Climate Funds Update

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The Green Climate Fund

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Climate Finance Fundamentals 11

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The operationalization of the Green Climate Fund (GCF) has had a slow but promising start this year after the adoption of its governing instrument at COP17 in Durban, South Africa. Agreement on the GCF was a key outcome at Durban, without which the "African COP" would have been considered a failure. The GCF was designed by a Transitional Committee (TC) in 2011, and is expected to become the main multilateral financing mechanism to support climate action in developing countries. It will be a legally independent institution with its own secretariat, functioning under the guidance of and accountable to the COP. The World Bank will serve as interim trustee. Since January 2012 the UNFCCC and Global Environment Facility (GEF) have served as Interim Secretariat, and have been proactive in facilitating the work of the fund. The process of selecting countries to fill the 24 seats on the GCF Board with an equal number of developed and developing country representation has been complex. The Board met twice in 2012, and expects to meet three times in 2013 to tackle more than 50 distinct tasks that need to be addressed before the GCF can disburse funds. Its overall vision, and ensuing "business model", are key issues to be decided. The Fund's legal personality will be conferred by an agreement with South Korea, which won the bid to host the GCF. A major challenge for the GCF is to secure adequate and sustained funding. Otherwise, it may be reduced to a beautifully articulated, but largely empty shell. Substantial pledges of long term climate finance are necessary to demonstrate real political commitment to the GCF and secure its viability.

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 instrument clarified contentious issues that delayed a decision on the GCF until the last hours of the Durban negotiations. Without agreement on the GCF, the "African COP" would probably have been considered a failure. This note outlines key features of the GCF governing instrument and their implications, and the challenges of operationalizing the GCF in light of decisions taken by the Board at their first two meetings in 2012.

The GCF, which is intended to become the main multilateral financing mechanism to support climate action in developing countries, was first conceived at the Copenhagen COP in 2009, where parties pledged to mobilize $100 billion a year in long-term finance by 2020. While the precise volume of finance to be channelled through the GCF remains unclear, over time it might manage tens of billions of dollars per year. This would be significantly more funding than the USD 7 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 climate fund. The GCF is also to channel "a significant share of new multilateral funding for adaptation," which is 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".

The Durban decision on the GCF stressed the need for an "early and adequate replenishment process", based on voluntary contributions. The long term capitalization of the fund, however, is uncertain, and tied to a need for greater clarity on how to source long term climate finance. Agreement on this issue could not be reached at Durban: instead, a program of workshops to explore options and inform deliberations at COP 18 was agreed. It remains to be seen whether this process has helped build momentum and prompt new commitments. Substantial financial pledges to the GCF (beyond administrative costs) are necessary if the GCF is to be more than 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 created a Transitional Committee (TC) composed of 25 developing country representatives and 15 developed country representatives to agree on design recommendations for COP 17 in Durban.

It became apparent early in the TC process that some developed and developing countries held widely differing visions of the functions, mandate, scope and operational needs of the GCF.

Developing countries made the case for a GCF with a capitalization of close to USD 100 billion annually by 2020. It would be primarily financed by new and additional, predictable public finance contributions from developed countries to fulfil their "common but differentiated responsibilities" under the UNFCCC. They felt that the GCF should allow developing countries simplified direct access to finance. Furthermore, the Fund would have its own legal personality, and strong mechanisms to ensure accountability to the UNFCCC COP.

By contrast, developed countries envisaged a GCF with loose ties to the COP and UNFCCC principles and mandates. Limited public finance would primarily be used to catalyse and leverage private sector action. Private finance would have a core role in supporting developing countries to respond to climate change. GCF finance would have to demonstrate measurable and verifiable results, and implementing entities would need to meet high fiduciary standards.

These different positions could not be reconciled in the TC process, which forwarded a draft governing instrument without consensus for approval by the COP 17. Many elements of this discord have begun to resurface at the first two GCF Board meetings of 2012, in discussions on the "business model" and vision of the Fund. A fundamental choice needs to be made between a "wholesale" business model wherein the GCF could channel large amounts of funding through existing funds and agencies, or a "retail" model in which it manages large volumes of funding directly. The choice of model has major implications for the size and responsibilities of the GCF Secretariat, and its administrative budget.

