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# The Reformed Financial Mechanism of the UNFCCC

Part I: Architecture and Governance

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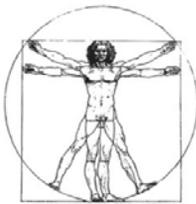
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## Summary for Policy Makers

The consensus for action to address climate change is based on the principle of common but differentiated responsibilities and on the obligations and commitments spelled out in Article 4 of the United Nations Framework Convention on Climate Change (UNFCCC). One of the main features of this Article is the commitment of developed countries to support developing country efforts. Coming to an agreement on how to address this obligation is generally considered one of the pillars for success in Copenhagen later this year. A well designed and well functioning Financial Mechanism that can facilitate funding and create incentives for new and additional resources in a transparent, accountable, efficient, and effective manner is also considered essential.

As the UNFCCC publication *The First Ten Years* points out, developed countries have many years ago ‘agreed that they would need to support the efforts of developing countries, but they argued against establishing a new financial mechanism believing that the Global Environment Facility, established in 1991, could serve the purpose’. In the build-up to Bali and beyond, it has become self-evident that scale of funding and the current operational arrangements are inadequate and that the Financial Mechanism is in need of major reform.

The following is an attempt to develop an institutional architecture and governance structure for a Reformed Financial Mechanism (RFM) under the UN Framework Convention on Climate Change (UNFCCC) that addresses the main concerns of Parties as articulated in their submissions to the UNFCCC and as compiled in the ‘Assembly Document’ of the AWG-LCA and other documents since the launch of the Bali Action Plan. The focus on this proposal is on governance – ‘who decides what.’ It does not address the issue of ‘burden-sharing’ – who pays how much, nor ‘eligibility’ – who gets how much.

### A. Institutional Architecture<sup>1</sup>

There are three general functions that need to be carried out to ensure a well functioning and generally acceptable financing regime: **revenue raising**, **revenue disbursement**, and **oversight**. To carry them out, two types of decisions are required, namely **operational** – those involved with issues such as resource mobilization, disbursement or supervisory activities, and **normative** – those concerned with architecture governance, or (operational) principles. Another characterization that is applied in the context of such decisions is whether they are **political**: that is, whether they are taken by (representatives of) the relevant political actors, in this case the Parties to the Convention.

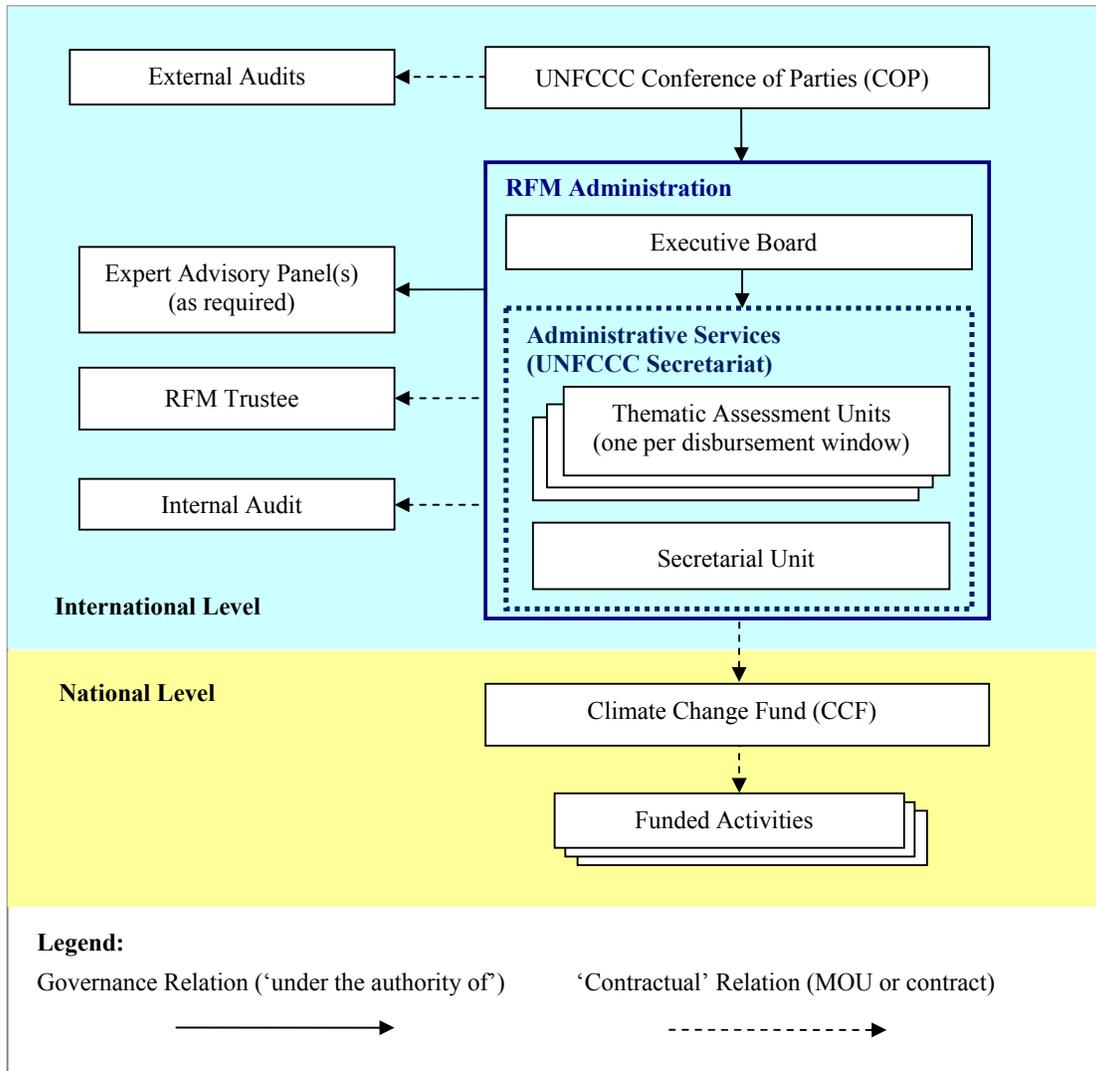
The key question is how to combine these two categorizations. Should all decisions be political, or should they all be non-political, or should ‘normative’ be identified with ‘political’ and ‘operational’ with ‘non-political’? Are there precedents of any of the three simple models? One system being used in many national contexts separates the legislative and the executive/administrative branches, with the former taking political decisions, most of which are normative, and their latter mostly operational ones, some of which political.

The institutional architecture of the RFM is based on a fundamental distinction between the Conference of the Parties (COP) as ‘legislative branch’, and an executive **Administration** headed by an **Executive Board** (‘Board’) **under the authority of the COP**. A number of other entities – such as an RFM **Trustee**, a **Board of Auditors** and national **Climate Change Funds** – are used to outsource some of the RFM activities.

As concerns the separation of powers between the COP and the RFM Administration, it will be critical to be as clear as possible about the respective decision-making spheres and responsibilities. This will apply in particular to the fact that, following the example of the Adaptation Fund, the RFM (Board) is to be under the authority of the COP (Fig. 1): What exactly does this authority entail?

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<sup>1</sup> The choice of nomenclature for the different institutions in the proposed reform of the architecture of the Financial Mechanism proposed here is only indicative and it is their function and not their name which is of importance in this context



**Figure 1. Institutional Architecture of the Reformed UNFCCC Financial Mechanism (RFM)**

The RFM Administration is divided into two components: The Board, and a subordinate *Secretariat*, itself composed of thematic *Assessment Units* and a unit to provide *Secretarial Support*. The division between the Board and subordinate Assessment Units is designed to draw an institutional boundary for political decision-making in the RFM Administration. This is done by confining political decision-making to the Board and by limiting the thematic Assessments Units to operational/technical administrative decisions.

## B. Governance

By ‘governance’ (of the RFM) we mean the system of decisions that have to be taken to operationalize and operate the financial flows to be managed through the RFM. In short, it is concerned with the question of ‘who takes which (type of) decision’ on *revenue*, *disbursement* and *oversight*.

### B.1. Revenue

The revenue regime deals with decisions of who is to pay how much, and under what modalities. They are under the sole remit of the COP, which is why they are not within the scope of this proposal.

## B.2. Disbursement

### B.2.1. ASSESSING COUNTRY NEEDS

The disbursement regime – the system of decisions that have to be taken to operationalize and operate spending under the RFM – involves decisions mainly related to three categories: *design* decisions, normally ‘normative’, related to spending categories, and under the remit of the COP; *funding* decisions on what particular activities are to be funded ‘on the ground’; and *budgeting*, where the main task is to implement the strategic direction of the COP for assessing country needs in the different disbursement windows on the basis of country *Climate Change Strategies*. These thematic country needs assessments are the basis for thematic budget proposals to be approved by the COP.

### B.2.2. THE MRV REGIME

It is assumed that financial MRV support would be counted as *contributions towards commitments* by Parties obligated to undertake them, which is why there is a need for an MRV Registry system, made up of a Central Registry with subordinate National Registries. Given the sensitive nature of the data, these National Registries are best housed in the national *Climate Change Funds*, with the RFM Administration compiling the Central Registry, on the basis of information provided by the National Registries. The Board is responsible for the monitoring and oversight of the National Registries. But it is the responsibility of the CCFs to calculate the relevant MRV figures on the basis of criteria agreed by the COP of what is to be measured, monitored and verified.

## B.3. Oversight and Outreach

In light of the significant sums of money that are expected to be channelled through the RFM, generally accepted oversight and outreach procedures are crucial for the credibility and acceptability of the RFM as a whole. As in the case of most, if not all international institutional arrangements, the oversight is to include an *internal* and an *external component*, involving a number of different oversight activities such as *financial, compliance* and *performance audits*<sup>2</sup> as well as *technical evaluations* and *monitoring*. Apart from this, there is to be an independent complaints procedure and an outreach and consultation process to enable stakeholders to provide direct input and feed-back to the Executive Board.

### B.3.1. INTERNAL OVERSIGHT

The Executive Board is responsible to the COP for the internal oversight of RFM activities (Board, Secretariat), covering:

- (i) *internal audits*, to be carried out by the *UN Office for Internal Oversight Services* (OIOS),<sup>3</sup> and
- (ii) *monitoring* and (technical) *evaluations* of the internal RFM activities, to be carried out by the RFM Secretariat.

### B.3.2. EXTERNAL OVERSIGHT

The COP is responsible for the external auditing of the RFM. As for all UN funds and programmes, this task is to be carried out by the *UN Board of Auditors*. The remit of the external audits will cover financial, compliance and performance audits of the RFM Administration as well spot checks of activities which are sub-contracted by the RFM. RFM contractors (such as the RFM Trustee, and the national Climate Change Funds) shall be contractually obliged

- (i) to have their RFM-funded activities externally audited –by the relevant national Supreme Audit Institutions (‘national audit offices’) in the case of the CCFs – in accordance with guidelines set up by the UN Board of Auditors and approved by the COP; and
- (ii) to grant the right of spot check access to either to the external auditor of the RFM (UN BOA),

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<sup>2</sup> Given that RFM is to be established as a UN fund (4.2.1), audits (external and internal) are to be carried by the relevant UN bodies, i.e. UN Board of Auditors (external audits), and UN OIOS (internal audits).

<sup>3</sup> [www.un.org/depts/oios/](http://www.un.org/depts/oios/)

or to a mutually acceptable third party.<sup>4</sup>

### **B.3.3. OUTREACH AND COMPLAINTS**

Outreach activities and complaints procedures are to ensure that

- (i) inputs by stakeholders are periodically provided to the Board and the COP, for example through regional sessions of a *Consultative Forum*, and that
- (ii) complaints of ‘malpractice’ come to the attention of the COP.

The RFM Secretariat is to organise the outreach activities of the RFM. The complaints procedure could be managed by a dedicated unit at the Secretariat, or by an independent body such as the UN Ombudsman.<sup>5</sup>

## **C. Institutions**

### **C.1. Executive Board**

The Executive Board (‘the Board’) under the authority of the COP is to be established as a legal entity under the UN system of funds and programmes. It is accountable to the COP for the operations of the RFM. Among the tasks to be undertaken are:

- (i) operationalizing the guidance and direction of the COP;
- (ii) setting guidelines (subject to COP approval) for the assessment of funding needs in the different thematic disbursement windows;
- (iii) setting guidelines (subject to COP approval), overseeing the implementation of the MRVs at the national level and overseeing the MRV registries;
- (iv) internal oversight, and facilitating outreach consultations with stakeholders.

#### **C.1.1. COMPOSITION**

The Executive Board, co-chaired by one developed and one developing country member, has a composition that ensures that the key interest groups and Parties have a voice in the direct political oversight of the RFM.

- **Full members:** The Board is to have 26 full (voting) members, representing the following constituencies: Major economies: 13 (G5: China, Brazil, India, Mexico, and South Africa and G8: Canada, France, Germany, Italy, Japan, Russia, United Kingdom, United States); most vulnerable countries: 6 (among which 2 LDCs and 2 SIDS); EIT: 2; and Regional Groups: 5 (one per region).
- **Non-voting members:** Non-voting members are there to facilitate direct input to Board discussions and represent the following (non-political) interests: thematic assessment units (one representative for each unit); secretarial services: 1 (Head of Secretariat, *ex officio*); RFM Trustee: 1 (Head of the Trustee RFM unit, *ex officio*); and CSOs: 4 (1 per relevant region). Depending on the number of Assessment Units, there would be at least 7 non-voting members.

#### **C.1.2. MEMBER SELECTION**

In order to assure transparency, full members shall be *elected* to the Board. The COP will approve a general candidate *competence profile* to assure the Board has the competence to run the RFM Administration on its behalf. Each constituency nominates at least two eligible candidates for each of their seats and puts them forward as constituency candidate lists. The constituency representatives are *elected by the whole COP* from the relevant constituency candidates.

Non-voting members are either appointed *ex officio*, or – in the case of CSO representatives – elected by the CSO representatives on the national CCFs.

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<sup>4</sup> This follows the example of UNDP, which uses the "national execution" modality for many of its projects around the world, and in which the practice is to agree with the government on a mutually acceptable third party audit institution to undertake regular certified audits

<sup>5</sup> <http://www.un.org/ombudsman/>

### **C.1.3. DECISION-MAKING**

The model chosen is that of *personal representation*: Board members are on the Board in their personal capacity as decision makers. While representing the interests of their constituencies, they are (i) entitled to take decisions on their behalf, and they (ii) have ultimate *collective responsibility to the COP*.

Decision-making on the Board must be beyond reproach in order to generate the necessary acceptability not only among the political stakeholders but far beyond, which is has to be fair and transparent

- **Fairness.** Decisions can be taken by consensus. However, there has to be the option to cast a vote, on a *one-member-one-vote basis*, as a matter of course and not only of last resort.
- **Transparency** can be enhanced by keeping the proceedings of the Board open (except in very exceptional circumstances), and by webcasting them, as has been the practice in the Adaptation Fund Board.

## **C.2. Support Services**

The work of the Board is to be supported by a number of services:

- (i) to help put together thematic spending budget requests for the COP (thematic Assessment Units) based on country Climate Change Strategies,
- (ii) to provide advice if required (Expert Advisory Panels),
- (iii) to keep the revenue in trust (RFM Trustee),
- (iv) to carry out external and internal oversight (UN Board of Auditors, UN Office of Internal Oversight Services), and
- (v) to provide logistical secretarial services (Secretarial Unit).

### **C.2.1. SECRETARIAT – THEMATIC ASSESSMENT AND SECRETARIAL SERVICES**

The Board shall be assisted by a Secretariat of professional staff appointed by the Board. The RFM Secretariat is to be operated as a self-financing division by the UNFCCC Secretariat, in conformity with Article 11.1 of the UNFCCC.

- **Thematic Assessment Units.** There will be a number of different thematic disbursement windows under the RFM. CCFs will be given guidance by the COP on how to present disbursement needs on the basis of country Climate Change Strategies.
- **Other Secretariat Services.** Apart from providing the usual *secretarial support* for the Board and other bodies involved in the the RFM Administration, the Secretarial Unit will
  - (a) carry out the required *central management/coordination of the MRV system*;
  - (b) carry out *internal monitoring* and *evaluations*;
  - (c) manage *complaints* (unless otherwise decided);
  - (d) and organize the *RFM Consultative Forum* which will be designed to provide the opportunity for relevant stakeholders to engage with one another regularly at (sub-) regional meetings, with a view to formulate positions on issues of mutual interests and to elect the designated representation to the Board.

### **C.2.2. EXPERT ADVISORY PANELS**

The Board is to have the right to convene Expert Advisory Panels, either standing or on an ad hoc basis. The role of these Panels is to give expert advice to the Board on any issue the Board chooses.

### **C.2.3. TRUSTESHIP**

The role of RFM trustee, to be *appointed on the basis of an open tender* and reviewed every five years, is standard.

## D. Climate Change Funds: National Climate Change Decision and Funding Hubs

The key advantage of having national funding and decision-making hubs is that,

- (i) following the subsidiarity principle, it provides in-country *direct access* to funding and relieves the international bodies, in particular the RFM Administration, of an otherwise unmanageable number of operational decisions, not only with regards to activity approval, but also to monitoring and fiduciary accountability,
- (ii) it enables a degree of RFM *oversight* which might be difficult to achieve under a decentralised model, and
- (iii) it enables the harnessing of *synergies*, say by funding cross-thematic (e.g. mitigation and adaptation) activities.
- (iv) it leaves the option for both *off-budget* and *on-budget* ('budget support') funding streams.

Given the diversity in national circumstances among the eligible recipient countries, both in size and institutional capacity – there clearly needs to be a *degree of flexibility* in designing these CCFs. Thus there may have to be room – particularly in the case of SIDS – for multi-national ('regional') CCFs, as well as for sub-national ('provincial') branch-funds, in the case of very large recipients.<sup>6</sup>

While there is a need for flexibility, there are also certain *core requirements* to achieving the overarching aim of broadest-based *in-country* acceptance of funding through these national funding hubs. As in the case of the RFM, the architecture of the CCFs has to ensure *equitable, efficient and effective* use of the funding. Moreover the CCF governance must be *fair* and *transparent*. In particular, it has to ensure that

- (v) there is proper representation in the decision-making process (including the domestic recipients of the funding),<sup>7</sup>
- (vi) everyone who is entitled to receive (restitution) payments will receive them.

### D.1. The Design Framework

The COP and the Board decide what minimum design and other conditions will have to be attached for receiving funds under the different disbursement windows. The following is an indicative (not exhaustive) list of such conditions:

**D.1.1. GOVERNANCE** The governance of CCFs must be transparent and inclusive, with representation of all relevant stakeholder interests with decision-making.

**D.1.2. FUNCTIONS** In addition to assessing, monitoring, and evaluating in-country funding activities, the CCFs will also be in charge of the relevant national MRV Registries and responsible for submitting information to central MRV registry.

**D.1.3. OVERSIGHT** The external oversight is principally to be carried out by the relevant national Supreme Audit Institutions ('National Audit Offices'), following COP approved guidance by the UN Board of Auditors, which will have to be given the right of access to carry out/arrange third party spot checks.

**D.1.4. OUTREACH** CCFs are to have regular opportunity to exchange experiences at least at the regional level. This is to be facilitated through the RFM Consultative Forum.

### D.2. Design Options

There are a number of options for the overall operation of the RFM financing regime, but which may not be suitable to all national circumstances, at least initially. However, given sufficient capacity

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<sup>6</sup> These decisions are left exclusively to the national governments.

<sup>7</sup> Indeed, we believe that subsidiarity should also be the guiding principle in the design of the CCFs and their domestic funding regimes.

building by United Nations agencies and other entities, they should become requirements.

***D.2.1. MULTIPLE REVENUE SOURCES*** Although the majority of revenue in the CCFs should be from the RFM, the option of other contributing sources (private sector, foundations, bilateral, even host country governments) should be left open.

***D.2.2. OFF-BUDGET TRUST FUND*** The format of an off-budget trust fund for the CCFs would enable the host governments to earmark the relevant funding without compromising fiscal principles, and it may be easier to grant the UN Board of Auditors the required right of access.

***D.2.3. PUBLIC-PRIVATE PARTNERSHIPS*** Private public partnerships are – because of their commercially sensitive nature – at least initially best handled at the national level. This is why the CCFs should be allowed to enter into such activities.

***D.2.4. MANAGE POSSIBLE RFM INSTRUMENTS*** CCFs may also be the best place to operate some of the proposed new financial instruments, such as climate change insurance.

## **E. Compatibility with other relevant proposals and initiatives**

On the revenue raising side, the RFM is compatible with most if not all of the proposals that have been submitted to date. Architecturally, the RFM fits with most of the building blocks of the G77 and China proposal. And it has some similarities with the architecture and governance of the World Bank Strategic Climate Fund (SCF) from which several useful lessons could be learned from its forthcoming pilot activities concerning, in particular, the further operationalization of disbursement modalities. This is likely to prove the most difficult and contentious issue, and key will be to avoid the danger of following the ill-fated GEF Resource Allocation Framework (RAF).

## I. Introduction

### I.1. The Structure

The Summary for Policy Makers contains a summary description of the ‘design core’ of the paper, namely the chapters on *Institutional Architecture* (Section 3), *Governance* (4), *Contribution and Commitments* (5), and the particular institutional characterizations of the *Executive Board* (5), the *Support Services* (6), and the national *Climate Change Funds* (7). This core material is preceded by a *Background* chapter (2) intended to provide some information of issues which are relevant but outside the narrow scope of the paper, and followed by a discussion on the RFM’s *Compatibility with other relevant Proposals and Initiatives* (8). A number of Appendices contain relevant documentary material.

