

# CLIMATE INVESTMENT FUNDS

CTF/TFC.1/5  
November 03, 2008

---

First Meeting of the CTF Trust Fund Committee  
Washington, D.C.  
November 17-18, 2008

## **PRIVATE SECTOR<sup>1</sup> OPERATIONAL GUIDELINES**

---

<sup>1</sup> Note that the proposed private sector operational guidelines are also applicable to both sub-sovereigns (entities that do not benefit from a sovereign guarantee), as well as Public Private Partnerships.

## **Introduction**

1. *Role of the Private Sector in an overall CTF strategy:* As the foundation of economic growth, the private sector has a significant role to play in the reduction of greenhouse gas emissions. Strategies for achieving transformational outcomes and progress towards low carbon development will therefore need to include a combination of public and private initiatives. The relationship between public sector reform and private sector action is clear; while many private initiatives can be tested and operate in a less than optimal policy and regulatory environment, full engagement, and wide scale growth of the private sector will only occur if the policy and regulatory environment is both attractive and stable within a country. An appropriate business environment is particularly important for promotion of small and medium-sized enterprises that are critical to broad-based growth and technology adoption.

2. Experience has shown that private sector initiatives, especially those addressing market barriers that are not regulatory (see below), can successfully proceed and at times be a stimulus for subsequent regulatory change. At the same time, advances in technologies and opportunities for high impact GHG reducing private sector initiatives change over time, requiring an interactive and fluid approach to strategy development. Private sector initiatives can sometimes be tested in markets before regulatory issues are addressed or before official country strategies are developed. In these instances, the information obtained from undertaking such private sector initiatives not only contributes to but may also become the foundation and basis for future policy and regulatory change.

3. *Demonstration, replication, scale-up:* Private sector initiatives are used to address two primary market challenges: a) a dichotomy between perceived risks and real risks; and b) the disincentive for private investors created by the high costs associated with being a first mover in a new market. In both cases, private investors are discouraged from entering a new sector on their own<sup>2</sup>. CTF private sector initiatives will seek to achieve scale-up (a significant proliferation of the types of projects being supported - without a subsidy) by demonstrating, and creating a track record through a few initial investments. Once the private sector: i) understands the real market risks, and/or ii) the cost of the new technology decreases, and/or iii) the cost of carbon becomes internalised, replication is expected to occur without further subsidy, followed by a scale-up of investment and market transformation within the relevant country and/or sector.

4. *Engaging the Private Sector:* This document describes how the CTF will engage the private sector and implement an effective public/private strategy, recognizing that CTF funding arrangements for engaging the private sector will be different than the arrangements applied for public sector proposal financing.

## **Private Sector Proposals**

---

<sup>2</sup> Note, i) if the real risks (e.g., of technology failure) are as high as the market perceives, or ii) if the eventual costs of the projects (beyond those for the first movers) remain high, so as to make the projects financially unfeasible without public support, then these projects should not be undertaken. This would result in significant market distortions.

5. Private sector proposals will be submitted in the form of either individual large-scale projects which use more than \$50 million of CTF funds (“Projects”), or program envelopes which aggregate several small and medium sized projects each utilizing less than \$50 million of CTF funds and all having a shared focus and objective (“Programs”). Proposals will explain how the Projects and Programs are expected to contribute towards the objective of achieving transformational outcomes in a sector, sub-sector, country, sub-national region, sub-region, or region while demonstrating that these outcomes would not be possible without support from the CTF.

### **Programming by MDBs**

6. MDBs may submit private sector proposals consistent with country investment plans (“Investment Plans”). However, in order to facilitate an early start-up of the CTF’s operations, MDBs may, during the first 6 months of CTF operations, submit proposals to the Trust Fund Committee once a country has requested a joint mission to prepare a CTF Investment Plan and after consultation with the relevant recipient country government. All proposals would need to demonstrate that they are consistent with the investment criteria established for private sector initiatives and the objectives of the CTF. The Trust Fund Committee would be responsible for approving CTF financing for each proposal during such interim period.

### **Timing, Form and Content of Private Sector Proposals**

7. Timing and Form of Private Sector Proposals: Private sector Project or Program proposals may be submitted to the Trust Fund Committee for consideration at any time throughout the year in line with an endorsed country or sub-regional Investment Plan. Proposals will be submitted using the template outlined in Annex A, which includes the investment criteria and relevant country and Project/Program information. MDB’s may submit multiple proposals simultaneously or sequentially and without limitation. Annex B outlines the private sector cycle of activities for the CTF. When submitting a CTF proposal, each MDB will have to balance the level of detail required to present to the CTF Trust Fund Committee with the need to manage client expectations. Each MDB may choose when, within its own internal processes, it submits a proposal for CTF funding; however in all cases, this must be prior to an MDB’s final Board approval.

