

The Adaptation Fund

AFB/B.3/3
September 8, 2008

Adaptation Fund Board
Third Meeting
Bonn, September 15-18, 2008

Agenda Item 5 (a)

DRAFT ROLE AND RESPONSIBILITIES OF THE ADAPTATION FUND TRUSTEE

(Prepared by Invited Trustee)

I. BACKGROUND

1. The Conference of the Parties to the United Nations Framework Convention on Climate Change (the Convention) decided in its decision 10/CP.7 that an adaptation fund (the Adaptation Fund) shall be established to finance concrete adaptation projects and programmes in developing country Parties that are Parties to the Kyoto Protocol to the Convention (the Kyoto Protocol), as well as activities identified in paragraph 8 of decision 5/CP.7. The decision was further endorsed by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) through its decision 28/CMP.1. In decision 1/CMP.3, the CMP decided that the Adaptation Fund shall finance concrete adaptation projects and programmes that are country driven and are based on the needs, views and priorities of eligible Parties, and that the Adaptation Fund Board shall be established as the operating entity of the Adaptation Fund.

2. In its decision 1/CMP.3, the CMP invited the International Bank for Reconstruction and Development (the World Bank) to serve as the trustee for the Adaptation Fund (the World Bank in such capacity, the Trustee) on an interim basis, and requested the Adaptation Fund Board to present the necessary legal arrangements to be concluded between the CMP and the Trustee for adoption by the CMP at its fourth session.

3. Decision 1/CMP.3 provides that the Trustee shall have the fiduciary responsibility and the administrative competence to manage the Adaptation Fund, and shall comply with principles and modalities for operations stipulated in relevant decisions of the CMP. It further provides that the Trustee shall be accountable to the Adaptation Fund Board for the performance of its fiduciary responsibilities and in particular for the monetization of certified emission reductions (CERs) in accordance with guidance provided by the Adaptation Fund Board.

4. In response to decision 1/CMP.3, the legal arrangement between the CMP and the Trustee will be concluded by way of decision by the CMP and the World Bank approving and accepting the terms and conditions of services provided by the World Bank as the Trustee (the Terms and Conditions). The terms set forth herein will be subject to acceptance by the Executive Directors of the World Bank of the invitation to serve as the Trustee, on the basis of the Terms and Conditions. The Trustee will commence provision of its services upon effectiveness of the Terms and Conditions.

II. TRUSTEE FUNCTIONS FOR THE ADAPTATION FUND

5. The Trustee will provide its services to the Adaptation Fund in accordance with the Terms and Conditions. In the event of any inconsistency between the Terms and Conditions and this document, the Terms and Conditions will prevail to the extent of the inconsistency.

6. The Trustee will establish a trust fund for the Adaptation Fund (the Trust Fund) to hold in trust the funds, assets and receipts which constitute the Trust Fund, on behalf of the Adaptation Fund. For the avoidance of doubt, no CERs will be held in the Trust Fund.

7. The Trustee will perform two core functions for the Adaptation Fund: (A) monetization of CERs for the Adaptation Fund, and (B) trust fund management, including financial

management of the resources of the Trust Fund; investment management; and accounting and financial reporting.

8. The Trustee will perform its functions consistent with its Articles of Agreement, by-laws, policies and procedures, and be accountable to the Adaptation Fund Board for performance of its functions.

A. Monetization of CERs

9. The Trustee will be accountable for the monetization of the CERs collected as the share of proceeds and forwarded to the Adaptation Fund in accordance with the guidance provided by the Adaptation Fund Board. Monetization of CERs is the transformation of the CERs into cash. The Trustee will undertake the monetization of CERs in accordance with paragraph 28 of decision 1/CMP 3. The monetization program is to be undertaken to (a) ensure predictable revenue flow for the Adaptation Fund; (b) optimize revenue for the Adaptation Fund while limiting financial risks; (c) be transparent and monetize the share of the proceeds in the most cost-effective manner, utilizing appropriate expertise for this task. These objectives will provide the basis for all work undertaken by the Trustee in connection with the monetization of CERs.

10. The Adaptation Fund Board will approve guidelines on monetization of CERs, based on proposals submitted by the Trustee. The guidelines will be consistent with the monetization objectives, taking into account changing market conditions and constraints, and may be amended from time to time as necessary. The Trustee will implement the CER monetization program in accordance with the guidelines.

11. Upon monetization of CERs, the Trustee will receive and hold the net proceeds of CER sales in the Trust Fund.

12. The Trustee will report to the Adaptation Fund Board on CER sales annually or as specified in the approved guidelines for monetization. The report will include summary and transaction information, such as price and volume information relating to CERs sold, the amount of CERs held in the account for the Adaptation Fund and any other relevant information.

B. Trust Fund Management

13. In the management of Trust Fund resources, the following services will be provided by the Trustee:

- (i) Financial management: management of the inflow of receipts from the sale of CERs; administration of contributions from donors, if any; recording of Adaptation Fund Board approvals of allocations; recording of commitments and cash transfers; management of reflows and currency conversions; management of cash flow; management of financial risk, including currency and interest rate risk management, as appropriate; and provision of financial and operational controls over the resources held in the Trust Fund.