### I.2. The Aim

The aim of this paper is develop a new institutional architecture and governance structure for the Financial Mechanism (FM) of the UN Framework Convention on Climate Change (UNFCCC) which would enjoy broad political acceptance among the main countries and country groupings, in the sense that

- those who (have to) pay would *wish* to use this mechanism, and
- those who (are entitled to) receive would *wish* to receive payments through it.

There are a number of reasons why such broad-based ownership is of particular importance to climate change finance, and why existing institutions fail to command this sort of broad political buy-in or ownership, and the paper will discuss these in more detail. At this initial stage, the key design parameters are as follows:

- The revenue is primarily<sup>8</sup> in the form of either assessed (developed country) payments or international levies.
- The architecture has to ensure *equitable*, *efficient* and *effective* use of the funding.
- Governance must be *fair* and *transparent*. In particular, it has to ensure that there is proper representation in the decision-making process, while avoiding any ‘over-politicization’ of executive decision-making.

As concerns methodology, the paper will rely heavily on *national or international precedents*. Indeed, many of the issues that have arisen in the context of managing international public sector funding flows for climate change purposes have been successfully dealt with in national contexts, and many of the lessons can be applied at the international level. As mentioned earlier, the full paper will elaborate in more detail on what these issues are. At this stage, the aim is simply to put forward an architecture and governance structure that would deal with certain issues, without getting into detailed arguments on the issues themselves.

### I.3. The Scope

As indicated by the sub-title, this paper is about a reform of the ‘architecture’ and ‘governance’ of the FM. While it is relatively simple to explain the former as referring to an order of institutions as represented in organization charts, ‘governance’ is not quite as

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<sup>8</sup> There is no reason to exclude donations either from the public or the private sector, provided they do not come with ‘strings attached,’ particularly with respect to governance.

straightforward. What we have in mind is, roughly speaking, a system of decision making, in this case to manage the activities of the envisaged Reformed Financial Mechanism (RFM).

A description of any governance system would thus generally have to include an institutional architecture, but its key feature has to be what might be called a *taxonomy of decisions and functions*, i.e. a systematic description of the types of decisions and functions involved in the management of the RFM.

In describing any scope of this kind, it is as important to highlight what is explicitly *not* being covered as it is to list items that are. In this case, the paper will not cover specific ‘burden sharing’ proposals (who pays how much), nor, for that matter, ‘eligibility criteria’ (who gets how much). The main focus is on governance: who decides what? Having said this, we will go beyond the confines of mere description by putting forward an analysis of certain other issues which do have a bearing on the overall architecture and governance. They are, as mentioned earlier, to be found in the *Background* Section, below.

## 2. Background

As mentioned in the introductory remarks, there are some issues which – although strictly speaking beyond the scope of this paper – are of relevance to the design of a generally acceptable institutional architecture and system of governance for the Financial Mechanism, and which we therefore felt cannot be left unmentioned.

We are acutely aware that there is unlikely to be consensus, particularly as regards such key issues as the nature of climate change payments (‘donations’ or ‘debt servicing’). Fortunately, it is not necessary to agree on these underlying background issues – or, for that matter, to buy into our analysis of them – to accept the design for the reformed FM put forward in the later sections. What is important is to be aware of the different assumptions that may lead one to come to these design conclusions.

### 2.1. Payment Modality: Climate change finance as restitution payments

Money can change hands in many different ways (‘modalities’) which are often reflected in the terminology used to describe the transactions. These modalities can have considerable impacts on what are regarded to be acceptable forms of governance for these transactions. Arguably the most neutral way of describing these transactions is as ‘payments’ by a ‘payer’ to a ‘payee.’ In the context of the Financial Mechanism, there are two kinds of payments, namely payments *to* the FM, and payments *by* the FM.

To distinguish between the two types of payments terminologically, one may wish to refer to ‘*contributions*’ (by ‘*contributors*’) to the FM, and ‘*disbursements*’ (to ‘*recipients*’) by the FM instead, but even this terminology may be not quite as neutral with respect to payment modalities as one might wish.

There are, as indicated, a number of different ways in which money can be paid/transferred/change hands. For example, money can be paid as a ‘*donation*,’ in which case the payer is referred to as ‘*donor*’<sup>9</sup> and (less popularly) the recipient as ‘*donee*’ Other modalities are categorized in terms of ‘*debts*’<sup>10</sup>, where a ‘*debtor*’ owes a debt to a ‘*creditor*.’ One payment modality of this type is that of ‘*giving a loan*,’ where the payer is the creditor and the recipient the debtor. In the case of ‘*loan re-payments*,’ the payer is in turn the debtor, and the payee the creditor. In any case, as concerns the governance of these transactions, it is generally accepted that both creditors and donors have a (moral) right to determine the rules and conditions for the payments, including who is to receive how much. The donees/debtors are, in principle, left with the decision whether they wish to accept the donation/loan or not.<sup>11</sup>

The same is, essentially, true of ‘*restitution*’<sup>12</sup> payments, where the payer owes the money to the payee. However, there is a significant difference between ordinary debts, and ‘restitution debts’. If an ordinary debt is repaid, then it is up to the creditors alone to decide how to use that repaid sum of money. The payer (debtor) has no say in this. In the case of restitution, however, payments are ‘*earmarked*’ for a certain purpose, and the payer does have

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<sup>9</sup> Donor: ‘One who gives or presents; a giver; esp. in Law, one who grants an estate, or power for execution. Correlative of *Donee*’[OED]

<sup>10</sup> Debt: ‘That which is owed or due; anything (as money, goods, or service) which one person is under obligation to pay or render to another.’[OED]

<sup>11</sup> The actual use of these terms and the associated practices are, of course, somewhat more ambiguous. Thus is not always the case that a payee actually has the luxury to reject a loan/donation, no matter whether he dislikes the conditions.

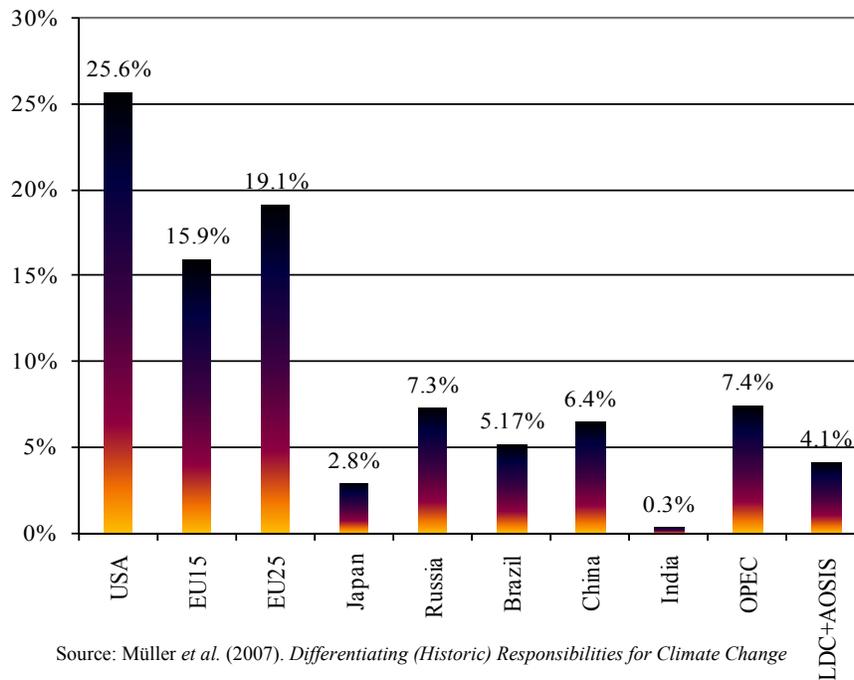
<sup>12</sup> **Restitution:** The action of restoring or giving back something to its proper owner, or of making reparation to one for loss or injury previously inflicted’[OED]

the (moral) right to expect the recipient to use the payments for this purpose. At the same time, restitution payments are debt payments, and as such give the recipient a right to a final say in determining the rules and conditions. The problem is that, even at the level of generality of these remarks, it is not quite as clear-cut, as in the case of donors/donees or creditors/debtors, who has the right to decide what. For example, it would seem that it should be the injured parties (the payees) who determine the disbursement of the restitution payments, but who decides who is injured and by whom in the first place? In short, just governance of this type of payments is rather more complex than for the other cases we mentioned.

India – in its Supplemental Submission on *Why Financial Contributions to the Financial Mechanism of the UNFCCC Cannot be Under the Paradigm of “Aid”* (see Appendix A.8) – is not only completely unambiguous about the fact that climate change finance has to be interpreted in terms of *entitlements* and not donations (‘aid’), but also mentions some derived key implications, namely the rejection of repayable loans, and the need for balanced governance structure, as well as for competitive procurement norms. We concur with the identification of climate change payments as based on entitlements, but at the same time believe that they belong to the above-mentioned restitution type, with the rather more complex implications than entitlements to simple debt repayments.

## 2.2. Who contributes how much?

The question of who contributes how much is, as mentioned earlier, not part of the scope of this paper. And yet, given the above mentioned governance implications of the payment mode, certain arguments which have been put forward in discussions on this issue need to be put into context as part of these background expositions.



**Figure 2. Percentage Shares in Strict Historic Responsibilities for Climate Change**

For example, one of the key features of what has become known as the ‘Mexican proposal’ is to divide the burden of contributions to climate change finance in accordance

with a formula that is meant to reflect the principle of common but differentiated responsibilities. While the proposal only expects industrialized countries to have *binding* contribution commitments, ‘emerging’ developing countries will only be eligible to obtain funding if they ‘*provide some contributions, against the insurance that they would then have the right to access amounts substantially larger than their own contributions .... The amount exceeding the level of their contribution would represent a positive incentive to expand the scale of the committed effort. In contrast to industrialised countries - with their binding commitments - developing countries which, in accordance with the criteria adopted, should contribute to the MCCF but which choose not to do so would be exempted from both the obligations and the benefits of the Fund, without being subject to any kind of penalty.*’<sup>13</sup>

The weakness of this approach is not that it tries to divide the burden of climate change equitably, but rather that it fails to take into account the full burden. The Mexican formula is concerned with sharing the burden of *contribution to a fund* (‘Multilateral Climate Change Fund’). It does not take into account the actual costs of climate change to countries. For example, assuming for the sake of argument that climate change costs relative to GDP are the same throughout the world, India and China would currently be burdened with 5% and 10%, respectively, of the global costs.<sup>14</sup> This would be more than their share in historic responsibility (see Figure 2) – in the case of India, considerably (1500 times) more. In other words, China and India are likely, if not certainly be to owed (net-) restitution under a fair burden-sharing regime, which is why it is difficult to see why their access to such funding should be conditional to them first making a payment, no matter how small.<sup>15</sup>

### 2.3. Fragmented or Consolidated Financing? A question of justice and trust

Should (public-sector-type) international climate change finance be *fragmented* (decentralised) or *consolidated* (centrally managed); and if consolidated, by whom?

Views on central management have been known to be conditional on who one has in mind would do the managing. For example, some who were opposed to creating a new operational entity for the Adaptation Fund on the grounds that institutional duplication should be avoided, rather quickly converted to the ‘let a thousand institutions bloom’ persuasion after the Adaptation Fund Board was actually established. And yet, the issue of whether (public-sector-type) climate change finance should be centrally handled or not goes beyond the question of who precisely would be handling it.

No one – to our knowledge – has as yet proposed that *all* international public sector funding for climate change *must* be centrally managed (collected/disbursed). Even the controversial stricture in the G77 finance submission regarding funding outside the UNFCCC does not preclude anyone from financing outside this framework. It merely states that such payments are not to be counted towards UNFCCC commitments.<sup>16</sup>

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<sup>13</sup> Benito Müller, *International Adaptation Finance*, OIES EV42, June 2008:p.11

<sup>14</sup> These are the 2006 shares of World PPP GDP [Source: The World Bank (2008), *2008 World Development Indicators* Online. Washington, DC: The World Bank]

<sup>15</sup> Indeed, even if one does not subscribe to the restitution nature of such payments, the logic of paying in to be eligible to draw money out is not self-evident. It seems to be akin to the modalities of a mutual assurance scheme, or a lottery.

But even this analogy breaks down because of the assurance that there will be more coming out of the fund than is being paid in. Why not just go for the net disbursement, without the conditionality?

<sup>16</sup> *Any funding pledged outside of the UNFCCC shall not be regarded as the fulfilment of commitments by developed countries under Art. 4.3 of the Convention, and their commitments for measurable, reportable and verifiable means of implementation, that is, finance, technology and capacity-building, in terms of para 1.b (ii) of the Bali Action Plan.* [FCCC/AWGLCA/2008/MISC.2/Add.1:p.]

To discuss the merits or demerits of consolidated funding in this context, one has to consider what the alternatives would be. The favourite alternative appears to be the model of ODA disbursement, be it directly through bilateral payments, or through multilateral organizations. For example, it has been suggested to us in conversation that countries eligible for funding would prepare national climate change plans which – after COP approval – they

#### **Box 1. Pronk's Billion and the Political Commitment of the Bonn Declaration**

During the negotiations on the Buenos Aires Plan of Action at COP6/bis (2000/01), one of the main developing country demands was for specific, quantified developed country commitment to provide new and additional resources for climate change activities. COP President Jan Pronk reacted with a proposal for Annex I Parties to formally commit themselves to contribute new and additional resources for climate change activities in non-Annex I Parties', totalling \$ 1 billion by 2005 at the latest. This was rejected, foremost by the United States, having just repudiated the Kyoto Protocol, and by Japan, not wishing to subscribe to any quantified commitment. In the end, only the EU15 together with Canada, Iceland, New Zealand, Norway and Switzerland were prepared to make a 'political commitment' to collectively provide \$410 million annually by 2005, paving the way for the successful conclusion of the negotiations on the Buenos Aires Plan of Action at COP7 in Marrakech.

Pallemaerts and Armstrong have recently evaluated the compliance with this 'political' commitment. While they were able to ascertain easily how much was paid into the existing dedicated multilateral climate change funds and instruments, they had considerable difficulties with the 'decentralized' bilateral transactions. They concluded that because the 'average annual level of financial support to developing countries collectively provided by the 15 EU Member States ... through specific multilateral climate change related funding channels falls well short of the level of ... to which they committed themselves. Whether or not the EU is complying with its political commitment under the Bonn Declaration depends entirely on these Member States' bilateral aid efforts and any additional contributions through other multilateral channels. Unfortunately, the information on such efforts in most of these countries' National Communications under the UNFCCC is insufficient to enable even an informed observer to make a reliable judgment about the volume of aid *additional to 2001 levels* that is effectively being provided at the present time.' [Marc Pallemaerts and Jonathan Armstrong, *Financial Support to Developing Countries for Climate Change Mitigation and Adaptation: Is the EU Meeting Its Commitments?*, Institute for European Environmental Policy, January 2009: 16]

could submit for funding to those countries with funding commitments. The problems with this suggestion become self-evident if it is applied to some domestic public disbursement contexts. For example, in the context of providing state pensions, the suggested disbursement model would be tantamount to the government asking pensioners to formulate a personal pension plan, which – following government approval – they could then take to the factory gate and submit to the workers for financing. Or, to use another analogy, it is as if governments – having approved spending plans put together by hospitals – would then ask these to collect the funding directly from the private sector.<sup>17</sup>

One of the main shortcomings of fragmentation in this context lies in ***assuring a fair distribution of inadequate funds***. A number of reasons, not least the practice of using bilateral funding to 'leverage political aims,'<sup>18</sup> make it unlikely that the aim of providing all

<sup>17</sup> The pension/hospital analogy also highlights the flip-side of the situation, namely the problems which someone with an obligation to pay may have in finding eligible recipients. Having a consolidated fund relieves individual tax-payers from the problem of having to find eligible recipients. Donor agencies have been facing the problem of having to spend more and more money with less and less staff, and it is difficult to see how they could cope with finding eligible activities in developing countries for the sort of amounts expected to be part of their country commitments.

<sup>18</sup> For more on this, see for example:

[1] Ilyana Kuziemko and Eric Werker, 'How Much Is a Seat on the Security Executive Board Worth? Foreign Aid and Bribery at the United Nations', *Journal of Political Economy*, 2006, vol. 114, no. 5; pp.905-930.

eligible recipients with a fair share could be achieved in the absence of consolidated management of these limited funds.

As implicitly acknowledged in the European Commission Communication (which favours a ‘decentralised’ approach, see A.5.24), another serious problem of fragmented financing is that it has proven to be *very difficult to track and verify transactions*, even if carried out as part of a ‘political commitment’ (as in the example described in Box 1). This has proven to be highly detrimental to the international climate change regime: the failure to deliver on funding promises, as well as questionable reporting practices,<sup>19</sup> have been among the main causes for the very regrettable erosion of trust by developing countries in the developed world. In the context of financial commitments this also means that it is difficult to see *how compliance could be monitored* in such a fragmented funding model.

The ‘decentralized’ model of fragmented financing thus has significant flaws and it stands to reason that following national ‘best fiscal practice’, the majority of this funding should be managed centrally through a single budget fund – similar to the ‘consolidated (revenue) funds’ of the UK and other Commonwealth countries. The next question thus has to be: Who should run such a ‘*consolidated international climate change fund*’? The Adaptation Fund negotiations and subsequent developments have demonstrated that none of the existing candidates would, at present, be able to muster the necessary level of political acceptance among recipient countries. To be clear, there will be room and even need for other actors such as IFIs and UN organizations in climate change finance, capacity building and execution under this proposal, particularly at the national level. The point is merely that the main flow of public sector finance should flow through the financial mechanism of the Convention – subject to the proposed reforms – in order to ensure that everyone who is entitled to receive climate change funding *gets their fair share*, and everyone who has an obligation to provide the funding *pays their fair share*.

Pre-empting the discussion somewhat (see Section 7), we need to highlight that consolidation is also an issue at the national level: Should there be one national, or several domestic funds, say one for each of the funding windows? We believe that having thematically differentiated national funds would not be practical, if only because many activities may have integrated components – i.e. mitigation *and* adaptation – which would be very difficult to accommodate under a (thematically) diversified system of domestic funds.

## 2.4. Mismanagement

One of the objections to managing climate finance under the UNFCCC – particularly with a developing country decision-making majority – is that the UN or developing countries are not (or do not have the capacity to be) sufficiently diligent. Given the recent evidence of bribery and corruption by world-renowned companies, respected banks, and business leaders, the appropriate conclusion has to be that corruption and misappropriation of funds is a general human phenomenon, confined neither to the UN nor to developing countries. Moreover, international organizations outside the UN are not self-evidently better equipped to deal with the problem than in the UN, as was revealed during a 2004 hearing of the US Senate Committee on Foreign Relations concerning misappropriation of World Bank funding.<sup>20</sup> In short, *accountability is a serious issue* and needs to be assured in and *by any institution* that

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[2] Axel Dreher, Peter Nunnenkamp, and Rainer Thiele, ‘Does US aid buy UN general assembly votes? A disaggregated analysis’, *Public Choice*, Volume 136, Numbers 1-2/July, 2008:pp. 139-164.

<sup>19</sup> Indeed, if some of the practices used to report on compliance were used in filing domestic tax returns, it would be difficult to avoid charges of ‘avoidance’ if not ‘evasion’.

<sup>20</sup> Carol Giacomo, ‘World Bank corruption may exceed \$100 billion’, Reuters 13 May 2004.

is to manage such a central climate change funding mechanism. This is why particular attention is given to this issue in proposed Reformed Financial Mechanism (see, in particular, 4.3, 6.3-4)

At the same time, it must be clear that under the restitution paradigm (2.1) it would be unacceptable, not to say immoral, to deprive people from receiving their legitimate restitution payments because of (perceived) bad governance and/or lack of ‘absorptive capacity,’ as has happened under the donation paradigm in the Resource Allocation Framework of the GEF,<sup>21</sup> and in the country selection for the World Bank Pilot Programme for Climate Resilience.<sup>22</sup> Under the restitution paradigm, the international community – represented by the COP and its financial mechanism – has the right to expect efficient use of its funds, but at the same time it has ***the obligation to ensure that those who are entitled to restitution actually receive it.*** This has important implications on the design of the institutional architecture and governance of the way in which the international climate change finance is managed, which we hope are addressed in the proposed Reformed Financial Mechanism. It also suggests the need for capacity building programmes to help countries which need it, to manage these funds efficiently.

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<sup>21</sup> ‘Two indices, the GEF Benefits Index and the GEF Performance Index, are combined [**by the GEF Secretariat**] to determine the share of resources that each country is allocated. The GEF Benefits Index measures the potential of a country to generate global environmental benefits while the GEF Performance Index measures a country’s capacity, policies and practices relevant to successful implementation of GEF programs and projects. A country’s share increases with higher values of each index.’[*GEF Resource Allocation Framework (RAF): Frequently Asked Questions*, [http://cfapp2.undp.org/gef\\_dialogue/guidance/raffaqs.pdf](http://cfapp2.undp.org/gef_dialogue/guidance/raffaqs.pdf).]