8. Content of Private Sector Proposals: Programs and Projects will be evaluated based on their merits as described in each proposal. Each proposal must include the following information:

- (a) *Strategy for achieving market transformation:* This section will describe how the Project or Program expects to achieve transformational action towards low carbon development in a sector, sub-sector, country, sub-national region, sub-region, or region. It will discuss how the proposal fits within: a) the identified role of the private sector as described in the Investment Plan, b) already established country objectives and strategies, c) the existing policy and

regulatory environment, and d) if relevant, how policy, regulatory and other institutional issues will be addressed to ensure the Project's or Program's success. Proposals must also describe how they leverage the MDB's currently ongoing activities and existing strengths.

- (b) *Description of the Project or Program:* Private sector proposals should contain the following elements:
- i. 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. Final approvals of CTF financing for Projects will be subject to the internal approval processes of the implementing MDB. No further approvals will be required by the Trust Fund Committee unless the final project design results in i) GHG savings that are less than 85% of the original estimate; and/or ii) the changes require an increase in the CTF element of the Project's budget; and/or iii) the ratio of funding from MDB/other financing sources to CTF funding decreases more than 10% from the original leverage ratio. In such cases the Project will be resubmitted to the Trust Fund Committee for approval of CTF financing via circulation on a no-objection basis for a period of 10 working days prior to being submitted through the MDB's internal approval processes. Minor but material updates or changes to the Project's design will be provided by the MDB through annual reports but will not require further approval by the Trust Fund Committee (see Reporting below).
  - ii. For each Program: a profile of the sub-projects expected to be financed under the Program. For purposes of confidentiality, names, if known at the time of the Program's submission, and details that would make a sub-project identifiable by third parties are not to be included in the Program description. Sub-projects within a Program will not require additional CTF approval, unless agreed otherwise by the CTF at the time of original approval. Final approval of CTF financing for sub-projects will be subject to the internal approval processes of the implementing MDB. Minor but material updates or changes to the Project's design will be provided by the MDB through annual reports but will not require further approval by the Trust Fund Committee (see Reporting below).
- (c) All proposals: a description of the elements that go beyond supporting a Project's or Program's financing needs, such as advisory services and knowledge management initiatives should be included. In keeping with MDB private sector practice a proposed Project or Program budget may be used for initiatives aimed

at reducing information barriers or other non-financial barriers to market transformation. These activities may include capacity building for private sector entities, particularly small- and medium-sized enterprises, and knowledge products aimed at sharing information among private sector entities, public sector organisations and public-private sector entities, including financial intermediaries, as well as between and among the MDBs, and other relevant development partners.

9. Investment Criteria: The investment criteria for private sector proposals are generally the same as those for the public sector; however, the performance indicators for each may be different in certain cases. Private sector proposals will be reviewed against the investment criteria outlined below, and when relevant, will be compared against other similar private sector projects. The criteria reflect a range of considerations, some of which can be quantified and some not; however, all must be considered together. These criteria will be reviewed by the Trust Fund Committee, in consultation with the MDB Committee, after the first year of operations to determine if amendments are needed to effectively evaluate the type of Projects and Programs actually being submitted for approval.

Demonstration Potential at Scale:

- (a) *Market Transformation Potential:* the degree the low-carbon technology market has expanded against the baseline (such as an increase in renewable energy installed capacity or market penetration of energy efficiency products), at the country or regional level.
- (b) *Scalability Potential:* the commercial viability of the technology and potential scalability of the Project or Program.

Additionality:

- (c) *Financial Sustainability:* the likelihood of long-term financial sustainability of a particular Project or Program once the CTF funds are not 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. Particular emphasis should be on a Project's or Program's ability to perform profitably under prevailing and projected market conditions. The CTF subsidy element of the investment should be transparent and provisions provided for limiting the scope, in terms of project finance component and time. 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.
- (d) *Financial Leverage:* the amount of resources mobilized from within the MDBs and other organisations, and by the private sector, both domestic and international sources, including carbon finance. CTF funds are expected to leverage other resources, specifically from the MDBs, other

financial institutions, bilateral donor programs, and the sponsor(s). All proposals will be required to consider the full range of financial mechanisms available in the market, including carbon finance. The MDB's decision to proceed with a particular Project or sub-project within a Program should take into account the degree of leverage obtained, while also considering whether the specific project elements to which CTF resources are applied, are well defined. Leverage ratios will be included as a range so as to provide flexibility to the MDB in implementing the Project or Program sub-projects, particularly since proposals are sent to the TFC at an early stage, and to avoid having to go back for a second approval.

