

The Adaptation Fund at a Crossroads

Report of a brain-storming dialogue organized by the Heinrich Böll Stiftung North America and the European Capacity Building Initiative (ecbi)

During the COP 20 in Lima, as Parties to the UNFCCC struggled to set parameters for a post-2020 climate agreement, its legal status and the institutional arrangements needed to implement ambitious climate actions, an expert discussion under Chatham House rules jointly organized by the Heinrich Böll Stiftung North America and the European Capacity Building Initiative (ecbi) on December 7, 2014, deliberated the future of the Kyoto Protocol Adaptation Fund in a global post-2020 climate framework.

Liane Schalatek from the Heinrich Böll Stiftung North America provided an introductory framing to and moderated the event, while **Benito Müller** from the European Capacity Building Initiative kicked off the well-informed discussion with a detailed presentation.¹ It elaborated on various scenarios to secure the Adaptation Fund's future in a new competitive environment that includes the Green Climate Fund (GCF) as a muscled and now well-resourced player in multilateral climate finance pursuing the COP's mandate from Durban to channel "a significant part of multilateral adaptation finance".

Framing the Discourse

As developing country delegates in Lima argued for the need for a finance roadmap to scale up climate finance to reach the US\$ 100 billion per year by 2020 promised them in Copenhagen and asked for developed country commitments for significant post-2020 finance flows to

1 http://www.eurocapacity.org/downloads/AF_presentation_Lima_1.pptx

secure an ambitious outcome at COP 21 in Paris this year, the biennial assessment and overview of climate finance flows released by the Standing Committee on Finance (SCF) in Lima² underscored that the UNFCCC climate funds, including the Adaptation Fund – though small in volume – remain at the heart of climate finance flows from developed to developing countries within the wider global climate finance universe with a variety of actors and sources estimated – using some broad definition of what constitutes climate finance – to reach between US\$ 340-650 billion. Adaptation financing, according to the SCF review, made up only a small fragment of that large overall number, some US\$22-25 billion in 2012 and 2013 and included significant domestic efforts by developing countries, but only US\$ 8 billion in flows from developed countries, including through climate-relevant multilateral and bilateral ODA. This is of course entirely inadequate, as the UNEP Adaptation GAP³ report revealed, which estimated that the plausible costs for adaptation in all developing countries could be close to US\$ 150 billion per year by 2030 and up to US\$ 500 billion per year by 2050, even under the increasingly unlikely scenario of keeping global warming under 2° C (and likely twice as high under a 4° C warming scenario). In light of these funding gaps the need for sustainable, predictable and adequate funding flows for adaptation, and for financing mechanisms

2 http://unfccc.int/files/cooperation_and_support/financial_mechanism/standing_committee/application/pdf/2014_biennial_assessment_and_overview_of_climate_finance_flows_report_web.pdf

3 http://www.unep.org/climatechange/adaptation/gapreport2014/portals/50270/pdf/AGR_FULL_REPORT.pdf

such as the Adaptation Fund, cannot be stressed enough. It is this shortfall of sustainable, adequate and predictable financing, of course that threatens the long-term viability and the innovative legacy of the Adaptation Fund, which began its operations in 2008, pioneered direct access for national implementing entities (NIEs), provides full cost grant financing for concrete developing country-owned adaptation projects and is governed by a Board with equitable representation between developed and developing country members, given developing countries the majority on the Board. The Adaptation Fund has now 44 projects worth US\$265 million under implementation through 17 national, 4 regional and 11 multilateral accredited implementing entities.⁴

The second review of the Adaptation Fund by the Conference of the Parties serving as meeting of the Parties to the Kyoto Protocol (CMP) with discussions in June⁵ and a decision in December 2014⁶ zeroed thus in on fundraising scenarios and options as well as possible institutional linkages of the Fund with entities under the UNFCCC Financial Mechanism as a way to secure the Fund's future. Although the Adaptation Fund is financed in part by a 2 percent levy on CDM projects, which netted US\$ 190 million from the monetization of certified emissions reductions (CERs) by mid 2014, the uncertainty of prices for CERs does undermine the Fund's operations. Contributions from Parties additionally added up to only US\$ 213.7 million by July 2014 (after a US\$ 100 million pledge of Parties at the CMP9/COP19) with a fundraising goal of Party contributions of US\$ 80 million for 2014 and 2015 respectively. As a consequence of funding demands exceeding funding availability, the Adaptation Fund Board (AFB) had to impose a US\$10 million funding cap for individual recipient countries, as well as a 50 percent cap for projects funded for implementation by multilateral implementing entities (MIEs) resulting in several ready MIE projects being placed in the pipeline awaiting approval pending funding availability. The total of US\$ 407 million received by the Adaptation Fund are less than the total of US\$ 906 million pledged to the Least Developed Countries Fund (LDCF), approximately in line with the US\$ 344 million committed for the Special Climate Change Fund (SCCF) – both specialized adaptation financing instruments under the Global Environment Facility (GEF) – and are dwarfed by the US\$10 billion pledged to the Green Climate Fund (GCF), which will allocate 50 percent of its funding to adaptation actions, with half of this funding reserved for small island developing states (SIDS), least developed countries (LDCs) and African states.