<sup>22</sup> ‘In looking at country vulnerability’, the first of the ‘first-order’ criteria for selecting pilot countries for the PPCR, the Expert Group is expected to not only take into account the strength of the physical climate impact signal, but also consider [...] adaptive capacity (being partly a combination of human development index (HDI) and governance).’[*Terms of Reference/Guidance for the Expert Group on the Selection of Countries to Participate in The Pilot Program for Climate Resilience (PPCR)*, revised 6 November]

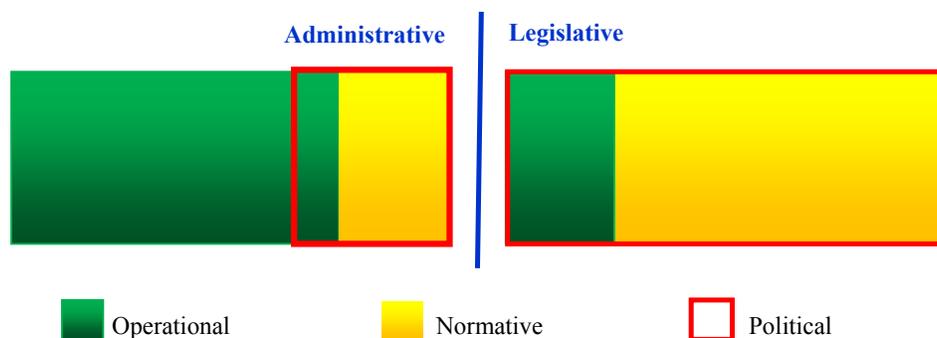
### 3. Institutional Architecture

#### 3.1. General Taxonomy of Functions and Decisions

Sound management of financial flows requires certain management functions to be carried out and decisions to be taken. The following systematic classification (taxonomy) of these functions and decisions is to provide the framework for the design of the institutional architecture and governance structure for the proposed *Reformed Financial Mechanism (RFM)* of the Convention.

There are three general functions that need to be carried out to ensure a well-functioning and generally acceptable funding regime: *revenue raising*, *revenue disbursement*, and *oversight*. To carry out each of these, certain decisions will have to be taken, which in turn can be divided into two types, namely *operational* and *normative*. Roughly speaking, normative decisions are concerned with general issues such as architecture, governance, or (operational) principles. Operational decisions, by contrast, are those involved in the relevant particular fundraising, disbursement or supervisory activities. Another distinction that is used in the context of such decisions is whether they are *political* or not, essentially referring to whether or not the decisions are taken by (representatives of) the relevant political actors, in this case the Parties to the Convention.

The key question in designing the desired institutional architecture and governance system is how to combine these two categorizations. Should all decisions be political, should they all be non-political, or should one identify ‘normative’ with ‘political’ and ‘operational’ with ‘non-political’? Are there any lessons to be learned from national precedents? In spite of their



**Figure 3. Decision Taxonomy – The National Paradigm**

simplicity, none of these three options seems to have been taken up at the national level. The closest to purely political decision-making would seem to be the direct democratic decision-making that can be found in some local assemblies. What has evolved nationally is rather an institutional division between legislative and executive/administrative branches, with the former taking political decisions, most of which normative, and the latter mostly operational ones, some of which political (see Figure 3).

#### 3.2. The Role of Political Decisions: National Precedents

The blueprint for many countries in this respect has been the system of government introduced in the 1787 US Constitution – the oldest written national constitution in operation – reflecting the ideas of John Locke and other thinkers of the Age of Enlightenment.

The ultimate political actors in this type of system are the citizens, who as constituents elect the members of the legislative branch (Congress) as well as the head and deputy head (President and Vice President) of the executive branch (Administration), who in turn propose senior political appointments (in particular Cabinet members) to assist in the running of the executive branch for approval by the legislative branch. Since all decision makers in the legislative branch are (elected) representatives of the political actors, all its decisions are political (in the sense used here). Yet while most of them are also normative, quite a few – such as budget approvals – are actually at the operational end of the spectrum. The executive branch, while mainly staffed with administrative personnel, does have political members who, as such, take political decisions. Regarding the ‘operational’/‘normative’ distinction, both are also taken in the executive branch.

Given the success of this governance/decision-making system, it might be useful to try and identify counterparts in the context of the UNFCCC regime. Assuming sovereign states as ultimate political actors, it seems to be clear that the only real candidate for the role of a *legislative branch is the Conference of Parties* (COP), although it is more akin to a local assembly than to Congress, if only because of the fact that the decision makers are the political actors themselves (the Parties), and not some form of representatives. Given this decision-making model, what is still required for the operation of the Financial Mechanism is an institution to serve as its administration. One of the salient features of this model is its checks and balances which provide for the possibility of non-political decision-making, but only in the context of direct political oversight (in addition to the functions performed by the legislative branch).<sup>23</sup>

Another feature of this model – the fact that it permits the exclusion of major political interests (institutionalized in political parties) from participating in the direct political oversight over the Administration – could, however, be relevant. In the FM context, it would translate into the COP electing the head of the FM administration who would then propose a list of political nominees to be approved by the COP. Given the cumbersomeness of this procedure even in the US, it is difficult to see how it could work in the context of the COP and the administration of the FM.

The US selection practice is not universally followed. For one, there is the practice of forming a ‘grand coalition’ where most if not all significant political interests (parties) are represented in the administration. Usually, this happens through an allocation of positions in the administration to parties, to be filled by the parties themselves. In some sense, this corresponds to the selection of the members of the Kyoto Protocol Adaptation Fund Board, which has seats allocated to certain groupings of Parties (e.g., Least Developed Countries, Small Island Developing States), who then select the members of the Board on their own.

Another, and – given its longevity and overall performance – possibly more appropriate version of such a grand coalition selection procedure is the one employed in choosing the heads of the Swiss administration. All major political parties have been part of this grand coalition since 1959. They are each allocated a predetermined number of seats in the council of ministers (Federal Executive Board). Each party puts forward a number of candidates (for their allocated seats) for *election* by secret parliamentary ballot. The system thus, in a sense, combines the inclusiveness of a grand coalition, with the parliamentary checks and balances of US Congressional approval of Cabinet nominees. One of the benefits of this procedure is

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<sup>23</sup> The US system of selecting the political members of the administration is special in that it mixes direct (s)election by the political actors (electorate) with appointments through their political representatives. However, in light of the fact that given the assumptions so-far, the electorate and the legislative branch are one and the same – namely the COP – this peculiarity of the US system is irrelevant in the present context.

that it tends to enhance the potential for consensus and compromise among the elected candidates, which is of particular importance for the Federal Executive Board because it is meant to work according to the so-called ‘principle of collegiality’ (*Kollegialitätsprinzip*): Executive Board members are supposed not to criticize one another publicly, indeed they are expected to support publicly all decisions of the Executive Board, even against their own personal opinion or that of their political party.

While it is unfortunately difficult to imagine – given the current climate of distrust – that an international body could be run with this sort of collegiality, the minimal lesson to be learned from the Swiss model is that the political members of the administration are there as decision makers. That is to say that, while expected to take into account (‘represent’) the interests of the constituencies that have elected them, they can take decisions in their own right, without having to consult/poll their constituents.

Having thus explored the fact that at the national level it is generally, if not universally believed that there needs to be direct political control over administrative decisions, the remaining central question is *how to avoid a paralyzing ‘over-politicization’ of the administration*. As it happens, this problem is by no means confined to coalition governments, but it is particularly acute in the context of coalitions. There are (at least) two mutually complementary ways in which this problem can be dealt with. One can introduce clear limits as to the type of decisions that can be taken by the political members of the administration, and – if necessary – one can support these limits by introducing institutional boundaries. Indeed, it stands to reason that this was one of the main reasons for introducing the institutional distinction between executive and legislative branches of government in the first place. As concerns the separation of powers between the COP and the RFM Administration, it will be absolutely essential to be as clear as possible about the respective decision-making spheres and responsibilities, particularly in light of the authority of the COP over the RFM Board. What exactly does this authority entail? We believe that this has to be much more specific than to revert to generalities such as were used in the context of the Adaptation Fund, where the remit of the CMP is specified as taking decisions on ‘overall policies’<sup>24</sup> The key to a well-functioning RFM will be the realisation by the COP that the Board being ‘under its authority’ cannot mean that *all* decisions of the Board should be subject to COP approval. Otherwise one would not need a political oversight layer in the RFM Administration, but could have the COP take all the political decisions, which, in our opinion, would mean a degree of political micro-management that would be nothing short of paralytic.

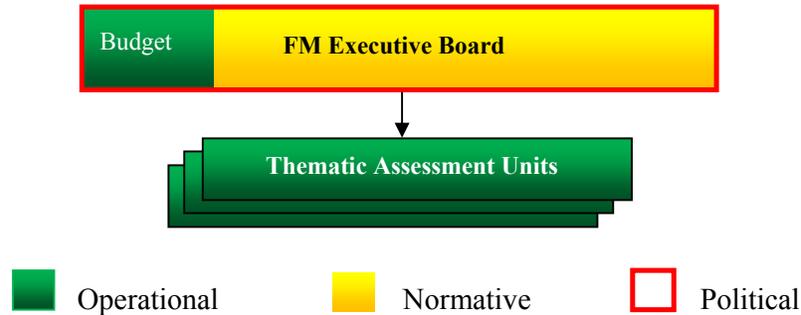
### 3.3 The RFM Institutional Blueprint

As mentioned above, the institutional architecture of the RFM (See Figure 1) is based on a fundamental institutional distinction between the COP as a legislative body, and an executive *Administration* headed by an *Executive Board* (‘Board’) under the authority of the COP. A number of other entities – such as an RFM *Trustee*, a *Board of Auditors* and (multi-) national *Climate Change Funds* – are used to ‘outsource’ some of the RFM activities. The Administration for the RFM is divided into two institutional components: The Executive Board, and a subordinate *Secretariat*, itself composed of thematic *Assessment Units* (AUs) and a *Secretarial Unit* to provide (logistical) support services.

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<sup>24</sup> ... the Adaptation Fund Board shall be established to supervise and manage the Adaptation Fund, under the authority and guidance of the [CMP], and shall be fully accountable to the [CMP], which shall decide on its overall policies in line with relevant decisions; [Para. 4, 1/CMP.3, FCCC/KP/CMP/2007/9/Add.1]

As witnessed by the division of the COP and the RFM Administration, one of (the best) ways of separating decision-making spheres as well as remits of responsibility is through ‘institutional divisions’ An institutional distinction between an Executive Board and subordinate Assessment Units would therefore have the advantage of providing an institutional boundary for political decision-making within the administration of the RFM, by confining political decision-making – that is to say decisions by political (i.e. COP) appointments – to the Executive Board, and to have the purely operational decisions of the thematic Assessment Units taken by professional administrators, appointed by the Board on a competitive basis (see Fig. 4).



**Figure 4. Administrative Decision Categories**

As the revenue will be spent on different categories of activities (*Disbursement Windows*) – such as mitigation, adaptation, technology transfer, capacity building – it stands to reason that the decisions to be taken in disbursing revenue for each of these categories will require some *sui generis* skills, and that it would not be possible that they could all be taken by one and the same group of people. It therefore makes sense to divide the task along the spending categories introducing a Assessment Unit for each of the designated Disbursement Windows (e.g. AU for Mitigation Finance, AU for Adaptation Finance, etc.).

## 4. Governance

The ‘governance (system) of the RFM’ is the system of decisions that have to be taken to operationalize and operate the financial flows to be managed through the RFM, with the assignment of the relevant decision makers/institutions. In short, ‘governance’ is concerned with the question of ‘who takes which decision?’

As mentioned earlier (3.1), the subject-matter of these decisions can be roughly divided into three types, namely *contribution*, a *disbursement* and *oversight* (concerned with the necessary oversight of these flows, be it in terms of performance evaluation, monitoring, auditing, and dealing with complaints).

Quite a number of these decisions, particularly in the design phase, will have to be taken by the COP as supreme authority over the RFM. The following discussion however focuses on the mechanics of those decisions that are left to the Administration of the RFM.

### 4.1. The Revenue Regime

The revenue regime deals with decisions of *who is to pay how much, and under what modalities*. As mentioned in the original list of general design parameters, the general idea underlying the design put forward here is that the revenue of the RFM will be primarily of

‘public sector type,’ i.e. derived from levies/taxation, both at the national and the international level. Most if not all the decisions regarding revenue raising are to be in the remit of the COP.

## 4.2. The Disbursement Regime

### 4.2.1. Taxonomy of Disbursement Decisions

The disbursement regime – the system of decisions that have to be taken to operationalize and operate spending under the FM – involves a number of different types of decisions.

**A. Design Decisions.** For one, there are decisions about overall design and strategy such as:

- Decisions on *spending categories*: e.g. adaptation, mitigation, tech transfer capacity building, etc.;
- Decisions on whether some of the revenue streams are to be *earmarked*, e.g. aviation passenger levy for adaptation, as proposed by the LDC Group;
- Decisions on *disbursement modalities*, in particular whether the FM should be allowed to give out (concessional) loans etc.,<sup>25</sup>
- Decisions on *eligibility criteria* (e.g. existence of country climate change strategies) and prioritization of categories.

These decisions are ‘normative’ in the above-mentioned sense (section 3.1) and are to fall under the remit of the ‘legislative branch’ i.e. the COP, although it may well ask the Board to submit relevant draft decisions for approval.

As concerns the design of the RFM, one of the fundamental and most important decisions will be to establish the RFM Administration – or rather its executive arm (the RFM Executive Board) – as *a legal entity under the UN system of funds and programmes*.

**B. Funding Decisions.** At the other end of the spectrum, as it were, are decisions on what particular activities are to be funded ‘on the ground’. In the RFM, these decisions are delegated to the country-level Climate Change Funds, and hence (deliberately) removed from the operational decision making process of the RFM Administration.

**C. Operational Budgeting Decisions** The main task of the RFM Administration is to implement the strategic guidance of the COP by translating it into guidelines for the assessment of country needs in the different disbursement windows, based on country Climate Change Strategies, and to use these assessments to put together thematic budget proposals for approval by the COP.

### 4.2.2. Budgeting Decisions

Of all the decisions that have to be taken to run the RFM, the most politically sensitive ones are those concerning the levels of revenue from, and the levels of disbursement to different countries and stakeholders. Revenue levels, under the RFM proposal, are to be the sole responsibility of the COP. The RFM Administration however has a central role in disbursing revenue to the eligible countries.

The RFM architecture allows for a variety of ways in which the decisions on how much each Climate Change Fund receives could be taken, ranging from a purely political decision

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<sup>25</sup> Note that this is quite different from the issue referred to in the Background session whether loans should be permitted as contributions to the FM. Indeed, if for some reasons, the COP were to decide that there are cases where loans would be useful, then this would be appropriate, while bilateral loans are not.

mode to a purely administrative one.<sup>26</sup> The disbursement mode under the RFM is somewhere in between those positions, in order to shield disbursement, as it were, against undue influence from either side. This is achieved by using a budgeting procedure which involves both the Executive Board *qua* direct political administration oversight body, and the purely administrative thematic Assessment Units:

1. The RFM Executive Board is in charge of putting together an **annual RFM framework budget** – including the revenue needed, and disbursement to the different thematic **funding windows**– for approval by the COP.
2. Countries submit annual **Climate Change Strategies** – in a format specified by the Executive Board – to be distributed to the thematic Assessment Units (AUs).
3. Each AU assesses the needs of each country for funding for the relevant theme on the basis of information provided in the country Climate Change Strategy, and the relevant thematic **disbursement guidelines** (operationalized in accordance with COP guidance by the Executive Board and approved by the COP).
4. Based on these assessments, the AUs prepare thematic funding requests to be reviewed by the Executive Board, incorporated in the RFM budget and forwarded to the COP for approval.
5. The COP reviews (amends, if necessary), and approves the thematic disbursement budgets, and sets the revenue levels to match it.
6. The country disbursement is carried out by the Executive Board on the basis of the approved budget and the relevant disbursement guidelines

The key to success for this type of budgeting decisions is whether the political representatives at the Board can agree to some form of **guideline-based evaluation of country needs**. The concept of a ‘rule-based’ approach has been close to irredeemably tarnished by the GEF Resource Allocation Framework (RAF), but we believe that it would be a mistake to blame the particular shortcomings of the RAF on the approach in general. The RAF is a simplistic instance of a guideline-based approach without political buy-in, but it does not discredit the idea of transparent, guideline-based disbursement procedures.

The key to avoiding a RAF-type fiasco is to make sure that rules are not simplistic formulae but thematic guidelines that have broad political acceptance. To find appropriate and generally acceptable guidelines for the different funding themes/windows is the key prerequisite for the proposed RFM.

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<sup>26</sup> The latter has its *de facto* precedent in the Global Environment Facility (GEF), where projects are vetted by the head of the administration (GEF Secretariat), before they are passed on to the political oversight body (GEF Council) for approval. The former corresponds in essence the modality adopted by the Adaptation Fund, where all funding decisions are taken by the political oversight body, the AF Board.

## 4.3. The Auditing and Outreach Regime

### 4.3.1. Why Auditing?

It is clear from overwhelming national evidence (Box 2) that an independent supervisory body charged with keeping administrations accountable to parliaments is crucial for the proper running of administrations.<sup>27</sup> In light of the significant sums of money that are expected to be channelled through the Reformed Financial Mechanism (RFM), generally accepted oversight and outreach procedures are crucial for the credibility and acceptability of the RFM as a whole.

#### **Box 2. Mission Statement by the Auditor-General of South Africa**

*The Auditor-General of South Africa exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector, thereby building public confidence. That is our constitutional mandate.*

*As the Supreme Audit Institution of South Africa, the Auditor-General is the only institution that, by law, has to audit and report on how the government is spending the South African taxpayers' money. This has been the focus of the Auditor-General as an institution since its inception in 1911. But when the country's new Constitution came into effect in 1996, the role and responsibilities of the AG were expanded even more, to enable the institution to fulfil its constitutional mandate.*

*In 1993, the Auditor-General became legally, financially and operationally independent from the public sector and is now governed by its own act ... The Constitution also ensures our independence.*

*To generate income, we charge government institutions for the audits we conduct. We report directly to Parliament. ... This means that as the Auditor-General of South Africa, I can perform my duties without fear, favour or prejudice, and as such can help build public confidence in our country's democracy.*

*In addition to regularity (financial) audits, the AG also conducts performance audits, information system audits as well as specialised audits and investigations.*

Source: [www.agsa.co.za/Home/ReputationpromiseoftheAuditorGeneral/tabid/90/Default.aspx](http://www.agsa.co.za/Home/ReputationpromiseoftheAuditorGeneral/tabid/90/Default.aspx)

#### **See, for example, also:**

**UK National Audit Office:** [www.nao.org.uk/about\\_us.aspx](http://www.nao.org.uk/about_us.aspx)

**Comptroller and Auditor General of India:** [www.cag.gov.in](http://www.cag.gov.in)

**Office of the Auditor General of Canada:** [www.oag-bvg.gc.ca/internet/English/admin\\_e\\_41.html](http://www.oag-bvg.gc.ca/internet/English/admin_e_41.html)

As in the case of most, if not all international institutional arrangements, the oversight is to include an **internal** and an **external component**, involving a number of different oversight activities such as **financial, compliance and performance audits**<sup>28</sup> as well as **technical evaluations** and **monitoring**. Apart from this, there is to be an independent complaints procedure and an outreach and consultation process to enable stakeholders to provide direct input and feed-back to the Executive Board.

### 4.3.2. Internal Auditing

The Executive Board is responsible to the COP for the internal oversight of RFM activities (Board, Secretariat), covering:

<sup>27</sup> The need for such an independent 'watchdog' may also have been the idea behind the *Independent Evaluation Panel* of the G77+China submission (A.1).

<sup>28</sup> Given that RFM is to be established as a UN fund (4.2.1), audits (external and internal) are to be carried by the relevant UN bodies, i.e. UN Board of Auditors (external audits), and UN OIOS (internal audits).

- (i) **internal audits**, to be carried out by the *UN Office for Internal Oversight Services* (OIOS),<sup>29</sup> and
- (ii) **monitoring** and (technical) **evaluations** of the internal RFM activities, to be carried out by the RFM Secretariat.

#### 4.3.3. External Auditing

The COP is responsible for the external auditing of the RFM. As for all UN funds and programmes, this task is to be carried out by the *UN Board of Auditors*. The remit of the external audits will cover financial, compliance and performance audits of the RFM Administration as well spot checks of activities which are sub-contracted by the RFM. RFM contractors (such as the RFM Trustee, and the national Climate Change Funds) shall be contractually obliged

- (i) to have their RFM-funded activities externally audited –by the relevant national Supreme Audit Institutions (‘national audit offices’) in the case of the CCFs – in accordance with guidelines set up by the UN Board of Auditors and approved by the COP; and
- (ii) to grant the right of spot check access to either to the external auditor of the RFM (UN BOA), or to a mutually acceptable third party.<sup>30</sup>

#### 4.3.4. Outreach and Complaints

To avoid malpractice and institutional ossification, it is important for the RFM to have working complaints and outreach procedures. This is why the Board is to be responsible for carrying out appropriate outreach activities, involving, in particular regular, (regional) sessions of the RFM *Consultative Forum*, to be organised by the Secretariat.

To address malpractice in RFM activities – including those that are sub-contracted – an appropriate complaints procedure is to be created, to be housed at the Secretariat, or at a suitable institution such as the UN Ombudsman.<sup>31</sup>

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<sup>29</sup> [www.un.org/depts/oios/](http://www.un.org/depts/oios/)

<sup>30</sup> This follows the example of UNDP, which uses the "national execution" modality for many of its projects around the world, and in which the practice is to agree with the government on a mutually acceptable third party audit institution to undertake regular certified audits

<sup>31</sup> <http://www.un.org/ombudsman/how.html>

## 4.4. The financial ‘MRV Support Regime’

The MRV regime will have to involve some form of registries. Given the issue of contribution and commitments (see 4.4.1.), it makes sense to have this registry system managed by the RFM and its associated national CCFs, which – in the spirit of the recent Chinese submission on the subject (A.6) – will be the focus of these activities.