- (e) *Effective Utilization of Concessional Finance:* adherence to the principals for using concessional funds outlined in Annex C. CTF funds should only be used by the MDB if it is unlikely that the project would go forward as contemplated without these resources (additionality).
- (f) *Mitigation of Market Distortions.* the avoidance of market distortions. Program and Project proposals must discuss how they would seek to minimize or avoid distorting markets, displacing private sector investment or reducing market competitiveness particularly when it is proposed to use funds as grants. Similarly, it will be important to ensure CTF funds are complementary to carbon finance, and it will be necessary to demonstrate that the CTF intervention would not be supporting projects that could otherwise be financed by the Clean Development Mechanism alone.

#### Potential for GHG Emissions Savings

- (g) *Emissions Reduction Potential of the Project or Program:* the amount of CO<sup>2</sup>-equivalent emissions savings that will result during the life of the technology from the proposed Project or Program. Emissions reductions will be calculated by assessing the energy savings attributable to the Project or Program for the country or region and technology specified multiplied by the CO<sup>2</sup> intensity of the marginal technology.<sup>3</sup>
- (h) *Cost-Effectiveness of CO<sup>2</sup> Reductions:* the expected GHG reduction during the life of the technology per CTF donor dollar invested.

#### Development Impact:

---

<sup>3</sup> To assess emissions savings in a robust and consistent manner, a methodology will be developed to take into account direct emissions savings from the investment based on existing practice.

- (i) *Co-benefits*: the co-benefits 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 will be asked to identify co-benefits and these will be viewed favourably in line with criteria agreed by the TFC. Examples of co-benefits include a reduction of air pollution, energy security, the diversification of energy supply, and acceleration of access to affordable, modern energy or transport services for the poorest.

Implementation Potential:

- (j) *Risks*: the risks inherent in the project and how these will be mitigated/addressed. The risks of the Project or Program (including implementation, financial, social and environmental, market transformation, etc.) must be discussed in light of why the project is expected to be successful. Each MDB will adhere to its own social and environmental safeguard policies.

**Financial Instruments and Procedures**

10. Each proposal must describe, in broad terms, the financing instruments to be utilized, and justify the use of each instrument in light of the market barrier being addressed and need to avoid or limit market distortions. The Proposal will explain if and how subsidies are limited to specific components, and discuss why this approach would provide significant additionality, i.e. why such projects would not go forward as contemplated without use of CTF funds.

11. CTF financing will not be uniformly offered to all private sector companies. In order to honour the CTF's objective of using the least amount of subsidy necessary to enable a project to take place, CTF funds will be structured on a case-by-case basis. For Program proposals, the amount and terms of the CTF funding offered to an individual sub-project client will be determined between the MDB and the client on the basis of efficient and effective use of CTF resources. Country, industry and individual company dynamics will impact the amount of subsidy a company will accept to undertake a project. Very often it will be the case that three different companies in the same industry will require three different levels of subsidy to implement a given technology. For example, if catalyzing market uptake of waste/heat recovery technologies in a sector were dependant on having the three market leaders implement the equipment, then the MDB would need to offer each company the minimum amount of subsidy required to have that company undertake the investment. If all companies were offered the same subsidy the MDB would likely be over-subsidizing some while not engaging others necessary to achieve the Program or Projects' objectives. Finding the right amount of subsidy is largely a matter of negotiation and is dependant on information not flowing between the companies or being available in the market.

12. *Modalities for blending with MDB financing.* To achieve greater leverage, private sector Projects and Programs will seek to blend CTF financing with MDB financing in the most efficient and effective way possible. Financing proposals offered to end-clients may or may not initially differentiate between funds provided by the CTF and funds provided by the MDB's own account, as highlighting the CTF funds could lead to the private sector entity demanding more subsidy than it otherwise would accept to undertake a given project.