The GCF Governing Instrument and its Operationalization

In 8 short pages, the GCF governing instrument outlines the broad framework and general direction for the GCF. Many crucial details will need to be decided by the GCF Board, which has started to address rules of procedure at its first two meetings in Geneva and in Songdo in 2012. This gives the Board both great flexibility and enormous responsibility. We elaborate some of the key issues to contend with:

Objectives and guiding principles: The GCF is intended to support 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." Realising this visionary objective will be central to the Board's work in 2013. The governing instrument also recognizes the need for GCF actions to promote "environmental, social, economic and development co-benefits and [to take] a gender-sensitive approach" in all climate actions. With its reference to gender-sensitivity in all its funding, and calls to strive for gender-balance in the GCF Board (although this is not reflected in the current composition of the Board) and Secretariat staff, the GCF is the first dedicated climate fund to include gender considerations from the outset. The Board still has to demonstrate how it will mainstream gender and equity considerations into its work plan. The Fund's core objectives include efficiency and effectiveness, but there is no explicit mention of equity.

Governance Structure: Selecting 12 Board members from developed countries and 12 from developing countries (with dedicated seats for Least Developed Countries and Small Island Developing States) proved highly contentious in both constituencies. Controversies over board member selection led to a four month delay in convening the first GCF Board meeting. When it did meet for the first time in August 2012 in Geneva, the Board decided to speed up the process to establish a fully independent secretariat led by an Executive Secretary to be selected through a transparent and merit based process before COP 19. In the interim, technical experts from the UNFCCC and the GEF provide temporary secretariat services to the Board and its two Co-Chairs from South Africa and Australia together act as the interim Executive. The World Bank will serve as interim trustee until Spring 2015; its role may not be permanent, as the final trustee is to be selected through an open and competitive bidding process.

GCF Relationship with the UNFCCC and the COP: The GCF is designated as an operating entity of the UNFCCC's financial mechanism to be "accountable to and function under the guidance of the COP". The governing instrument states that 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 similar to the GEF-model, which is based on a memorandum of understanding with the COP. Interpretation of this language has been contentious, and has been a difficult issue at the first two GCF meetings. For some recipient countries, this relationship is not close enough, whereas for some contributor countries, it is too close. At its second meeting, the Board endorsed a report of its activities to be submitted to the COP18 in Doha. The COP may in turn offer the GCF Board specific guidance on its work programme.

Legal Personality: Both the governing instrument and the cover note specify that the GCF will have its own juridical personality and legal capacity. This was an important issue for developing countries, who did not want the GCF to be set up under the auspices of an existing institution. It is particularly important for the GCF to have legal personality if it is to provide more than grant finance. The ability to confer such personality was a key criterion in selecting a host country for the GCF. The host selection process was initiated with the formation of a selection committee at the first board meeting in Geneva to evaluate candidate countries bids. The final decision was taken through rounds of secret ballot voting to eliminate candidates, which resulted in a decision that Song Do, South Korea would host the GCF. The other candidates were Mexico, Namibia, Switzerland, Poland, and Germany. Once the COP confirms the host country selection in Doha, work will begin on the host country agreement in 2013. South Korea has promised that it will be able to quickly confer legal personality to the GCF through an act of parliament within the next few months.

Operational Modalities: While the GCF will start out with adaptation and mitigation funding windows, the Board has flexibility to introduce additional funding windows, such as for activities to reduce emissions from deforestation and degradation (REDD+), for technology transfer, or for a small-grants facility. The fund will offer grants, concessional loans and other financial instruments as approved by the Board. While both the cover note and the governing instrument instruct the Board to balance allocation between mitigation and adaptation, it is not clear how "balanced" should be defined. Recipient country institutions (including sub-national level institutions) will have direct access to the GCF through accredited national implementing entities, building on the precedent piloted by the Adaptation Fund. National development banks are also likely to play a role. However, accredited entities will need to meet strong fiduciary standards; the experience of the Adaptation Fund suggests that countries may need support and capacity building in order to demonstrate they can meet such standards. In addition, countries will be able to access GCF funds through accredited multilateral agencies such as multilateral development banks and UN agencies in keeping with the dominant practices of the GEF and the CIF. Some countries have made the case for support for "readiness activities" that strengthen capacity to programme and manage climate finance to be an early priority for the GCF.