### 4.4.1. Contributions and Commitments

In the initial description of the ‘design parameters’ it was assumed that the RFM would primarily cover public sector revenue either in the form of payments by countries or as revenue from international levies – akin to the CDM-levy such as Norwegian or the LDC proposal (IAPAL). While most of the country payments will be assessed contributions – and thus meant to count against the relevant funding commitments – this is not intended to exclude the possibility of purely voluntary contributions, even by non-state actors. The ideal would be to have such voluntary contributions channelled through public-private partnerships facilitated by Parties with binding commitments (see Box 4 for some possible

#### **Box 3. Potential Public Private Partnerships under the RFM**

What PPPs are possible will depend on what is finally agreed to be measured, reported and verified and therefore to be counted as commitments against those countries obligated to make them. And how these are reported, measured and verified is subject to final agreements on criteria that will be dependent on their impact in reducing GHG emissions. Following are some hypothetical examples of possible PPPs in which the contribution could be counted against the obligation and commitments of the country or countries:

- **REDD:** A country or group of countries mobilize the private sector to team up with the government(s) to set up a major PPP to help developing countries introduce policies and measure to reduce the rate of deforestation.
- **Mitigation:** A country or group of countries mobilize a particular sector or sectors in its/their country(ies) to establish a special fund that would, through the FM, support cooperative action in that sector or sectors in countries interested to do so on a voluntary basis.
- **Adaptation:** A country or groups of countries create a PPP with a major group of insurance and reinsurance companies in its/their country(ies) to support a major initiative to build up the resilience of a group of particularly vulnerable countries.
- **Mitigation and Adaptation:** A country or group of countries team up with a number of companies interested to support low carbon development paths focused on energy efficiency in a group of selected sectors (e.g., building and transportation) and a major fund is created to support the introduction of SD PAMS focused on those sectors, and which could include a combination of mitigation and land use change both urban and peri-urban.

Note that these PPPs would be different from, say, Programmatic CDM in that they would be based on incentive schemes to make action happen rather than the (carbon) market.

examples).

While it is clear that assessed contributions by Parties to the RFM will count towards their commitment, the question remains how to deal with public sector payments that do not flow through the RFM. There are cases – such as the provision of export guarantees, or the ‘climate proofing’ of ODA – where it would not make sense to have the payments flow through the RFM and which should, nonetheless, be eligible to count towards commitments; but only under certain conditions (e.g., if they are genuinely additional to ODA, as would be the case if they are generated from domestic carbon permit auctioning). In this context, the

RFM would be the institution to monitor the respective conditions for compliance eligibility set by the COP and to record compliant transactions.

Another issue that must be considered is whether, and to what extent, *private sector transactions* are to be counted towards fulfilling the Bali Action Plan. For example, take the case of an individual (person/firm) *a*, subject to a mitigation regime in a country *A*. To comply with its obligation under this regime, *a* purchases *x* CERs for the total cost of *y* from a (unilateral) CDM project owned by project host *b* in country *B*. The question then is, should the financial transfer of *x* from *a* to *b* be MRV registered? The answer is: “That depends!” If the CERs are used as offsets for *a* to comply with a mitigation target in *A*, then the answer must be negative, for in that case, the transaction was a simple trade, and not a financial support to cover the incremental costs of *B* reducing its emissions by *x*. However, if the CERs bought are *not* used as offsets, but are retired by *A* – as envisaged in Müller and Ghosh (2008) – then the transfer of *y* should be registered as financial MRV support by *A* for the MRV reduction of *x* in *B*.

#### 4.4.2. MRV Registry System

The MRV registration system will not only record financial information, but also data on the other MRV parameters mentioned in paragraph 1.b.ii of the Bali Action Plan. These are: technology transfer, capacity building, and mitigation actions in developing countries. Given the diverse nature of the data to be recorded in the (national) MRV Registries, there could be many institutions where they could be housed. However, we believe that the financial data will not only be the most pervasive, but also the most sensitive in the whole MRV system, which is why it makes sense to house the national MRV Registries in the relevant national climate change funding hubs, i.e. the national Climate Change Funds. Accordingly, the RFM Administration is to have responsibility for compiling a central MRV Registry, on the basis of information provided by the national registries kept at the relevant national CCFs.

The Board is responsible for the monitoring and oversight of these national MRV Registries. But it is the responsibility of the CCFs to calculate – on the basis of criteria agreed by the COP – the relevant MRV figures. It is expected that during the course of the year, negotiators will come to an agreement as to what is to be measured, monitored and verified. It will be the responsibility of the RFM Executive Board to set the guidelines for selecting the types of activities that will be eligible (e.g. specific mitigation activities with quantifiable GHG reductions, SD PAMS, sectoral programmes, REDD, etc.). The decisions to be reached at Copenhagen will provide the basis for what it is to be included. Once these decisions are made, the Executive Board will also set guidelines to be followed by the CCFs which in turn will submit these estimates to the Executive Board for inclusion in the central MRV Registry, and applied against a compliance system.

## 5. The Executive Board

### 5.1. Remit, Responsibility, and Accountability

The Executive Board ('the Board') is accountable to the COP for the operations of the RFM. While individual members represent the interests of their 'constituencies,' (see 5.4 and Appendix B), they have a primary *collective responsibility* to the COP. As such, Board members will attend any UNFCCC meetings as representatives of the RFM (*UN Observer*), and will not be members of other delegations. Among the tasks to be undertaken by the Board are:

- Operationalizing the guidance and direction of the COP, particularly with reference to the disbursement of funds and the MRV regime.
- Setting the guidelines (subject to COP approval), overseeing the implementation of the MRVs at the national level, and overseeing the MRV registries.
- Setting the budget for the thematic funding windows (subject to COP approval).
- Internal monitoring and evaluation.
- Outreach consultations with stakeholders (Consultative Forum).

### 5.2 Composition

A pre-allocation of full seats in the Executive Board is to ensure that the key interests groups and Parties have a voice in the direct political oversight of the RFM.

#### 5.2.1. Full (voting) Members

The Board is envisaged to have 26 full (voting) members, representing the following *Constituencies*:

- **Major Economies: 13**

**G5** China, Brazil, India, Mexico, and South Africa;

**G8**<sup>32</sup> Canada, France, Germany, Italy, Japan, Russia, United Kingdom, United States;

- **Most Vulnerable Countries: 6** (among which **2 LDC**, **2 SIDS**);
- **EIT: 2**
- **Regional Groups: 5** (1 per UN Region).

While this seat distribution does not fully determine the composition of the Board with respect to other categories, it is possible to give some indications as to possible ranges (see Table 1). For example, it can be deduced that there is likely to be 'North/South parity' with a propensity for a slight developing country majority. The Board is headed by 2 co-chairs elected from the membership by the membership: one from Annex I and one from non-Annex I.

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<sup>32</sup> The European Union has all the privileges and obligations of G8 membership except the right to host and chair a Summit (see [http://www.deljpn.ec.europa.eu/union/showpage\\_en\\_union.external.g8.php](http://www.deljpn.ec.europa.eu/union/showpage_en_union.external.g8.php)). As the EC is a Party to the UNFCCC, it might be appropriate to include it among the representatives of major economies. In that context we could imagine replacing the EU G8 member seats by a seat for the European Commission and two seats for the EU Member States. This would reduce the Board membership to 25, and the Annex I (non-Annex I) range to between 10 and 14 (11 and 15), thus tipping the balance slightly in favour of developing countries.

**Table 1. Potential Distribution of Full Board Members**

	Annex I	non-Annex I	OECD	G77+China
G8	8	0	7	0
G5	0	5	1	4
MVC	0	6	0	≤6
EIT	2	0	≥0	0
RGs	≥1	≤4	≥0	≤4
<b>Total</b>	<b>11 to 15</b>	<b>11 to 15</b>	<b>≥8</b>	<b>≤14</b>

### 5.2.2. Non-voting Members

There should be a number of non-voting members of the Board, not least to facilitate direct input into Board discussions of some key (non-political) interests. The heads of the *Secretariat* and the *Assessment Units* should *ex officio* be part of the Board deliberations. Similarly it might be advisable to have representatives of the RFM *Trustee* and selected Climate Change Funds. Given the experiment in the governance of the World Bank Strategic Climate Fund (see 8.2) – there may be room for a representation of relevant *Civil Society Organizations* (CSO). Indeed, in light of the stipulation that these organizations are to be represented in the governance of the national Climate Change Funds (see 7.1.1), the CSO representatives on the Board could be selected at consultation meetings during the regional conferences of the RFM Consultative Forum.

Depending on the number of thematic funding windows, the Board is envisaged to have at least 7 non-voting members, namely

- **Thematic Assessment Units:** 1 per Unit (Head, *ex officio*);
- **Secretariat:** 1 (Head, *ex officio*);
- **RFM Trustee:** 1 (Head of the Trustee RFM Unit, *ex officio*);
- **CSOs:** 4 (1 per relevant Region, elected from and by the CCF CSO representatives).

### 5.3. Member Selection

In order to assure transparency, full members shall be *elected* to the Board. Moreover, the COP will approve a general candidate *competence profile* to assure the Board has the competence to run the RFM Administration on its behalf. Each constituency nominates (at least two) eligible candidates for each of their seats and puts them forward as constituency candidate lists. The constituency representatives are *elected by the whole COP* from the relevant constituency candidate lists.

Non-voting members are either appointed *ex officio*, or – in the case of CSO representatives – elected by the CSO representatives on the national CCFs, say in the context of the respective regional sessions of the Consultative Forum.

### 5.4. Decision-making

#### 5.4.1. Representation

There are a number of procedural arrangements which could be used to allow the Board constituencies to be involved in, and take ownership over, the deliberations of the Board through the members they put up for election (see Appendix B for a brief discussion of these options). The model chosen here is that of *personal representation*: Board members are on

the Board in their personal capacity as decision makers. While representing the interests of their constituencies, they are entitled to take decisions on their behalf, and they have ultimate collective responsibility to the COP. As such they are expected to act in accordance with the *collegiality principle* – which usually governs Cabinet decision-making at the national level – and not dissent publically with Board decisions.

#### 5.4.2. Procedure

**Voting.** The decision-making process on the Board must be beyond reproach. For this reason we envisage two alternative decision-making procedures: For one, decisions can be taken by consensus. There is also to be the option to cast a vote on a one-member-one-vote basis. There may be issues that mandate a (secret) ballot, and others that could proceed on a consensus basis (with the proviso that consensus is not achievable if a vote is asked for).

Contrary to the view which is sometimes put forward in favour of the ‘avoid voting at all cost’ practice which prevails in many international bodies – e.g. in the Global Environment Facility which has not seen a single vote in its 18-year history, or the World Bank Strategic Climate Fund, which *only* allows for consensus decision making (See 8.2) – we believe that voting, provided that it is fair and transparent, is not only not divisive, but can generate acceptance of the decisions even among those who did not approve them. This, in turn, is essential if the Board is to function under the principle of collegiality.

**Transparency.** Another key component in generating acceptability, not only among the political stakeholders – i.e. governments in their role as Parties to the Convention – but far beyond, is the transparency of proceedings. It can be considerably improved through simple communication tools such as webcasts of the proceedings, as is the practice in the meetings of the Adaptation Fund Board.

## 6. Support Services

The work of the Board is to be supported by a number of services, whether to help with country *Climate Change Strategies* to put together thematic spending budget requests for the COP (Secretariat thematic Assessment Units), to provide advice if required (Expert Advisory Panels), to keep the revenue in trust (RFM Trustee), to carry out internal and external auditing, monitoring and evaluations (Board of Auditors, UN Office of Internal Oversight Services), or simply to provide logistical secretariat services (Secretariat).

### 6.1. The Secretariat: Thematic Assessment and Secretarial Services

As per the G77+China submission, *the Board shall be assisted by a Secretariat of professional staff* (A.1.14) appointed by the Board. The RFM Secretariat is to be operated as a self-financing division by the UNFCCC Secretariat, in conformity with Article 11.1 of the UNFCCC.<sup>33</sup>

#### 6.1.1. Thematic Assessment Units

There will be a number of different thematic disbursement windows under the RFM. CCFs will be given guidance by the COP – operationalized by the Board – on how to report on their disbursement needs based on the relevant country Climate Change Strategies. These CCF reports will have to be evaluated by qualified personnel, and this is to be the remit of the thematic Assessment Units, (to be housed in the RFM Secretariat). Like all Secretariat staff, the staff of the thematic Assessment Units are to be *qualified professionals*, recruited on a *competitive basis*, and *contracted by the Board*.

#### 6.2.2. Secretarial Services

Apart from providing the usual *secretarial support* for the Board and other bodies involved in the the RFM Administration, the Secretarial Unit will

- (a) carry out the required *central management/coordination of the MRV system*;
- (b) carry out *internal monitoring* and *evaluations*;
- (c) manage *complaints* (unless otherwise decided);
- (d) and organize the *RFM Consultative Forum* which will be designed to provide the opportunity for relevant stakeholders to engage with one another regularly at (sub-) regional meetings, with a view to formulate positions on issues of mutual interests and to elect the designated representation to the Board.

### 6.2. Expert Advisory Panels

The Board is to have the right to convene Expert Advisory Panels, either standing or on an *ad hoc* basis. The role of these Panels is to give expert advice to the Board on any issue the Board chooses. Note that this function is fundamentally different from that undertaken by the Secretariat Assessment Units, whose function it is to provide technical assessments of the thematic disbursement needs based on submissions by the CCFs and guidelines by the Board.

### 6.3. Internal Oversight

Following the common practice in UN bodies, the RFM Administration should be subject to

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<sup>33</sup> Note that in order to enter contracts with contractors such as the Trustee and the CCFs, the Board needs to be a legal entity, and as such will have to have an official Seat.

an appropriate internal auditing, monitoring and evaluation procedures. At this stage, it is envisaged that – subject to a feasibility study – the internal audit be carried out by the *UN Office for Internal Oversight Services* (OIOS, [www.un.org/Depts/oios/](http://www.un.org/Depts/oios/)) with its remit of assisting the UN *in protecting its assets and in ensuring the compliance of programme activities with resolutions, regulations, rules and policies as well as the more efficient and effective delivery of the Organization’s activities; preventing and detecting fraud, waste, abuse, malfeasance or mismanagement; and improving the delivery of the Organization’s programmes and activities to enable it to achieve better results by determining all factors affecting the efficient and effective implementation of programmes.*

The RFM Secretariat is to carry out internal monitoring and evaluation, as well as manage the complaints procedure (unless otherwise decided).

#### **6.4. Board of Auditors**

In light of the fact that the RFM is to be created as part of the UN funds and programmes (4.2.1), the RFM would fall under the remit of the *UN Board of Auditors* (UN BOA) for the purpose of external auditing. The COP may wish to stipulate certain additional external auditing activities, such as spot checks of the RFM contractors, who would have to be obliged to give the right of access to the Board of Auditors as part of their contractual obligations. Alternatively, the spot checks could be carried out by mutually acceptable third party auditors.

#### **6.5. RFM Trustee**

The role of a trustee for the sort of disbursement activities envisaged in the RFM is absolutely standard and does not need particular elaboration in this context, except for the fact that we concur with the G77 and China submission that the RFM Trustee should be appointed on the basis of an open tender. We furthermore believe that the appointment should be reviewed on a five-year basis. Moreover, the RFM Trustee should be audited by the Board of Auditors.

## 7. Climate Change Funds: The national decision and funding hubs

The validity and usefulness of our overarching design principle – namely that

- those who (have to) pay would *wish* to use this mechanism, and
- those who (are entitled to) receive would *wish* to receive payments through it

– does not cease at national borders. The key advantage of having these national funding and decision-making hubs is that,

- (i) following the subsidiarity principle, it provides in-country **direct access** to funding and relieves the international bodies, in particular the RFM Administration, of an otherwise unmanageable number of operational decisions, not only with regards to activity approval, but also to monitoring and fiduciary accountability,
- (ii) it enables a degree of RFM **oversight** which might be difficult to achieve under a decentralized model, and
- (iii) it enables the harnessing of **synergies**, say by funding cross-thematic (e.g. mitigation and adaptation) activities.
- (iv) it leaves the option for both **off-budget** and **on-budget** (‘budget support’) funding streams.

Given the diversity in national circumstances among the eligible recipient countries, both in size and institutional capacity, there clearly needs to be a **degree of flexibility** in designing these CCFs. Thus there may have to be room – particularly in the case of SIDS – for multi-national (‘regional’) CCFs, as well as for sub-national (‘provincial’) sub-funds, in the case of very large recipients.

While there is a need for flexibility, there are also certain **core requirements** to achieving the overarching aim of broadest-based *in-country* acceptance of funding through these national funding hubs. As in the case of the RFM, the architecture of the CCFs has to ensure **equitable, efficient** and **effective** use of the funding. Moreover the CCF governance must be **fair** and **transparent**. In particular, it has to ensure that

- (vii) there is proper representation in the decision-making process (including the domestic recipients of the funding),<sup>34</sup>
- (viii) everyone who is entitled to receive (restitution) payments will receive them.

### 7.1. The Framework

Climate Change Funds (CCFs) are the national funding ‘work-horses’ of the RFM. The recent Bangladeshi Multi Donor Trust Fund (see 7.2) could be a template, but as mentioned above, it may not be suited to all country circumstances. Indeed, the experiences with the Bangladeshi MDTF should itself provide valuable lessons about the design of CCFs.

#### 7.1.1. Design Requirements

There will have to be certain minimal requirements on the design of CCFs if the objectives of the RFM are to be achieved. However, these requirements must be legitimate. In particular, they must not illegitimately infringe on entitlements to funding (see 2.4). Given

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<sup>34</sup> Indeed, we believe that subsidiarity should also be the guiding principle in the design of the CCFs and their domestic funding regimes.

the nature of climate change finance (2.1), only the COP can legitimately impose such requirements, and only if the process of doing so is generally accepted as fair and transparent. This is why a broadly accepted international financing mechanism has to be the corner stone of (public sector) climate change finance

The COP and the Executive Board will have to decide what sort of requirements will have to be satisfied to receive funds under the different disbursement windows. At this stage, all that can reasonably be done is to provide an indicative, non-exhaustive list:

- **GOVERNANCE** The governance of CCFs must be transparent and inclusive, with representation of all relevant stakeholder interests with decision-making.
- **FUNCTIONS** In addition to assessing, monitoring, and evaluating in-country funding activities, the CCFs will also be in charge of the relevant national MRV Registries and responsible for submitting information to central MRV registry.
- **OVERSIGHT** The external oversight is principally to be carried out by the relevant national Supreme Audit Institutions ('National Audit Offices'), following COP approved guidance by the UN Board of Auditors, which will have to be given the right of access to carry out/arrange third party spot checks.
- **OUTREACH.** CCFs are to have regular opportunity to exchange experiences at least at the regional level. This is to be facilitated through the RFM Consultative Forum.

### 7.1.2. Design Options

There are a number of options which we think would benefit the overall operation of the RFM financing regime, but which may not be suitable to all national circumstances, at least initially.

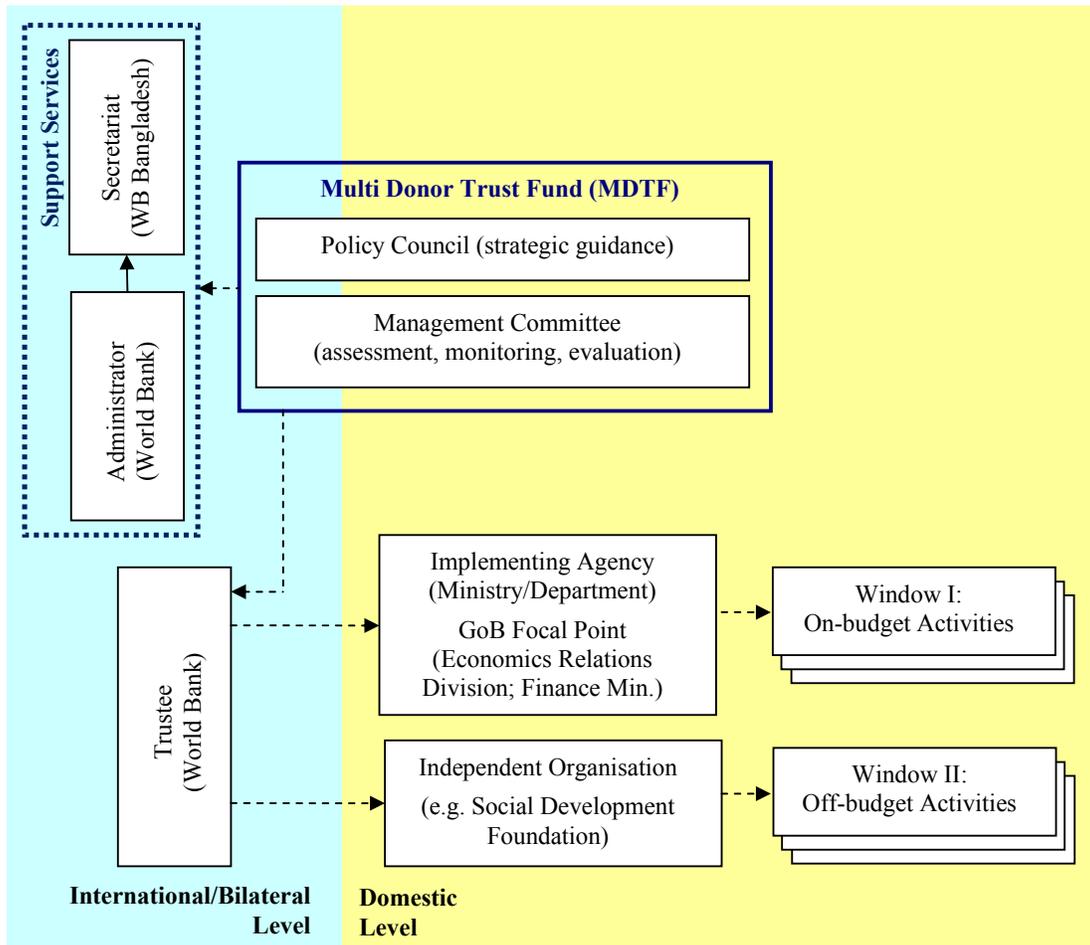
- **MULTIPLE REVENUE SOURCES** Although the majority of revenue in the CCFs should be from the RFM, the option of other contributing sources (private sector, foundations, bilateral, even host country governments) should be left open.
- **OFF-BUDGET TRUST FUND** The format of an off-budget trust fund for the CCFs would enable the host governments to earmark the relevant funding without compromising fiscal principles, and it may be easier to grant the UN Board of Auditors the required right of access.
- **PUBLIC-PRIVATE PARTNERSHIPS** Private public partnerships are – because of their commercially sensitive nature – at least initially best handled at the national level. This is why the CCFs should be allowed to enter into such activities.
- **MANAGE POSSIBLE RFM INSTRUMENTS** CCFs may also be the best place to operate some of the proposed new financial instruments, such as climate change insurance.