13. *Financial Instruments.* MDBs may use or create financial instruments as appropriate to meet the needs of their private sector clients and achieve the goals of the Project or Program. Each MDB must explain in the proposal why it believes it can structure and implement the financial instruments proposed for each Project and Program. CTF resources may be combined with other instruments and mechanisms available in the market, such as GEF resources, other donor funds, and/or carbon credits. In the case of such resource pooling and to the extent available at the time of submission, underlying Project and Program proposals may need to explain the particular advantages of combining these tools in the specific circumstances. It will be important to share and build upon lessons learnt through deployment of various financial instruments, and identify opportunities for replication and scale-up as appropriate.

14. *Pricing and terms.* The pricing and terms of the CTF funds offered to private sector clients will be tailored to address the specific risk, market, and structural aspects of each Project and Program. MDBs will seek to ensure that the subsidized financing minimizes or avoids market distortions.

### **Results Measurements**

15. In line with the Investment Criteria, proposals must include performance indicators for each Project, Program and the sub-projects within each Program, along with a timeline for such indicators<sup>4</sup>.

### **Administrative and Project Management Costs**

16. In line with the World Bank CIF Board Document, CTF budgets will be prepared to reflect the understanding that “compensation for administrative services and project related activities will be on the basis of full cost recovery for the entities but should be guided by the principles of value for money, reasonableness, and transparency”.

17. Project costs refer to the MDBs' expenditures related to the identification, preparation, appraisal, approval, supervision and evaluation of a specific Project or Program and the sub-projects therein. The MDBs would apply their investment lending policies and procedures to all operations financed by the Funds.

---

<sup>4</sup> Please note that a review of the Results Measurement framework for both public and private sector projects will be undertaken during the January 2009 CTF Trust Fund Committee meeting.

- (a) *Project and Program Preparation includes:* development of project concept and review; due diligence and design;
- (b) *Sub-project Preparation includes:* project concept preparation and review; due diligence; structuring, approval preparation and review; preparation and negotiation of legal agreements; and, board approvals;
- (c) *Project and Sub-project Implementation includes:* loan/grant disbursement management; oversight of, or management costs related to, sponsor capacity building or completing knowledge management products; and procurement and management of consultants;
- (d) *Project and Sub-project Supervision includes:* monitoring and completion of reports, site visits, negotiation and implementation of waivers and restructurings; monitoring and evaluation of individual projects including independent evaluation of completion/performance reports.

**Cost Recovery:**

18. Private sector budgets will comprise two elements; a Program Management & Administrative Services budget (PMAS) and a Project and Sub-project Implementation and Supervision Budget (PSISB).

19. *Program Management & Administrative Services (PMAS):* When constructing an annual administrative budget, the Trustee, the Administrative Unit, and the MDBs will use common, standard expense categories as outlined in the Climate Investment Funds FY09 Budget Paper. PMAS budgets will include Project and Program preparation work as well as administrative expenses needed to operate the program within the MDB.

20. *Approval of Administrative Budget by the Trust Fund Committee:* Each MDB will prepare, on an annual basis, a proposal for compensation for the agreed administrative services for the upcoming year. The Trust Fund Committees would endorse the entities' activities for the upcoming year and approve the request for compensation. Upon approval by the Trust Fund Committee, the Trustee would be authorized to commit and transfer the entire amount approved to the entities. Each approval would be subject to an end of year adjustment based on actual costs.

21. *Compensation for Project and Sub-project Implementation and Supervision Budget (PSISB):* The budget for PSISB will be prepared for the whole project life cycle and include estimated annual expenditures. The total budget, including an annual breakdown of expenditures, will be submitted for approval together with the Project or Program proposal. Upon approval by the Trust Fund Committee, the Trustee will commit the entire implementation and supervision budget; the Trustee will transfer the annual

amount approved to the respective MDBs on a yearly basis. The fiscal year allocation within the approved implementation and supervision budget will be subjected to annual adjustment based on actual costs. In addition to staff, consultants, travel and related costs for implementation and supervision of all projects, PSISB budgets will cover project preparation, due diligence, investment negotiations, and portfolio management for sub-projects within a Program.

### **Reporting**

22. MDBs will report on the progress of all Projects and Programs annually or more frequently if requested by the Trust Fund Committee. To ensure consistency in reporting and evaluation, universal measurement criteria will be developed by the MDB Committee. The measurement criteria will be in line with already existing best practice.

