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Brief 11

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The Green Climate Fund

The decision at the COP17 in Durban, South Africa, to adopt a governing instrument for the Green Climate Fund (GCF), as well as a transitional process for its full operationalisation by 2014, was a key component of the "Durban Package". Without agreement on the GCF, the "African COP" would have been considered a failure. The GCF was designed by a Transitional Committee (TC) in 2010 with the goal of becoming the main multilateral financing mechanism to support climate action in developing countries. Under a compromise decision reached at the last minute in Durban, the new GCF will be a legally independent institution with its own separate secretariat and the World Bank as its interim trustee, but functioning under the guidance of and accountable to the COP. How to define and shape this relationship between the GCF and the COP will be the first order of business for the new GCF Board, which could meet as early as end of April. An Interim Secretariat with UNFCCC and GEF staff will provide support for the 24 new Board members with equal representation of developed and developing countries. Since the Durban Package did not reach any agreement on long-term sources of climate financing, the biggest challenge for the GCF will be to secure adequate and sustained funding. Otherwise, the GCF is in danger of becoming a beautifully articulated, but largely empty shell. Substantial, financial pledges made quickly by contributing countries would be necessary to show broad political support for the GCF and secure its viability; whether this actually happens in 2012 remains to be seen.

Overview

A key component of the "Durban Package", agreed upon at the 17th session of the UNFCCC's Conference of the Parties (COP 17) held in Durban, South Africa, was the COP's decision to adopt the governing instrument for the Green Climate Fund (GCF) as well as a time plan for a transitional process until COP 19. A cover note to the governing instruments provides some clarification on contentious issues that had held up a decision on the GCF until the last hours of the Durban negotiations. With the Durban compromise decision, it is hoped that by 2014, the GCF will be fully operational. Without such a decision, the "African COP" in South Africa would have had to be considered a failure.

This note describes the GCF design process, some of the main points of the GCF governing instrument and their implications, and the process and challenges going forward to operationalise the GCF as quickly and sustainably as possible.

The GCF was conceived as the main multilateral financing mechanism to support climate action in developing countries at the Copenhagen COP in 2009, as parties pledged to mobilize $100 billion in long-term financing per year by 2020. While the precise volume of finance to be channeled through the GCF is still unclear, it could handle potentially tens of billions of dollars per year. This would be significantly higher than the $6.5 billion pledged to the Climate Investment Funds, the largest multilateral climate funds that exist today, or to the Global Environment Facility, which is the longest standing source of climate finance. The GCF is also supposed to channel "a significant share of new multilateral funding for adaptation," which is structurally underfunded in the current global climate finance architecture. The GCF will be an operating entity of the financial mechanism of the Convention under Article 11, and will be "accountable to and function under the guidance of the COP". Although the Durban decision on the GCF stressed the need for an "early and adequate replenishment process", based on voluntary contributions, it does not address how to secure sufficient long term capitalization of the Fund, for example through assessed budgetary contributions. The issue of long-term financing and its sourcing remains unresolved in the UNFCCC process – the Durban Package committed only to a very weak program of workshops until COP 18. How to provide sustained funding for the GCF needs to be addressed urgently, and substantial financial pledges need to be made quickly by contributing countries to prevent the GCF from being a beautifully articulated, but largely empty shell.

The GCF Design Process and COP Decision

The decision to establish the GCF was part of the Cancun Agreements of COP 16 in Cancun, Mexico in 2010, which also set up a Transitional Committee (TC) – composed of 25 representatives from developing countries and 15 from developed countries – to work out design recommendations for the GCF and present them to the COP 17 in Durban. Over the course of a seven-month period, the TC held four official meetings and several information gathering workshops addressing comprehensive terms-of-reference for its work. The TC work was centered along four thematic workstreams: on i) objectives and guiding principles of the GCF; ii) its governing arrangements; iii) operational modalities; and iv) monitoring and evaluation.

Early in the TC process it had become apparent that developed and developing countries held widely differing visions of the functions and mandate, scope and operational capabilities of the future GCF.

Developing countries throughout the TC process had elaborated on their vision of a GCF with a capitalization of close to US$ 100 billion annually by 2020. It would be primarily financed by new and additional, predictable and adequate public contributions by developed countries fulfilling their "common but differentiated responsibilities" under the UNFCCC. They felt that the GCF should allow developing countries simplified direct access based on recipient country-preferences. Furthermore, the Fund should have its own legal personality and strong accountability ties to the COP.

By contrast, developed countries sketched the outlines of a GCF with reduced links to the COP and the UNFCCC principles and mandates. Limited public finance would primarily be used to catalyze and leverage private sector investment. Private money would form the core of the sum needed to help developing countries to make the transition to ambitious low-emission development pathways. GCF financing would be based on measurable and verifiable results, subject to implementing entities fulfilling high fiduciary standards.

