

CLIMATE INVESTMENT FUNDS

March 17, 2010

**CTF FINANCING PRODUCTS, TERMS AND REVIEW PROCEDURES FOR PRIVATE SECTOR
OPERATIONS**

Introduction

1. The Trust Fund Committee is being requested to approve the attached document "CTF Financing Products, Terms and Review Procedures for Private Sector Operations". This document was drafted jointly by the MDBs to provide guidance in the use of CTF funds in private sector investments and complements the "CTF Financing Products, Terms and Review Procedures for Public Sector Operations" which were approved on May 28, 2009.
2. This paper establishes: i) the financing products for which the multilateral development banks (MDBs) may deploy CTF resources in private sector operations; ii) the expected terms and principles for such financing; iii) the procedures to ensure standard of care within the MDBs with respect to the deployment of such resources; iv) the procedures for handling investments including problem investments with respect to the deployment of such resources; and, v) the supervision and reporting procedures for such investments. It is proposed that this document be kept under review by the Trust Fund Committee on the basis of actual experience in its application.
3. CTF funds are expected to target three types of private sector players: i) project sponsors (e.g. developers of clean technologies or large companies implementing new technologies); ii) investors in climate mitigating projects (banks, pension and equity funds, insurance companies, etc.); and iii) financial intermediaries developing new lines of credit for climate change investments (banks, leasing companies, ESCOs, etc).

Barriers addressed through private sector interventions

4. In the private sector, decisions to undertake new investments are based on the risk-return expected from the investment¹. If the risks are expected to be high, the return on that investment must also be commensurately high if the private sector is to engage in the project. As a result, CTF's direct private sector investments seek to address the risk-return imbalance which occurs in many early market projects and which prevents the scale-up and proliferation of such projects. In all cases the objective of CTF funds is to reduce the barriers for early market entrants such that additional investors, developers and financial intermediaries will subsequently enter the market without additional CTF support. This is typically achieved by i) mitigating risks for several early entrants until a track record can be established which would reduce the risk for later entrants, and/or ii) off-setting the incremental costs faced by early entrants (which reduce the return on such projects), but which will not be borne by later entrants. In all cases CTF funds are used to encourage investors to undertake projects they otherwise would not or to fast-track the scale-up of such projects.
5. *High cost of early entrants:* Early entrants often face higher costs than later entrants into the market. Such costs include those resulting from being the first companies to negotiate contracts and establish procedural "precedents" within the sector

¹ Note that every investor, developer or financial institutions will perceive different levels of risk for the same project based on their own knowledge and experience of a market or sector.

(e.g. knowing which government and other institutions have authority for which part of the development process – often the “rules of the game” and roles of each authority body are established or clarified as the first projects move through the process). High costs are also the result of more expensive technology inputs that are not yet manufactured at scale and higher debt service costs because investors perceive more risk in projects without a track record. It is envisioned that concessionally priced CTF funds would be used in such cases to off-set some of these costs and encourage developers to enter the market. With scale up of the market, later entrants are expected to face lower technology costs due to production at scale. Cost barriers are typically addressed through lower interest rate loans.

6. *Risk*: It is important to note that although CTF funds may be used in higher risk investment structures MDBs would not use CTF funds to support investments where there are upfront expected losses in a specific transaction, as doing the latter would lead to market distortions (by supporting unsustainable markets). In sectors where the teams managing CTF funds believe that the real market risks are lower than the market perceives them to be, the teams managing CTF funds would seek to use CTF funds as a risk mitigant to encourage private companies and the MDB’s own operations to undertake investments they otherwise would not. Typically risk is addressed through guarantees, first loss instruments, subordinated debt or equity.

Examples of private sector barriers:

- a. Many financial institutions (FI) hesitate to develop energy efficiency or renewable energy financing lines when there is a cost in terms of learning curve and new procedures with no track record on revenue potential and loss performance for such loans. Using CTF funds to absorb the losses that FIs fear would exceed their other typical business lines can give these institutions the comfort needed to undertake the new investment while a track record is being established.
- b. Perceived risk also inhibits investors to finance renewable energy projects in markets where the sector is not yet developed and there is no track record. Generally, if an investor is to assume high risks, the return on those investments must be adequate to compensate for such risks. Many times, however, the expected returns on early entrant renewable energy projects are not high enough to compensate for the lack of track record that exists (in part because of the higher costs that early entrants have to absorb that later entrants don’t), even though those same returns may be enough to compensate later entrants for the lower risks that they will later assume (because of a by then established track record). To address the barriers to early entrants, CTF funds could be used to either cushion the risks (through subordination, guarantees or equity gap coverage), off-set the upfront costs (through lower pricing on investments), or both (concessionally priced subordinated instruments or guarantees), as the case requires.
- c. In yet another example, renewable energy developers may hesitate to invest in certain markets if they perceive the credit profile of contract off-takers or the

structure of a contract to be weak. In such cases, CTF funds could be used to credit enhance, through guarantees, the off-taker or contract off-take agreement, and enable the investment to happen. Here again, the establishment of a track record would encourage new players into the market as the perceived risk decreases.