- (ii) Investment management: investment of funds; periodic review of the risk profile and asset composition of investment benchmarks; and allocation of investment income to the Trust Fund on a monthly basis.
- (iii) Accounting and financial reporting: maintenance of accounting records and financial data; provision of periodic financial reports; preparation of annual, audited financial statements; coordination of external audit of the Trust Fund, and review of the consistency of specified financial data provided to the Trustee.

III. OPERATING PROCEDURES FOR TRUST FUND MANAGEMENT

14. **Investment Management:** In accordance with the policies and procedures of the World Bank, the Trust Fund resources will be kept separate and apart from the assets of the World Bank, but may be commingled with other trust fund assets maintained by the World Bank for administrative and investment purposes. The World Bank will keep separate records and accounts for the resources held in the Trust Fund. Pending transfer of funds, the World Bank will invest funds held in the Trust Fund in accordance with the Trustee's policies and procedures for the investment of trust funds administered by the World Bank. Investment income earned will be credited to the Trust Fund to be used for the same purposes as other funds held in the Trust Fund.

15. **Allocation, Commitment and Transfer of Funds:** Subject to the availability of resources held in the Trust Fund, the Trustee will record commitments and make transfers of funds from the Trust Fund, in the manner agreed between the Adaptation Fund Board and the Trustee. Such commitments and transfers will be made only at, and in accordance with, written direction provided to the Trustee by the Adaptation Fund Board or other person designated in writing by the Adaptation Fund Board for this purpose.

16. In case of the transfer of funds to implementing entities (expected initially to be the GEF Agencies performing the functions and responsibilities of implementing entities), the Trustee will enter into agreements with the implementing entities, setting out the financial procedures applicable for commitment and transfer of funds. Implementing entities will bear the responsibility for the use of Trust Fund funds transferred or for activities carried out therewith. It is understood that implementing entities will be responsible for, among others, the following tasks:

- conducting the necessary technical, environmental, social and financial due diligence in project preparation;
- entering into grant and other financing agreements with recipients;
- supervising, monitoring, and reporting on implementation of project activities and use of funds; and
- ensuring that AF-funded activities are carried out in a sound manner consistent with CMP and AF Board decisions.

17. In case of the commitment and transfer of funds directly to eligible Parties or to executing entities, commitments and transfers will be made only if the AF is endowed with the necessary legal and administrative capacity to carry out the above listed tasks under paragraph 16, either on its own or through other legal entities contracted by the AF. Any such commitments and transfers would be made pursuant to an agreement between the Trustee and the AF setting out the financial procedures applicable for commitment and transfer of funds in such cases.

18. The Trustee will not enter directly into any agreements with an eligible Party or executing entity. Upon transfer of funds, the Trustee will have no responsibility for the use of Trust Fund funds transferred or for activities carried out therewith (as further described in paragraph 22 below).

19. **Contributions:** If so requested by the Adaptation Fund Board, the Trustee may accept, in the manner and on terms agreed between the Adaptation Fund Board and the Trustee, monetary contributions from donors to support the operations of the Adaptation Fund. The Trustee will enter into a trust fund administration agreement with each donor setting out the terms and conditions applicable to the administration and management of the contributions.

20. The Adaptation Fund Board Secretariat will ensure that the Trustee receives all information necessary in order to carry out its responsibilities.

21. **Trustee Costs and Expenses:** Costs and expenses incurred by the Trustee in connection with the performance of its functions, including CER monetization and trust fund management, will be reimbursed on a full cost-recovery basis from the assets held for the Adaptation Fund, consistent with the World Bank's policy to recover its full costs in the provision of trustee and administrative services. For this purpose, the Trustee will annually submit to the Adaptation Fund Board a proposal for the services and activities to be provided by the Trustee and estimated fees, costs and expenses to carry out such services and activities for the initial and/or upcoming year, as applicable. Upon mutual agreement between the Trustee and the Adaptation Fund Board on such proposal, the Trustee will transfer from the Adaptation Fund resources the estimated amount to its own account; provided, however, that the amount transferred to cover the fees, costs and expenses will be subject to end-of-year adjustment to reflect actual costs and expenses incurred.

IV. LIMITED FIDUCIARY RESPONSIBILITIES OF THE TRUSTEE

22. In its role as trustee for the Adaptation Fund, the Trustee's responsibility will be limited to the management of the funds held in the Trust Fund, sales of CERs, financial management and sound investment of funds, recording commitments and making cash transfers of these funds, and the provision of regular reports and maintenance of accounting records and financial data, in accordance with the Terms and Conditions. In fulfilling its responsibility, the Trustee will rely on decision, instructions, directions or guidance provided to the Trustee in writing by the Adaptation Fund Board or such other person designated in writing by the Adaptation Fund Board, pursuant to the Terms and Conditions. The Trustee will not supervise, track, report on, or verify activities of implementing or executing entities or any other recipients of Adaptation Fund

resources, nor will it supervise the use of funds by such entities. Accordingly, the Trustee will have no responsibility for the use of resources once they are transferred by the Trustee.

23. Under the Terms and Conditions, the Trustee will be indemnified, out of the assets held for the Adaptation Fund, including the Trust Fund resources, for any liabilities, claims, losses, costs and expenses incurred by the Trustee in connection with or arising out of its activities as the Trustee, including sales of CERs. Such indemnification will not include any liabilities, claims, losses, costs or expenses incurred by the Trustee as a direct result of its own gross negligence or willful misconduct.