## 7.2. The Bangladeshi Multi-Donor Trust Fund Model

According to a recent draft Concept Note, the objective of the Bangladeshi **Multi-Donor Trust Fund for Climate Change** (MDTF) is *to support the implementation of Bangladesh's Climate Change Strategy and Action Plan* (Strategy) that was launched on 10 September 2008. *The benefits of having a MDTF, according to the Note, are many: high-level coordination, elimination of overlaps, donor harmonization, flexibility in fund management, transparency, and the possibility of attracting additional funds from both local and external sources.* The MDTF is meant to become a 'one-stop' mechanism for large scale climate change financing in Bangladesh.

### 7.2.1. Institutional Architecture

As illustrated in Figure 6, the MDTF is to be institutionally divided into a **Policy Council**, a **Management Committee**, a **Secretariat**, and an **Administrator**.<sup>35</sup> A **Trustee** is to disburse the funding under two windows: an **on-budget window** for funding public sector projects; and, an



#### Legend:

Governance Relation ('under the authority of')

Contractual Relation (MOU or contract)



**Figure 5. Institutional Architecture of the Bangladeshi Multi Donor Trust Fund (MDTF)**

<sup>35</sup> Country Director of the World Bank.

**off-budget window** for funding projects from civil society. All projects are to be rigorously reviewed to ensure consistency with the priorities laid out in the Strategy.

**The Policy Council (PC)** is to be chaired by the (Permanent) Secretary of the Planning Division, and comprise representation – at the level of Secretary – of 8 government agencies: the Finance Division, the Ministry of Environment and Forests, of Agriculture, Livestock and Fisheries, Water Resources, Food and Disaster Management, Local Government, Rural Development and Cooperatives, and Communication. In addition there will be a maximum of three donor and a maximum 2 civil society members.<sup>36</sup>

The Policy Council will endorse overall priorities, give strategic guidance and ensure that the MDTF provides coherent support to Bangladesh’s CCSAP. The Council will operate by consensus. In the event of no consensus, the Policy Council will resort to majority voting.

**The Management Committee (MC)** is to be chaired by the Secretary of Finance Ministry’s Economic Relations Division (the designated government focal agency for the MDTF). It is to be co-chaired by a donor representative and the Administrator (Bangladesh Country Director of the World Bank). It will have at most 7 members from government agencies, at most 5 representatives of donor agencies, as well as a representative from civil society.

The Management Committee is to be responsible for (i) reviewing the basic principles, objectives and guidelines for MDTF operations, (ii) assessing funding proposals, (iii) monitoring progress of MDTF implementation, and (iv) reviewing, monitoring and evaluation reports (prepared by the Secretariat for submission to the Policy Council and the donors).

**Secretariat.** The Administrator will manage the MDTF's work programme on behalf of government and contributing donors, through the Secretariat. The Secretariat will carry out the day-to-day running of the MDTF, and prepare semi-annual reports and submit them to the MC. The latter will share the reports with the PC and donors.

### 7.2.2. Governance: Approval Processes

The Fund is to have two windows: an on-budget window for funding public sector projects; and, an off-budget window for funding projects from civil society. All projects funded through the MDTF will be rigorously reviewed to ensure consistency with the priorities laid out in the Strategy. **On-budget activities** are to be approved in a six-step process:

1. A Project Concept Note is to be submitted to the Chair of the MC.
2. The MC is to review and endorse the Concept Note
3. Projects greater than US\$3.6m will be reviewed by the World Bank, in accordance with its guidelines on the basis of a Project Appraisal Document (PAD).
4. The MC comments on the PAD.
5. Government clearance of the project
6. Negotiation of a grant agreement between the World Bank and the project implementing agency.

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<sup>36</sup> Observers are intended to include Ministries of Health, Energy, Home and Defence, and Education, as well as the Country Directors of the World Bank (Administrator), and the ADB, the Resident Representative of the UN and the Head of the EC Delegation.

**Off-budget activities** will focus on community-based activities that fall under the Strategy. The MC will give the overall responsibility to process and implement off-budget activities – including the call for proposals, review monitoring, supervision, and compliance with fiduciary requirements – to an independent organization, such as the Social Development Foundation (SDF). NGOs submitting proposals to the selected independent organization must be officially registered with the NGO Affairs Bureau. Community-based organizations, research institutions, and other civil society groups may also submit proposals. Each proposal must be accompanied by a copy of the NGO registration or the organization’s official incorporation and the organization’s most recent independent financial audit.

### 7.2.3. Suitability and Appropriateness

As indicated earlier (7.2.1), there needs to be some flexibility in the design of the national Climate Change Funds which are to serve as national decision and funding hubs under the RFM, and some elements of the Bangladeshi MDTF may not always be suitable or indeed might be generally inappropriate.

With the involvement of donors and the World Bank envisaged in the Concept Note, the MDTF actually has a hybrid national/international governance, which is not what we had in mind for the national Climate Change Funds under the RFM. Indeed, the involvement of non-national actors in the MDTF governance has attracted a considerable amount of

#### **Box 4. MDTF – A CSO Update from Bangladesh**

*Members of civil society from Bangladesh and different parts of the world remain critical on the World Bank’s appointment as the Trustee of MDTF, which they believe undermines governance of the fund.*

*In an open letter to the Chief Adviser, Caretaker Government (25 November 2008), a group of organizations representing the civil society from home and abroad protested the creation and operationalizing of MDTF in a non-transparent way and involvement of the World Bank in its management. The reason, they state is because a) MDTF ignores the basic principle of generating climate adaptation financing, namely the polluters pay principle, b) it will set an example that the World Bank will use to replicate in other most vulnerable countries, and c) the Bank will be in a position to impose conditionality on access to and use of the MDTF. The letter advocated and urged the Government of Bangladesh to manage the MDTF, exercising the principle of democratic ownership.*

*The very fact that the Bank is already identifying and pre-selecting projects to pipeline for the year 2009 without any national consultation or public disclosure at all may weigh in favor of these apprehensions.*

Source: ‘Multi Donor Trust Fund (MDTF) – Update,’ in *Bali to Copenhagen: A Monthly Newsletter on Climate Change*, Issue 6, Dhaka: Sustainable Development Resource Center (SDRC) December 2008

criticism (Box 5). A Bangladeshi/British CSOs statement following the *UK Bangladesh Climate Change Conference* in September 2008, for example, demanded that *administration and management of climate funding should be the primary responsibility of the government of Bangladesh, with support and monitoring from an **independent**<sup>37</sup> national board on climate change to include a relevant range of stakeholders, including local community representatives. Bangladesh should develop its own management mechanism and be supported to do so by the international community.*

As concerns the governance of the envisaged RFM national Climate Change Funds, two things are clear:

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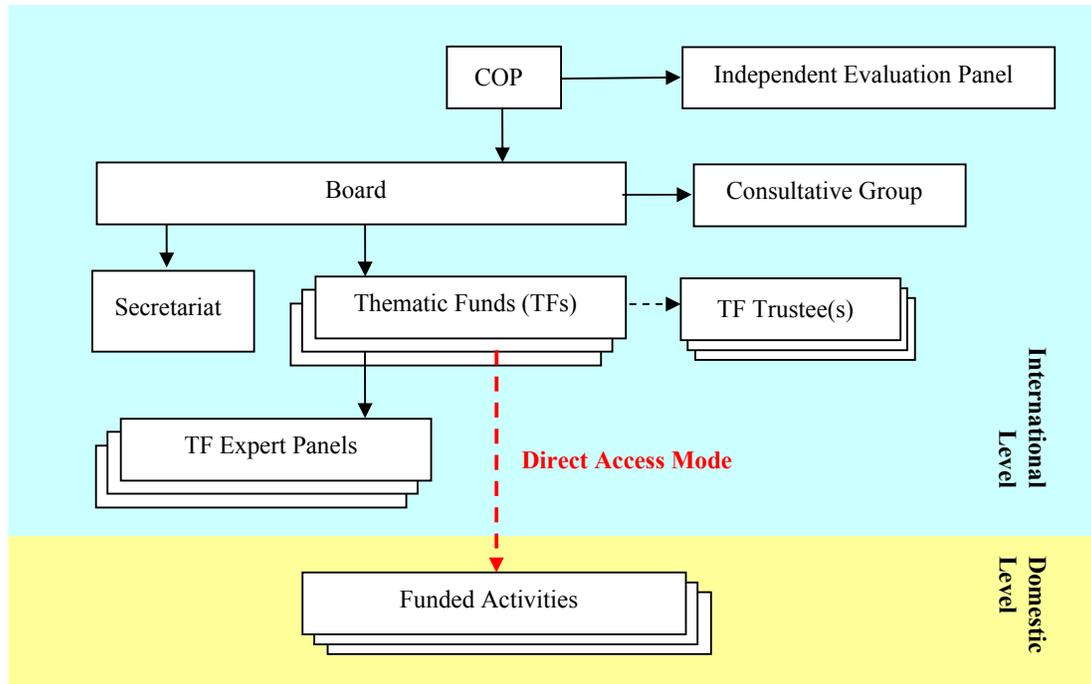
<sup>37</sup> Emphasis in the original.

- (i) RFM disbursement *per se* **does not warrant ‘donor involvement’**,  
and – should the format of a trust fund be adopted – then
- (ii) the CCF Trustee appointment should be through **competitive tender**, as in the case of  
the RFM Trustee.

## 8. Compatibility with other relevant Proposals and Initiatives

### 8.1. UNFCCC Party Submissions

Architecturally, the proposal put forward here is based on (most of) the building blocks of the G77+China design (see A.2) – as endorsed by India (A.4.2) and China (A.7.5) – with its Board, *assisted by a Secretariat of professional staff contracted by the Board* (A.2.14), expert groups or technical panels (A.2.17), and a trustee *selected through a process of open bidding* (A.2.16). Indeed, the RFM Board of Auditors can be seen as a development based on the G77+China proposal of an *Independent Evaluation Panel* (A.2.18)



#### Legend:

Governance Relation ('under the authority of')      'Contractual' Relation (MOU or contract)



**Figure 6. Institutional Architecture of the G77+China Proposal**

The main architectural divergence from the G77+China proposal lies in the use of national Climate Change Funds, as opposed to creating thematic '*specialised*' funds at the international level (A.2.15). The reason for this is our belief in the appropriateness of the principle of subsidiarity, and the need to avoid very large and unwieldy central administrative services (see Box 6).

Having said this, the thematic disbursement windows of the RFM, reflected in the relevant Assessment Units, are consistent with the G77+China proposal that the *COP and the Board shall establish specialised ... funding windows under its governance*. (A.2.15). The idea of using such dedicated in-country funds has been proposed by Switzerland (A.3) and is actually being implemented in Bangladesh (7.2).

The RFM also replaces the *Consultative Group* of the G77+China submission with a *Consultative Forum*, which we believe will serve the purpose of outreach and consultation better than a standing body.

### Box 5. The Montreal Protocol Multilateral Fund Model

The *Multilateral Fund for the Implementation of the Montreal Protocol* is often put up as an example of good governance (see, for example, A.4.1), and while it does indeed have some very progressive governance features, its disbursement model can, in our opinion, not be up-scaled to handle the expected sums of climate change finance (\$100bn to \$150bn annually). The fact is that between 1991 and 2006, the MF received \$2bn (91% of \$2.2bn pledged), with which it funded 5520 projects. That is on average **\$133m per annum** on 368 projects, managed by a staff of 28. And while it may be possible to obtain some economies of scale, it is clear that to handle *a thousand times* more funding in the centralised MF model would require a very large secretariat indeed.

Source: MF Secretariat, *Creating a Real Change for the Environment*, September 2007.

As to the RFM governance, we believe that it satisfies the principles laid down in the Convention and also those put forward by the G77+China. In particular, we believe that it has *an equitable and geographically balanced representation of all Parties within a transparent and efficient system of governance* (Art 11.2, UNFCCC), and that it ensures *recipient country involvement during the stages of identification, definition and implementation, rendering it truly demand driven* (A.1.6)

The one point where we nominally diverge from the G77+China principles is that the RFM does not envisage ‘direct access’ to the international RFM bodies, simply because we do not believe that this is required, given that all access to the national Climate Change Funds will be ‘direct’ in the sense in which this term is generally used in this context.

On the revenue raising side, the proposed architecture is compatible with most if not all of the proposals that have been submitted to date, such as the G77 submission (A.1.8-12), the Norwegian proposal for international AAU auctioning, the LDC proposal of an air passenger levy and the proposals put forward in the recent Communication by the European Commission (A.3.10-12).

## 8.2. Party Communications etc.

### 8.2.1. Communication of the European Commission

Although the EC Communication is not about the financial mechanism, it does not explicitly exclude the possibility of an institutional architecture and governance as proposed in this paper. However, the need for *a centralized governance structure at UN level in order to organize the auctioning process, to set spending priorities and to channel the funds for mitigation and adaptation* (A.5.18), is actually portrayed as a drawback<sup>38</sup> of international auctioning of emission permits (a.k.a. ‘Norwegian proposal’). It is contrasted to the advantage of *annual financial commitments* (A.5.17) by developed countries – with *increasing contributions over time* (A.5.21) by developing countries, *in line with their financial capability* – under which *countries could raise financial contributions individually, and spend them in a decentralized manner using all the existing bilateral and multilateral channels* (A.5.18).

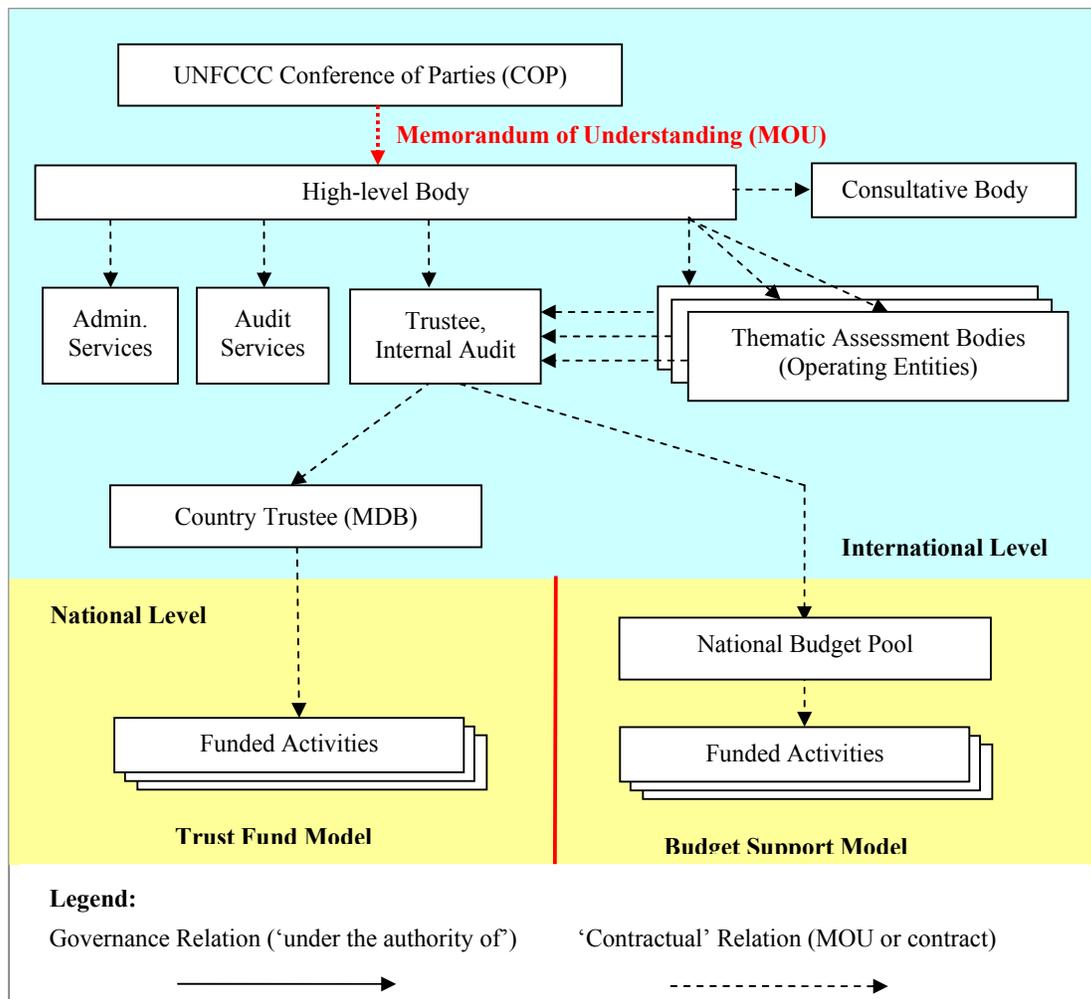
As to the Commission’s view on governance, we would have without reservations agreed with the draft statement that *governance and institutional structures of funds are important*

<sup>38</sup> The paragraph begins by listing predictability and decentralized spending as advantages of assessed contributions, with compliance monitoring as a potential problem. Turning to the Norwegian proposal, the paragraph raises the disadvantage of it not necessarily leading to predictable financial flows, and *also* that it would require a centralised governance structure.

to provide legitimacy and accountability, and for their overall functioning. After all, the whole aim of this project was precisely to provide these elements for international (public sector) climate change finance. Unfortunately, the draft statement did not make it into the final version of the Communication. What remained was the idea that adequate governance could be provided in a largely decentralised setting, coordinated solely through a *high-level forum on international climate finance, ... bringing together key decision makers from the public and private financial sector, as well as international financial institutions (A.5.24)*. We cannot agree with this for the reasons explained in Section 2 ('Centralized versus Decentralised Financing').

### 8.2.1. UK Discussion Paper on the Future Financial Architecture for Climate Change

A recent UK discussion paper on the *Future Financial Architecture for Climate Change* introduces a '**Compact Model**' (CM) with an institutional architecture (Figure 7) which does have close similarities with the RFM, and is indeed presented as a 'future financial mechanism' to be established under Article 11 of the UNFCCC.



**Figure 7. Institutional Architecture of the Compact Model**

At the international level (see Fig. 7), there is a one-to-one correspondence between the architectural entities in the RFM and the Compact Model, with the exception of the *Country Trustees (MDBs)*, for which there is no pre-designated correlate in the RFM model, and the

*Consultative Body* which in the RFM is replaced by a function (*Consultative Forum*) managed by the RFM Secretariat.

The *High-level Body* (HLB) is clearly similar to the RFM Executive Board, with the *Thematic Assessment Bodies* (TABs) and the *Administrative Services*, corresponding to the Secretariat and the thematic Assessment Units of the RFM Secretariat. Moreover, the *Audit Services* can be identified with the external audit entities envisaged in the RFM, with the internal audit function in the CM carried out by the CM *Trustee*, itself corresponding to the RFM Trustee. At the national level, there is also a degree of correspondence between the *National Budget Pools* and the national Climate Change Funds of the RFM. The discussion of the similarities and differences between the two models will hence be mainly about the governance of and the relations between them.

The assumption in the diagram is that the High-level Body would not be a legal entity, and hence could not enter into contractual arrangements. Disbursement would be in analogy to the *World Bank Climate Investment Funds* (CIFs). Indeed, a closer look at the disbursement relations of the CM reveals a certain similarity with the CIFs, particularly with that of the *Strategic Climate Fund* (SCF), as discussed in Section 8.3 below: The main difference is that in the CM, *the MDBs are moved into the position d in the SCF occupied by the Implementing Agencies, which, in turn seem to be taking over from the SCF Programme Sub-Committees.*

#### *High-level Body versus Executive Board.*

The role of the COP ('UNFCCC') under the CM of 'setting targets, identifying sources of finance and agreeing the broad policy framework' is very similar to the one envisaged under the RFM, except for the provision of analytical gaps which in the RFM would, if anything, be part of the task of the Advisory Panels. Moreover, the CM concern of 'there being a clear distinction between policy guidance (the UNFCCC) and execution (others)' was also one of the guiding ideas in designing the RFM architecture, as was the idea that 'decision making should be devolved as much as possible' (in the RFM referred to as the principle of subsidiarity'). There is also a strong similarity between the functions of the top-level administrative bodies, i.e. the RFM Executive Board and the CM HBL, with the latter deciding 'on the gross allocation of resources between themes (e.g. mitigation and adaptation)' and being 'responsible for MRV of financial support'.

Are there any differences at all in the conception of the roles of the COP and the respective top-level administrative bodies? It is difficult to say because the CM description is not really detailed enough to judge, but there is one area where the two models diverge: the relationship between the two. In the RFM, the Executive Board is *under the authority of* the COP, while in the CM the HBL is *guided by and 'accountable to the COP via an MoU arrangement'*.

