ADAPTATION FUND

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Adaptation Fund Board
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Agenda item 9 a)

POTENTIAL LINKAGES BETWEEN THE ADAPTATION FUND AND THE GREEN CLIMATE FUND

Background

1. At its 24th meeting, the Adaptation Fund Board (the Board) discussed inputs to be provided to the Conference of the Parties serving as meeting of the Parties to the Kyoto Protocol at its 10th session (CMP 10) on the second review of the Adaptation Fund (the Fund). The Board decided to *[r]equest the secretariat to prepare a document containing elements on potential linkages with the Green Climate Fund [GCF] for consideration by the Board during the intersessional period.*[1]

2. In preparing the requested document, the secretariat built upon document AFB/B.20/5, — Strategic prospects for the Adaptation Fund — discussed by the Board at its 20th meeting in March 2013. Since that time, the GCF has made significant progress toward its operationalization. These developments are considered in this document, which is presented for consideration by the Board during the intersessional period between its 24th and 25th meetings. In writing this document, the decision-making autonomy of the Fund and the GCF is acknowledged, and it is noted that modalities for future operations do not prejudge decisions that are fully outside of the Board's governing authority. The scenarios in this document do not, in any form, prejudge any discussion or decision by the GCF Board, or the CMP/COP.

The situation of the Adaptation Fund, and scenarios presented in document AFB/B.20/5, Strategic prospects for the Adaptation Fund

3. Recipients strongly support the Fund for a number of reasons. The Fund:

- Is fully operational and recipient countries are already familiar with its established policies and procedures;
- Has a proven record (and a pioneer role) in providing direct access. It is currently the only Fund with direct access projects/programmes under implementation and has been successful in establishing an accreditation system allowing national institutions to directly access adaptation finance, with a track record of 17 national Implementing entities (NIEs) accredited so far. In addition, it is the first climate fund to engage in enhanced direct access, providing not only country ownership but country driven-ness;
- Provides continuous support to countries through the accreditation process and its readiness programme. This support includes improvement in resource management, institutional capacity, and project development, implementation and management by NIEs through compliance with fiduciary standards and environmental/social safeguards;
- Is operationally independent and performs its functions without extensive external support;

[1] Decision B.24/29, Paragraph (a)

- Has a unique mandate to address concrete adaptation projects and provides targeted and specialised support to project proponents through its review process, even for smaller projects in highly localized contexts;
- Promotes greater (recipient) country ownership though is governance structure;
- Supports recipient countries with a lean administration and professional and experienced secretariat staff.

4. These strong tangible and intangible assets constitute the essence of the Fund and thus will continue for as long the Fund exists.

5. Among the relevant issues taken into account in document AFB/B.20/5, are the progress toward the operationalization of the GCF, including GCF Board decision B.08/03 on assessment of institutions accredited by other relevant Funds and their potential for fast-track accreditation; the work of the Standing Committee on Finance (SCF); and the second review of the Adaptation Fund undertaken by CMP 10.

6. In addition to these developments within the UNFCCC process, there is a growing body of independent studies on the climate funds, such as the November 2014 report by WWF, "Early Experiences in Adaptation Finance: Lessons from the four multilateral climate change funds"[2] There are also studies on direct access, such as the report **"**Learning from Direct Access Modalities in Africa" by Germanwatch, the Heinrich Böll Foundation, and the Climate and Development Knowledge Network (CDKN), which conducted field surveys among the Fund's NIEs in Africa.[3]

7. The WWF study does not make specific recommendations for the Fund, but at the general level regarding access modalities it finds that "**[d]irect access should be scaled up to ensure country ownership of adaptation actions**."[4] The report notes, however, that "**[a] range of access modalities will be needed to match differing country capacities and needs**."[5] On financing instruments, the WWF report concludes that "**[i]ncreased coordination of international public funds is needed to improve efficiency of adaptation projects and programs**."[6] It further states that "**[f]uture adaptation funds, including the GCF, should avoid the establishment of entirely new mechanisms and processes in the design of its adaptation window, and seek to build on and improve existing systems for adaptation finance.**"[7] According to the report, "recipient countries, implementing entities and fund managers now have over a decade of

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[2] *Available at* http://assets.worldwildlife.org/publications/745/files/original/Early_experiences_in_adaptation_finance.pdf?1418139351.