The Role of the Private Sector: The GCF will have a private sector facility, to directly and indirectly finance private sector activities. Creating such a facility was a priority for many developed countries that saw leveraging and mobilising private sector finance as an essential function for the GCF if it is to have a "transformational" impact. Furthermore, developed countries face constraints mobilising large amounts of public finance in times of fiscal austerity, which increases their interest in catalysing private investment. By contrast, many developing countries feel that the core mandate of the GCF should be to mobilise public finance, with only a supplementary role for the private sector in international climate finance commitments. 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 review proposed private sector projects on a "no objections" basis, which gives recipient countries de-facto veto power over business activities that are not consistent with national priorities or impinge on national sovereignty. National designated authorities (NDAs) will be set up to serve this role: the functions that these institutions assume in practice at the national level remain to be seen. The operationalization of the private sector facility will be an early priority in the Board's work plan for 2013.

Monitoring, Evaluation, Transparency and Accountability: The GCF will monitor the impact, effectiveness and efficiency of its funding by developing a results framework. The Fund's work will also be subject to periodic scrutiny through the establishment of an independent GCF evaluation unit, which will report directly to the Board (similar in function to the evaluation units of the World Bank and other MDBs). Its findings will also be shared with the COP. The GCF will also have several accountability mechanisms, including an independent fraud unit and an independent redress mechanism to address any complaints related to Fund operations. Such a redress mechanism should allow project affected people to challenge any funding decisions that may negatively affect them. The exact form and function of these accountability mechanisms will be decided in 2013. In addition, the COP will have the authority to commission an independent assessment of the GCF to evaluate overall Fund performance, including of its Board.

A key issue is how transparent the fund will be, including to the public. Transparency can foster efficient decision making and strengthen accountability, particularly to public stakeholders. The specifics of the GCF's disclosure practices remain to be agreed, but there is a strong case to be made for adopting good practices pioneered by other funds including by making key preparatory and decision documents publicly available, and webcasting overview proceedings. Translating key documents into other UN languages besides English may also help foster more inclusive engagement including by developing country members of the board.

Standards and Safeguards: The GCF Board will have to agree fiduciary and environmental and social standards for all activities and entities involving GCF funding, including multilateral and national implementing entities. The process for agreeing these standards will be important, and there is an opportunity for the GCF to set new norms for good practice on this count. The integrity of these standards will also shape perceptions of the accountability and effectiveness of the fund, both for member governments, as well as for civil society. The fund is to provide support for developing country institutions to build their capacities to meet robust standards if needed, in response to expressed concerns that overly stringent standards might prevent developing country institutions from direct access.

Stakeholder and Observer Input and Participation: The GCF governing document creates formal space for stakeholder participation in the operations of the fund. Stakeholders are broadly defined as "private sector actors, civil society organizations, vulnerable groups, women and indigenous peoples." Two civil society and two private sector representatives are included as active observers on the GCF Board. At other multilateral funds, active observers are able to make interventions as issues arise, suggest agenda items for Board meetings, and request expert input to the Board discussion, but do not vote on decisions. However, the concrete mechanisms that enable formal observer and broader stakeholder involvement and participation, and the scope of engagement remain to be decided by the Board in 2013. Experience from the first two GCF Board meetings suggests that the Board in principle welcomes interaction with stakeholders at its meetings. But some Board members may be reluctant to grant comprehensive formal access and involvement rights if there is no clarity on the role, rights and involvement of alternate Board members and advisors in Board proceedings. Developed countries fear that excessive inclusion of alternates and advisors may result in developing countries having greater presence on the board than its 12 developed / 12 developing country governance framework anticipated. It will be crucial for the GCF Board to not fall behind existing good practices for stakeholder engagement. These include, for example, support for legitimate self-selection processes for civil society representatives. Beyond board level engagement, there are more important issues related to the engagement and inclusion of stakeholders in the design, development and implementation of strategies and activities that are financed by the GCF. Sustained and effective involvement of stakeholders is likely to be crucial for the legitimacy and long-term success of the GCF.