Whatever one takes these relationships to be, the one thing that is clear: they have a significant history in the UNFCCC process, not least in the negotiations of the Adaptation Fund, which for all too long were bedevilled by an 'MoU or not MoU' debate (not wishing to name any particular existing institutions). One of the key implications of the COP authority over the RFM Executive Board is that the Board members are representatives of COP constituencies and, as such, chosen by them. This raises two questions which remain unanswered in the UK discussion paper?

- Who chooses the members of the CM High-level Body and how?

- What are the similarities and differences (if any) between the CM High-level Body and the Trust Fund Committees of the World Bank CIFs?

### ***Assessment Bodies versus Assessment Units***

At the level of thematic assessment of national plans/Climate Change Strategies, the key difference is, again, relational. The RFM envisages simple administrative Units, as part of the RFM Secretariat, under the authority of the Executive Board. The CM envisages the thematic assessment to be out-sourced to ‘existing institutions which have been reformed to ensure they are fit for purpose’ meant to ‘will report annually to the HBL on progress and spend’.

The Thematic Assessment Bodies (TABs) are meant to develop ***National Allocation Frameworks*** – based on factors such as ‘capacity to absorb financing, resources available from other sources, need’ – which, once approved by the High-level Body (HLB), will determine the (thematic) country finance, ***released by the TABs***. The TABs are meant to be (independent) ***operating entities***, taking the key disbursement decisions. The HLB, while responsible for auditing the TABs (with the support of independent auditors) has no say in the disbursement decisions of the TABs. This is why it is essential to know:

- Who exactly are these TABs meant to be?

Given that both the TABs and the RFM Assessment Units are meant to be staffed by ‘experts appointed through open competition’, one may also wish to know:

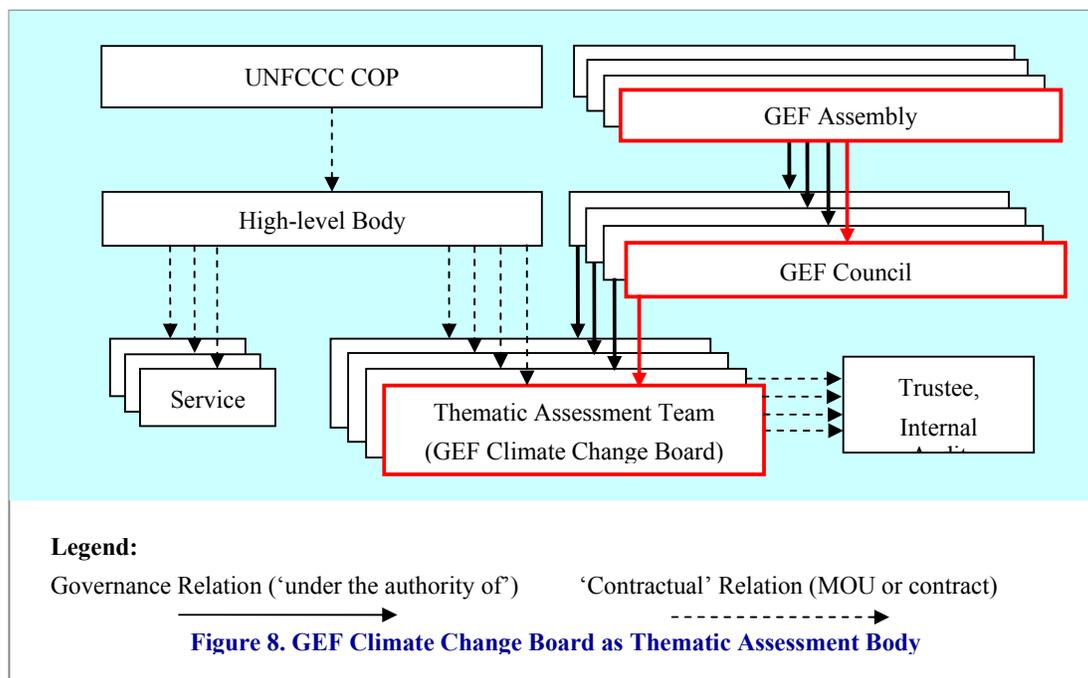
- What is the rationale for housing these expert groups in different existing organizations?

Ultimately, the answer seems to be given at the very beginning of the CM paper: *‘The current debate in the UNFCCC about the future institutional arrangements for climate finance revolves around the issue of control. Contributors and recipients each have their own ideas about the appropriate institutional solutions to support their vision.’*<sup>39</sup> And while it is true that ‘we need to find the middle ground and develop a new delivery model that is capable of operating at scale’ we also must not forget that part of the improvement of the current delivery model of the financial mechanism has to be significantly improved political buy-in/acceptance, and it is highly unlikely that this will be achieved by simply multiplying the operating entities.

The discontent with the current set-up of the financial mechanism is (the perception) that guidance by the COP to the single operating entity has more often than not been ignored, largely due to what has become known as ***‘dual-governance problem’***: the fact that the operating entity has its own independent and supervening governance hierarchy. It is difficult to see how this will improve even if the institutions which are meant to become the TABs are ‘reformed to ensure they are fit for purpose’ particularly since the COP guidance in the CM will be to the HLB, and not to the operating entities.

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<sup>39</sup> Emphasis added.



As it happens, the GEF Secretariat has recently<sup>40</sup> put forward a reform proposal that includes the establishment a *GEF Climate Change Board* which could be used as one of the TABs of the CM. Figure 8 – illustrating such use – shows that the issue at hand is not so much a question of fitness for purpose of existing institutions, but of the CM itself. Delegating the thematic assessment to separate independent bodies/operating entities *simply proliferates the existing dual governance problem*, because each of these will have its own governance structure, which – as in the case of the present governance of the financial mechanism – will prevail over any conflicting demands from ‘outside’ (viz. the UNFCCC). This is why we believe that

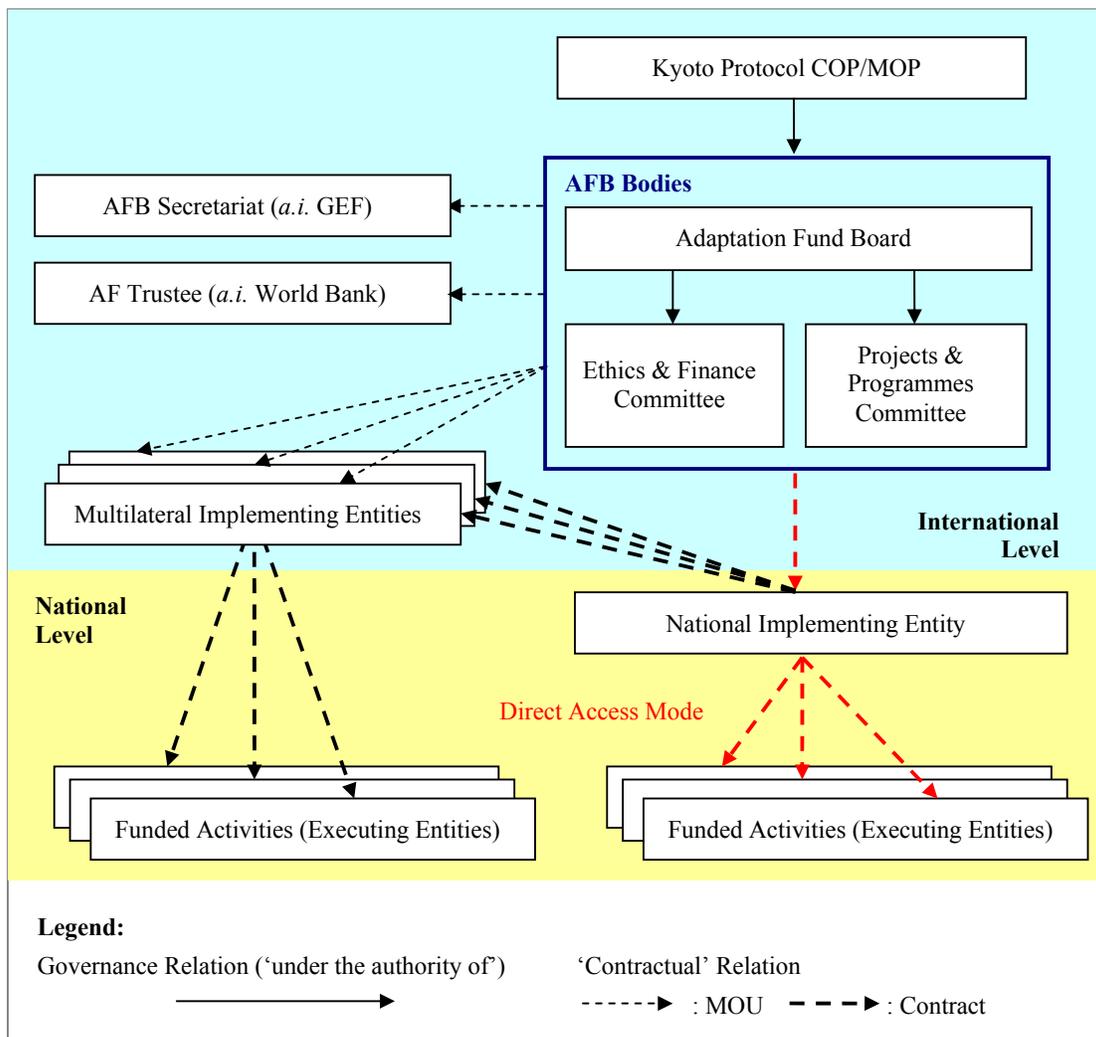
- (i) it makes more sense to gather the respective assessment teams ‘under one hat’ – to have them as Assessment Units of one single entity, the RFM Secretariat; and that
- (ii) this can be done not only without loss but an increase of efficiency or effectiveness because of the relatively small team size that will be required by virtue of having most of the decision-making delegated to the national level.

However, overall the good news as concerns the compatibility of the RFM with the CM is that they are by and large what mathematicians would call structurally isomorphic. The key difference is ‘merely’ who would be in control. This is where a new way forward would have to be found, and lessons be learned. What would need to be avoided is a replica of the dispute that raged over the control of the Adaptation Fund, with its unhappy forced marriage of Board and operating entity. There are other ways of limiting politicization of administrative decisions, and the key will be to do this without losing political buy-in/acceptance.

<sup>40</sup> In the context of the recent Paris opening round of the deliberations on the Fifth Replenishment of the GEF Trust Fund.

## 8.2 The Adaptation Fund

As reflected in a recent headline ('Model Fund Makes Good Progress'<sup>41</sup>), the Adaptation Fund – established by the governing body of the Kyoto Protocol ('COP/MOP', or 'CMP') in 2007 – is indeed seen by many, particularly in the developing world, as a model.<sup>42</sup> After some initial teething problems<sup>43</sup> – the Board has indeed made good progress at its fifth meeting, in particular towards finalising the crucial operational policies and guidelines. The following account of the involvement of implementing and executing entities is a personal interpretation of the Board discussions at that meeting, and should be taken as that. The rest of the architecture and governance is defined in Decision 1 of CMP.3 in 2007, and the Rules of Procedure of the AFB, adopted by CMP.4 in 2008.



**Figure 9. Institutional Architecture of the Adaptation Fund**

<sup>41</sup> *ECO*, Issue No.3, Volume CXVII, 31 March 2009.

<sup>42</sup> As witnessed in the *Intervention by India on Financing Issues and Agreements Needed for Enhancing Implementation of the Framework Convention* during the recent meeting of the AWG-LCA in Bonn. See, in particular, para. 5, and also Appendices 4 and 8 below.

<sup>43</sup> At the root of these problems was, if anything, the ill-defined nature of the relations of the AFB with, on the one hand, the GEF (as secretariat service provider), and on the other with the CMP, under which authority it operates.

### 8.2.1 'Under the Authority'

In 1/CMP.3, the COP/MOP decided that 'the *operating entity of the Adaptation Fund shall be the Adaptation Fund Board*, serviced by a *secretariat* and a *trustee*'<sup>44</sup>, and that the AFB shall be 'under the authority and guidance of the [COP/MOP], and shall be fully accountable to the [COP/MOP], *which shall decide on its overall policies* in line with relevant decisions'<sup>45</sup>. While this specifies what the COP/MOP *shall* (and by implication the AFB shall *not*) decide, nothing is said about what, if anything, is in the sole remit of the AFB to decide, although it is quite clear to everybody that the COP/MOP should not 'micro-manage' the AF. To elaborate this relationship of 'being under the authority' will be one of the key issues for the RFM proposal, as it is clear that the authority of the COP over the RFM Board is non-negotiable, and that this will only be acceptable to many developed countries if it is clearer what this is meant to entail.

### 8.2.2 Composition, Decision Making, and Transparency

The composition, decision-making rules, and procedural transparency are among the real novelties of the AF. They are among the main reasons for the unprecedented degree of developing country ownership over AF. No other international institution involved in (climate change) finance can claim to anything close. Apart from a developing country majority, one of the key features of the AFB composition is that the key recipient constituencies – namely Least Developed Countries and Small Island Developing States – are both explicitly represented. Decision making is based on a one-member-one-vote rule, although consensus is still given priority. But the fact that if there were a vote, developing countries could muster a majority does change the consensus dynamics, for example, from the one at the GEF, with the implicit 'donor veto' due to its mixed voting rule.

The AFB procedures are also exemplary with respect to their transparency. Not only are accredited UNFCCC observers – Parties, Intergovernmental as well as Non Governmental Organisations (NGO) – allowed to attend the AFB meetings, but those who are unable to do so can follow them through live web-casts. This ensures ownership of the AFB not just by Parties, but also by these observer stakeholders, as witnessed in the above-mentioned ECO article.

### 8.2.3 Implementing and Executing Entities

Decision 1/CMP.3 stipulates that Parties shall have direct access to the AF. According to the draft OPGs, this is to be operationalised by way of National Implementing Entities (NIEs), which the OPGs differentiate from the Multilateral Implementing Entities (MIEs) as currently used in the GEF project cycle. Parties will be asked to nominate a NIE to function as their 'point of contact' with regards to AF matters. The national NIE will have to endorse all projects/programmes to be eligible for AF funding, and will submit proposals to the AFB.

In addition, if a NIE is accredited as meeting the fiduciary standards of the AF, then it will also be entitled to receive funds directly from the AF. If an NIE is not accredited, then the funding will have to flow through an MIE. NIEs can of course always choose to contract MIEs, although it is not quite clear as yet what the overall contractual relations would be in the case the NIE is not accredited.

The idea reflected in Figure 8 is that MIEs would, even in this case, be contracted by the NIE, and that the respective financial flow from the AF to the MIE would be covered by an

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<sup>44</sup> 1/CMP.3 para. 3.

<sup>45</sup> 1/CMP.3 para. 4.

MOU between the AFB and the MIE. This would keep the eligible Parties, in form of their national NIEs, ‘in the driving seat’, and would most closely reflect the arrangements under the RFM.

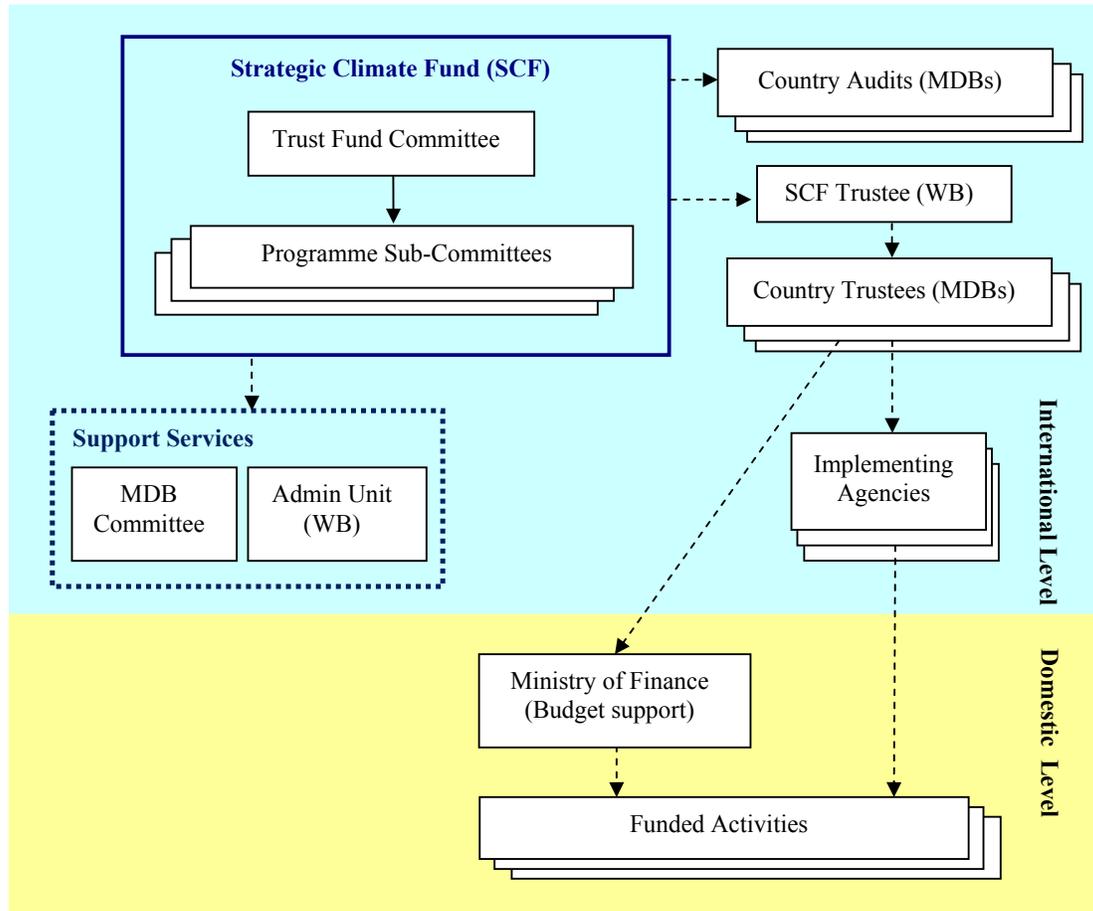
In sum, the nomination of national NIEs by eligible Parties as their representatives *vis à vis* the AF is a crucial step in the direction of the RFM model. The main remaining question concerning the compatibility with the RFM model would be the level of subsidiarity: who actually approves the projects/programmes. However, this may well be part of the lesson learning potential of the AF, which may begin with the more traditional model (i.e. project approval by the AFB), and gradually delegate more and more decisions to the NIEs at national level, in which case it could easily be incorporated in the RFM model.

## 8.3 The World Bank Strategic Climate Fund

### 8.3.1. Institutional Architecture

The architecture and governance of the World Bank *Strategic Climate Fund* (SCF) has certain similarities to the Reformed UNFCCC Financial Mechanism (RFM), and lessons learned could indeed be useful in that context, as envisaged in a recent UK submission to the SCF entitled *Sharing Lessons with UNFCCC* (see A.6).

Institutionally, the SCF comprises a *Trust Fund Committee* (TFC), and a sub-ordinate *Sub Committee* for each of a number of thematic funding windows called *Programmes*.



**Legend:**

Governance Relation (‘under the authority of’)      ‘Contractual’ Relation (MOU or contract)



**Figure 10. Institutional Architecture of the World Bank Strategic Climate Fund (SCF)**

Currently, there are three such funding windows under design, namely the *Pilot Programme for Climate Resilience* (PPCR), *Forestry Investment Programme* (FIP), and the *Scaling Up of Renewable Energy Programme* (SREP). The SCF is supported by a SCF *Trustee* (WB), a *Multilateral Development Bank Committee*, and an *Administrative Unit* (WB) to provide secretariat services.

### 8.3.2. Governance: Remit and Responsibilities

**The Trust Fund Committee (TFC).** The TFC combines functions which in the Reformed Financial Mechanism (RFM) would be the responsibility of either the COP or the Executive Board, respectively. Among the ‘COP-level’ responsibilities are:

- approving establishment of programs under the SCF and the scope and objectives governing the use of these funds;
- ensuring that the strategic orientation of the SCF is guided by the principles of the UNFCCC;
- approving trust fund financing for administrative budgets;
- providing guidance on the convening of the Partnership Forum;
- approving annual reports of the fund;

Akin to the functions of the RFM Executive Board, the TFC has responsibility for

- ensuring monitoring and periodic independent evaluation of performance and financial accountability of MDBs;
- establishing a Sub-Committee for each program established under the SCF and designating who may participate in the Sub-Committee;
- ensuring that lessons learned are transmitted to the UNFCCC and other relevant bodies;
- reviewing reports from the Trustee on the financial status of the fund.

The one aspect of the budgeting process where the TFC has so far no role to play is the allocation of funding between the different Programmes, which is completely at the discretion of the donors. However, in future, the TFC may be given a role in advising the donors on gross allocations between programmes and identifying additional financing gaps.

**The Programme Sub-Committees.** The responsibilities of the Programme Sub-Committees also cut across the institutional divisions in the proposed RFM. On the one hand, the Sub-Committees have responsibilities that would, if anything, be located at the RFM Executive Board or COP-level, namely

- approving programming priorities, operational criteria and financing modalities for the SCF programme;
- approving periodic reports to the Trust Fund Committee on the operations of the programme.

On the other, the Sub-Committees also have the responsibility for ‘approving SCF program financing for programs and projects’ which is not meant to be in the remit of the RFM. Indeed, in conformance with the principle of subsidiarity, the approval of projects would definitely, and that of programmes (depending of what one means by the term), most likely be delegated to the national Climate Change Funds (CCFs).

It thus looks as if there is no correlate to the RFM Assessment Unit responsibility of country funding needs assessments based on information provided in country Climate Change Strategies. However, as many of these issues are currently still under design, it might be best to consider them in the context of the Pilot Programme for Climate Resilience (PPCR).