[3] *Available at* http://us.boell.org/sites/default/files/uploads/2014/12/learning_from_direct_access_modalities_in_africa_germanwatch_1.pdf.

[4] WWF, Early Experiences in Adaptation Finance: Lessons from the four multilateral climate change funds, p. 47 (Nov. 2014).

[5] *Id.*

[6] *Id*. at 48.

[7] *Id.* at 50.

experience managing adaptation finance. In that time, many recipient countries have built institutional capacity and developed comprehensive adaptation plans, and have developed a familiarity with the modalities and procedures of existing adaptation funds. Alongside this, multilateral funds have increased the transparency of their selection and approval processes while better communicating their funding requirements to potential beneficiaries. Increased familiarity with existing processes and the closer alignment of national planning documents, project designs and fund objectives, is largely responsible for reducing the turn-around time in accessing adaptation finance. **Developing entirely new institutions and processes in parallel to existing ones could undermine this institutional knowledge and lead to needless duplication of effort.**"[8]

8. Given the objectives and guiding principles that Parties to the UNFCCC have set for the GCF in its Governing Instrument (GI), including the aim to become the main global fund for climate change finance, the following questions are relevant:

- What role can or should the Fund play during and following the operationalization of the GCF?
- What would be the most appropriate institutional arrangement to ensure institutional coherence and synergy?

9. In order to answer the questions above, document AFB/B.20/5 presented three potential scenarios. Each scenario is not exclusive, and there could be further variations derived from each option. It is also worth noting that the feasibility of each scenario may change in the medium term (2–4 years), based on the evolution of the international climate finance architecture. Before the Board considers any of these scenarios, it is important to note that any scenario requiring the involvement of the GCF will require decisions by the Fund and GCF boards. The scenarios in this document have not been discussed with the GCF Board.

Scenario 1: Status quo

10. *The Fund continues its current interim arrangements with the Global Environment Facility (GEF) and the World Bank, and retains its lines of accountability and reporting under the authority and guidance by the CMP. The Fund and the GCF are functionally independent from one another.*

Scenario 2: Operational linkage between Fund and the GCF

11. *Given the legal capacity of the Board, the GCF could conclude agreements with it, limited to certain operational aspects. This modality would allow the GCF to channel some of its operations (and resources) through the Fund (e.g. direct access, concrete adaptation projects). These agreements do not imply any change in the institutional arrangements for the Fund, and could be concluded by the Board regardless of them.*

Scenario 3: Institutional integration

[8] *Id.* at 50–51.

12. *Different degrees of integration between the Fund and the GCF could be envisaged. Options may include the Fund serving as: a delivery mechanism for concrete adaptation projects for the GCF; a specialized instrument of the GCF; or a dedicated mechanism based on innovative sources (building on the experience of the CER-monetization process), etc.*

Analysis of scenarios 2 and 3 presented in document AFB/B.20/5

13. Since this document focuses on the potential linkages with the GCF, scenario 1 of document AFB/B.20/5 will not be discussed here. Rather, the document analyses the viability of scenarios 2 and 3 above, how they fare with respect to the potential linkages between the two funds, and their overall desirability. The document also analyses in which of these scenarios the Board can exercise influence or steer action, if any.

Operational linkage scenario (scenario 2)

14. Given the legal capacity of the Board, the GCF could conclude agreements with it, limited to certain operational aspects. This modality would allow the GCF to channel some of its operations (and resources) through the Fund (e.g. direct access, concrete adaptation projects). These agreements do not imply any change in the institutional arrangements for the Fund, and could be concluded regardless of them.

15. This scenario is in line with the objective of coherence and complementarity expressed in the mandate of the Standing Committee on Finance (SCF), in several decisions by the Parties, and in the GCF GI, in the context of an emerging institutional architecture of the financial mechanism of the UNFCCC.

