



## ADAPTATION FUND

AFB/EFC.20/9  
15 March 2017

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**ADAPTATION FUND BOARD**  
Ethics and Finance Committee  
Twentieth Meeting  
Bonn, 14-15 March 2017

### **REPORT OF THE TWENTIETH MEETING OF THE ETHICS AND FINANCE COMMITTEE**

#### **Agenda Item 1: Opening of the meeting**

1. The outgoing Chair of the Ethics and Finance Committee (EFC), Ms. Tove Zetterström-Goldmann (Sweden, Annex I Parties), opened the meeting and greeted the participants at 9.00 a.m. on 14 March 2017.

#### **Agenda Item 2: Transition of the Chair and Vice-Chair**

2. Ms. Patience Dampsey (Ghana, Non-Annex I Parties) took over the Chairmanship of the EFC. Ms. Zetterström-Goldmann took over the Vice-Chairmanship from Ms. Dampsey.

#### **Agenda Item 3: Organizational matters**

a) *Adoption of the agenda*

3. The agenda below was based on documents AFB/EFC.20/1/Rev.1 (Provisional agenda) and AFB/EFC.20/2/Rev.1 (Annotated provisional agenda).

4. The Vice-Chair proposed that a sub-item on the possible need to develop a separate investment policy for Adaptation Fund assets held by the World Bank be added under Other Matters, noting a potential reputational risk in the event such investments could be associated with fossil-fuel related investments.

5. Thus amended, the agenda was adopted.
  1. Opening of the meeting.
  2. Transition of the Chair and the Vice-Chair.
  3. Organizational matters:
    - a) Adoption of the agenda;
    - b) Organization of work.
  4. Options for an evaluation function and cost implications.
  5. Material change in projects funded by the Fund.
  6. Financial issues:
    - a) Investment income;
    - b) Financial status of the Trust Fund and CER monetization;
    - c) Work plan for the fiscal year 2018;
    - d) Board and secretariat and trustee budgets for the fiscal year 2018.
  7. Appointment of the Independent Review Panel for the second phase of the overall evaluation of the Fund.
  8. Other matters.
  9. Adoption of the recommendations and report.
  10. Closure of the meeting.

*b) Organization of work*

6. The EFC adopted the organization of work proposed by the Chair.

7. In accordance with paragraph 29 of the rules of procedure, the Chair then called upon all EFC members to orally declare any conflict of interest that they might have with any item on the current meeting agenda. One member indicated that he might have a conflict of interest when issues involving the United Nations Development Programme (UNDP) were discussed.

**Agenda Item 4: Options for an evaluation function and cost implications**

8. Introducing the item, the representative of the secretariat recalled that, at its twenty-eighth meeting, the Board had requested the secretariat to present further information on two options for

a long-term evaluation function of the Fund, namely Option 1, assigning the evaluation function to the Global Environment Fund Independent Evaluation Office (“GEF IEO”), and Option 2, creating a Technical Evaluation Reference Group (“TERG”) for the evaluation function (decision B.28/36). Document AFB/EFC.20/3 (Updated options for an evaluation function and cost implications) had been prepared by the secretariat in response to the Board’s request.

9. Following the presentation, members of the EFC voiced a number of concerns and questions. Addressing concerns regarding cost, the representative of the secretariat explained that some of the costs for both options were fixed, but that a large proportion of the costs would vary according to the Fund’s evaluation needs. Based on this explanation, it was proposed that the mid-term and final evaluation requirements for the next two or three years be compiled to help the Board get a better idea of the workload and costs involved.

10. Some of the concerns expressed also related to access to adaptation experts, as well as the adequacy of the GEF IEO’s adaptation expertise. Although the representative of the secretariat indicated that both options allowed for the use of adaptation experts on an ad hoc basis and that, in his experience, the GEF IEO had sufficiently strong adaptation expertise, it was suggested that the Board consider assembling a group of adaptation experts to develop the evaluation function terms of reference. The expert group could subsequently be dissolved in the event that the GEF IEO was selected for the evaluation function.