**PPCR Approval Procedures.**<sup>46</sup> Under the PPCR, each of the ‘pilot countries’ will be

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<sup>46</sup> **NB:** These procedures are still under discussion. At the moment of writing, the situation is as follows:

11. *The Sub-Committee agreed that for the purposes of initial discussions with proposed pilot countries*

choosing an MDB – either their RDB or the WB – as *country trustee*. Each country will work up a tailor-made integrated *Climate Resilient National Development Plan* (National Plan). These National Plans will have to be submitted for approval to the PPCR Sub-Committee (Sub-Committee) in order to be eligible for PPCR funding.

The approval of the National Plans is to be based on an assessment of their climate resilience. It is a prerequisite for funding, and will be used to determine how much the country will actually receive (based on the approved fundable activities submitted in the Plan). There is also the suggestion of caps on how much a countries can maximally receive – and not how much they are entitled to – based on three criteria, namely exposure to climate hazards; vulnerability (linked to poverty); and scale.

There will be closed executive sessions of the Sub-Committee in which countries present their implementation plans and/or individual projects. After Sub-Committee endorsement and PPCR finance allocation, projects will be subject to normal MDB planning processes.

Ideally, the implementing agency here will be the Ministry of Finance of the pilot country provided fiduciary standards of the country are appropriate (as judged by agreed international standards). If levels of fiduciary risk are too high, other modalities such as sector budget support and sliding scales can be used. Other agencies, such as UNDP or a RDB can be chosen by the country to administer the programme funds

### 8.3.3. Lessons to be learned

Having attracted considerable criticism in their initial incarnation as *Pilot Adaptation Fund* (Müller 2008), the initial ideas about the composition of the decision making bodies of the SCF have been significantly improved, not least in admitting parity between developed and developing countries on the Committees. Unfortunately, the changes still fall short of the standards set by the Adaptation Fund, with its one-member-one-vote procedure explicitly endorsed by the submission by India (A.3.1). The idea of ‘decisions by consensus with equal representation’ – as suggested in the UK submission (A.6), may indeed be novel in the context of the World Bank, but it is by no means cutting edge. What is potentially genuinely novel and could provide valuable lessons in this context is the envisaged inclusion on Civil Society Organisation (CSO) representation in the SCF decision making processes (see IUCN 2009)<sup>47</sup>

As indicated in the UK submission (A.6), there are other lessons that the World Bank CIF process might yield for the UNFCCC, and indeed for the proposed RFM, with respect to *funding country led investment plans*. The UK Submission suggests a *number of questions that piloting the investment plans for climate finance through the CIFs might help answer*:

- *Do investment plans meet the basic principles: are they programmatic? Are they country led? Do they allow climate investments to be scaled up successfully?*

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*it could be indicated to each pilot country that the median level of funding available to pilot countries would be approximately \$US50 million, approximately half of which was likely to be available in grant form. It was reiterated that no country would be obliged to accept concessional loan financing as a condition of receiving grants.*

- 13 (e) *more consideration is required to guide resource allocation, and in particular, what activities/components are suitable for grants and what activities may usefully be supported by highly concessional loans.*[Summary of the Co-Chairs PPCR Sub-Committee Meeting, January 27-28, 2009]

The version described here is based on conversations with members of the UK PPCR team.

<sup>47</sup> International Union for the Conservation of Nature (IUCN), 2009, *Review of practices on NGO/CSO Participation and proposal for the CIF Committees*, SCF/TFC.2/Inf.2, January 16, 2009

- *What technical assistance is most helpful in preparing national plans?*
- *How are stakeholders best engaged in the investment planning process?*
- *What criteria are best applied in reviewing national plans?*
- *Investment plans under the Funds will be assessed for implementation potential, consistent with standard MDB criteria. These assessments should help establish what environment facilitates effective adaptation and mitigation investments and encourages private sector investment.*
- *How can the investment planning process ensure that environmental and social co-benefits are integrated into climate change programmes and vice versa?*

However, the one issue which is likely to prove the most difficult and contentious, that is, the manner in which countries are allocated funding, is left out of this catalogue. And we believe that there is a danger with some of the current thinking regarding the determination of disbursements of following in the footsteps of the ill-fated GEF Resource Allocation Framework (RAF). This would be a great shame and a genuinely wasted opportunity.

## Appendices

These Appendices contain *selected excerpts* from submissions to the UNFCCC and other official documents by Parties, listed in chronological order. The paragraph numbering does *not* correspond to the original documents, and is only meant for ease of cross-referencing in this paper. Thus ‘A.2.3’ refers to the third paragraph of the second section of Appendix 2.

### A.1. World Bank Strategic Climate Fund, 3 June 2008

[http://siteresources.worldbank.org/INTCC/Resources/Strategic\\_Climate\\_Fund\\_final.pdf](http://siteresources.worldbank.org/INTCC/Resources/Strategic_Climate_Fund_final.pdf)

#### *Trust Fund Committee*

- [1] A Trust Fund Committee will be established to oversee the operations and activities of the SCF. The Trust Fund Committee will consist of:
- (a) eight representatives from donor countries to the SCF identified through a consultation among such donors, and eight representatives from eligible recipient countries identified through a consultation among interested recipient countries; provided; however, (i) if there are less than eight donor countries contributing to the SCF during the first year of the SCF operations, potential donor countries, identified through a consultation among the donor and potential donor countries, may serve as representatives from donor countries, and (ii) if there are less than eight donor countries contributing to the SCF in the subsequent years, the number of donor country representatives and recipient country representatives, respectively, shall be reduced to equal the number of actual donors contributing to the SCF. Representatives will serve for two year terms, except that they will serve for one year term for the first year of the SCF operations. Representatives may be reappointed;
  - (b) a senior representative of the World Bank, recognizing the role of the World Bank as the overall coordinator of the CIF partnership;<sup>48</sup>
  - (c) a representative of the MDB partners to be identified by the MDB Committee and chosen on the basis of rotation among the MDBs.<sup>49</sup>
- [2] Members of the MDB Committee and the Trustee may attend the Trust Fund Committee as observers. Any additional member of any Sub-Committee may be invited to attend the Trust Fund Committee as an observer.
- [3] To ensure good linkages with key partners so as to promote the efficient use of resources and complementarity with other sources of financing, the Trust Fund Committee will invite as observers representatives of GEF, UNDP, UNEP, and the UNFCCC. The Trust Fund Committee may also invite representatives of other organizations with a mandate to address climate change. Civil society will also be invited to identify a representative to observe the Trust Fund Committee. Recognizing the special areas of competence of the observers, the Trust Fund Committee will invite observers to engage in an active dialogue.

#### *Chair of the Trust Fund Committee*

- [4] The Trust Fund Committee will have two co-chairs. One co-chair will be elected from

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<sup>48</sup> The role of representatives of the World Bank and the MDB partners will be similar to that of ‘non-voting’ members of other Boards.

<sup>49</sup> Same as above.

among the country members of the Trust Fund Committee for the duration of the meeting, alternating from one meeting to another between recipient and donor representatives. The other co-chair will be the World Bank Vice President for the Sustainable Development Network.

### ***Decision making***

- [5] Decision-making will be by consensus of the voting members of the Trust Fund Committee. Consensus is a procedure for adopting a decision when no participant in the decision-making process blocks a proposed decision. For the purposes of the SCF, consensus does not necessarily imply unanimity. A dissenting decision maker, who does not wish to block a decision, may state an objection by attaching a statement or note to the decision. If consensus is not possible, then a proposed decision will be postponed or withdrawn.

### ***Functions of the Trust Fund Committee***

- [6] The Trust Fund Committee will be responsible for:
- (a) approving establishment of programs under the SCF and the scope and objectives governing the use of these funds based on a consultative process and an analysis to determine the utility of new fund programs;
  - (b) ensuring that the strategic orientation of the SCF is guided by the principles of the UNFCCC;
  - (c) establishing a Sub-Committee for each program established under the SCF and designating who may participate in the Sub-Committee;
  - (d) approving trust fund financing for administrative budgets;
  - (e) providing guidance on the convening of the Partnership Forum;
  - (f) ensuring monitoring and periodic independent evaluation of performance and financial accountability of MDBs;
  - (g) approving annual reports of the fund;
  - (h) ensuring that lessons learned are transmitted to the UNFCCC and other relevant bodies;
  - (i) reviewing reports from the Trustee on the financial status of the fund; and
  - (j) exercising such other functions as they may deem appropriate to fulfill the purposes of the fund.
- [7] The Trust Fund Committee will meet at such frequency as it may decide, but not less than once a year.

### ***Sub-Committee***

- [8] The Trust Fund Committee will establish a Sub-Committee for each of the programs under the SCF. The Sub-Committee will include:
- (a) Up to six representatives from donor countries to the program identified through a consultation among such donors, at least one of which should be a member of the SCF Trust Fund Committee;
  - (b) A matching number of representatives from recipient countries to the program, at least one of which should be a member of the SCF Trust Fund Committee;

- (c) In addition to the designated members of the Trust Fund Committee, members of the Sub-Committee will include, as additional members, such other representatives designated by the Trust Fund Committee for this purpose.

[9] The functions of the sub-committee will include:

- (a) approving programming priorities, operational criteria and financing modalities for the SCF program;
- (b) approving SCF program financing for programs and projects;
- (c) approving periodic reports to the Trust Fund Committee on the operations of the program;
- (d) ensure complementary between activities foreseen for the SCF Program and activities of other development partners active in the field of climate change adaptation, including the GEF and the UN, and ensure effective cooperation between the Program and the GEF and UN country activities to maximize synergies and avoid overlap;
- (e) exercising such other SCF functions as they may deem appropriate to fulfil the purposes of the SFC program.

[10] The Sub-Committee will meet at such frequency as it may decide, but not less than once a year concurrently with the Trust Fund Committee. Further, the Sub-Committee may review and approve trust fund financing for programs and projects without meeting, but through such other means and procedures appropriate for project or program review.

[11] Each Sub-Committee will elect its own Co-Chairs.

[12] Except as otherwise specifically provided, the procedures applied to the Trust Fund Committee will apply to the Sub-Committee.

#### ***Commitment of Trust Fund Resources***

[13] The Sub-Committee may approve allocation of SCF program resources for programs, projects and other activities, subject to the amount of resources available in the trust fund for the SCF program and within the allocation for the program agreed by the Trust Fund Committee. The Trustee will make commitments to MDBs for transfer of funds in accordance with approval of the Sub-Committee, but only to the extent that such resources are available in the trust fund for the relevant program.

#### ***Monitoring and Evaluation***

[14] Monitoring and evaluation of results will be critical for the Trust Fund, and each MDB will follow its procedures for monitoring and evaluation. There will be annual reporting on the SCF Programs by the MDBs to the Trust Fund Committee through the appropriate Sub-Committees, and an independent evaluation of the operations of the Trust Fund and the impacts of its activities will be carried out jointly after three years of operations by the independent evaluation departments of the MDBs. Results achieved through the fund will be published and publicly available. Full reporting criteria will be agreed by the Trust Fund Committee.

#### ***Supporting units established under the CIF***

[15] Bearing in mind the objectives of: minimizing transaction costs, and following to the extent possible the MDB processes rather than establishing separate institutional structures, it is proposed that the following units will provide services to the funds and

programs:

- (a) MDB Committee;
- (b) Administrative Unit;
- (c) Trustee.

## A.2. UNFCCC Submission by Philippines on behalf of G-77 and China, 25 August 2008

FINANCIAL MECHANISM FOR MEETING FINANCIAL COMMITMENTS UNDER THE CONVENTION  
FCCC/AWGLCA/2008/MISC.2/Add.1:pp.35–37

### Principles

- [1] The following are principles for enhanced action on the provision of financial resources and investment to support action on mitigation and adaptation and technology development and transfer. The mechanism shall:
- [2] Be underpinned by the principle of equity and common but differentiated responsibilities
- [3] Operate under the authority and guidance, and be fully accountable, to the COP;
- [4] Have an equitable and geographically-balanced representation of all Parties within a transparent and efficient system of governance (Article 11.2);
- [5] Enable direct access to funding by the recipients; and
- [6] Ensure recipient country involvement during the stages of identification, definition and implementation, rendering it truly demand driven.
- [7] The goal is to bring about coherence in the global financial architecture for financing under the authority and governance of the COP.

### Sources of Funding

- [8] The main source of funding will be through the implementation of commitments under Article 4.3. The funding will be new and additional financial resources, which is over and above ODA. The major source of funds would be the public sector.
- [9] Any funding pledged outside of the UNFCCC shall not be regarded as the fulfilment of commitments by developed countries under Art. 4.3 of the Convention, and their commitments for measurable, reportable and verifiable means of implementation, that is, finance, technology and capacity-building, in terms of para. 1.b (ii) of the Bali Action Plan.
- [10] It should be ensured that there be predictability, stability and timeliness of funding.
- [11] The resources shall be essentially grant-based (particularly for adaptation), without prejudice to certain concessional loan arrangements in appropriate form, to meet the needs of a specific programme.
- [12] The level of the new funding can be set at 0.5% to 1% of the GNP of Annex I Parties. Quantified commitments by developed countries to adequate and predictable funding for mitigation and adaptation must be addressed. The portion of funding that must be allocated to adaptation and mitigation and their respective means of implementation shall be decided by the Board and periodically reviewed, taking especially into account the historical imbalances in and the urgency of funding for adaptation.

### Design and Structure:

- [13] The COP is the supreme decision-making body of the Convention, under whose authority and guidance the mechanism will operate. The COP shall decide on the policies, programme priorities and eligibility criteria.
- [14] The COP will appoint a Board, which shall have an equitable and balanced representation of all Parties within a transparent and efficient system of governance. The Board shall be assisted by a Secretariat of professional staff contracted by the Board.
- [15] The COP and Board shall establish specialized funds, and funding windows under its governance, and a mechanism to link various funds.
- [16] Funds would be administered by a Trustee or Trustees selected through a process of open bidding.
- [17] Each of the separate funds may be advised by an expert group or committee, which could also be supported by a technical panel or panels addressing specific issues addressed by the fund.
- [18] To ensure transparent and efficient governance, other possible components of the structure include a consultative/advisory group of all relevant stakeholders, and an independent assessment panel.
- [19] Modalities for the determination of the role of existing funds and entity/ies for the operation of the financial mechanism will have to be worked out.

### A.3. UNFCCC Submission by Switzerland, 3 October 2008

FUNDING SCHEME FOR BALI ACTION PLAN – A SWISS PROPOSAL FOR GLOBAL SOLIDARITY IN FINANCING ADAPTATION

[http://unfccc.int/meetings/ad\\_hoc\\_working\\_groups/lca/items/4578.php](http://unfccc.int/meetings/ad_hoc_working_groups/lca/items/4578.php)

- [1] The revenues generated under this proposal in each country are partly channelled into a National Climate Change Fund (NCCF) for financing national climate change policies according to the country's specific needs and legal frame covering adaptation, technology transfer or mitigation measures.
- [2] A share of revenues differentiated according to groups of countries formed on the basis of the per capita GDP shall flow into a global Multilateral Adaptation Fund (MAF)

#### **National Climate Change Funds**

- [3] Each country which decides to participate in the scheme shall autonomously operate its own NCCF. These national funds shall also operate as partner institutions to the Multilateral Adaptation Fund (MAF) and are encouraged to address the priorities of national climate change programmes and to closely coordinate with other national climate policy financing facilities depending on the national circumstances such as vulnerability to climate change and economic development.
- [4] These NCCFs are seen as complementary vehicles to the project based disbursement through implementing agencies as they are operating under the GEF or under the funds established under the Marrakesh Accord. NCCF funds can be used according to national priorities for adaptation as well as for mitigation measures such as improving the energy- and climate efficiency of buildings, cars, electrical equipment, or power plants and promotion of renewable energy.
- [5] Possible examples for existing national climate change funds or guidelines for designing such funds are the China CDM Fund and the Green Investment Schemes (GIS) developed between Russia and potential AAU buyers, respectively.

## A.4. UNFCCC Submission by India, 17 October 2008

GOVERNMENT OF INDIA SUBMISSION ON FINANCING ARCHITECTURE FOR MEETING FINANCIAL COMMITMENTS UNDER THE UNFCCC

### **Institutional Base/Governance of the Financial Architecture**

- [1] Although the Convention is silent on the choice of an Institution to manage the funds made available, it is quite explicit in stating under Article 11.1 that the proposed financial mechanism “shall function under the guidance of and be accountable to the Conference of the Parties, which shall decide on its policies, programme priorities and eligibility criteria”. Article 11.2 further states that the “financial mechanism shall have an equitable and balanced representation of all Parties within a transparent system of governance”. While creating the Adaptation Fund (AF) the foregoing provisions were fully adhered to. At Nairobi the second meeting of the CMP actually decided that the AF should be under the ‘authority’ of the COP in addition to the requirement of ‘being under the guidance and accountable to’. The Nairobi decision also adopted “a one country one vote” rule in relation to the operation of the AF and a majority representation for developing countries on the governing body (Decision 5/CMP.2.para 3). CMP.3 at Bali created the Adaptation Fund Board with a majority of members from developing countries and designated representatives from the two main recipient interest groups i.e. Group of Least Developed Countries and the Alliance of Small Island States. Moreover, it was decided that Parties should have direct access to the funds, and the involvement of the GEF and the World Bank in the running of the AF was reduced to an interim provision of secretariat and trustee services respectively. The AF structure succeeded in developing an equitable and balanced representation of all parties within a transparent system of governance as required under Article 11.2 of the Convention. The same is true for the Multilateral Fund under the Montreal Protocol.
- [2] Anything short of the above precedents would be a step backwards and, hence, the proposed financial architecture must be under the direct control of COP as detailed in paragraph 10. An Executive Board, with an equitable and balanced representation of all Parties, appointed by COP must manage the proposed financial architecture. A professional secretariat and appropriate technical committees that establish eligibility, evaluation and compliance criteria, in conformance with the Convention, would assist the Executive Board. Direct access to funding by developing country Parties and their involvement in every stage of the process, through the COP, will make the architecture demand driven. A Trustee selected through open competitive bidding among reputed and pre-qualified institutions would administer the funds.
- [3] It must be recognized that any funding that is pledged or becomes available outside the governance structure foreseen under the Convention and highlighted above, cannot be counted towards the fulfilment of the commitments made by developed country Parties under the Convention. The Convention would be undermined if parallel initiatives outside the governance structure foreseen by the Convention are considered towards fulfilment of commitments of developed country Parties under the Convention
- [4] Establishing various verticals along which funding could be made available under the proposed financial architecture or the various criteria that warrant funding is also

beyond the scope of this note. Suffice it to say that the proposed financing architecture should be organized into functional windows to address specific requirements such as a Technology Acquisition and Technology Transfer Fund for available climate friendly technologies, a Venture Capital Fund for emerging climate technologies, Collaborative Climate Research Fund, Adaptation Fund etc. The financing architecture could integrate other funds operating under the Kyoto Protocol to avoid duplication. It might be argued that the proposed financial structure would be unwieldy and ineffective because of concentration of all activities under one umbrella. It is pointed out that the only unifying force is a common architecture of governance, funding and investment policies under the direct control of and accountable to COP. Each vertical will be operated and will grow independently under this common architecture.

## A.5. European Commission Communication, 28 January 2009

TOWARDS A COMPREHENSIVE CLIMATE CHANGE AGREEMENT IN COPENHAGEN,

Communication From The Commission To The Executive Board, The European Parliament, The European Economic And Social Committee And The Committee Of The Regions

COM(2009) 39 final

### **Financing low carbon Development**

[1] A comprehensive Copenhagen agreement must be underpinned by adequate financial resources to enable its implementation. Especially in the current economic situation, the Copenhagen agreement must ensure that climate change goals are delivered cost-effectively. Commission analysis shows that an effective global carbon market can greatly reduce costs in developed and developing countries, but there is a need to significantly scale up, redirect and optimise finance and investment. The international financial architecture to support efforts to tackle climate change must follow principles of sound governance maximising effectiveness, adequacy, efficiency, equity, accountability, coherence and predictability. Spending priorities in the context of the Copenhagen agreement should focus on effective mitigation action through performance-based incentives and on adaptation in developing countries. Potential sources of financing include for instance private and public funding and the use of grants and loans under international, bilateral and multilateral efforts. EU contributions will be at both Community and Member States level. Financing instruments and institutions to fight climate change should be coherent and complementary to existing international bodies and financial institutions and take account of the current debate about their respective roles and responsibilities.

### **Financing the reduction of emissions**

#### *Developing countries*

[2] National low-carbon development strategies will have to provide an estimate of additional net investment costs for mitigation and the viable financing and mitigation policy options to leverage such investments.

[3] The following sources of funding for developing countries exist:

[4] **Domestic:** Until 2020, most actions identified in national low-carbon development strategies have low incremental costs or even generate a net benefit in the midterm, but require up-front investment. For instance, it is estimated that more than half of the reductions in the energy sector can be realised through energy efficiency measures. Financing of these measures will primarily need to come from the private sector and households, and government policies can leverage this finance. This will trigger substantial domestic investment and boost energy secure economic growth. International loan programmes could also help to tap into international private capital.

[5] **External:** The low-carbon development strategies will need to identify mitigation action that goes beyond low cost/short term net benefit options and that require financing beyond the domestic capabilities of the respective developing country. Support for the incremental costs of such investment must come from the full range of sources and innovative financing mechanisms, including public funds and international carbon crediting mechanisms. It is estimated that these crediting mechanisms can provide one third or more of the additional investments in developing countries.

