶⁹

The related risk of non-payment of contributions, which similarly could affect the ability of GCF to finance programs and projects, arises when pledges fail to be converted or when pledge agreements/arrangements are otherwise not honoured. This risk is particularly acute in the case of contribution arrangements which are non-legally binding documents and thus more susceptible to

66 See note 50, Annex I, Section VII.

67 See note 17, Annex XXII.

68 Green Climate Fund, 'Decisions of the Board – Seventeenth Meeting of the Board' GCF/B.17/21 (2017), Annex VI.

69 Green Climate Fund, 'Risk appetite statement (Component II)', (2017), [4].

political changes. In order to minimise this risk, the Secretariat must monitor contributions and report on them to the Board, convert pledges or encash promissory notes in a timely and scheduled manner, regularly and actively engage with relevant contributors and diversify contributors.

GCF must also grapple with the potential risk of incurring losses in the value of contributions due to Foreign Exchange (FX) rate fluctuations, referred to as the FX risk. Due to constantly changing nature of FX rates, the USD equivalent value of contributions denominated in non-USD currencies varies over time, resulting in increases or decreases in the USD equivalent value, to which the Fund is exposed.⁷⁰ The prevailing approach has been natural hedging and, where possible, matching currencies of loan contributions to the currencies of GCF's commitments to AEs. For instance, if the main currency is USD in the country in which an AE is incorporated, then any potential exchange risk is mitigated by ensuring that the loan to that country is disbursed in USD accordingly. For various reasons, these approaches have proven an insufficient buffer. Accordingly, GCF is currently in the process of examining alternative options for mitigating the FX risk. Additional options outlined in a recent report to be considered by the Board include the establishment of an FX reserve to act as an FX commitment risk buffer, the limited use of hedging in the FX Market and the adoption of the EUR as the accounting base currency.⁷¹

3.8 *Trigger for the Green Climate Fund's Replenishment*

In contrast to the 60 % trigger initially adopted for the first replenishment, there has since been a movement towards launching GCF's next replenishment a fixed 30 months after the beginning of the first replenishment programming period, i.e. July 2022.⁷² There was strong support from several contributors to have a fixed four-year period as this enhances the predictability of contributions and sound financial management.⁷³ The changing of the trigger for the next replenishment reflects ongoing efforts by GCF to pursue best practice in fulfilling its mandate, specifically in relation to the need to provide predictable financial resources to developing countries.

70 Green Climate Fund 'Initial analysis of options to minimize the effects of currency fluctuations on the commitment authority of the GCF' GCF/B.27/18 (2020), [3].

71 Ibid, [14]-[33].

72 Green Climate Fund 'Summation by the Global Facilitator – First Replenishment of the Green Climate Fund First Consultation Meeting' (2019), [20].

73 Ibid.

4 Conclusion

At its core, GCF is a mechanism for the crucial transfer of financial resources from developed countries to developing countries to accelerate climate action and achieve the goals set out in the Paris Agreement and the Convention. GCF's success as the leading climate finance institution depends to a great extent on the sustainability of its model and its ability to garner widespread international support. Broad and representative participation in the governance of GCF is therefore key to ensuring its actions and policies respond to the diverse needs of the global community. For example, the composition of GCF's Board is, in essence, the operationalisation of genuine North-South cooperation in action. It is unique to the GCF that the Board is composed of an equal number of members from the developing (South) and developed (North) country Parties. The board consists of 24 members in total and a two-thirds majority of the members must be present at decision making procedures to constitute a quorum. Decisions are made by consensus and in the event consensus cannot be achieved and the voting procedures are triggered, any such decision must have a four fifths majority before the decision can be valid and effective. Furthermore, the voluntary deployment of resources to GCF and its vast network of accredited and direct access entities is a model to be emulated in not only addressing climate change but wider issues such as poverty alleviation and sustainable development. It is from this perspective that GCF is unique in its quest to advance the frontiers of North-South cooperation in a tangible way. To retain its central position in the field of climate finance and continue to accelerate the green transition, GCF must maintain its participatory governance and decision-making procedures, monitor its policies for effectiveness, and continue to evolve based on lessons learnt.

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