11. Having considered the two options for the evaluation function of the Adaptation Fund proposed in document AFB/EFC.20/3, the Ethics and Finance Committee recommended that the Adaptation Fund Board (the Board) request the secretariat to prepare, for consideration by the Ethics and Finance Committee at its twenty-first meeting, a document containing, for each of the two options, additional information on (i) an indicative three-year work program, including estimated costs, for the evaluation function based on the foreseen workload, including the expected numbers of medium-term and final evaluations and other evaluations to be carried out; and (ii) how the necessary technical expert guidance and inputs would be arranged at the set-up stage of the function and during its implementation, including possible assistance provided by the GEF-IEO, should Option 2 be selected, or by a Technical Evaluation Reference Group, should Option 1 be selected.

**(Recommendation EFC.20/1)**

#### **Agenda Item 5: Material change in projects funded by the Fund**

12. Presenting the item, the representative of the secretariat recalled that, at the nineteenth meeting of the EFC, the secretariat had drawn attention to requests received from implementing entities relating to Article 4.03 of the standard legal agreement between the Board and implementing entities but not covered by that article. Furthermore, the secretariat had indicated that the wording of Article 4.03 allowed for different interpretations among implementing entities, notably relating to how the ten per cent budget threshold was calculated. As a result, the Board, in decision B.28/34, had requested the secretariat to prepare a proposal clarifying the scope of “*material change*” under Article 4.03 of the standard legal agreement between the Board and implementing entities (amended in October 2015). The secretariat’s proposal was contained in document AFB/EFC.20/4. The document also contained a suggested way forward for dealing with requests related to changes in original project activities, outputs or outcomes and/or associated targets and indicators. Such requests often accompanied requests for a material change but were not covered by Article 4.03, which only covered budgetary changes.

13. The ensuing discussion centred on changes in original target indicators at the activity, output or outcome level, which often had little or no budgetary impact and for which there was currently no control process, although the secretariat was made aware of them through annual project reporting.

14. It was generally acknowledged that it was important to be flexible and such changes should be allowed, although there were different proposals for limiting them. The representative of the secretariat underscored that the changes in question were minor and ideally should not require Board approval, which would entail a considerable amount of work for the Board. It was also very common for one or two project activities to prove unfeasible in the field and to be cancelled, even though the implementing entity might not wish to formally delete them. For the secretariat, the goal was to avoid frequent changes of that nature by making it somewhat difficult to do. One way to achieve that was to require a full review of the amended project, which had been done in the past and which the secretariat could easily handle.

15. Having considered the proposal set out in document AFB/EFC.20/4, the Ethics and Finance Committee recommended that the Adaptation Fund Board decide to:

- (a) Further define a material change as “any cumulative total budget change at output-level between the revised budget and the original budget that involves ten per cent (10%) or more of the total budget of the project/programme”;
- (b) Request implementing entities wishing to submit a request for a material change to do so through the secretariat prior to the implementation of the change described in the request;
- (c) Specify that such requests for a material change should include at least a revised budget at output-level with comparison to the original, a revised results framework with comparison to the original, a written clarification on the material change itself and the reasons for the material change, and a letter from the designated authority endorsing the material change; and
- (d) Recall that the existing caps on an implementing entity’s fees and execution costs shall apply and shall not be exceeded due to budget changes.

**(Recommendation EFC.20/2)**

16. Having considered the information contained in document AFB/EFC.20/4 with respect to requests for revision of the original target indicators for activities, outputs or outcomes, the Ethics and Finance Committee recommended that the Adaptation Fund Board (the Board):

- (a) For changes in project activities or associated indicators or targets, including introductions, modifications and deletions, request the implementing entities to inform the secretariat of such changes as soon as possible;
- (b) For changes in project outputs, including introductions, modifications and deletions, request the implementing entities to obtain prior approval from the Board, and to communicate such changes to the secretariat in order to obtain such approval;
- (c) For changes in project outcomes, including introductions, modifications and deletions, on the understanding that such changes would only be accepted in exceptional

circumstances, request the implementing entities to obtain prior approval from the Board following a full technical review of the revised fully-developed project/programme document by the Project and Programme Review Committee, and to communicate such changes to the secretariat for the purposes of such technical review and approval; and

(d) For changes in project output or outcome indicators and/or associated targets, including modifications and deletions, on the understanding that such changes would only be accepted in exceptional circumstances and up to the submission of the first Project Performance Report for the project/programme, request the implementing entities to obtain prior approval from the Board following a full technical review of the revised fully-developed project/programme document by the Project and Programme Review Committee, and to communicate such changes to the secretariat for the purposes of such technical review and approval.