Ultimately, these opposing positions could not be reconciled in the TC. As a result, the draft governing instrument was forwarded without consensus to the COP17 in Durban for Parties there to secure a compromise. The COP's decision to approve the draft governing instrument unchanged, but with a detailed cover note addressing some key concerns explicitly represents this hard fought for compromise.

The GCF Governing Instrument

In 8 short pages, the governing instrument only outlines the broad framework and general direction for operationalising the GCF, while the cover note provides some clarification on contentious issues, such as judicial personality or direct access for the private sector to the GCF. Many details have yet to be decided by the new GCF Board, giving the Board both great flexibility and enormous responsibility. Some of the key issues and key provisions are listed below:

- **Objectives and guiding principles:** To capture a high level of ambition for the GCF, as well as define its added-value to existing climate funds, the governing instrument refers to supporting a "paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change." However, there is no explicit reference to equity considerations in conjunction with recognized Fund core objectives of efficiency and effectiveness. The objectives recognize the need for GCF actions to promote "environmental, social, economic and development co-benefits and taking a gender-sensitive approach" in all climate actions. With its reference to a gender-sensitive approach in all its funding, as well as calls to strive toward gender-balance in the GCF Board and Secretariat staff, the GCF is the first dedicated climate fund to include gender considerations from the outset.

- **Governance Structure:** While the governing instrument gives clear guidance for the representation of developing countries on the Board (including dedicated seats for the Least Developed Countries and Small Island Developing States), developed country representation on the GCF board may be decided on the basis of their financial contributions. The GCF will have a fully independent secretariat headed by an Executive Secretary to be determined based on merit in a transparent process. In the interim (until COP19), a temporary secretariat will be staffed by technical experts from the UNFCCC and the GEF, and the new Board in one of its first actions will have to decide on an Interim Secretariat head with expertise in the design and management of funds. The World Bank was chosen to be the interim trustee for the first three years, but not necessarily its permanent one; this position is to be filled by an open and competitive bidding process – at the insistence of developing countries.

■ **GCF Relationship to the UNFCCC and the COP:** This was key point of contention during the TC process; developing countries insisted on establishing the GCF with close ties to the UNFCCC, while some developed countries would have preferred to have no ties to the convention. The GCF is now designated as an operating entity of the UNFCCC's financial mechanism like the GEF – for some recipient countries this relationship is not close enough, and for other contributing countries, it is too close. This also explains why some disputed questions about the GCF-UNFCCC relationship were addressed in the cover note to the decision, for example that the COP will have to endorse the Board decision about the host country for the GCF. Probably the most important task for the new GCF Board in 2012 will be to define the arrangements between the COP and the GCF by COP18. Developing countries are likely to disagree on how close the oversight of the GCF by the COP should be in order to fulfill the mandate to be "accountable to and function under the guidance of the COP". Currently, the governing instrument dictates the Board will submit annual reports and take action responding to guidance it receives from the COP on its programs, policies and priorities. This is essentially the GEF-model. However, developing country board members may well aim for the GCF to go beyond the existing memorandum-of-understanding (MOU) between the UNFCCC and the GEF.

■ **Legal Personality:** Both the governing instrument and the cover note spell out that the GCF will have its own juridical personality and legal capacity, a key demand of developing countries wanting to avoid setting up the GCF under the auspices of an existing institution. Having legal personality will be an important attribute for the GCF should it wish to provide more than grant finance. It also has important symbolic value, as much effort has been invested in creating a new fund that is relatively independent of existing institutions involved in climate finance. The GCF cover text also indicates that conferring such personality will be a key criterion for the GCF Board to select the host country of the GCF, which will be one of its work priorities for 2012. This will trump other considerations, for example, the desire to see the GCF based in a developing country. Several countries, including South Korea and Germany have expressed interest, with the latter already hosting the UNFCCC Secretariat and having conferred judicial personality to the Kyoto Protocol Adaptation Fund.

■ **Operational Modalities:** The GCF will start out with only adaptation and mitigation funding windows, but the Board retains the flexibility to add other ones. Possible candidates would be a REDD+ window, one for technology transfer or a small-grants facility. Grants, concessional loans and other financial instruments, to be approved by the Board, will be used. While both the cover note and the governing instrument instruct the Board to balance allocation between mitigation and adaptation, the decision text does not specify how balanced allocation is to be defined within the GCF. Like the Kyoto Protocol Adaptation Fund, it will allow recipient countries, direct access through accredited national implementing entities, but also sub-national actors in developing countries. They will need to fulfill strict fiduciary standards, raising the question of what kind of capacity building funding support might be needed to help developing countries in building and accrediting these and if the GCF should provide it. The experience of the Adaptation Fund suggests that support for building such capacities is greatly needed. A focus on capacity building and "readiness" to manage climate finance may be an appropriate early priority for the GCF. GCF funds can also be accessed through accredited multilateral agencies such as multilateral development banks and UN agencies in keeping with the dominant practices of existing multilateral climate funds.