16. Regarding the rationale for the GCF to establish an operational linkage with the Fund, the first argument is that, as the WWF study concluded, the GCF should build on and improve existing systems for adaptation finance rather than establish entirely new mechanisms and processes.[9]

17. In light of the recent GCF Board decision B.08/03 on fast-track accreditation, the accredited implementing entities that were in full compliance with the Fund's standards prior to 17 October 2014 are eligible to apply for fast-track accreditation as GCF implementing entities. This decision constitutes a step forward in terms of complementarity and coherence between the two funds, since the GCF Board decided to rely on the assessment of the Fund insofar as no gaps in the fiduciary and environmental and social standards have been identified.[10]

18. In that context, one could indeed envisage the Fund becoming functionally the (or one of the) channels for direct access funding for micro and small GCF adaptation projects/programmes.

[9] WWF, Early Experiences in Adaptation Finance: Lessons from the four multilateral climate change funds, p.50 (Nov. 2014).

[10] GCF/B.08/45, GCF Board decision B.08/03, paragraph (d) and (f). The latter specifically outlines gaps for fiduciary standards and environmental and social safeguards, which would be the focus of the fast-track accreditation. Available at http://www.gcfund.org/fileadmin/00_customer/documents/MOB201410-8th/GCF_B.08_45_Compendium_fin_20141206.pdf

This is in line with the argument—on the basis of paragraph 36 of the GCF GI—that in order to function at scale, the GCF will need to focus on programmes, and “outsource” all project activities to multilateral and national intermediaries/funding entities.[11] In that sense, scenario 2 has another significant advantage for the GCF, giving it the ability to spend funds quickly on the outstanding Fund’s project pipeline without jeopardizing the viability of the Fund. Indeed, this may be a way in which the GCF can really hit the adaptation funding ground running.

19. There are (at least) two ways in which this scenario could be implemented:

(a) The Fund, having a governing body with legal capacity, could be accredited as intermediary of the GCF. This option seems possible because the Fund may meet the relevant specialized fiduciary standards.

(b) Following paragraphs 33–34 of the GI,[12] the GCF and Fund Boards could enter into some form of MOU or legal agreement under which the Fund could receive GCF funds and serve as a delivery partner for specific activities where the Fund holds a comparative advantage. A potential concern with scenario 2 could be whether introducing the Fund as a “middle man” would not simply increase the overall administrative costs, thus leave less funding for the intended recipients. This legitimate concern can be addressed through an agreement between the principal (GCF) and the agent (the Fund). After all, it should be possible not to duplicate the processes, which means that the sum total of administrative costs should remain the same as if the projects were handled without an intermediary. The costs of this option, however, should not exceed those that processing an agreement with donor countries imply. The secretariat will not charge any additional “fees” for matters related *inter alia* to its project review and monitoring operations, which are already part of its core tasks. The implementing entities will charge the usual fees. Rather than increasing costs, having the Fund take over certain duties could lower the overall share of GCF resources needed for administration during the initial period, given that the Fund’s procedures have been tried and trimmed over its five years of operations and it has established low administrative costs. Such an arrangement would also enable the Fund to share with the GCF its practical experiences on lean administration.

20. In conjunction with either of the two options above, a process enhancing complementarity between both funds could be initiated. This process would draw on the comparative advantages of each fund and on the exchange of knowledge and information between both secretariats, which is currently underway. The areas in which this complementarity process could be initiated are:

[11] See, for example, Benito Müller, *A Delhi Vision: for the Green Climate Fund Business Model Framework – Some Thoughts on Access and Disbursement*, Oxford Energy and Environment Brief, February 2013

[12] Governing Instrument for the Fund, para. 33, V. A. Complementarity and coherence

33. The Fund shall operate in the context of appropriate arrangements between itself and other existing funds under the Convention, and between itself and other funds, entities, and channels of climate change financing outside the Fund.

34. … The Fund will also initiate discussion on coherence in climate finance delivery with other relevant multilateral entities.

- Accreditation: building on the process of exchange of information currently underway and decision B.08/03 of the GCF Board, continue to harmonize the accreditation process valid for both funds. One potential idea would be to share/split the workload for NIE accreditation, with one of the funds' accreditation panels focusing on, for example, fiduciary standards, and the other focusing on environmental and social safeguards could be piloted. The accreditation would be valid for both funds and would target what the GCF considers "micro" and "small" projects.
- Readiness: the two funds could undertake joint readiness activities, in particular for supporting NIE accreditation and project development by NIEs. GCF Board decision B.08/10 on "Revised programme for readiness and preparatory support" in paragraph q) mentions coordination and MOUs with institutions involved in delivery of readiness support, including through information sharing and dialogues.
- Results: the two funds could coordinate the development of key adaptation indicators to embed at the project level. This would also enhance the coherence of the two funds with the ability to aggregate certain outcomes and impacts from both funds and eventually measure them at a global level
- Building a project/programme pipeline for the GCF drawing on the Adaptation Fund portfolio under implementation. In the case of "micro" and "small" projects implemented by NIE, the GCF could outsource the portfolio to the Adaptation Fund. Once the NIE have proven that they can successfully implement projects/programmes, they could access further funding under the GCF.[13]