**(Recommendation EFC.20/3)**

17. Having considered the information contained in document AFB/EFC.20/4, the Ethics and Finance Committee recommended that the Adaptation Fund Board request the secretariat to consolidate all previous decisions related to requests for direct project services, requests for material change, and requests for revision of original activity/output/outcome and/or associated indicators and targets into a new annex of the Operational Policies and Guidelines related to project/programme implementation, and to present it to the Ethics and Finance Committee at its twenty-first meeting.

**(Recommendation EFC.20/4)**

18. Having considered the information contained in document AFB/EFC.20/4, the Ethics and Finance Committee recommended that the Adaptation Fund Board amend the standard legal agreement between the Board and Implementing Entities as follows (see underlined section):

*4.03. Any material change made in the original budget allocation for the Project by the Implementing Entity, in consultation with the Executing Entity, shall be communicated to the Board for its approval and shall be made in conformity with the Operational Policies and Guidelines of the Fund. "Material change" shall mean any cumulative total budget change at output-level between the revised budget and the original budget that involves ten per cent (10%) or more of the total budget of the project/programme.*

**(Recommendation EFC.20/5)**

**Agenda Item 6: Financial issues**

a) *Investment income*

19. Introducing the item, the representative of the secretariat recalled that, at the twenty-eighth meeting of the Board, the secretariat had indicated that it needed more information from the implementing entities in order to make a recommendation on how to deal with investment income earned by implementing entities on amounts transferred to them for Fund projects and programmes. Consequently, the Board had requested the secretariat to launch a survey of Implementing Entities to collect the available investment income for 2014, 2015 and 2016 and to

present a recommendation based on the survey results (decision B.28/42). The survey had been sent out in late 2016 and responses collected in January and February 2017. Twelve of the twenty-eight implementing entities with ongoing projects had responded, including three multilateral implementing entities. Following an analysis of the results, two options for dealing with the investment income generated by the Fund's project grants had been prepared in consultation with the Trustee. The two options could be found in document AFB/EFC.20/5 (Investment Income Earned by Implementing Entities).

20. During the ensuing discussion, it was generally recognized that most of the amounts involved were too small to warrant the transaction costs involved in returning the investment income to the Adaptation Fund Trust Fund. Still, there were concerns regarding how the implementing entities would allocate the funds in question, and some members felt that the funds should be refunded when economically feasible. The representative of the secretariat noted that annual financial reporting requirements provided the Secretariat with the opportunity to monitor the use of such funds and to ensure that they were used for projects. Furthermore, any remaining funds, including investment income, were refunded to the Adaptation Fund Trust Fund at the end of a project. Nevertheless, it was felt that more information was needed, particularly from multilateral implementing entities, before a decision could be made on how to deal with investment income generated on amounts held in respect of project grants.

21. Having considered the analysis contained in document AFB/EFC.20/5, the Ethics and Finance Committee recommended that the Adaptation Fund Board request the secretariat:

- (a) To compile a comprehensive analysis after following up with the Implementing Entities that did not respond to the survey launched pursuant to decision B.28/42; and
- (b) To prepare, in consultation with the trustee, a recommendation on an approach for dealing with investment income generated by the Implementing Entities on amounts held in respect of project grants, to be presented to the Ethics and Finance Committee at its twenty-first meeting.

**(Recommendation EFC.20/6)**

*b) Financial status of the Trust Fund and CER monetization*

22. The representative of the trustee provided an update on the financial status of the Adaptation Fund Trust Fund and monetization of Certified Emission Reductions (CERs), as contained in documents AFB/EFC.20/6 (Adaptation Fund Trust Fund: Financial report prepared by the trustee) and AFB/B.29/Inf.4 (Trustee presentation: update on status of resources and CER monetization). He informed the EFC that the trustee was going through required internal procedures following up on the decision by the AF Board and CMP to extend the trustee's mandate upon expiry at end-May 2017.

23. Since inception, total revenue to the Adaptation Fund had amounted to US\$ 631.9 million, including US\$ 197.1 million from CER sales, US\$ 422.8 million from donations, and US\$ 7.0 million from investment income generated by the trustee. Funds available for new project and program approvals had increased to US\$ 234.4 million as at the end of December due to US\$ 85 million in additional donations received. Since the twenty-eighth meeting of the Board, donation agreements had been signed with Brussels Capital Region (EUR 2.50 million), Flanders (EUR 6.25 million), Germany (EUR 50 million), and Sweden (SEK 200 million).