7. *Combined Risk and Cost barriers:* The structuring of CTF funds will in principle follow the same principles of risk-return as private funds, i.e., subordinated debt or equity will get commensurately higher returns compared with senior loans in the same transaction. At times, however, CTF funds will need to address a combination of risk and cost barriers in the same transaction. This becomes a challenge in terms of risk/reward because a subordinated loan which addresses risk for an investor may still need to off-set the high costs of being an early market entrant for the developer (in this example it is important to ensure the risk-return balance is sufficient to entice both parties – the investor and the developer - if the project is to take place). In such cases MDBs may need to price their subordinated instruments at concessional interest rates in order to address both barriers; otherwise, if the subordinated debt were priced at a market interest rate² the investment would be decreasing the risk barrier for the investor while increasing the cost barrier for the developer by adding higher debt service costs to the project. MDBs will always seek to price the CTF funded instruments on the least concessional terms possible.

Principles for using CTF funds in private sector investments

8. CTF funds used in private sector investments will adhere to the principles outlined in paragraph 3 of the Clean Technology Fund Financing Products, Terms and Review Procedures for Public Sector Operations, dated April 28, 2009 and approved on May 28, 2009.

9. Because each country, sector and project faces a unique set of barriers, CTF financing will not be uniformly offered to all private sector companies. As a result, the following principles for use of CTF funds in private sector investments have been designed to guide the MDBs in structuring private sector investments.

10. *Minimum concessionality:* The pricing and terms of the CTF funds offered to private sector clients will be tailored to address the barriers identified for each case. MDBs will seek to provide the minimum concessionality needed to catalyze projects and programs within a sector. In order to honor this principle, CTF funds will be structured on a case-by-case basis to address the specific barriers identified in each project/program. The amount and terms of CTF funding offered to an individual client will be determined between the MDB and the client on the basis of efficient and effective use of CTF and MDB resources. While an attempt will be made to quantify the additional costs faced by early entrants and compare that with the subsidy element implicit in the financing terms being offered, country, industry and individual company dynamics will impact the

² It must be noted that in many cases there is no “real” market interest rate because financiers are not providing subordinated debt at any price. In such cases, the MDBs will approximate a market interest rate by adding a “risk premium” to the interest rate being charged on senior debt.

amount of concessionality a company will accept in order to undertake a project. Very often three different companies in the same industry will require three different levels of concessionality to implement a given technology. For example, if catalyzing market uptake of waste/heat recovery technologies in a sector were dependent on having the three market leaders implement the equipment, then the MDB would need to offer each company the minimum amount of concessionality required to have that company undertake the investment. If all companies were offered the same concessionality the MDB may over-subsidize some while not providing enough concessionality to engage key companies that are necessary to achieve the program or projects' objectives. Finding the right amount of concessionality³ is largely a matter of client needs, market conditions and negotiation, and is dependent on information not flowing between the companies or being available in the market. MDB's will always seek the minimum concessionality necessary to enable projects to happen and will justify the amount of concessionality requested in each CTF proposal.

11. *Avoiding distortion and crowding out:* CTF financing will target the CTF related benefits of the projects and will be proportional to the incremental costs of their achievement. CTF funds will not be priced or structured to displace commercial financing or set unsustainable expectations in a market. CTF funds will be used to "crowd in" the private sector by enabling projects and investments to happen that otherwise would not by catalyzing those investments with their concessionality.

12. *Leverage:* CTF funds will seek to catalyze and maximize the amount of MDB and other bilateral financing as well as commercial financing available for its projects and programs. A key feature of the CTF will be its ability to unlock both MDB and other private sector financing for clean technology investments and catalyze ongoing sustainable investments in these sectors beyond the initial CTF investments.

13. *Financial Sustainability:* CTF programs will be developed to maximize the probability of long-term financial sustainability once the CTF funds are no longer available/have been used. Projects and programs should not be approved if they are likely to be dependent on a continuous flow of CTF funds. After taking into account the CTF financing, particular emphasis should be on a project's or program's ability to perform profitably under prevailing and projected market conditions. The project or program should at a minimum have the potential to achieve a substantial reduction in the need for subsidies in similar future projects beyond the initial few projects supported by CTF.

14. *Absence of Foreseeable Losses:* In all cases, the use of CTF funds will be applied prudently in the project's financial structure, such that the CTF component of the financing is not be expected to experience a foreseeable loss.

³ Concessionality (or the subsidy element) of a CTF investment is calculated as the difference between the hypothetical market interest payments and the actual CTF interest payments over the life of the loan and discounted using the relevant zero-coupon swap curve in the relevant currency; divided by the amount of CTF financing. For non debt products the interest payments in this calculation would be substituted by the relevant investment payments (eg. guarantee fees).