Three Scenarios for the Adaptation Fund in a New Competitive Environment⁷

The Adaptation Fund (AF) is at an existential crossroads in the new “competitive environment” created with the establishment of the Green Climate Fund (GCF). The Adaptation Fund Board and its Secretariat have discussed strategic prospects for the AF ever since a first AFB document was presented in December 2012,⁸ with a more updated and refined version presented in March 2013.⁹ Since then, the GCF has made significant progress toward full operationalization, including in setting its initial allocation framework, in determining its framework for the accreditation of implementation partners and through a successful initial resource mobilization effort.¹⁰

The GCF like the AF will not implement activities itself (unlike the UN agencies or MDBs) but will work through two types of accredited (sub-)national, regional and multilateral entities, including by providing direct access to accredited (sub-)national and regional entities:

- Implementing Entities (IEs), used for project management purposes, and
- Intermediaries, able to take funding decisions on behalf of the GCF through grant allocation, loan provision, financial blending, provision of guarantees or equity investments.

The GCF furthermore distinguishes between:

- Small/micro scale projects/programmes of less than US\$10million of total (including blended) finance, and
- medium/large ones which are more (which range from US\$10 million to up to and including US\$ 250 million).

At its 8th meeting in October 2014, the GCF Board decided to allow all the IEs of the AF (multinational, regional and national), and the Implementing Agencies of the GEF to apply for fast-start accreditation to the GCF as IEs as well as to invite a number of EU donor agen-

4 <http://unfccc.int/resource/docs/2014/tp/07.pdf>

5 <http://unfccc.int/resource/docs/2014/sbi/eng/l17.pdf>

6 https://unfccc.int/files/meetings/lima_dec_2014/decisions/application/pdf/auv_cmp10_2reviewaf.pdf

7 This section draws heavily on an ecbi synopsis document available at <http://www.eurocapacity.org/downloads/Synopsis.pdf>

8 Document AFB/B.19/05, available at: <https://adaptation-fund.org/sites/default/files/AFB.B.19.5%20Strategic%20Prospects%20for%20the%20Adaptation%20Fund.pdf>

9 Document AFB/B.20/05 available at <https://www.adaptation-fund.org/sites/default/files/AFB.B.20.5%20Strategic%20Prospects%20for%20the%20Adaptation%20Fund.pdf>

10 See the HBF GCF Summary Report from its 8th Board meeting available at http://us.boell.org/sites/default/files/boell_gcf_bm8_summaryreport_movingbeyond_schallatek_02.pdf

cies to apply for fast-track GCF accreditation as intermediaries. This followed an assessment by the Board that institutions accredited by the AF, the GEF and EU Development Cooperation only show minor gaps between their respective fiduciary principles and environmental and social safeguards and those required by the GCF, with the GCF Accreditation Panel expected to only focus on these identified gaps in assessing the accreditation request to the GCF.¹¹

Given the underlying decisions by the GCF Board to open accreditation to any and all organizations satisfying the relevant fiduciary standards and environmental and social safeguards, the picture of GCF accreditations is potentially extremely complex, not to say chaotic, as it allows theoretically for a multitude of entities, including from a single recipient country, to seek accreditation with and funding from the GCF. By contrast, the AF presents a much more streamlined, not to say more rational picture, primarily due to the decision to have only one national entity per country directly accessing the AF. In all but one case – namely a South African organization serving both as National Implementing Entity (NIE) and as intermediary for a small grants facility in an enhanced direct access (EDA) role – the implementing entities under the AF only focus on project management of implementation via executing entities, but do not make individual funding decisions within the project approved by the AFB.

