



ADAPTATION FUND

AFB/B.26/5
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Adaptation Fund Board
Twenty-sixth Meeting
Bonn, Germany, 8-9 October 2015

Agenda item 8 a)

**STRATEGIC DISCUSSION ON OBJECTIVES AND FURTHER
STEPS OF THE FUND: POTENTIAL LINKAGES BETWEEN
THE FUND AND THE GREEN CLIMATE FUND**

Background

1. At its 24th meeting the Adaptation Fund Board (the Board) requested the secretariat to prepare a document containing elements on potential linkages of the Adaptation Fund (the Fund or AF) with the Green Climate Fund (GCF), for consideration during the intersessional period between its 24th and 25th meetings. The secretariat produced document AFB/B.24-25/1, Potential linkages between the Adaptation Fund and the Green Climate Fund, which builds upon the options outlined in document AFB/B.20/5, Strategic prospects for the Adaptation Fund, discussed at the 20th Board meeting in March 2013. Document AFB/B.24-25/1 analyzed in particular two scenarios: (a) establishment of an operational linkage with the GCF, through either accreditation or an ad hoc agreement or memorandum of understanding; and (b) institutional integration between the two funds. By decision B.24-25/9 the Board decided to request the secretariat to further assess: (i) the potential for the Fund to apply as a financial intermediary of the GCF; and (ii) the feasibility of entering into some form of memorandum of understanding or legal agreement under which the Fund could programme GCF funds; and present its conclusions to the twenty fifth meeting of the Board.

2. Following the presentation by the secretariat at its 25th meeting, the Board decided to request the secretariat, in consultation with the trustee, as appropriate, to prepare a document for consideration by the Board at its 26th meeting containing further legal, operational, and financial analysis on the implications of various linkages with the GCF, and to report back at its 26th meeting.

3. This document contains an analysis of the legal, operational, and financial implications of the options for potential linkages with the GCF outlined in decision B.24-25/9, based on the available GCF documentation, for consideration by the Board. The analysis in this document focuses mostly on the first option in the above mentioned decision (accreditation of the Fund as intermediary of the GCF). The rationale for this focus is that the implications of pursuing the second option (memorandum of understanding or legal agreement to programme GCF funds) may be similar to those for option one. The assessment of the implications for the AF of any linkages with the GCF is at this point fairly limited, given that some key documents have yet to be developed by the GCF secretariat and approved by the GCF Board. Any operational linkage between the AF and the GCF will need to avoid duplication and inconsistency of policies and procedures, reporting requirements, tracking of funds, and funding decisions in order to be effective and efficient.

Option 1: Accreditation of the AF as intermediary of the GCF

4. In order to channel funds from the GCF as intermediary, the Board may request the secretariat to prepare an accreditation application to the GCF. While the potentially different roles and responsibilities of intermediaries and implementing entities have yet to be defined by the GCF, this case would fall under the international access category (for international entities, including UN agencies, multilateral development banks, international financial institutions and regional institutions). Having said that, it would not be appropriate for the secretariat to anticipate the outcome of the accreditation process, which requires a detailed assessment by the GCF Accreditation Panel taking into account the fiduciary and environmental and social standards.

Therefore, whether the AF meets or does not meet the GCF accreditation standards is beyond the scope of this document. However, assuming that the AF is accredited, the implications may be the following:

Legal implications

5. The Board, as the operating entity of the AF, represented by its Chair, may be required to sign an agreement with the GCF. The Board has legal capacity to enter into agreements with other legal entities, such as the GCF. This is what the Board does every time a project/programme is approved.

6. The nature and scope of the legal obligations that the Board will be undertaking by signing an agreement with the GCF are expected to be outlined in a model legal agreement. This document is not available in the public domain. Therefore, the legal implications of an agreement with GCF are unclear at this point.

7. An issue that requires clarification to analyze the legal implications for the AF is whether the roles and responsibilities of a financial intermediary may be different from the role of an implementing entity for the GCF (i.e. financial intermediaries would approve projects/programmes and would be bound by the terms and conditions of the agreement with their implementing entities but would not supervise implementing entities, which would bear full accountability for implementation).