Financing Products and Terms

15. *Financing Products:* Unlike public sector CTF loans, which are given to governments that in turn structure their investments into projects and programs, CTF investments which go directly into private sector programs or projects through MDBs must give the MDBs the flexibility to structure the project in such a way that the CTF funds can clearly address and overcome the barriers that prevent transformation. For purposes of clarity, CTF funds will not always be subordinated to other lenders or to MDBs. While the MDBs have tried to anticipate the barriers that exist globally, and the types of instruments needed to address them, markets change, barriers change, and the need for financing changes over time. It is therefore essential that MDBs have the flexibility to develop new financial instruments not envisioned in this document if the need arises to achieve the objectives of the CTF. In all cases, the MDB would be responsible for explaining why it believes it can structure and implement the financial instruments proposed in the CTF proposal. See Annex A for some examples of CTF private sector instruments that may be utilized by the MDBs.

16. *CTF subordination to MDB investments:* As noted earlier, subordinated loans or guarantees are sometimes (but not always) needed to mitigate project risks so that an appropriate risk-return balance can be achieved to catalyze investors to finance climate mitigation projects. Over the years the MDBs have built a significant track record of investments in emerging markets. This experience and market knowledge reduces the risks that MDBs assume in their projects and improves the expected risk-reward balance for such projects. As a result, the MDBs will often undertake projects in emerging markets that other private investors, who lack such knowledge and experience, will not. However, some projects the CTF Trust Fund committee is considering for approval would require the MDBs to go beyond their “business as usual” to finance projects in sectors where there is less track record, and where the returns are less certain. As financial institutions themselves, the MDBs are unable to take risks that are not covered by an appropriate return without threatening their own credit rating and negatively impacting their ability to conduct their regular business operations. CTF funds may therefore be used to enable the MDBs to undertake projects they otherwise would not be able to consider without such funds. CTF funding that is subordinated to an MDB investment mitigates the risk for the MDB and enables it to broaden the scope and scale of the CTF relevant, transformational investments that it can undertake.

17. Climate finance is not necessarily different from any other new market being developed by the MDBs. Typically, the MDBs have expanded into other new markets when there has been a willing party to mitigate the higher risk portion of investments while the MDB is establishing its own track record in the new sector. This has been the case in the expansion into health and education investments where health and education associations (groups that know and understand the risks of their client base best) assume the first losses while the MDBs remain in more senior positions, until confidence can be established in the underlying portfolio’s performance. Guarantees from strong sponsors is another way of achieving the risk coverage needed to venture into new and untested

markets. Unfortunately, in climate finance, the risks are much less tested than in other sectors, and to date only donor groups have been willing to provide the risk coverage needed to allow the MDBs to venture into this new product area.

18. Risk mitigation is the primary reason CTF financing may need to be subordinated to an MDB investment; however, not all CTF projects address risk barriers and therefore not all CTF investments would be subordinated to MDB transactions. The transactions most likely to require subordination are first loss and guarantee products for financial institutions (where a lack of track record would not allow the MDB to take on the first loss component themselves⁴), and some direct renewable energy and energy efficiency investments where perceived risk perception is a barrier⁵. CTF financing is not expected to be subordinated to MDB investments when the only barrier being addressed is cost. While the MDBs may not be able to provide the terms necessary to offset such costs from their own account, in such transactions, CTF funds would rank *pari passu* with the MDB financing. In transactions where the MDBs have become comfortable with the risks of a project while the market has not, and cost is a barrier, both the MDB and CTF could be structured in a subordinated position to other lenders; here, the pricing and repayment terms for the CTF component could be different than the MDB investment but the seniority and security would be *pari passu* with the MDB. When MDBs seek CTF funds for investments that are subordinated to the MDB's own investment, MDBs will justify the need for such structures in the CTF proposal being submitted for Trust Fund Committee approval. Subordination of CTF funds to MDB funds must be clearly noted in the summary terms section of each CTF proposal.

19. *Pricing and terms*: MDBs will indicate to the Trust Fund Committee in the CTF proposal the range of financing terms for CTF funds that would be offered to clients, including a range for price, tenor, subordination and security, along with a justification for why such terms are required. When CTF proposals are for programs that include heterogeneous investments (e.g. for differing technologies or different types of recipients – e.g. solar developers and a solar manufacturer) establishing a range of terms may be more difficult. In such cases, the MDB will seek to outline to the Trust Fund Committee in the CTF proposal the possible uses of CTF funds and will in all cases establish a floor price for any CTF investment. (see also paragraph 28 below on amendments to CTF proposals). The MDB will inform the Trust Fund Committee on a confidential basis⁶ on the final terms once they have been determined and agreed.

⁴ Note that the MDBs that have developed a track record of projects which use GEF funds in a first loss position to promote energy efficiency lending through financial institutions, are now beginning to consider sharing some of the first loss risk in similar transactions. Such a “shift in MDB risk appetite” is a demonstration of how establishing a track record can change behavior and lead to sustainability.

⁵ These instruments would still be subject to paragraph 12 regarding no foreseeable losses.

⁶ Bearing in mind the potential effects any disclosure of project-specific information may have on the recipient of CTF funds and the MDBs (including inconsistency with the MDBs' own disclosure policies), any information provided by an MDB regarding project-specific information will be kept confidential by the Trustee, the Trust Fund Committee and any relevant contributors. For the purposes of this document "confidential basis" means after the signing of a confidentiality agreement per paragraph 46.