11 Ibid.

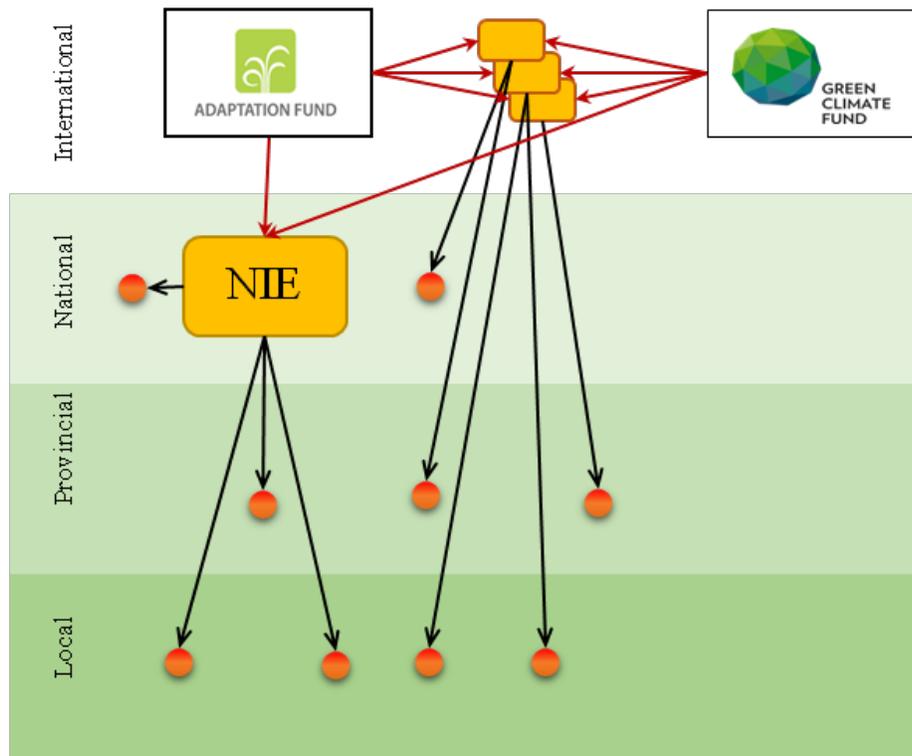
There is the possibility that the GCF might follow the AF example in the context of its programmatic Enhanced Direct Access modality, by also using at most one national intermediary – National Funding Entity (NFE) – per recipient country.

With the GCF set to become the main multilateral fund for climate finance (as intended in the GCF’s Governing Instrument, which also mandates that the GCF operates in complementarity and coherence with existing funding mechanisms), the AF and its Board and Secretariat is tasked to consider the most appropriate institutional arrangements between the AF and the GCF. At its twentieth meeting in April 2013, the AF Board considered three scenarios regarding the relationship between the AF and the GCF.

“Status Quo” Scenario

A “Status Quo” scenario foresaw that the institutional arrangements continue as they currently are. This, as Benito Müller argued in Lima, is not a sustainable scenario, particularly in the absence of predictable and adequate resourcing of the AF. Given the inevitable difference in financial scale between the two funds, project developers will vote with their feet and turn to the GCF for funding. Indeed, this process of demand depletion of the AF has been significantly strengthened through the GCF fast-

Image 1: The “Status Quo” Scenario



Source: Presentation by Benito Müller, ecbi, in Lima, available at http://www.eurocapacity.org/downloads/AF_presentation_Lima_1.pptx

track accreditation of the AF IEs, for now there is a real danger that the AF IEs will turn away from the AF and toward the GCF, taking with them their project pipelines that could not be funded at the AF due to a lack of resources. In other words, given the status quo's unpredictable and inadequate resource situation, the AF is highly likely to simply wither away in this scenario.

