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Agenda Item 17

CRITERIA FOR THE ESTABLISHMENT OF TRUST FUNDS WITHIN THE GEF

Recommended Council Decision

The Council, having reviewed document GEF/C.40/12, *Criteria for the Establishment of Trust Funds within the GEF*, and having recognized the need to introduce greater flexibility within the GEF to respond to new convention guidance not adequately addressed by any current GEF programming, decides to establish a standing trust fund in which multiple interim windows can be created to be managed by the GEF. The Council requests the Secretariat and Trustee to establish the standing trust fund in accordance with the conditions articulated in the document, including the Trustee's Annex.

EXECUTIVE SUMMARY

1. This document addresses the question how does the GEF respond when new guidance is given by the conventions which the GEF serves and donors agree to pay for it in the GEF. Noting that currently new resources cannot be added to the GEF Trust Fund without reopening the programming document and altering the burden share, the document explores practical options to allow the Facility to respond pragmatically in these circumstances as financial mechanism of the GEF conventions, while protecting the integrity of the GEF and its primary Trust Fund.

2. The document concludes by recommending the establishment of a standing trust fund in which multiple windows can be created within a given replenishment period. This standing fund would be managed by the GEF and would operate under the following specific conditions:

- any new trust fund windows should be established only in response to CoP guidance for which there is not adequate provision in the current GEF programming;
- new windows must be interim in nature, with a requirement that the Council would review each window prior to the end of the replenishment cycle;
- donors would be required to contribute to the fund over and above their regular contributions to the GEF Trust Fund.
- contributions to any window in the standing fund should be voluntary in nature.

3. Annexed to this document is a set of guiding principles and procedures developed by the GEF Trustee for establishing a Standing Trust Fund to be managed by the GEF.

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BACKGROUND

1. At the 39th meeting of the GEF Council in November of 2010, the question of the desirability of and need for creating opportunities within the GEF to capture additional resources to respond to new guidance from the conventions for which the GEF serves as a financial mechanism (the GEF conventions) arose more than once. The issue first came up when the Council Member from Japan proposed for the Council's consideration that the GEF manage a new trust fund on access and benefit sharing, in response to guidance from the 10th Conference of the Parties (CoP) of the Convention on Biological Diversity (CBD) at the Nagoya meeting. Later, during a discussion on how to strengthen the relationships between the GEF and the different GEF conventions, the issue again arose in the context of how to enable the GEF to respond robustly to new convention guidance that emerges between GEF replenishment cycles.

2. The GEF's inability to respond quickly to new guidance from the GEF convention CoPs has been raised on many occasions over the years. The Evaluation Office of the GEF addressed the issue squarely in the Fourth Overall Performance Study of the GEF (OPS4), which noted that when a CoP provides "guidance that would move the GEF in new directions" after a GEF replenishment has been concluded, "the GEF needs to wait until the next replenishment to take such guidance into consideration." OPS4 noted that this problem "is complicated by the fact that GEF does not allow donors to target contributions to special guidance in its main Trust Fund, although this is possible in the Special Climate Change Fund (SCCF)."¹

3. Discussions at the 39th GEF Council meeting acknowledged that this problem has been unresolved for a long time. In order to consider seriously the value of new trust funds as one possible means to respond to CoP decisions that arise between replenishments, and to place the proposal of Japan in a broader context, the Council requested the GEF Secretariat to prepare a document that would outline general criteria for the establishment of new trust funds within the GEF for the spring 2011 GEF Council meeting. This document proposes such criteria after underscoring why it is important to allow for the additional capacity.

4. It should be emphasized that establishing a new trust fund within the GEF is not the only means for the GEF, as a convention's financial mechanism, to respond effectively to donors' desires to finance new priorities in line with decisions of the CoP. Consequently, this document also explores and compares additional options for accepting new resources into the GEF to respond to guidance of the GEF convention CoPs that seeks between replenishments to move the GEF in new directions.

¹ See OPS4, pp. 44-49.

PROVIDING THE GEF SUFFICIENT FLEXIBILITY TO RESPOND TO CoP GUIDANCE IN A TIMELY FASHION

5. The question to answer is: when new guidance is given to the GEF and donors agree to pay for it in the GEF, how does the GEF respond? Currently, new resources cannot be added to the GEF Trust Fund without reopening the programming document and altering the burden share. The GEF must identify a more practical option if it wants to remain as financial mechanism of the GEF conventions. If the GEF does not respond pragmatically in these circumstances, interested donors will naturally put the resources into another institution, as today the GEF is the only institution penalized by an inability to accept new funds over a period of four years.

6. Allowing donors to place resources in the GEF in response to new CoP guidance would maintain the integrity of the GEF as an integrated financial mechanism for the major international environmental conventions and allow the GEF Council to continue to approve programming across the range of issues related to the GEF conventions. The GEF would also be in a position to decide when and how the new area of programming should be folded into, or kept separate from, the GEF Trust Fund during subsequent replenishment discussions.