8. An additional legal issue is whether for the Board to pursue this option it may require approval by the CMP. The Standing Committee on Finance has suggested that this may be the case for “institutional linkages” between the Fund and institutions under the Convention, such as the GCF: “There was broad understanding among the SCF members that “institutional linkages” could require a decision by the COP/MOP in most cases, while “relations” would not.”¹ In case the Board decides to pursue any of the options analyzed in decision B.24-25/9, the Board may want to consider asking the CMP for guidance on this matter.

9. Depending on the option pursued, there may be legal implications for the AF trustee (the World Bank):

- (a) If it is contemplated that GCF funds are to be received into the AF trust fund held at the World Bank, amendments may be required to the terms and conditions governing the services provided by the World Bank as trustee for the Adaptation Fund (T&C). Currently the T&C provide only for the acceptance into the AF trust fund of the proceeds of carbon asset monetization and, if requested by the Board, contributions from other parties (donations) to support the operations of the Fund. (ref. T&Cs, para 17). It should be recalled that amendments to the T&C are effective only after adoption of same by both the CMP and the World Bank (at the level of its Executive Directors).

¹ See document SCF/2015/10/12, Working paper on possible future institutional linkages and relations between the Adaptation Fund and other institutions under the Convention (Draft – version 9 June 2015, paragraphs available at http://unfccc.int/files/cooperation_and_support/financial_mechanism/standing_committee/application/pdf/working_paper_af_institutional_linkages_rev.pdf

- (b) A separate legal agreement between the GCF and the World Bank as AF trustee may be required to accept GCF funds into the AF trust fund.
- (c) The T&C applicable to donations to the AF trust fund have been agreed by the Board and are the same for all donors contributing to the AF trust fund. Funds contributed by each donor cannot be earmarked. If the GCF requires different terms and conditions for the use of its contributed funds, or requires that its funds are earmarked, a separate trust fund may also need to be established at the World Bank; the World Bank as AF trustee would have to agree to such establishment.
- (d) In the event the World Bank no longer serves as the interim trustee for the GCF (e.g. after April 2018), a separate legal agreement between the new GCF trustee and the World Bank as AF trustee may be required to accept any cash transfers from the GCF into the AF trust fund at the World Bank. The terms of such agreement would need to be acceptable to the World Bank as AF trustee

Operational implications

10. An important issue to analyze operational implications is which policies and procedures will apply to projects/programmes funded with GCF-contributed funds (i.e. review criteria, reporting responsibilities, fees, RBM). This is unclear at this point. Another issue is whether the Board would be able to submit a broad programme for funding to the GCF and approve the individual projects/programmes in the broad programme following AF policies and procedures. This is also unclear at this point.

11. As per GCF Board decision B.05/05,² “in relation to adaptation, resources will be allocated based on: (i) the ability of a proposed activity to demonstrate its potential to adapt to the impacts of climate change in the context of promoting sustainable development and a paradigm shift; (ii) the urgent and immediate needs of vulnerable countries, in particular LDCs, SIDS and African States;”

12. Development of a funding proposal: The investment criteria that an accredited implementing entity needs to take into account in developing a funding proposal for the GCF are detailed in the initial investment framework.³ An investment framework guidance document that may provide further information on how the investment criteria are interpreted by the GCF Board/secretariat has yet to be developed. At a first glance, the GCF criteria seem more detailed but in line with the AF's project/programme review criteria.

13. Proposal submission and approval: The GCF proposal approval process⁴ mandatorily requires a two-step submission for individual projects. There are no specific references to submission of a work programmes by accredited entities. It is unclear whether intermediaries may

² Available at: <http://www.gcfund.org/operations/resource-guide/investment-framework-board-decisions/33-allocation-of-fund-resources.html>

³ Document GCF/B.09/23, annex III, available at: http://www.gcfund.org/fileadmin/00_customer/documents/Operations/IF_subcriteria_assessment_factors.pdf

⁴ Document GCF/B.07/11, annex IV, available at: http://www.gcfund.org/fileadmin/00_customer/documents/Operations/4.2_Project_Approval_Process.pdf

submit a programme and in such case be allowed, once this is approved, to use their own project cycles for approving the individual projects in the programme.