20. *Grants for Advisory Services / Technical Assistance:* In addition to investments, CTF funds may be used for technical assistance / advisory services to address non-financial barriers that prevent market transformation. If such funds are anticipated within a program, the MDB will indicate so in the CTF proposal, including the amount required, the barriers being addressed and how the CTF funds will be used (e.g. for publications, workshops, institutional capacity building, etc.). Advisory services/technical assistance is often required to ensure adequate market capacity, market knowledge, information sharing and a comprehensive approach to transformation. The use of CTF funds for such work must be justified according to its key contribution to the achievement of the transformation objective in the private sector and to the lack of alternative sources of finance. Grant funds may also be used for project preparation purposes. When necessary, such grant requests would also be included in the CTF proposal.

Guidelines for structuring and implementing CTF investments:

21. Private sector CTF investments will be made in accordance with the investment criteria established in paragraphs 11 and 12 of the CTF Private Sector Operational Guidelines, which were approved on January 12, 2009.

22. Unless otherwise approved by the Trust Fund Committee in the CTF proposal, CTF funds will be allocated by the Trustee to the MDB, and be repayable to the Trustee, in United States Dollars or Euros. However, MDBs may denominate individual financing provided by them to the beneficiaries according to their own policies and procedures, subject to the MDB assuming any exchange rate risk⁷.

23. The MDB will, for purposes of each financing, conclude either a separate agreement with the beneficiary of CTF funds, or a single agreement with separate tranches for the CTF and MDB investments.

24. The design and implementation of activities financed with CTF resources will ensure that appropriate environmental and social safeguards arrangements are carried out in accordance with each MDB's policies and procedures.

25. Agreements between MDBs and beneficiaries will incorporate provisions for default interest (in addition to regular interest) in the case of a default scenario⁸. The CTF investment will apply the same rate of default interest that the MDB applies for its own investment in the same project.

26. The MDBs will follow their own operational procedures regarding notification of the national government of a proposed financing before Board consideration.

⁷ It should be noted that not allowing CTF funds to be on-lent in local currencies reduces the flexibility of the funds and increases the costs and complexity of the project, as currency risk must be hedged. It should further be noted that most of the MDBs are prevented by their guidelines to incur such exchange rate risk.

⁸ Most MDBs charge a standard rate of 2% for default interest.

27. Except as otherwise justified and approved in the CTF proposal, where CTF concessional rate loan products are pari passu to a senior MDB loan:

- a. In determining whether any guarantee or security for the CTF loan will be obtained, the MDB will adopt the same approach as the one used for the MDB's own loan;
- b. In respect of negative pledge covenants in MDB loan agreements, the CTF loan will have the benefit of any such negative pledge covenant;
- c. In respect of suspension, cancellation and acceleration of CTF loans, the CTF loan agreements will provide for suspension and cancellation provisions and acceleration events like those included in relation to the MDB's own loan unless to do so would negatively impact the objectives to be achieved by the CTF funds, as outlined in the CTF proposal.

28. Where the CTF funds are to be made available for subordinated debt instruments, regardless of their concessional status and relative status compared to the MDB loan:

- a. Senior creditors would not expect a subordinated lender to be able to force acceleration of the project debt where the borrower remains current on the senior creditors' debt.
- b. Senior creditors would expect subordinated lenders to take a subordinated security, if such loan is to be secured; and
- c. Subordinated CTF loans would rank behind senior lenders in any share of recovery proceeds.

29. Similarly, where the MDB proposal relates to a joint MDB and CTF equity investment, with the exception of provisions for return on investment, the MDB will obtain the same terms for the CTF equity investment, and proposed exit provisions, as the MDB's own equity investment, unless to do so would negatively impact the objectives to be achieved by the CTF funds, as outlined in the CTF proposal.

30. Where the MDB proposal relates to a grant component, the grant would not generally be reimbursable except where misused. Potential misuse of the grant components will be assessed under the Results Measurement Framework as approved by the CTF Trust Fund Committee.

Role of the CTF Trust Fund Committee in approving private sector financing terms

31. The CTF Trust Fund Committee is responsible for approving the range of terms of outgoing CTF financing as outlined at the time of submission of the CTF proposal by the MDB. Such proposal will include a range of terms expected to be offered on the CTF funds as outlined above, recognizing that program proposals may only be able to identify

the types of structures contemplated for the various interventions. The final terms will be notified to the Trust Fund Committee on a confidential basis once these have been agreed. If during the implementation of a project, it becomes clear that the terms of the CTF funds should fall outside of the approved terms; the MDB would be required to circulate on a confidential basis, on a two week no-objection basis, an amendment to the CTF proposal which outlines the new terms being requested and the justification for the change.