“Institutional Integration” Scenario

Another scenario considered by the AF Board in 2013 and also discussed as part of the CMP second review elaboration was one of “institutional integration,” according to which the AF could serve either as the “Adaptation Window” of the GCF; as a specialized instrument or window of the GCF; or as a dedicated mechanism based on innovative financing approaches (and drawing on the experience of the AF with the monetization of CERs). While it would be undoubtedly possible to “integrate” certain institutional aspects of the AF into the GCF architecture (something that is indeed already happening with the envisaged wholesale accreditation of the AF IEs through the fast-track accreditation approach), such an institutional integration would not be an integration of the AF itself, but in the words of Benito Müller in Lima rather akin to what in the private sector is known as “asset stripping”. This is because some of the defining aspects of the AF, in particular the AF Board with its equitable representation with developing countries in the majority, could never

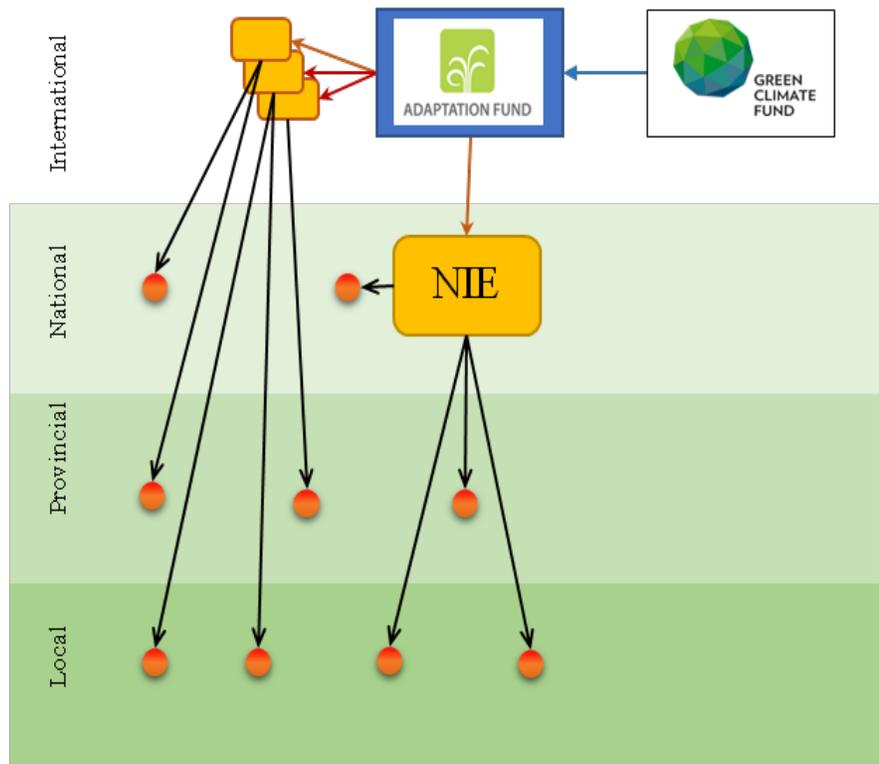
be “institutionally integrated” into the GCF, whose Board has an equal representation of developed and developing country members. Given that the GCF Board will also be constrained time-wise in the number of projects and programs that they can approve, it is also likely that some GCF-internal funding decisions could be approved by the GCF Executive Director. This would most likely involve projects in the micro- and small size category (up to US\$10 million of total funding), which is currently the maximum size of the projects that in the AF are dealt with at Board level.

Thus, in both these scenarios the AF would ultimately cease to exist, replaced by the GCF. This, however, would be a loss as even with its funding constraints, the AF, has proven to be an innovative, efficient and effective funder of concrete adaptation projects. The AF has all the hallmarks of a highly qualified specialized retailer whose services cannot and should not be provided at the same level of excellence by (what should be) a wholesale agent, so the argumentation of Benito Müller in Lima.

“Operational Linkage” Scenario

The only viable scenario for a relationship between the AF and the GCF, according to Benito Müller, is for the AF to receive predictable and adequate “core funding” from the GCF, as envisaged in the AF Board’s “Operational Linkage” scenario. This would clearly avoid the Status

Image 2: The “Operational Linkage Scenario



Source: Presentation by Benito Müller, ecbi, in Lima/Peru, available at: http://www.eurocapacity.org/downloads/AF_presentation_Lima_1.pptx

Quo Scenario “voting with feet” while still giving the GCF a ready-made pipeline for immediate funding. Indeed, ideally there should be a mutually agreed division of labor between the AF and the GCF, in which the GCF should outsource the majority if not all micro/small adaptation projects, including all ordinary direct access adaptation projects in that category, to the AF. In order for the AF to serve as the main channel for primarily direct access funding for micro and small GCF adaptation projects and programs, the AF could for example seek accreditation to the GCF as intermediary fulfilling specialized fiduciary criteria (to allow for individual grant allocation decisions by the AFB). Alternatively, the AF could enter into a legal agreement or memorandum of understanding (MOU) with the GCF serving as a delivery partner for the GCF. With micro/small adaptation projects outsourced to the AF, under such a scenario the GCF would focus instead on working with intermediaries and implementing entities on medium to large scale adaptation projects, including through the possibility of Enhanced Direct Access programs via National Funding Entities. Indeed, Müller argued that this sort of outsourcing should be across the board and not just for adaptation. The GCF should not be directly involved in dealing with micro/small scale projects. They should be funded through international and national intermediaries instead.

