



ADAPTATION FUND

AFB/PPRC.20/4
3 March 2017

Project and Programme Review Committee
Twentieth meeting
Bonn, Germany, 14-15 March 2017

Agenda item 6

PROPOSAL CLARIFYING THE SCOPE OF APPLICATION OF THE FULL COST OF ADAPTATION REASONING CRITERION

Introduction

1. At its second meeting in November 2006, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) decided that the Adaptation Fund (the Fund) would be guided by a series of principles, among which was "*Funding on full adaptation cost basis of projects and programmes to address the adverse effects of climate change*". The Operational Policies and Guidelines (OPG) and associated annexes have further refined the notion and implication of the full cost of reasoning.
2. At its nineteenth meeting, the Project and Programme Review Committee (PPRC) of the Adaptation Fund Board (the Board) reviewed a proposal seeking to enhance capacity of Micro, Small and Medium agricultural Enterprises (MSMEs) and their resilience to climate change through the provision of financial and non-financial services. The proposed programme planned to be partly funded by the Adaptation Fund, and co-financed by the Implementing Entity, a regional development bank.
3. During the presentation of this proposal to the PPRC, the secretariat explained that one of the challenges with the proposal was that it presented some issues related to the mandate of the Fund, and to the necessary arrangements for this type of projects with co-financing. Indeed, the document "*Instructions for preparing a request for project or programme funding from the Adaptation Fund*", contained as an annex to the Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund (OPG), states, in the section related to the financing of the full-cost of adaptation, that "*the AF project should be able to deliver its outcomes and outputs regardless of the success of other project(s)*".
4. The aforementioned proposal included activities that, if funded by the Fund, would have been highly dependent on the implementation and delivery of other adaptation activities from a co-financed component of the project. As a result, there was a need to explore ways to address cases where the delivery of Fund-supported activities was dependent on delivery of co-financed adaptation activities. The secretariat also explained that, on the other hand, the Operational Policies and Guidelines of the Fund stated that the Board might provide further guidance on financing priorities, including through the integration of information based on further research on the full costs of adaptation and on lessons learned.
5. Following that discussion, the PPRC, having considered the implications that the current guidance contained in the Annex 5 of the Operational Policies and Guidelines of the Fund may represent for innovative project/programme proposals that include adaptation co-financing, decided to recommend that the Board request the secretariat to prepare a proposal for consideration by the PPRC at its twentieth meeting clarifying the scope of application of the full cost of adaptation reasoning criteria.
6. Having considered the comments and recommendation of the PPRC, the Board subsequently decided to request the secretariat to prepare a proposal for consideration by the PPRC at its twentieth meeting clarifying the scope of application of the full cost of adaptation reasoning criterion (decision B.28/33).
7. The secretariat has developed the present document that includes a proposal for clarifying the scope of application of the full cost of adaptation reasoning criterion.

Background of the full cost of adaptation reasoning criteria

8. At its second meeting in November 2006, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) decided that the Adaptation Fund would be guided by a series of principles, among which was "*Funding on full adaptation cost basis of projects and*

*programmes to address the adverse effects of climate change*¹.

9. During the first five meetings of the Board, the topic of establishing Operational Policies and Guidelines for the Fund had been continuously discussed by the Board. At its fifth meeting, the Board adopted, through Decision B.5/4, provisional Operational Policies and Guidelines for Parties to access resources from the Adaptation Fund², in which the principle set by the CMP at its second meeting was referred to. Indeed, in the Operational and Financing Priorities section, the provisional Operational Policies and Guidelines for Parties to access resources from the Adaptation Fund mentioned that *“Funding will be provided on full adaptation cost basis of projects and programmes to address the adverse effects of climate change. Full cost of adaptation means the costs of concrete adaptation activities to be implemented to address the adverse impacts of and risks posed by climate change”*.