Safeguards for using CTF funds within the MDBs

32. The CTF Trust Fund Committee decided to channel CTF funds through the MDBs to achieve a number of benefits, including: i) the opportunity to leverage and scale-up MDB funding; ii) increasing efficiency and reducing costs by utilizing the MDB's established infrastructure, policies and procedures, and iii) tapping into the MDB's well established network and project development ability. However, MDB management of CTF funds, which are coupled with their own funds, results in a number of perceived and potential conflicts of interest. The MDBs take the responsibility of managing third party funds seriously and have each developed safeguards to manage such conflicts of interest.

Financing Procedures and Conditions

CTF Approval procedures:

33. Private sector projects and programs are expected to be approved following the procedures outlined in paragraphs 9 and 10 of the "CTF Private Sector Operational Guidelines" which was approved on January 12, 2009. Proposals will be submitted using the revised template provided in Annex B of this document and will follow the timeline outlined in Annex B (titled "Proposed Private Sector Cycle of Activities") of the CTF Private Sector Operational Guidelines.

Disbursement procedures for private sector CTF investments from the CTF:

34. MDBs that deal with the private sector undertake certain reputational and at times financial exposure during project financing. MDBs would, for example, lose credibility with their private sector clients (as well as co-lenders) if a CTF investment were not funded upon request due to insufficient cash in the CTF accounts. Therefore, the MDBs may incorporate into their CTF proposals, a specific request for the Trust Fund Committee to approve that the Trustee provide an unconditional letter of commitment which would ring fence available cash for the proposed projects included in the proposal (subject to prior clearance by the TFC/Trustee that such available cash existed). While an actual cash transfer from the Trustee on behalf of the CTF to the MDB for each such project would only take place after approval by the MDB's Board approval of the project (per Annex B of the CTF Private Sector Operational Guidelines), the unconditional letter of commitment would allow the MDB, the client and co-lenders to enter into negotiations with the comfort that funds would be available at the time of disbursement.

Procedures for suspension, cancellation and acceleration of outgoing CTF investments:

35. The MDB will determine, in accordance with its policies and procedures, whether to (i) suspend, cancel or accelerate any CTF investment, (ii) declare an event of default, terminate, or exit from, any CTF investment, (iii) grant any waiver, or agree to an amendment, to any CTF investment terms, including a waiver or amendment that may result in not taking action under (i) and (ii) above, and (iv) enforce any security or guarantee provided for any CTF investment, or (v) pursue other remedies available to the MDB. When CTF loans rank pari passu with MDB investments, and the MDB pursues any of the above remedies with respect to its own investment, it will pursue the same remedy with respect to the CTF investment (unless otherwise agreed with the Trust Fund Committee).

36. Similarly, and irrespective of the ranking of the loans, if both the CTF investment and MDB co-financing have not been fully disbursed, suspension or cancellation of disbursement of one would normally result in suspension or cancellation of disbursement of the other unless to do so would negatively impact the objectives to be achieved by the CTF funds, as outlined in the CTF proposal.

37. The MDB will be responsible for returning to the Trustee all interest/returns, including default interest, fees and principal payments on the CTF investments received by it from a borrower/investee. Processing the payment of those interest/returns, including default interest, fees and principal payments plus the MDB investment income will be made in accordance with the Financial Procedures Agreement entered into between the Trustee and the MDB. In any event, any payment defaults or negative returns which are not recovered in respect of or arising under a CTF investment will be borne by the CTF, without recourse to the MDB's own assets, unless such loss is incurred as a result of the MDB's gross negligence or willful misconduct, in accordance with the Financial Procedures Agreement entered into between the Trustee and the MDB.

38. There will not be any sharing of payment proceeds received by the MDB under the CTF investment and MDB co-financing or any other MDB investments.

Procedures for handling problem investments:

39. If there is a payment default by an MDB client, under a CTF investment that continues for 30 calendar days or more, the MDB will promptly report on a confidential basis such default to the Trustee, so that the Trustee may promptly report to the Trust Fund Committee. MDBs will consult with the Trust Fund Committee on any anticipated sales which would result in a negative return to the CTF once such losses can reasonably be anticipated⁹.

⁹ It must be noted that exit prices are negotiated and the final sales price in a transaction may only be known shortly in advance of the transaction closing. In any event, the MBDs will make all reasonable efforts to notify the Trust Fund Committee of anticipated losses through the Trustee as soon as losses are anticipated.

40. Once a course of action has been determined by the MDB, but in any event within 90 calendar days following a default, the MDB will (a) inform the Trust Fund Committee of its proposed course of action (confidentially)¹⁰, and (b) consult with the contributors on the proposal. The MDB may set a deadline for receiving comments from the contributors. After the consultation with the contributors, the MDB will determine if and what (further) action shall be taken. The MDBs and contributors may agree at any time to have the CTF investment assigned or novated to one or more contributor(s), or a third party agency¹¹. If as a result of any action proposed to be taken, the MDB is expected to incur any cost, the MDB will seek approval from the Trust Fund Committee (or such other body as the Trust Fund Committee may designate)¹² for allocation of the Trust Fund funds to cover such costs. The MDB will then take appropriate action in accordance with its own policies and procedures, but only to the extent that the costs related to the CTF component of the transaction for such actions are borne by the Trust Fund and resources have been allocated to the MDB to fully cover such costs.