The Discourse in Lima: Participants’ Contributions, Opinions, and Questions

The Lima event devoted the majority of its time to a frank exchange under Chatham House Rule. The opinions and contributions of participants, including some questions and concerns, are thus not attributed, but instead clustered to the extent possible thematically, reflecting some recurring themes during the discussion.¹²

Future Funding for the AF

The discussion in Lima centered around the question of where the future funding for the AF would be coming from and the potential competition with other funds engaged in adaptation financing, particularly the GCF. Some speakers pointed out markedly that the lack of resources for the AF did not reflect a lack of effectiveness but was rather indicative of political dynamics and preferences. Some participants clarified their understanding that funding for the AF under an operational linkage scenario with the GCF would be additional to existing sources of AF funding, with some speakers highlighting that an AFB resource mobilization task force should look at a more

¹² Thanks to the participants of the event in Lima who took and shared their notes with HBF and ecbi for the purpose of this summary report. A list of participants is annexed to this event report.

diversified set of financial sources for the AF, including partnership with philanthropic foundations as well as linkages to the market mechanisms under the new post-2020 climate agreement. Putting the AF directly under the UN-FCCC as an option under the new agreement would help the AF according to one participant to profit from different levy resources. The possibility of the AF being allowed to tap into national or regional emissions trading schemes was also brought up.

Feasibility and Desirability of the “Operational Linkage” Scenario

In Lima participants wondered about the feasibility of the “operational linkage” scenario, particularly of whether accrediting the AF as an intermediary under the GCF or entering into an MOU with the GCF could be decided by the AFB or needed a CMP or COP decision, with Benito Müller reiterating his understanding that the Boards of both organizations could decide on the appropriate arrangements. Some speakers worried that such a decision on institutional linkage arrangements could be difficult to achieve from the GCF Board, which includes members from countries not signatories to the Kyoto Protocol under which the AF is formally under. Several participants stressed that a GCF collaboration with the AF under an “operational linkage” scenario would help in quickly delivering much needed adaptation finance, especially during a transition period in the first years of the operation of the GCF and should thus be encouraged. Some felt that such an operational linkage might also allow the AF to overcome its current limitation to the small scale by allowing for a scaling up of the AF experience to broader, larger projects. Others worried that such a linkage may not be enough to ensure the viability of the AF and more attention will have to be paid towards decisions in COP 21 regarding the future financial architecture under the convention starting in 2020. This lack of clarity about its role in the new climate finance architecture, the AF shares it with the LDCF and the SCCF, which face similar uncertainty, with calls for the Standing Committee on Finance to sort out the mutual relations between all of these funds and the GCF and to improve the consistency of the overall architecture. Other discussants felt that the status quo of the AF was not that bad, as developing countries had great affinity with the Fund and enjoyed legitimacy for financing concrete activities. Some warned of putting all eggs regarding the future viability of the AF into a GCF “operational linkage” basket, fearing that as an intermediary for the GCF, the mobilization of funds might not be that speedy.

Future of Direct Access and Enhanced Direct Access

Many discussants highlighted the role of direct access for NIEs – and regional implementing entities (RIEs) for smaller countries not able to accredit NIEs – in strengthening country ownership. Several speakers wanted to see more “enhanced direct access” in line with the recently approved AF project in South Africa, seeing it as a great model for the GCF in order to give countries even more ownership over its adaptation programming. Some participants raised the specter that if NIEs under direct access were limited to apply only for micro or small projects or programs, governments with substantial adaptation need might instead prefer to work on large programs with MIEs and intermediaries, thus jeopardizing the future of direct access in many developing countries. Other discussants rejected a pre-conceived link between direct access and project/program size. Yet other participants stressed that even with MIEs in the picture NIEs would be needed in many countries to absorb and to implement substantial adaptation finance by a GCF focused on “wholesale” funding and thereby leaving opportunities for the AF, through its NIEs to do “retail” adaptation financing.