■ **The Role of the Private Sector:** The GCF will have a private sector facility, which would allow direct and indirect financing by the GCF for private sector activities, which was a priority for many developed countries. Facing financial constraints at home, industrialized countries want their financial support for the GCF to leverage and crowd in private sector investments. This is seen as key to a "transformational" funding role for the GCF. Many developing countries, in contrast, see public finance support as the main source of GCF financing, with only a supplementary role for the private sector, especially small and medium-sized enterprises in recipient countries. They raised concerns about the consistency of private sector actions with national priorities. In the spirit of ensuring country ownership – a guiding governance principle for the GCF-- countries will be able to review proposed private sector projects on a "no objections" basis, which gives a recipient country de-facto veto power over business activities it considers inconsistent with national climate policies. National designated authorities (NDAs) will be set up to serve this role, although the concrete functions that these institutions will end up having in practice at the national level remains to be seen.

■ **Monitoring and Evaluation and Accountability:** The GCF Board will monitor the impact, effectiveness and efficiency of its funding by developing a results measurement framework. The Fund's work is also subject to periodic scrutiny through the establishment of an independent GCF evaluation unit, which will report directly to the Board (similar to evaluation units at the World Bank and other MDBs) and share its reports also with the COP. In addition, the COP will have the authority to commission an independent assessment outside of the GCF, with would evaluate the overall Fund performance, including that of its

Board. The GCF will also have several accountability mechanisms, including an information disclosure policy, an independent fraud unit and an independent redress mechanism to receive complaints related to Fund operations. Such a redress mechanism to allow affected people to challenge harmful funding decisions is so far missing from most existing climate funds. The exact form and function of these accountability mechanisms is to be decided by the GCF Board.

- **Standards and Safeguards:** At the insistence of industrialized countries, the GCF Board will determine best practice fiduciary standards covering all activities and entities involving GCF funding, including multilateral and national implementing entities. To address the developing countries' concern that overly stringent fiduciary standards might preclude recipient countries from directly accessing GCF funding, the Fund is supposed to support the strengthening of capacities in recipient countries where needed. The Board is also to agree on and adopt best practice standards for environmental and social safeguards, which will apply to all projects and projects financed by the GCF, including those implemented by national implementing entities. As in the case of fiduciary standards, NIEs will be supported by the Fund in their capacities to meet the adopted set of safeguards. The definition of "best practice", will be crucial to the political support of the Fund both among developed and developing countries, but also importantly by non-governmental stakeholders.

- **Stakeholder Input and Participation:** In the GCF governing document, stakeholders are broadly defined as "private sector-actors, civil society organizations, vulnerable groups, women and indigenous peoples." They are allowed input and participation in the design, development and implementation of the strategies and activities financed by the GCF. However, the concrete mechanisms that enable this involvement and participation remain to be decided by the Board. Civil society representatives were able to attend the TC meetings and influence the discussions throughout the TC process, through text submissions and expert testimony. This sets a high expectation for active civil society engagement with the new GCF and the opportunity for an interactive dialogue with the Board from the very beginning. The governing instrument stipulates the inclusion of two civil society and two private sector representatives as active observers on the GCF Board. They will be able to make interventions at and suggest agenda items for Board meetings, and request expert input to the Board discussion. They will not vote on decisions. It will be crucial to get quick GCF Board approval for financial support for the self-selection process of civil society representatives to the GCF Board, a practice established at some existing multilateral climate funds. As the GCF Board will likely not tackle the issue of stakeholder participation in its very first meetings, it should give guidance to the GCF interim secretariat to allow for stakeholder participation at least in line with the TC practice.

The Process ahead

UNFCCC Parties have until end of March 2012 to determine through their regional groupings and constituencies the nominees for the 24 Board seats. Nominations to the TC process were guided more by political considerations than skills or overall expertise. Many hope that the GCF can avoid this precedent. While the future GCF Board will need to be mindful of the history and context of the Fund's genesis, a focus on politics that ignores pragmatic issues could undermine the GCF's credibility and may erode support. The first GCF Board meeting will be held in Geneva at the end of April, with a second one expected in early July in South Korea and the potential for a third meeting before COP 18 in Qatar. Parties have until April 15th to submit their applications to host the Fund.

There is no deadline for making financial contributions to cover the start-up costs for the Fund. Korea, Denmark and Germany have made pledges totalling more than €55 million so far both directly to the GCF (Denmark and South Korea) and as bilateral support to recipient countries to prepare them for GCF activities (in the case of Germany). Those pledges need to be fulfilled speedily, and their example needs to be followed by other developed countries quickly in a show of broad political support for the new Fund. Beyond the start-up contributions, industrialized countries also need to indicate broadly, how much they are willing to contribute to the GCF in the medium and long-term as part of their promise to raise the level of long-term climate finance to US$100 billion per year by 2020 and in order to make the GCF the key instrument in fulfilling this promise.

References and useful links:

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