41. However, prior consultation with the Trust Fund Committee will not have been needed (i) for any actions commenced by the MDB and (ii) for allocation of resources for any costs incurred in connection with those actions, where the MDB commenced its actions (reasonably and in good faith) either (a) prior to any consultation referred to in paragraph 39 above or (b) during or after any such consultation where the MDB considers that swift action is required, in each case, to protect, defend or secure the CTF investment. In such cases the MDBs will inform the Trust Fund Committee prior to taking such actions on a confidential basis as knowledge of such information by the counterparty could undermine the effectiveness of the MDB's actions. The Trust Fund Committee (or such other body as the Trust Fund Committee may designate) will allocate the resources to reimburse the MDB for any such costs, upon submission of a request by the MDB showing the cost items/expense list and the particular amounts incurred and the action taken to protect, defend or secure the CTF investment.

Procedures for handling recovery proceeds:

42. The MDBs are responsible for returning to the CTF via the Trustee all proceeds recovered from defaulted investments as will be reflected in the Financial Procedures Agreement.

Project Administration Fees

¹⁰ Bearing in mind the potential effects any disclosure of the proposed actions may have on (i) the bargaining positions of the borrower and the lenders, and (ii) the liability of the MDB to other banks in a syndicate, any information provided by an MDB regarding possible actions will be kept confidential by the Trustee, the Trust Fund Committee and any relevant contributors.

¹¹ To the extent the agreement cannot be freely assigned by the MDB, the MDB may include in the CTF investment agreement a clause giving the MDB the right to make such assignment.

¹² Per the CTF Sunset clause, paragraphs 53-55 of the CTF Governance Framework document.

43. Implementation and supervision costs will be determined according to the guidelines outlined in paragraphs 19-22 of the CTF Private Sector Operational Guidelines, approved on January 12, 2009, and will be submitted as part of each CTF proposal.

44. Eligible implementation and supervision costs will be determined in accordance with the policies and procedures of the respective MDBs.

Supervision and Reporting

45. Supervision and reporting will be conducted in accordance with paragraph 23 of the CTF Private sector Operational Guidelines, which were approved on January 12, 2009. Measurement criteria for each project will conform to the requirements determined under the Results Measurement Framework as approved by the CTF Trust Fund Committee. In addition, any MDB using CTF funds in a subordinated position to their own funds must report to the Trust Fund Committee on an annual basis, i) how the additional risk assumed by the CTF investments is delivering additional impact, and ii) the MDB's preparedness to invest on similar terms to the CTF investments in similar future projects.

46. In accordance with the Financial Procedures Agreement executed between each MDB and the Trustee, each MDB will provide the Trustee with certain confidential financial information on the projects within its portfolio. The confidential information will include (i) financial information on each project that is required to facilitate the financial management of the CTF account and is provided on a quarterly basis and (ii) final terms of each project (financial instrument (loan, guarantee, etc), interest rate, amortization schedule, tenor, and security/ranking (secured/unsecured, senior/subordinated, etc)) to be provided within 30 days following the project's financial closing. In order to maintain the confidentiality of the information, project specific information relating to the CTF private sector projects as outlined in this document will be provided by the Trustee or the relevant MDB to a relevant country contributor only after signature of a confidentiality agreement between the Trustee or relevant MDB and the contributor country requiring such information, in order to avoid conflicts with the MDB's policies on disclosure of information.

Annex A

Examples of Private Sector Financing Instruments (not comprehensive)

Concessional interest rate loans and loans with performance incentives

1. Concessional interest rate loans are used to off-set the high costs of early market entrants as described earlier.
2. Credit lines and loans with incentive characteristics such as performance bonuses or interest rate reductions provide clients with the incentives to achieve certain milestones or targets established at the onset of the program. These loans are used to fast track the rate of implementation of a program or to direct funding to a sector that otherwise wouldn't get funded. These instruments are most effective with local banks that are comfortable with the risk of a new initiative but that need to incentive either for their clients or loan officers to "kick-start" a new line of business (such as clean energy lending). In this financial structure the donor's funds are coupled with, and leverage, MDB funds to provide the client with one aggregate loan. The bonus or interest rate reduction is deducted from the donor's portion of the loan.
3. *Relevance for climate change:* Concessional interest rate loans can be valuable as a means of encouraging large renewable energy developers to enter new sectors that have high early entrant costs.
4. Loans with incentive features can be used to encourage local banks to develop lending programs for small sized renewable energy and energy efficiency projects; working through local banks is particularly appealing for small sized investments given the scale required to have a climate change impact (in this structure scale is achieved through a local bank's network and client relationships).