**Annex A**

**CTF PRIVATE SECTOR PROPOSAL TEMPLATE**

<i>Name of Project or Program</i>	
<i>CTF amount requested (US\$):</i>	
<i>Country targeted</i>	
<i>Indicate if proposal is a Project or Program</i>	
<b>DETAILED DESCRIPTION OF PROJECT OR PROGRAM</b>	
<p><b><i>Description of the Project or Program including:</i></b></p> <ul style="list-style-type: none"> <li>➤ for each Proposal, a description of the country and sector targeted, as well as the technology supported, including an explanation for the technology choice.</li> <li>➤ 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.</li> <li>➤ 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</li> <li>➤ 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)</li> <li>➤ a description of the elements that go beyond the financing offered, such as advisory services and knowledge management initiatives and instruments.</li> <li>➤ note the expected life of the Project or Program from date of approval (investment &amp; supervision period)</li> </ul>	
<p><b><i>Describe the Proposal’s strategy for achieving market transformation including:</i></b></p> <ul style="list-style-type: none"> <li>➤ 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.</li> <li>➤ describe how the Proposal fits i) the identified role of the private sector as described in the Investment Plan; ii)</li> </ul>	

<p>within a country’s existing regulatory environment and government policies; and iii) where it doesn’t how this will be addressed/ mitigated</p> <ul style="list-style-type: none"> <li>➤ explain how the MDB will leverage its ongoing activities and existing strengths</li> </ul>	
<b>FIT WITH INVESTMENT CRITERIA</b>	
<p><b><i>Market Transformation Potential</i></b></p> <ul style="list-style-type: none"> <li>➤ Highlight the degree of market expansion expected to be achieved by the Project or Program at the country or regional level.</li> <li>➤ Indicate how the project may overcome financial and non-financial barriers, and demonstrate what may be necessary to lead to market transformation.</li> </ul>	
<p><b><i>Scalability Potential</i></b></p> <ul style="list-style-type: none"> <li>➤ Demonstrate the commercial viability of the technology and outline prior examples of successful application and its potential scalability.</li> <li>➤ Identify what policy, regulatory and financial mechanisms may be necessary to scale-up and/or replicate the investment.</li> </ul>	
<p><b><i>Financial Sustainability</i></b></p> <ul style="list-style-type: none"> <li>➤ 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.</li> <li>➤ Identify specific institutional factors that will be necessary to enhance the commercial viability of the technology/project, if any.</li> </ul>	
<p><b><i>Financial Leverage</i></b></p> <ul style="list-style-type: none"> <li>➤ 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.</li> </ul>	

<p><b><i>Market Distortions</i></b></p> <ul style="list-style-type: none"> <li>➤ 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.</li> </ul>	
<p><b><i>Effective Utilization of Concessional Finance</i></b></p> <ul style="list-style-type: none"> <li>➤ Justify why the concessional finance is needed (why the projects would not go forward without concessional finance);</li> <li>➤ Discuss why the structure suggested is most appropriate for achieving the Proposal's goals.</li> <li>➤ Note the use of any other concessional or carbon related finance in the project and how CTF will add value.</li> </ul>	
<p><b><i>Note the Emissions Reduction Potential</i></b></p> <ul style="list-style-type: none"> <li>➤ Calculate the amount of CO<sup>2</sup>-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 CO<sup>2</sup> intensity of the marginal technology.</li> </ul>	
<p><b><i>Cost-Effectiveness of CO<sup>2</sup> Reductions</i></b></p> <ul style="list-style-type: none"> <li>➤ The expected GHG reduction during the life of the technology per CTF donor dollar invested.</li> </ul>	
<p><b><i>Co-benefits</i></b></p> <p>The co-benefits 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 co-benefits include energy security in terms of avoided imports of fuels and, diversification of energy supply, and acceleration of access to affordable, modern energy or transport services for the poorest.</p>	

<p><b><i>Risks</i></b></p> <p>➤ Discuss the risks inherent in the Project or Proposal and how these are being mitigated/addressed.</p>	
<p><b><i>Performance Indicators</i></b></p> <p>List relevant “Performance Indicators” for the project.</p>	