24. Opportunistic CER sales continued at a modest pace, notwithstanding continued oversupply in the markets and very weak demand from buyers. The average price achieved for CERs by the trustee was US\$ 1.75 to date in fiscal year 2017, significantly above prevailing market prices of approximately 0.30 euros.

25. Following his presentation, the representative of the trustee responded to a number of questions from EFC members. He reported that there had been no meaningful increase in demand for CERs, but that investment income had increased due to rising interest rates in the United States.

26. The Ethics and Finance Committee took note of the trustee's report.

*c) Work plan for the fiscal year 2018*

27. Introducing the item, a representative of the secretariat began by presenting the elements of document AFB/EFC.20/7 (Work Plan for the Fiscal Year 2018) relating to compliance with the work plan for fiscal year 2017 and the proposed secretariat work plan for fiscal year 2018. A second representative then presented the readiness programme proposed work plan for fiscal year 2018. Following the presentations, the representatives of the secretariat highlighted some of the information in the document in response to questions from members. In addition, the representative of the secretariat recalled decision B.22/24 that set aside US\$ 503,000 for the readiness programme; decision B.23/21 that specified that US\$ 300,000 of the previous amount would be used for readiness grants; decision B.25/27 that set aside US\$ 400,000 and decision B.27/38 that set aside US\$ 590,000, for readiness grants. He also explained that US\$ 460,206 remained from the above amounts to be used for future readiness grant approval decisions. The recommendation to supplement the remaining amount with an additional US\$ 238,794 would bring the total amount available for future readiness grant approval decisions to US\$ 700,000.

28. Having considered the information contained in document AFB/EFC.20/7, the Ethics and Finance Committee recommended that the Adaptation Fund Board:

(a) Approve the draft secretariat work schedule and the proposed work plan for the Readiness Programme for fiscal year 2018, as contained in AFB/EFC.20/7; and

(b) Approve the readiness budget increase of US\$ 239,794 to be set aside for direct transfers from the resources of the Adaptation Fund Trust Fund for allocation as small grants under the Readiness Programme, to be transferred on the instructions of the Board as outlined in Annex II of document AFB/EFC.20/7.

**(Recommendation EFC.20/7)**

*d) Board and secretariat and trustee budgets for the fiscal year 2018*

29. Prior to the discussion on the budgets, EFC members heard a presentation on the FIF Collaboration Platform by a representative of the World Bank.

30. Representatives of the secretariat and a representative of the trustee presented the various elements of document AFB/EFC.20/8 (Administrative budgets of the Board and secretariat, and the trustee for the fiscal year 2018). Following their presentations, they responded to a number of questions from members of the EFC and provided additional clarifications.

31. Having considered the information contained in document AFB/EFC.20/8, the Ethics and Finance Committee recommended that the Adaptation Fund Board (the Board):

- (a) Approve the proposed budget of **US\$ 4,991,415** to cover the costs of the operations of the Board and secretariat over the period 1 July 2017 to 30 June 2018, comprising **US\$ 3,613,050** for the secretariat administrative services (the main secretariat budget), **US\$ 300,000** for the overall evaluation (Phase II), **US\$ 473,780** for accreditation services and **US\$ 604,585** for the Readiness Programme;
- (b) Approve the proposed budget of **US\$ 588,000** for trustee services to be provided to the Adaptation Fund over the period 1 July 2017 to 30 June 2018, and, as a cost-saving measure, approve an indefinite suspension of the preparation of annual externally audited financial statements, relying instead on the annual Single Audit of Trust Funds and financial reports on the status of the Adaptation Fund Trust Fund provided periodically by the World Bank as Adaptation Fund Trustee;
- (c) Authorize the trustee to transfer the amounts in paragraph (a) to the secretariat, and the amount in paragraph (b) to the trustee; and
- (d) Request the secretariat to assess the option of further development of the FIF collaboration platform and to prepare a recommendation for consideration by the EFC at its twenty-first meeting.