Subordinated Debt and Mezzanine Finance (to senior debtors which may, or may not include an MDB)

5. Subordinated debt and mezzanine financing, refers to loans that in case of payment defaults or bankruptcy have a lower repayment priority compared to other company or project loans. Subordinated debt strengthens a company/project's equity profile and enables/encourages commercial lenders to provide senior debt financing. Donor funds that are used as subordinated loans effectively leverage senior financing. While this type of debt has some equity characteristics, it is normally repaid on a regular schedule.
6. *Relevance for climate change:* Subordinated debt has high potential for impact. In addition to subordinated loans for large scale renewable energy projects, subordinated debt is being tested with financial institutions who on-lend donor funds along with their own and MDB financing to small renewable projects. The donor funds in such cases are used to fill the 'equity gap' that exists for many small sponsors. In cases where high

capital costs and risk perception barriers are being addressed through the use of subordinated debt, concessional rates could also be a structural feature of the product in cost barriers are also trying to be addressed.

Guarantees and Insurance

7. Guarantees and insurance products enhance the credit worthiness of a transaction because the guarantor agrees it will cover some, or all, of any defaulted payment or repayment per an original contract; guarantees are sought when payment or repayment flows are risky. Guarantees allow MDBs to use their strong credit rating to provide comfort to decision makers that cash flows will take place. This can influence banks and other financiers to provide funding for low carbon technologies (by extending tenors, a project's financial viability becomes more attractive to a sponsor and enables them to make the investment). In general guarantees can be used to cover any of the risks the market will not bare, including credit risk, technology risks, or changes to the project's regulatory environment. Donor funds would be used to provide guarantees for climate change initiatives when no party is willing to pay for such guarantee.

8. *Relevance to climate change:* Guarantees can be applied in different ways to support the development of the renewable energy sector, for example, by enhancing the expected revenue stream from a Power Purchase Agreement, by increasing access to bank finance, or by extending loan tenors and improving the financial viability of a project.

Risk Sharing

9. Risk Sharing is a way of “sharing” the risk of a portfolio of sub-projects with a local bank or financial institution. While the bank funds the sub-project loans from its own account, MDBs guarantee a portion of the repayments from borrowers if a sub-project defaults. A risk-sharing product gives a bank comfort that their risks are mitigated during the period when they are learning a new line of business and a performance track record is being established for the underlying loans. In this structure, donors play a critical role by covering the losses from the first few defaults (if any) which occur in a portfolio of projects (first loss). To date the experience with risk sharing structures has been positive both in terms of low to no losses and the amount of funding leveraged from financial institutions.

10. *Relevance for Climate Change:* Risk-sharing is an effective way to engage a financial intermediary to lend for sectors such as energy efficiency and small scale renewable energy.

Equity

11. Equity is a capital investment in a company or project that is not repaid on a fixed schedule. Equity provides unlimited revenue potential if the project is successful, but risks losing part or all of the investment if the project is not successful. Within the CTF context, equity could be needed to support projects that have viable business plans but

where sponsors either do not have the financial wherewithal to implement the project alone (senior debtors require varying levels of equity investments depending on the level of risk perceived in a project or market), or because project developers themselves do not want to take the risks to enter a new market. While subordinated debt has some of the risk profile of equity, it is primarily a structure that mitigates risk for senior debtors; equity on the other hand, shares, or encourages developers to undertake risks they otherwise would not.

Relevance for climate change: Equity could be used to fast-track development of a renewable energy sector in a country where regulatory changes have just taken place or are anticipated to take place. There is a long development stage for most renewable energy projects and the CTF may wish to fast-track project implementation to achieve its ultimate goal of offsetting GHG emissions. If developers are uncertain about a government's commitment to regulatory change, these developers may hesitate to begin the development stage of projects. If however, an MDB, through its relationship with a government and because of that government's engagement in a CTF program, believes that the regulatory environment will become or remain supportive to the relevant technology, it may wish to use equity as a means to encourage project development sooner than would otherwise happen. The equity in this case would be used to share in the development costs of the project (thereby reducing risks for the developer) but would also share in the upside of the project. For purposes of clarity, it is noted that with many early entrant projects, high costs are also a barrier. As a result, to address the cost barrier, the equity returns may be different (or not) for the project sponsor and the CTF investment. In all cases, the MDB would seek to obtain the least concessional/most advantageous terms for any CTF investment.

Annex B (Revised¹³)
CTF PRIVATE SECTOR PROPOSAL TEMPLATE

<i>Name of Project or Program</i>	
<i>CTF amount requested / Total Project Cost (US\$):</i>	
<i>Country targeted</i>	
<i>Indicate if proposal is a Project or Program</i>	
DETAILED DESCRIPTION OF PROJECT OR PROGRAM	
<p><i>Description of the Project or Program including:</i></p> <ul style="list-style-type: none"> ➤ for each Proposal, a description of the country and sector targeted, as well as the technology supported, including an explanation for the technology choice. ➤ for each Project, a description of the project in generic terms; for purposes of confidentiality, company names and details that would make the project identifiable by third parties are not to be included in the description. ➤ for each Program, a profile of the sub-projects expected to be financed under the Program (sector, average size, geography, ranges of expected results, etc.) and the number of investments expected in portfolio ➤ the financial instruments expected to be used including how the concessional finance portion will be applied (which components of the project, percent of overall financing, etc) ➤ a description of the elements that go beyond the financing offered, such as advisory services and knowledge management initiatives and instruments. ➤ note the expected life of the Project or Program from date of approval (investment & supervision period) 	
<p><i>Describe the Proposal's strategy for achieving market transformation including:</i></p> <ul style="list-style-type: none"> ➤ explain how the Project or Program addresses the objective of transformation to a low carbon economy in terms of market transformation at a country and/or sector level. ➤ describe how the Proposal fits i) the identified role of the private sector as described in the Investment Plan; and ii) within a country's existing regulatory environment and government policies; where it doesn't explain how this will be addressed/mitigated ➤ explain how the MDB will leverage its ongoing activities and existing strengths 	