21. If funding comes from the GCF, then the Fund may have to follow the strategic guidance (at least for this funding) of the GCF, which will increase the coherence between the GCF and Fund.

22. This scenario would also provide adequate and predictable funding for the Fund, in line with previous decisions made by the Parties.

Institutional integration scenario (scenario 3)

23. *Different degrees of integration between the Fund and the GCF could be envisaged. Options may include the Fund serving as: the "Adaptation Window" of the GCF; a specialized instrument or window of the GCF; or a dedicated mechanism based on innovative sources (building on the experience of the CER-monetization process), etc*.

24. Different degrees of integration could be considered, ranging from the absorption of the Fund into the GCF to becoming a sub-fund or window under the GCF dedicated to concrete adaptation projects/programmes of a certain size, direct access, etc.

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[13] The GCF uses the following classification of projects and programmes (GCF/B.08/45, GCF Board decision B.08/02, Annex I, para 12):

- Micro: up to and including $10 million
- Small: above $10 million and up to and including $ 50 million,
- Medium: above $ 50 million and up to and including $ 250 million,
- Large: above $ 250 million

25. While the processes and procedures could be integrated by simply replicating them, other aspects may be more difficult to 'integrate' in the GCF, such as the project portfolio under implementation, the governing body, and the secretariat. These aspects present legal and administrative challenges and in any case will require a process and a decision at the COP/CMP level, which is beyond the remit of the Board.

26. This scenario in any of its options requires a gradual process and, moreover, the full operationalization of the GCF. It seems premature at this point to make decisions that may have irreversible implications for the Fund. The absorption or integration of the Fund into the GCF might be desirable in the future. However, before deciding to "merge" the funds, some issues need to be resolved and the GCF needs to become fully operational and its effectiveness tested. Thus, the Fund fills a gap: financing concrete adaptation in non-Annex I Parties, including through direct access, something no other fund is doing at this point. A more gradual process is therefore more desirable. Further decisions on integration may be made based on the results of such a process.

Conclusions and way forward

27. Scenario 2, i.e. the Fund receiving core-funding from the GCF — either as an intermediary of the GCF by accreditation or entering into some other type of arrangement based on paragraphs 33–34 of the GCF GI — seems the most viable and desirable way of linking both funds at this stage. In parallel, a process to integrate the procedures and enhance collaboration on matters such as accreditation, readiness, results-based management framework, and project/programme pipeline could be initiated.

28. Moreover, scenario 2 would not require a COP/CMP decision but would be within the remit of the Board. Thus, the Board could decide to either apply for accreditation as a multilateral intermediary to the GCF—i.e. to become accredited for "the Fund's basic fiduciary standards, the specialized fiduciary standard for grant award and/or funding allocation mechanisms, and ESS"[14]—or to start engaging with the GCF Board on some other form of association as intermediary. The GCF Board, however, may be reluctant to treat the Fund differently from other intermediaries unless it receives guidance from the COP in that sense, and this is why the accreditation alternative may have a greater chance of success.[15]

Recommendation

29. The Board may wish to request the secretariat to

(a) Further assess:

(i) The potential for the Adaptation Fund to apply as a financial intermediary of the Green Climate Fund; and

[14] *See* GCF/B.08/45, GCF Board decision B.08/03, paragraph (g) on fast-track accreditation of the EU DEVCO agencies, i.e. the EU member states bilateral aid agencies. Note that an entity can become accredited as an Intermediary without having to be accredited as Implementing Entity, which would be the case of the Fund.
[15] *See supra* note 8.

(ii) The feasibility of entering into some form of a MOU or legal agreement under which the Fund could programme GCF funds; and

(b) Present its conclusions to the 25th Board meeting.