14. RBM framework: The GCF RBM framework⁵ in line with the AF's framework and has many similar overall objectives. The scope of the GCF framework seems broader, and it touches upon topics that Fund's framework does not necessarily cover (such as health for instance). The AF and GCF frameworks both have five "core indicators". They are somewhat similar in substance, however it is unclear how they will be operationalized, including defining reporting procedures to capture these indicators. The GCF overall system and procedures has yet to be finalized.

15. Depending on the options chosen, there may be operational implications for the AF trustee:

- (a) Both funds would need to clarify which operational policies apply or take precedence in the event of inconsistencies (e.g. those of the Fund, or of the GCF). Operational implications could include adjustments to financial reporting that may be required to reflect funding made available by the GCF (e.g. as a 'donation' to the AF trust fund, or by other means). Insofar as contributions to the GCF are reported as such by the World Bank as interim trustee for the GCF, agreement may be required on how GCF transfers to the AF would be reported, to avoid potential double-counting of Parties' contributions to adaptation finance.
- (b) As interim trustee for the GCF, direct transfers by the World Bank from the GCF trust fund are possible only at the explicit instruction of the GCF Board. If approval from both boards were required for cash transfers to take place, this could result in a cumbersome and inefficient process to provide funds to Implementing Entities.
- (c) As indicated above, the World Bank as AF trustee could receive transfers from the GCF, however in the event the World Bank is no longer the interim trustee for the GCF (e.g. after April 2018), the World Bank would need to review the possibility of accepting direct cash transfers from a third party for deposit to the Fund trust fund.

Financial implications

16. Depending on the options chosen, there may be financial implications for the AF trustee:

- (a) Cash transfers to the AF trust fund: Presently the World Bank, as interim trustee for the GCF, transfers GCF trust fund resources to GCF-accredited entities only at explicit written instruction of the GCF. In the event of accreditation with the GCF, funds could potentially be transferred from the GCF trust fund to the AF trust fund. As indicated above, such funds could not be earmarked for specific purposes as all funds provided to the AF trust fund are pooled and allocated for use by the Board.

⁵ Document GCF/B.07/11, annex X, available at:
http://www.gcfund.org/fileadmin/00_customer/documents/Operations/5.2_RMF.pdf

- (b) Cash transfers from the AF trust fund: Following the transfer of GCF funds to the AF trust fund, the trustee would be able to transfer such funds only to AF-accredited implementing entities, in accordance with the T&C.
- (c) Treatment of liquid balances in the AF trust fund: As all funds are pooled in the AF trust fund, it will not be possible to track and return any investment income/loss in respect of GCF funds transferred to the AF trust fund. The legal arrangements between the Board and the GCF would also need to be consistent with the financial management, reporting and other procedures of the trustee, in accordance with the legal arrangements between the World Bank and the CMP (for the AF) and the World Bank and the GCF (for the GCF).
- (d) The Board may need to pay accreditation fees to the GCF.
- (e) As indicated in previous sections, if the World Bank is no longer trustee for both funds, alternate legal, operational and financial arrangement would need to be established.

17. As indicated above, the GCF model agreement has yet to be finalized; there could be other potential implications for the AF based on GCF requirements to manage GCF contributed funds that may add to the current administrative costs.

Conclusion

18. Taking into account all of the above, an operational linkage between the AF and the GCF will need to avoid duplication and inconsistency of policies and procedures, reporting requirements, tracking of funds, and funding decisions. One possibility to achieve this may be that, in the context of such an operational linkage between the two funds:

- The GCF operational policies and procedures (including approval by the GCF Board) apply to a broad programme submitted by the AF; and
- The AF operational policies and procedures (including approval by the AF Board), already vetted by the GCF through the accreditation process, apply to the individual projects/programmes within the broad programme.

Whether this would be possible under the applicable GCF rules is not clear at this point.

Option 2: Memorandum of understanding or legal agreement to programme GCF funds

19. This option is contingent to a negotiation between representatives of the two funds that will define the terms and conditions of the MOU/legal agreement. It may allow more flexibility for the two funds to agree upon specific or differentiated requirements. This option however also requires political will from both parties to engage in a negotiation process. This option, if politically feasible, may allow both funds to tailor the MOU/legal agreement to the specific situation, features, and type of projects/programmes funded by the AF and to come up with an option that may avoid duplication and inconsistency, and reduce administrative costs.

20. Considerations and conclusions explained above for option 1 apply to this option *mutatis mutandi*.