## Annex B

### PROPOSED PRIVATE SECTOR CYCLE OF ACTIVITIES

Steps/Actions Required	Responsible Party	Performance Standards
1. Preparation of Investment Plans including identification of areas for private sector activity	Recipient country Government, MDBs and private sector	According to template approved by TFC
2. Prepare and submit proposals to TFC for approval	MDB	In the form of Annex A (proposal template)
3. TFC reviews proposals and approves	TFC	In the form of Annex A
4. Trustee commits amount of approved proposal	Trustee & MDB	As agreed with Trustee
5. Appraise, structure, and negotiate Projects and individual Program sub-projects	MDB	Based on CTF private sector investment criteria.
6. Resubmission of any Proposal that differs substantially from Approval	MDB to TFC	Memorandum circulated on a no-objection basis
7. MDB management-level approval <sup>7</sup>	MDB	According to MDB's operational policies and procedures
8. In accordance with each MDB's internal requirements a summary of project information which indicates at a minimum the company name and a brief project description will be circulated to the TFC when it is released to the public	MDB	No later than 30 days prior to MDB Board approval (for information purposes only)
9. MDB obtains board approval for Project, Program, or sub-project, as appropriate	MDB Board	According to MDB's operational policies and procedures
10. MDB submits cash transfer request to IBRD as Trustee	MDB and Trustee	As agreed with Trustee
11. MDB signs legal contracts with client	MDB and private sector	According to MDB's operational policies and procedures
12. Supervision and management of the portfolio projects	MDB	Consistent with MDB's operational policies and procedures
13. Annual Report submitted to Administration Unit	MDB	Based on the Performance Indicators established at Proposal Approval

## Annex C

### Principles of using concessional funding of the Clean Technology Fund

#### 1. Fundamental Approach

- (a) *Avoiding distortion and crowding out:* Financial support through the CTF should be targeted at global benefits of the projects and proportional to incremental costs of their achievement. It should be structured in a way that maximizes incentives to improve environmental performance of the projects and their early implementation. It should not compete with the private financial sector, but instead should be structured so that it reinforces the activities of the private project sponsors and leverages private finance to uncharted territories of targeted projects. Where these principles are compromised by donor conditions, the MDB will seek to minimise the adverse impact of the financing structure.
- (b) *Guarding flexibility:* Different countries have different risk profiles and different barriers to the implementation of projects. Applying a uniform rate for concessional risks may over subsidise some recipients, while being insufficient to prompt action with others. Ideally, requests for concessional elements should be accompanied by rigorous analysis of the reasons for the level chosen, and an assessment of the risks and benefits attached to it.

#### 2. Calculation of subsidy base and subsidy intensity

- (a) Significant portion of concessional financing (in particular grants) will be used for technical assistance and advisory services [it might be helpful to define technical assistance as the definition might differ across MDBs] to project sponsors and local financial institutions, such as project preparation, training of project sponsors and financial institutions, and marketing of project opportunities to them. MDB experience shows that project-related technical assistance is the most effective and the least distortionary way of removing many institutional barriers to targeted projects, such as lack of know-how and excessive risk perception. Well-targeted technical assistance reduces the need for investment subsidies.
- (b) Subsidy to project costs borne by project sponsors, in whatever form, will be calculated as CTF \$ invested per 1 tonne of CO<sub>2</sub>e reduced against reasonably established baseline and boundaries. However, because of the diversity of private climate mitigation projects and clients, the MDB requires flexibility in determining certain parameters of this formula:
  - i. *Level of concessionality (subsidy intensity)* will differ by project type, technology, sector and the country in order to account for specific market conditions and different incremental costs. A flat subsidy rate per 1t of CO<sub>2</sub>e could result in insufficient cash flow to trigger some climate mitigation projects (e.g. energy efficiency in buildings or municipal infrastructure) and in excessive cash flow (windfall profits) for other projects (e.g. certain process improvements in industry, certain renewable energy sources).

- ii. *Proxies for measured CO<sub>2</sub>e emission reduction* will be applied in particular for small projects reached through financial intermediaries. Direct measurement of emission reduction may be feasible for large, stand-alone projects (e.g. rehabilitation of thermal power or heating plants). However for smaller projects a more practical and efficient approach would be to rely on conservative and robust technical proxies that would ensure proportionality with climate impact, but would be easier to monitor.
- iii. *Timing of disbursement.* The strongest incentive structure would be provided if performance premiums mimicked the cash flow of the carbon finance transactions and were disbursed upon delivery of verified emission reductions. However an accelerated schedule of disbursement (e.g. upon technical project milestones) can be applied for certain project and client types, where payments on delivery would not trigger the projects either because of high implicit discount rates applied by project sponsors or lack of up-front cash flow. Accelerated disbursement will be designed so as not to lose incentives for project's 'climate performance'.