10. At its seventh meeting (October 2009), the Board adopted Operational Policies and Guidelines through Decision B.7/2, following a process of elaborating the aforementioned provisional document. In that document, the paragraph related to funding of full adaptation cost was slightly amended and read *“Funding will be provided on full adaptation cost basis of projects and programmes to address the adverse effects of climate change. Full cost of adaptation means the costs associated with implementing concrete adaptation activities that address the adverse effects of climate change. The Fund will finance projects and programmes whose principal and explicit aim is to adapt and increase climate resilience. The project proponent is to provide justification of the extent to which the project contributes to adaptation and climate resilience. The Board may provide further guidance on financing priorities, including through the integration of information based on further research on the full costs of adaptation and on the lessons learned”*. This first operational version of the OPG introduced the possibility for the Board to provide further guidance on financing priorities based on further research on the full costs of adaptation and on lessons learned.

11. At its twenty-second meeting (October 2013), through decision B.22/23, the Board approved amendments to the operational policies and guidelines for Parties to access resources from the Adaptation Fund, its related templates, and instructions. These instructions, (*“Instructions for preparing a request for project or programme funding from the Adaptation Fund”*) formalized a working definition for full cost of adaptation that had been established through the work of the Board and the secretariat, and included the following section: *“The Adaptation Fund does not require co-financing for the projects/programmes it funds. The principal and explicit aim of the project/programme should be to adapt and to increase resilience of a specific system or communities, to the adverse effects of climate change and variability. Therefore, the proposal should demonstrate that the project/programme activities are relevant in addressing its adaptation objectives and that, taken solely, without additional funding from other donors, they will help achieve these objectives. Although co-financing is not required, it is possible and often cost-effective to implement Adaptation Fund projects in parallel with projects funded from other sources. In such a situation, the Adaptation Fund project should be able to deliver its outcomes and outputs regardless of the success of the other project(s) [...]”*. These instructions introduced the idea that, in the case of projects or programmes funded from other sources, the Adaptation Fund project should be able to deliver its outcomes and outputs regardless of the success of the other (co-financed) project(s).

12. The current OPG were updated most recently after the twenty-seventh meeting of the Board (March 2016), through decision B.27/28. However, the section related to the full cost of adaptation quoted above was not amended.

Analysis of the case proposal

13. The aforementioned proposal that was considered at the nineteenth meeting of the PPRC consisted of the implementation of three components that were intrinsically linked to each other.

¹ FCCC/KP/CMP/2006/10/Add.1

² AFB/B.5/4 Rev.2

Indeed, the planned approach in this proposal was that some financial loans would be granted by the Implementing Entity to MSMEs through Intermediary Financial Institutions (IFIs), only with the condition that the Fund would fund other components. That would form the first component of the project and would be integrally co-financed by the Implementing Entity. Once MSMEs would have demonstrated that such loans have allowed the implementation of adaptation activities, awards (i.e. grants) would be provided to MSMEs and IFIs with funding from the Fund. That component 2 was planned to be entirely financed by the Fund. Finally, the Fund was proposed to entirely support a third component, which would implement capacity-building activities and trainings to IFIs and MSMEs in order to build their capacity to implement effectively adaptation activities. In terms of timeline, the capacity building activities would be first delivered (component 3, AF-funded) before the loans would be granted (Implementing Entity-funded component 1). Once such loans would be granted and adaptation activities completed, the adaptation awards would be awarded to IFIs and MSMEs (AF-funded component 2). In other words, it seems that the Adaptation Fund project would not be able to deliver its outcomes and outputs regardless of the success of other co-financed projects since AF-funded awards (component 2) would not be provided unless MSMEs receive loans and each successfully implement at least one adaptation activity through those loans under component 1.

14. The following sections present options for defining the scope of application of the full cost of adaptation reasoning criterion.

Option 1: Status Quo (For proposals with co-financed adaptation activities, the Adaptation Fund component should be able to deliver on its related outcomes and outputs regardless of the success of the co-financed component)

15. An option would be for the Board to reconfirm the status quo situation with respect to the current interpretation of the full cost of adaptation reasoning, untying the approval of projects/programmes with co-financing to the delivery of outputs and outcomes of co-financed project(s). The portion of funding requested from the AF should be enough to deliver on the AF project's expected outcomes and outputs.

Pros

- i) For any projects/programmes approved by the Board with co-finance, the outputs and outcomes of the Adaptation Fund project/programme will not be jeopardized should the co-financed project(s) fail to deliver on its outputs/outcomes.