The GCF Board Meetings and Work Plan

At its first Board meeting in Geneva in August 2012, the new Board formally took charge, making clear that the full operationalization of the Fund will be a Board-led process. The Board expressed its intent to act as an efficient decision-making forum rather than a political negotiating body. This resolve is likely to be tested in 2013 when the Board tackles the ambitious work plan it approved at its second Board, as it includes many contentious issues as priorities.

First on the work agenda is the business model for the GCF. This includes deciding on a wholesale or retail model for fund delivery, as discussed, and a suite of financial instruments to be used (as well as a decision about how much additional public and private finance they should mobilize). Decisions on the complementarity of the GCF with other channels of climate finance and linkages with thematic bodies of the UNFCCC also need to be taken. Operationalizing the private sector facility of the GCF is, as mentioned, a priority for many: its structure needs to be agreed (including whether it should have separate governance). Some countries have referenced the relationship between the World Bank and its private sector arm, the International Finance Corporation, as a possible model. These discussions are likely to be quite controversial. A whole range of decisions on modalities for accessing the fund need to be made, including which entities will be eligible, and the standards they must meet. This raises a number of legal issues around the respective responsibilities and accountabilities of the Fund and its implementing entities. In addition, a vision for the fund and an ensuing results framework for monitoring and evaluating impact will be necessary.

The effectiveness of the Board as a decision-making body remains to be seen: the task before it is complex, and it will need to find creative and efficient ways to bring issues to resolution. Practical measures might include the use of electronic and virtual exchange as a way of consulting or clarifying issues in between meetings, or by delegating responsibility for sub-tasks to committees or working groups.

These discussions must be framed by a process to mobilise resources for the fund. Some developed countries have indicated that they should be ready to pledge funding to the GCF by late 2013 once more progress on these substantive issues has been made. For serious progress to be made, however, serious money must also be on the table. In parallel, modalities to support readiness and preparatory activities (particularly in the interim period before the full operationalization of the GCF in 2013) need to be agreed.

There is no deadline for making financial contributions to the Fund. In the immediate term the GCF does not have enough funding to cover its 2013 administrative budget of USD 7.5 million. A number of countries, including South Korea, Denmark, Norway, Australia, Finland, Netherlands and Germany have made pledges and contributions for this purpose totalling USD 6.1 million, of which USD 2.9 million had been received at the end of September 2012. Some countries have also agreed to the use of leftover funding from the TC process in 2011 to go toward the administrative budget of the GCF. Pledges need to be fulfilled quickly. Beyond much needed contributions to start-up costs, industrialized countries also need to indicate broadly how much they are willing to contribute to the GCF in the medium and long-term, recognising the fund's central role in delivering on the commitment to raise the level of long-term climate finance to USD100 billion per year by 2020.

Table 1: Current finances of the GCF (USD thousands)

Country	Pledge	Deposit	Remaining TC Funding
Australia	513	513	
Denmark	867		254
Finland	646	646	
Germany	1,014		282
Korea	2,099	2,099	
Netherlands	286	286	
Norway	700*		337
Spain			92
Sweden	800*		
Switzerland			80
UK	648		
US			275
New total (including new pledges made at Songdo)	**7,573**	**3,544**	**1,319**

NOTE: * DENOTES NEW PLEDGE AT SECOND GCF BOARD MEETING IN SONGDO, SOUTH KOREA

SOURCE: DOCUMENT GCF/B.02-12/06/REV.01, ADMINISTRATIVE BUDGET OF THE GCF, AND AUTHOR NOTES

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The Climate Finance Fundamentals are based on Climate Funds Update data and available in English, French and Spanish at **www.climatefundsupdate.org**

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