AF Strengths and “Value Added”

Speakers acknowledged that the AF experience has been useful for the world of climate finance and that experience should continue to be available to other funds, with the AF, still a young institution itself, improving mechanisms and strategies to capture and secure lessons learned for the future. Many participants felt that the AF has successfully paved the way for the GCF, including with regard to country ownership and the pioneering of the direct access and enhanced direct access modalities. They warned that as the GCF has taken up lessons from the AF and is still in its operational infancy, it would be foolish to cut off the AF and other pre-existing funds prematurely and instead integration, such as the possible alignment of AF and GCF indicators and criteria, should be a more gradual process over the medium- to long term, if at all.

Several speakers underscored that to address the complex challenges of adaptation a multitude of financial entities with different approaches and criteria and a diversity of instruments was needed. Some discussants, using the analogy of David versus Goliath to qualify the AF and GCF respectively, emphasized the small size and flexibility of the AF allowing for quicker delivery of adaptation finance where it is needed the most and providing the best instrument for adaptation financing on the local, sub-national and national level. They saw the relevance of the AF undiminished despite the push by the GCF for more programmatic approaches, arguing that even in such

a context there still would be a need for smaller individual projects recognizing and addressing the local complexities which a large-scale approach would not be capable of. They also pointed out that the AF accompanied its local, sub-national or national investment interventions with actions to improve the wider policy framework and to build institutional capacity and in this sense was already doing programmatic work. Lastly, the focus of the AF on vulnerable communities was also emphasized as a special strength in comparison with the focus of the GCF on vulnerable sectors.

Next Steps for the Adaptation Fund

Since Lima, the AFB secretariat has issued a document for consideration by the AFB on the potential linkages between the AF and the GCF. The paper,¹³ released in mid-February, in building on previous discussions on the three possible scenarios for a relationship between the AF and the GCF, supports the further exploration of the “operational linkage” scenario in which the AF would receive some core funding from the GCF, either through the option of applying as a financial intermediary to the GCF or by entering into a MOU or legal agreement under which the AF could program GCF funds. The AF Board is expected to discuss those options at its upcoming 25th meeting from April 7- 10, 2015.

13 Document AFB/B.24-25/1, available at <https://www.adaptation-fund.org/node/4107>

ANNEX:

List of Participants of the Lima Discussion

1. Ms. Diann Black-Layne, Chair of the Standing Committee on Finance, Antigua and Barbuda
2. Mr. Jozef Buys, Member of the Standing Committee on Finance and Alternate Member of the GCF Board , Belgium
3. Ms. Patience Dampney, Member of the Adaptation Fund Board, Ghana
4. Mr. Charles Ehrhart, Foresta, Evaluator of the Adaptation Fund , New Zealand
5. Ambassador Aliioaiga Feturi Elisaia, Alternate Member of the GCF Board and UN Ambassador, Samoa
6. Ms. Inka Gnittke, German Environment Ministry, Germany
7. Ms. Tove Goldman, SIDA, Sweden
8. Mr. Sven Harmeling, CARE, Germany
9. Mr. Mamadou Honadia, Chair of the Adaptation Fund Board, Burkina Faso
10. Mr. Saleemul Huq, IIED, Bangladesh
11. Mr. Farukh Khan, Climate Advisor in the UN Secretary General's Office, Pakistan
12. Ms. Marcia Levaggi, Manager of the Adaptation Fund Board Secretariat, Argentina
13. Mr. Marc-Antoine Martin, Member of the Adaptation Fund Board, France
14. Mr. Benito Müller, ecbi/Oxford Climate Policy, Switzerland
15. Mr. Daouda Ndiaye, Adaptation Fund Board Secretariat, Senegal
16. Mr. Dethie Soumare Ndiaye, CSE, Senegal
17. Mr. Mikko Ollikainen, Adaptation Fund Board Secretariat, Finland
18. Mr. Jean-Luc Redaud, French Water Partnership, France
19. Ms. Liane Schalatek, Heinrich Böll Stiftung North America, Germany/USA
20. Mr. Stefan Schwager, Member of the GCF Board, Switzerland
21. Mr. Jens Siegl, European Community, Denmark
22. Mr. Masashi Taketani, UNFCCC Secretariat, Japan
23. Mr. Pieter Terpstra, World Resources Institute, The Netherlands
24. Mr. Philip Weech, Member of the Adaptation Fund Board Secretariat, The Bahamas