Cons

- i) Certain types of project/programme proposals where the delivery of the Adaptation Fund project/programme would be highly dependent on the delivery of outcomes/outputs of co-financed project(s) may not be approved by the Board;
- ii) This situation may hinder the approval of innovative projects/programmes and also potential leverage created by co-finance in Adaptation Fund projects/programmes.

Option 2: The Board could fund proposals with co-financed adaptation activities, for which the delivery of the Adaptation Fund component' outcomes and outputs could be tied with the delivery of the co-financed component

16. Another option would be for the Board to tie the approval of projects/programmes with co-financing to the delivery of outputs and outcomes of co-financed project(s).

Pros

- i) Certain type of projects/programmes proposals where the delivery of the Adaptation Fund

project/programme would be highly dependent on the delivery of outcomes/outputs of co-financed project(s) may be approved by the Board;

- ii) This situation may catalyze the amount of finance leveraged through co-finance in Adaptation Fund projects/programmes;
- iii) The situation could foster private sector involvement and attract innovative projects with co-financing and where the delivery of Adaptation Fund projects/programmes are tied to the success of co-financed projects.

Cons

- i) There might be a risk for some Adaptation Fund projects/programmes with co-financing to not achieve their expected outputs/outcomes in case the co-financed project(s) fails to deliver its outcomes and outputs.

Option 3: The Board could fund proposals with co-financed adaptation activities, for which the delivery of the Adaptation Fund component's outcomes and outputs could be tied with the delivery of the co-financed component, under certain conditions

17. Another option would be for the Board to accept proposals with co-financed adaptation activities, for which the delivery of the Adaptation Fund component's outcomes and outputs could be tied with the delivery of the co-financed component, under certain conditions. Such conditions could include the demonstration that adequate implementation arrangements are in place to ensure synergy and coordination for a proper delivery and monitoring of the consolidated results framework, providing rationale for having such intrinsic linkages between this and the co-financed project(s), identifying this aspect as a project/programme risk and requesting an appropriate risk management strategy and plan to monitor and mitigate this risk, and defining legally binding measures (through specific language in the agreement) between the Board and the IE to ensure that the conditions are fulfilled.

Pros

- i) Certain type of projects/programmes proposals where the delivery of the Adaptation Fund project/programme would be highly dependent on the delivery of outcomes/outputs of co-financed project(s) may be approved by the Board;
- ii) This situation may catalyze the amount of finance leveraged through co-finance in Adaptation Fund projects/programmes;
- iii) The situation could foster private sector involvement and attracts innovative projects with co-financing and where the delivery of Adaptation Fund projects/programmes are tied to the success of co-financed projects.

Cons

- i) There might be a risk for some Adaptation Fund projects/programmes with co-financing to not achieve their expected outputs/outcomes in case the co-financed project(s) fails to deliver its outcomes and outputs. However, this risk would be lower than option 2, as it will be mitigated through appropriate strategies, as explained above.

18. Without systematically closing the door to project/programme proposals with co-financing where the delivery of the Adaptation Fund project outputs and outcomes are intrinsically linked to the delivery of co-financed components, that option would require the Implementing Entity to reflect on that matter and to identify a strategy to minimize such risk at design stage, and to implement a risk management strategy during implementation.

Option 4: Status quo (For proposals with co-financed adaptation activities, the Adaptation Fund component should be able to deliver on its related outcomes and outputs regardless of the success of the co-financed component) and request the secretariat to perform an analysis of the full costs of adaptation

19. Another option would be for the Board to reconfirm the status quo situation with respect to the current interpretation of the full cost of adaptation reasoning and request the secretariat to perform an analysis of the full cost of adaptation and present it at the next PPRC meeting. Based on the results of the analysis and lessons learned on how the full cost of adaptation has been described and applied so far by the Fund, the Board could eventually decide, aligned with the Operating Policies and Guidelines (*“The Board may provide further guidance on financing priorities, including through the integration of information based on further research on the full costs of adaptation and on the lessons learned”*) to untie or not the approval of projects/programmes with co-financing to the delivery of outputs and outcomes of co-financed project(s)) or to take any other decisions as deemed appropriate.

Recommendation

20. The Project and Programme Review Committee (PPRC) may want to discuss the options presented in document AFB/PPRC/20/4 and consider recommending a way forward to the Adaptation Fund Board including approving one of the options presented in this document.