## **Addressing and financing adaptation to inevitable climate change**

- [6] The Copenhagen agreement should provide a framework for action on adaptation, which should include the following elements:
- [7] The need for all to adapt: Support for doing so should be provided to the most vulnerable and the poorest. Only by anticipating potential adverse effects early enough and adapting accordingly can very costly damage be avoided.
- [8] A commitment to systematically integrate adaptation into national strategies: This should be a shared responsibility for both developed and developing countries.
- [9] Improving the tools to define and implement adaptation strategies including methodologies and technologies for adaptation, capacity building and a strengthened role for the UNFCCC process by mobilising stakeholders, including international organisations, and ensuring a more coordinated approach to risk management/disaster risk reduction.
- [10] To pool experience, the EU should recommend that a technical panel on adaptation be set up under the UNFCCC. All countries should be required to draft comprehensive national adaptation strategies. Efficient adaptation policies will need to move beyond the urgent and immediate adaptation needs. There should be a transition from project based approaches towards a long-term strategic integration in a country's broader planning and development strategy. Experience gained in this respect through the Global Climate Change Alliance (GCCA) will be useful. Financial and technological support should be provided to the most vulnerable countries, in particular LDCs and Small Island Developing States.
- [11] The costs of capacity building and priority action in most vulnerable countries could, to a large extent, be covered by the existing Adaptation Fund. But although estimates of additional costs for adaptation vary widely, the Adaptation Fund will be insufficient to support adaptation in all developing countries. Hence innovative sources of finance will have to be utilised to match adaptation needs. Similarly to mitigation, the financing options need to be tailored to actual investment. The UNFCCC Secretariat estimated that adaptation costs in all developing countries could range between € 23-54 billion per year in 2030. A large number of early measures will even generate a net benefit to the economy, for instance measures to improve water use efficiency in areas that will suffer from water shortages. A multilateral insurance pool to cover disaster losses should be explored to complement existing funding mechanisms in case of climate related natural disasters. The European Commission is already involved in piloting such schemes.

## **Financing global research, technology development and demonstration**

- [12] A major boost must be given to research, development and demonstration of low-carbon and adaptation technologies in all economic sectors and activities. This should build on the needs identified in national low-carbon development strategies and assessments made by the Facilitative Mechanism for Mitigation Support, and could include capacity building, science and technology-oriented cooperation, reducing market access barriers on environmental goods and services and improved global research coordination.
- [13] For all these activities, additional public financing will be needed. Globally, it would be desirable to at least double energy-related RD&D by 2012 and increase it to four times its current level by 2020, with a significant shift in emphasis towards low-carbon

technologies, especially renewable energy sources. Likewise, research on impacts, adaptation and other mitigation options to climate change need to be strengthened at the international level. A commitment to do so should form an integral part of the Copenhagen Agreement. The Commission should work with Member States to promote, in a coherent way, international science and technology co-operation for all climate-related research, including low-carbon technologies, across all sectors.

- [14] To accelerate the development and kick-start deployment of strategically important low-carbon technologies, the EU is implementing the European Strategic Energy Technology Plan (SET-Plan). The EU is also planning to create one of its first Knowledge and Innovation Communities on climate mitigation and adaptation as part of the European Institute on Innovation and Technology (EIT), in line with the broader RD&D policy objectives of the EU. Under the revised EU ETS, 300 million allowances are set aside to help stimulate the construction of carbon capture and geological storage demonstration plants as well as innovative renewable energy technologies. Moreover, the Commission is preparing a Communication on the financing of low-carbon technologies.
- [15] Finally, more efforts, including via all forms of education, need to be made to advance the understanding of the evolution of climate and its impacts to society, economy and ecosystems.

#### **Innovative international funding sources**

- [16] Developed countries will contribute via public funding and the use of carbon crediting mechanisms. Public financial contributions should be comparable and be based on the polluter-pays principle and each country's economic capability. The scale of contributions should be negotiated and form an integral part of the Copenhagen Agreement.
- [17] Two principal options to generate innovative funding have been identified. The first option determines the annual financial commitment of developed countries on the basis of an agreed formula. Such a formula could be based on a combination of the polluter pays principle (i.e. total amount of allowed emissions) and its ability to pay (i.e. GDP/capita). Under the second option a certain percentage of the allowed emissions would be set aside from each developed country. These emissions are then auctioned to governments at the international level. This percentage could increase progressively in line with the per capita income.
- [18] The first option provides certainty as to the total amount of funding committed. Countries could raise financial contributions individually, and spend them in a decentralised manner using all the existing bilateral and multilateral channels. This would, however, require a robust and transparent system for monitoring, reporting and verification of additional public funding for climate-related actions. To ensure compliance with funding commitments, a corresponding number of emission rights could be withheld for those countries that do not provide the agreed amount. The second option would not necessarily generate predictable levels of funding as governments could instead also use carbon credits from the Clean Development Mechanism. It would also require a centralised governance structure at UN level in order to organise the auctioning process, to set spending priorities and to channel the funds for mitigation and adaptation.
- [19] For the EU, significant additional public revenue will be generated by auctioning allowances in the EU ETS. Member States could use some of this revenue to honour

their international financial obligation under the future climate change agreement under both options.

[20] Both instruments can be combined with funding that could come from a global instrument to address international aviation and maritime transport (e.g. the proceeds from auctioning allowances under a global cap and trade system applying to those sectors).

[21] It should be explored how developing countries, except the LDCs and Small Island Developing States (SIDS), could also make increasing contributions over time, in line with their financial capability.

### **Funding early action**

[22] Capacity building in order to ensure that the institutional capacity is developed to mobilise efficient reduction and adaptation will be key in the years immediately after a new agreement is reached.

[23] Early action makes adaptation and the transition towards a low-carbon economy smoother. The EU should explore the possibility of developing a frontloading mechanism to rapidly deliver substantial funding in favour of the most vulnerable and poorest developing countries. This would be a bridging initiative in the transition period between 2010 and the full scale implementation of the new financial architecture to be agreed in Copenhagen. Based on the issuance of bonds, the proposed Global Climate Financing Mechanism (GCFM) would allow early spending on priority climate-related actions. These funds would in particular allow for an immediate reaction to urgent adaptation needs with a high return such as disaster risk reduction. A share of the funds raised could also support mitigation activities, in particular, those that generate synergies between mitigation and adaptation such as reducing emissions from deforestation. The GCFM aims at raising around € 1 billion per year for the period 2010-2014, provided that Member States make appropriate pledges.

### **Governance of international financial flows for climate change**

[24] As the sources of funding for adaptation and mitigation are likely to be multiple, coordination and cooperation will need to be improved. A high-level forum on international climate finance should bring together key decision makers from the public and private sectors and international financial institutions. It would regularly review funding availability and expenditure and provide recommendations for improvements. This forum should cooperate closely with the Facilitative Mechanisms for Mitigation Support.

## A.6. UK: Sharing Lessons with UNFCCC, 23 January 2009

Submitted by the Trust Fund Committee Member from the United Kingdom

SCF/TFC.2/7

### Learning Objectives

- [1] The list below identifies the potential areas of learning that are common to all Funds and programmes. There will be other areas of learning particular to each programme / Fund. These specific areas can be explored within the context of those programmes and are not covered here.
- [2] Funding country led investment plans. The CIFs fund country owned national plans which take a programmatic approach. This compact / investment plan approach is based on a relationship between contributors and recipients which involves mutual commitment and responsibilities. Programmatic approaches emphasise budget support, sector wide approaches and co-ordinated investments across key sectors. The rationale for testing this approach when the Funds were being designed was that investment plans were a way to scale up climate investment and integrate climate financing into each country's existing development plans, in support of nationally defined objectives.
- [3] There are a number of questions that piloting the investment plans for climate finance through the CIFs might help answer:
  - Do investment plans meet the basic principles: are they programmatic? Are they country led? Do they allow climate investments to be scaled up successfully?
  - What technical assistance is most helpful in preparing national plans?
  - How are stakeholders best engaged in the investment planning process?
  - What criteria are best applied in reviewing national plans?
  - Investment plans under the Funds will be assessed for implementation potential, consistent with standard MDB criteria. These assessments should help establish what environment facilitates effective adaptation and mitigation investments and encourages private sector investment.
  - How can the investment planning process ensure environmental and social co-benefits are integrated into climate change programmes and vice versa?
- [4] The Climate Investment Funds will pilot new governance structures and decision making processes: decisions by consensus with equal representation. By piloting these new approaches to governance through the CIFs we hope to be able to answer questions about how to design effective and inclusive decision making processes.
- [5] One of the Funds' aims is to leverage finance from the private sector. They will pilot different approaches to engaging the private sector in adaptation and mitigation investments. We hope the Funds will answer questions on the best mechanisms to engage the private sector and which incentives they respond best to.
- [6] Monitoring and evaluation. Robust M&E frameworks will be very important in establishing the impact of the CIFs on the ground. Some of the processes and procedures developed as part of these frameworks may provide experience that would be relevant for future Monitoring, Reporting and Verification.
- [7] Additionality. The Funds aim to provide finance that is additional to both current MDB projects and CDM funding; they should meet financing needs where there is no other source of finance. This experience should help better quantify 'additionality' and

explore the role for this type of public finance in relation to climate change. The procedures should be simple so as not to create undue process and cost and should respond to changing circumstances, such as new technology being covered by the CDM.

- [8] The role of MDBs. The MDBs have a role to play in helping their clients to respond to the challenges of climate change. The Funds will help explore how best the Banks can support their clients in relation to climate change. Working on the Funds should also help MDBs to consider more ambitious lending on e.g. cleaner energy use.
- [9] The use of different financing products. The CIFs will employ a range of financing types/products for different tasks and will be able to provide valuable experience about what types of finance are most effective in different situations.
- [10] Lastly, there will be lessons that emerge as we continue to work on the CIFs that we cannot anticipate yet. It will be important to document and communicate such emerging learning, both positive and negative.

## A.7. UNFCCC Submission by China, 6 February 2009

CHINA'S VIEWS ON THE FULFILLMENT OF THE BALI ACTION PLAN AND THE COMPONENTS OF THE AGREED OUTCOME TO BE ADOPTED BY THE CONFERENCE OF THE PARTIES AT ITS 15TH SESSION

### **Enhanced action on the provision of financial resources and investment**

- [1] China fully supports the establishment of a Financial Mechanism for Meeting Financial Commitments under the Convention, proposed by the Philippines on behalf of G77 and China, for the operationalisation of an effective financial mechanism under the COP.
- [2] Developed country Parties shall take substantive action to provide financial resources from their public finance on a grant basis to developing country Parties, in accordance with Article 4.3, 4.4, 4.5, 4.8, 4.9 and Article 11 of the Convention.
- [3] The financial resources provided by developed country Parties shall be new, additional, adequate, predictable and sustainable. The funding scale shall be at the level of a certain percentage, e.g. 0.5%-1%, of their annual GNP in addition to the existing ODA.
- [4] The developed country Parties shall fulfill their financial commitments under the Convention in a measurable, reportable and verifiable manner; any funds pledged outside the UNFCCC shall not be regarded as the fulfillment of commitments by developed country Parties for the implementation of Article 4.3 of the Convention and the Bali Action Plan.
- [5] The funding is used to enhance actions on adaptation, mitigation and technology development and transfer, as well as related capacity building. For this purpose, it is suggested that the institutional arrangement be composed of the Convention Adaptation Fund, the Mitigation Fund and the Multilateral Technology Acquisition Fund. Innovative financial instruments, e.g. Venture Capital Fund and Climate Insurance Fund, could be developed and integrated into the financial mechanism, for addressing risks associated with climate change.
- [6] The governance of the financial mechanism shall be under the authority and guidance of the COP with equitable and balanced representation of all Parties in a transparent and efficient manner. The funds under the financial mechanism shall be managed with easy

accessibility and low administrative cost. The financial mechanism shall be operated by a Board accountable to the COP, with the support of a Secretariat, a Scientific Advisory Panel, a Monitoring and Evaluation Panel, and a Trustee or Trustees.

- [7] The financial mechanism shall facilitate linkages between various funding sources and separate funds in order to promote access to a variety of available funding sources and reduce fragmentation. Modality/ies of determining the role of existing funds and entity/ies for the operation of the mechanism shall be developed.

## A.8. Supplemental UNFCCC Submission by India, 10 February 2009

WHY FINANCIAL CONTRIBUTIONS TO THE FINANCIAL MECHANISM OF THE UNFCCC CANNOT BE UNDER THE PARADIGM OF “AID”

### **Background:**

- [1] The UNFCCC requires the establishment of a Financial Mechanism under Art 11. An Adaptation Fund has already been set up by with a unique governance structure. The Bali Action Plan (BAP) (Decision 1/CP 13) identifies “Finance:” as one of the 4 “Building Blocks” of the future climate change arrangements.
- [2] It is clear that the scale of finances required are extremely large, and going by available, partial and broad brush estimates, may range, in the case of GHG Mitigation, to several hundred billion US \$ per year and, in the case of Adaptation, at least several tens of billions of US\$ per year. The resources currently provided (GEF contributions, CDM levy for the Adaptation Fund) are currently in the range of a few hundreds of millions of US\$ only per year. It is clear that new and additional resources of a very high order must be found to support the actions of developing countries under Para. 1(b)(ii) of the BAP.

### **Entitlement not Aid:**

- [3] In the current discourse on financing resources to be provided towards implementation of Article 1(b)(ii) of the BAP, there is a tendency to equate such resources to foreign “aid” or Overseas Development Assistance. However, the new Financial Architecture for Climate Change derives from the UNFCCC and is fundamentally different from donor-driver aid flows, which rarely take into account the priorities of the recipient countries. There is also an inbuilt bias in favour of using such funds to source supplies and technology from the donor country or countries, even though more appropriate and cost effective solutions may be available elsewhere, including from within the recipient country itself. Therefore, it is necessary to clearly distinguish between fund flows that are based on the conventional aid paradigm and establish a new, multilateral financial architecture for climate change.

### **Towards a New Financial Architecture for Climate Change:**

Specifically, arrangements under BAP need to embody the following:

- [4] ***Legal obligation, no Repayable “Loans”:*** First, unlike in the case of “development finance”, there is clear legal recognition in the UNFCCC of the “common but differentiated responsibilities and respective capabilities” of Parties for addressing climate change. Accordingly, the provision of financial resources for climate change must relate explicitly to this legal principle in any future climate change arrangements, and cannot be subject to decisions of developed country Governments and legislatures. The providers of finance cannot be discretionary “donors”, but must be legally obligated “assesseees”. This would also rule out repayable financial contributions; legal obligations premised upon responsibility are not repayable.

- [5] **Balanced Governance Structure:** Second, the flow of resources to developing countries must be in line with the basis of provision of funding, i.e. under BAP: [Para 1 (e)] in case of mitigation, in respect of nationally appropriate mitigation actions under Para 1(b)(ii) which requires that these must be supported and enabled by the provision of “technology, finance, and capacity building”, and Para 1(c) in respect of adaptation. Quite obviously, there is no scope for unilateral determination by the assesses (developed country Parties) of which developing country Parties may be funded, or the extent (quantum) of funding required, or the funding modality (project, program, budgetary contribution). A multilateral governance structure that is sufficiently responsive to the perspectives of the developing country Parties undertaking the climate change actions is essential.
- [6] **Procurement:** Third, a more balanced governance structure would enable the Financial Mechanism to work out and implement procurement norms that are competitive in terms of technical capability and cost, unlike the present situation where the technical evaluation criteria may be biased in favour of developed country suppliers.
- [7] **No Conditionalities:** Fourth, the climate change funds are meant for addressing climate change actions in relation to BAP, and not to any other objectives. Accordingly, any covenants other than those strictly consistent with the BAP, i.e. MRV requirements as set forth in Para 1(b)(ii) of the BAP, would be impermissible.

## A.9. United Nations Board of Auditors

Source: <http://www.un.org/auditors/board/mandate.shtml#orgaud>

### *Mandate*

- [1] By Resolution 74 (I) of 7 December 1946, the General Assembly established the United Nations Board of Auditors to audit of the accounts of the United Nations organization and its funds and programmes and to report its findings and recommendations to the Assembly through the Advisory Committee on Administrative and Budgetary Questions. For this, the General Assembly appoints three members, each of whom must be the Auditor-General (or officer holding the equivalent title) of a Member State. The members of the Board have joint responsibility for the audits.

### *Tenure of Office*

- [2] By Resolution 55/248 of 12 April 2001, the General Assembly approved a change in the term of office of members of the Board to a non-consecutive term of six years' duration commencing 1 July 2002. Previously, members were appointed for a three year term which was renewable. Appointments are staggered in such a way that the term of office of one of the members expires every two years. The General Assembly therefore appoints a new Board member every two years.
- [3] If a member of the Board ceases to hold office as Auditor-General (or equivalent title) in her/his country, the tenure of office is terminated and the person who succeeds her/him as Auditors-General becomes the new Board member. A Board member may not otherwise be removed during her/his tenure except by the General Assembly.
- [4] The members of the Board are expected to be available for approximately two weeks each year for meetings of the Board and Panel of External Auditors of the United Nations, the Specialized Agencies and the International Atomic Energy Agency. In addition, each member has to be available for whatever consultations are necessary throughout the year with the United Nations Administration, the Advisory Committee on Administrative and Budgetary Questions and other governing bodies.
- [5] In addition to a full-time Director stationed in New York, each member provides audit staff from his/her national audit office to conduct audits at various United Nations locations. For the purpose of making a local or special examination or of effecting economies in the audit cost, the Board may engage the services of any national Auditor-General (or officer holding the equivalent title) or commercial public auditors of known repute or any other person or firm which, in the opinion of the Board, is technically qualified.

### *Procedures for Appointment*

- [6] The General Assembly appoints a new Board member every two years at its regular session. At least six months before this regular session, the General Assembly issues an announcement of the impending vacancy of a Board member effective 1 July of the following year.
- [7] Member States wishing to put forth the candidacy of their Auditors-General (or officers holding the equivalent title) would do so to the Fifth Committee of the General Assembly. The Fifth Committee in turn will submit to the General Assembly a draft decision containing the name of the Member State whose Auditor-General (or officer holding equivalent title) has been recommended for appointment.

### ***Independence***

- [8] The Board of Auditors is completely independent and is solely responsible for the conduct of the audit. The Advisory Committee on Administrative and Budgetary Questions may, however, request the Board to perform certain specific examinations and issue separate reports on the results.
- [9] The Board is the sole judge as to the acceptance in whole or in part of certifications and representations by the Secretary-General and may proceed to such detailed examination and verification as it chooses of all financial records, including those relating to supplies and equipment. The Board and its staff also have free access at all convenient times to all books, records, and other documentation which are, in the opinion of the Board, necessary for the performance of the audit.
- [10] Information, which is classified as privileged and which the Secretary-General (or his designated senior official) agrees is required by the Board for the purposes of the audit, and information classified as confidential, is made available on application.

### ***Allocation of Assignments***

- [11] The Board allocates and rotates the audit work among its members, subject to the concurrence of the Advisory Committee on Administrative and Budgetary Questions (ACABQ). Audit assignments are shared among members of the Board on an equitable basis. In the allocation of assignments, the following factors are taken into account:
- An equitable distribution of responsibility for preparation of the free-standing reports to the General Assembly;
  - The need to assign related audits to a single member so that the benefits of familiarity and expertise can be maximized;
  - Geographical and logistical factors; and
  - The balance between giving members enough time to become familiar with an organization and thus making an effective contribution, and the need to rotate assignments periodically.

## A.10. To Represent or Not to Represent? Three Decision Making Models

### **The 'Envoy' Model**

The members are chosen to be 'envoys' of constituencies, in the sense that if a Board decision requires a vote, the members cannot vote themselves but have to go and poll the members of their constituencies (on a one-country-one-vote basis). This is, in principle (if there ever is a vote), the model applied in the GEF Executive Board. Note, incidentally, that the GEF model includes a minority safeguard for donors, in the mixed voting system. It is clear that in this system, the locus of decision-making is actually not the Board, but the constituencies, and that since these constituencies are simply a 'regional' partition of the electorate, that as far as voting is concerned, the model is really one of direct democracy (with some minority safeguards). The effect is that the constituents would, in principle, directly take the decisions of the Board. There was consensus that this was not a model to be followed.

### **The 'Simple' Representative Model**

The second model to be discussed was based on a representative interpretation of the democratic process, where the constituents delegate their decision-making power to the elected representatives. As such, these representatives sit on the Board in their personal capacity and are able to vote (on a one-member-one-vote basis) on any issue without having to poll any of the constituents. The 'simple' model envisaged that the election of members should be carried out by the COP as a whole (on a one-country-one-vote basis), and that, as such members would represent the COP as a whole and not be individually responsible to any constituents or groups of constituents.

A problem that was raised in this context was whether such a system could really safeguard 'minority' interests, which was seen to be required in order to establish the necessary 'buy-in' of these minorities. The solution, it was suggested, would be to enshrine these minority interests in the mandate of the Board, to be developed by the COP.

### **The Interest Representative Model**

The third model was essentially built on the idea that there should be an element of interest-group representation through the Board members, but without giving the interest groups the right to be involved in the decisions themselves. There are two variants of this interest representative model

- (a) Interest groups (e.g. LDC Group, AOSIS, Annex II etc.) could be given the right to elect a number of representatives for themselves.
- (b) Interest Groups could be given the right to have a number of representatives on the Board, and put forward a list of candidates for these positions, but the election would be by the whole COP (this corresponds to the electoral procedure for the Swiss Federal Executive Board (the Swiss Executive Branch).

In both cases, the members would be plenipotent representatives, i.e. they would be taking their decision on their own, in their personal capacity (on a one-member-one-vote basis), albeit keeping in mind the interests they are representing.