¹³ The revised Annex B in this document supersedes Annex B of the Private Sector Operational Guidelines approved on January 12, 2009.

FIT WITH INVESTMENT CRITERIA	
<p><i>i) Potential GHG Emissions Savings:</i></p> <ul style="list-style-type: none"> ➤ Calculate the amount of CO²-equivalent emissions savings expected to result during the life of the technology and/or service from the proposed Project or a range for the Program. Emissions reductions will be calculated by assessing the fuel savings attributable to the Project or Program for the country or region and technology specified multiplied by the CO² intensity of the marginal technology. ➤ Note whether the technology is technically viable, commercially available and whether mitigation potential is high or low (per paragraph 11 i) of this document). 	
<p><i>ii) Cost-Effectiveness:</i></p> <ul style="list-style-type: none"> ➤ The expected GHG reduction during the life of the technology per CTF donor dollar invested. ➤ Note if a reduction in the cost of the technology is expected due to technological progress, learning curves or any other market occurrence. 	
<p><i>iii) Demonstration Potential at Scale:</i></p> <ul style="list-style-type: none"> ➤ Note: i) the expected GHG emissions from the sector under a business as usual case; ii) the expected reduction of emissions resulting directly from the CTF financed intervention; and iii) potential emissions savings that would result if the CTF intervention were to be replicated throughout the targeted area or sectors. 	
<p><i>iv) Development Impact:</i></p> <ul style="list-style-type: none"> ➤ Describe non-GHG related development impacts achieved through the Project or Program. A key objective of the CTF is to demonstrate the potential for low-carbon technologies to contribute to sustainable development and the achievement of the Millennium Development Goals. Proposals with co-benefits will be viewed favourably. Examples of development impacts include reduction in energy intensity of GDP or for the relevant sector; energy security in terms of avoided imports of fuels and diversification of energy supply; acceleration of access to affordable, modern energy or transport services for the poorest; and a reduction in air pollution 	
<p><i>v) Implementation Potential:</i></p> <ul style="list-style-type: none"> ➤ Note the extent to which the current regulatory environment supports, or does not impede, the development of the private sector; where barriers exist, explain how these will be addressed. Outline the range of resources mobilized by non-CTF funds, including the MDBs and the private sector – both domestic and international, including carbon finance if appropriate. 	

<p><i>vi) Additional Costs & Risk Premium:</i></p> <ul style="list-style-type: none"> ➤ Explain how CTF financing is being tailored to address the identifiable additional cost of an investment or to address risk perception and other non-financial barriers. Note whether CTF financing will complement other forms of donor or CDM finance. 	
<p><i>vii) Financial Sustainability</i></p> <ul style="list-style-type: none"> ➤ Describe how sustainability will be achieved (i.e. why similar future projects would need significantly less or no concessional finance). Projects should not be approved if they are dependent on a continuous flow of CTF funds. The Project or Program should at a minimum have the potential to achieve a substantial reduction in the need for subsidies in future projects. ➤ Identify specific institutional factors that will be necessary to enhance the commercial viability of the technology/project, if any. 	
<p><i>viii) Effective Utilization of Concessional Finance</i></p> <ul style="list-style-type: none"> ➤ Justify why the concessional finance is needed (why the projects would not go forward without concessional finance). ➤ Discuss why the structure suggested is most appropriate for achieving the Proposal's goals. ➤ Quantify the level of subsidy expected to be offered under the Program using the methodology outlined in footnote 3 of the body of this document. ➤ Note the use of any other concessional or carbon related finance in the project and how CTF will add value. ➤ For benchmarking purposes, determine if concessional finance is being used or planning to be used in other similar projects in the same market. If yes, provide the concessional terms when information is available and how those terms relate to the proposed CTF financing. If no concessional finance has been used in similar projects, explain why they've been able to go forward without concessional finance. 	
<p><i>ix) Mitigation of Market Distortions</i></p> <ul style="list-style-type: none"> ➤ Discuss how the Project or Program will seek to minimize or avoid distorting markets, displacing private sector investment, including carbon finance where it is supporting similar investments within a country and/or sector, or reducing competitiveness. 	
<p><i>x) Risks</i></p> <ul style="list-style-type: none"> ➤ Discuss the risks inherent in the Project or Proposal and how these are being mitigated/addressed. 	
<p><i>xii) Performance Indicators</i></p>	

➤ List relevant “Performance Indicators” for the project.	
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