**(Recommendation EFC.20/8)**

**Agenda Item 7: Appointment of the Independent Review Panel for the second phase of the overall evaluation of the Fund**

32. Introducing the item, the representative of the secretariat recalled that the Board, in its decision B.28/35, had approved the implementation of phase 2 of the overall evaluation function, to be overseen by an Independent Review Panel, and requested that the evaluation task force propose a three-member independent review panel for consideration by the Board during the intersessional period and that the secretariat make the necessary administrative arrangements. Due to delays, the proposal could not be made during the intersessional period. Document AFB/EFC.20/Inf.1 contained information on the Independent Review Panel members recommended by the evaluation task force.

33. In response to questions from members, the representative of the secretariat added that two of the three proposed panel members had worked on Phase 1 of the evaluation, and the third had been selected from a group of people identified by the secretariat based on a number of criteria, including their familiarity with the Fund, their familiarity with the substance of climate change adaptation, and their availability in a consulting capacity.

34. Having considered the information contained in document AFB/EFC.20/Inf.1, the Ethics and Finance Committee recommended that the Adaptation Fund Board:

- (a) Appoint Ms. Eva Lithman as the lead evaluation expert, Mr. Ian Noble as the adaptation expert, and Ms. Doreen Stabinsky as the civil society representative of the independent review panel (the IRP) for the second phase of the Fund's overall evaluation; and



- (b) Request the secretariat to provide the IRP with the necessary support to carry out their work.

**(Recommendation EFC.20/9)**

**Agenda Item 8: Other matters**

- a) *Possible need to develop a separate investment policy for Adaptation Fund assets held by the World Bank*

35. At the request of the Chair, the representative of the trustee gave a presentation on the investment management of the cash balances in the Adaptation Fund Trust Fund, noting that funds were pooled with the over US\$ 20 billion of other trust fund balances at the World Bank and managed on a commingled basis, allowing the Fund to benefit from economies of scale, lower cost, and risk mitigation over a wide asset base.

36. He explained that the trustee had four model portfolio investment options available for trust funds, based on two key criteria: i) the cash flows and duration the liquid balances can be invested; and ii) the risk tolerance of the client. The primary objective across all model portfolios was capital preservation. In light of the duration of the trustee mandate and the expected liquidity needs of the Fund, the only option available to the Fund was the one with a maximum one year investment horizon, along with cash to meet cash transfer needs. That portfolio contained only short-term fixed income securities and money market instruments, with no equities nor corporate bonds, and was therefore considered neutral from an “Environmental, Social and Governance” (ESG) perspective. The portfolio currently comprised about 40 per cent government securities such as US treasury bills and 40 per cent sovereign guaranteed and agency securities, with the balance held in AAA-rated asset-backed securities and money market instruments.

37. The representative of the trustee also reported on work underway within the World Bank to develop a ‘Responsible Investments Policy’ designed to formalize existing due diligence and risk processes that take account of ESG considerations and introduce ESG approaches to investment portfolio options. He noted that the Fund could potentially benefit from the application of the policy should Fund assets ever become eligible for investment in longer-term model portfolios.

38. Following discussion on the matter, the Ethics and Finance Committee took note of the information provided by the representative of the trustee.

**Agenda Item 9: Adoption of the recommendations and the report**

39. The present report was adopted based on the draft report contained in document AFB/EFC.20/L.1, as orally amended.

**Agenda Item 10: Closure of the meeting**

40. The meeting closed at 4:25 p.m. on 15 March 2017.

**ANNEX I**

**Ethics and Finance Committee  
Twentieth Meeting  
Bonn, Germany, 14 and 15 March 2017**

**EFC members present in the meeting**

Ms. Patience DAMPTEY (Chair) (Ghana, Non-Annex I Parties)

Ms. Tove ZETTERSTRÖM-GOLDMANN (Vice-Chair) (Sweden, Annex I Parties)

Mr. Mohamed ZMERLI (Tunisia, Africa)

Mr. Naser MOGHADDASI (Iran, Asia-Pacific)

Ms. Yadira GONZALEZ COLUMBIE (Cuba, Latin America and the Caribbean)

Mr. Philip WEECH (Bahamas, Latin America and the Caribbean)

Ms. Umayra TAGHIYEVA (Azerbaijan, Eastern Europe)

Mr. Aram TER-ZAKARYAN (Armenia, Eastern Europe)

Mr. Naresh SHARMA (Nepal, Least Developed Countries)

Mr. Samuela LAGATAKI (Fiji, Small Island Developing States)

Ms. Sylviane BILGISCHER (Belgium, Western Europe and others)

Mr. Antonio NAVARRA (Italy, Western Europe and others)