7. At the same time, some Council Members share an understandable concern not to overwhelm the GEF with multiple new funds, each of which take months of time and substantial financial resources to set up. What the GEF can do to respond to this concern is to minimize the implications of accepting funds between replenishment periods by applying the criteria set forth in this document and by designing a single fund to be governed by the GEF Council to manage donor contributions provided to the financial mechanism in response to new guidance from the CoP of a convention for which the GEF serves as financial mechanism.

GUIDING PRINCIPLES FOR CAPTURING NEW RESOURCES IN THE GEF BETWEEN REPLENISHMENT PERIODS IN RESPONSE TO CoP GUIDANCE

8. The design of a system whereby the GEF can accept new resources between replenishment periods for specific purposes in response to CoP guidance should be guided by the rationale motivating the policy, namely to respond in a timely manner, as the financial mechanism, to CoP guidance. At the same time, the design must address concerns of Council Members over the establishment of a process to accept new funds between replenishments, including the following:

- Such a system could draw financial resources away from the GEF Trust Fund.
 - a. Replenishment Participants may reduce their pledges to the GEF Trust Fund in anticipation of creating within the GEF a new means to finance projects in their priority issue areas.

- b. If and when the new programming priorities are to be absorbed into the programming of the GEF, commensurate new resources might not be forthcoming, thus diluting resources available for existing GEF focal area objectives.
- A system allowing the GEF to accept additional resources for a specific purpose would be tantamount to a policy allowing earmarking at the GEF.
 - A system allowing the GEF to accept additional resources for a specific purpose might lead towards an excessive proliferation of GEF trust funds, thereby making the GEF unwieldy, fragmented, and difficult to manage.

ALTERNATIVE MODALITIES FOR CAPTURING NEW RESOURCES IN THE GEF BETWEEN REPLENISHMENT PERIODS IN RESPONSE TO COP GUIDANCE

Expanding the Existing GEF Trust Fund

9. An obvious option for responding to novel CoP guidance introduced between replenishment negotiations would be to accept additional funds in the GEF Trust Fund between replenishment negotiations and integrate the new guidance into GEF programming. While this is possible, it could prove to be a cumbersome solution. First, it would be necessary for the Council to re-open discussions on programming during the replenishment period since it would be necessary to create a new programming priority. This could risk reopening replenishment discussions, unless explicitly agreed otherwise by every Council Member. A second programming negotiation would be costly and could drag on for months. Programming negotiations typically run their course over a period of close to two years. In addition, the programming document is presented to the GEF Assembly after it has been completed. Presenting a renegotiated programming document to the Assembly would be very costly, but not to do so would not be respectful of the Assembly.

10. Integrating the new guidance into GEF programming could also mean renegotiating the relevant GEF Focal Area Strategy to account for the intended outcomes and objectives and indicators for the new programming area.

11. This solution also takes the GEF Trust Fund closer to “earmarking” in the GEF Trust Fund, since it would be understood that the supplemental contributions from Participants would link to an agreement to add particular new priorities and funding levels for them.

12. Finally, this approach offers less flexibility to test out new policies and governance models. For example, the Access and Benefit-Sharing (ABS) fund will be designed to accept resources from the private sector, which the GEF Trust Fund is not set up to do. It is easier and carries less risk to undertake a novel policy move in a small, interim trust fund whose programming objectives may or may not be integrated later on into the GEF Trust Fund than it is

to modify the rules of the GEF Trust Fund to accommodate novel aspects related to new CoP guidance.

13. Nevertheless, the option of accepting additional funds in the GEF Trust Fund could be the most straightforward means of integrating the new CoP guidance into GEF programming if it could be done without entering into new programming discussions and in a way that would respect the role of the Assembly of the GEF. A possible way forward would be to provide discretion to the GEF Secretariat in each replenishment programming document to modify programming resource allocation decisions up to a maximum amount, for example, 5% in response to new CoP guidance that brings with it new donor resources. However, this discretion would only cover situations where the resources coming to the GEF in response to new CoP guidance were relatively small over the four year replenishment period.

Creating One or More New Trust Funds between Replenishment Periods under Specific, Established Conditions

14. Another option for providing the GEF with adequate flexibility to respond to convention guidance between replenishments would be to create one or more new trust funds to be managed by the GEF for specific purposes in response to CoP guidance.

15. The GEF has in the past taken a decision to manage new trust funds in response to CoP guidance, such as the Least Developed Country Fund (LDCF), SCCF, Adaptation and Nagoya Protocol Implementation Fund. These funds were created in response to specific new programming priorities of the GEF convention CoPs. However, they were created in the absence of any articulated criteria or set policies to guide the GEF Council through its decision to associate these funds to the GEF.

16. Moving forward, the GEF Council could decide to allow for the creation of new trust funds within the rubric of a policy outlining specific criteria for their establishment.

17. Alternatively the GEF could opt to establish a standing trust fund with multiple windows that could be opened and closed as needed to direct financing toward new programming priorities endorsed in new CoP guidance.

18. This fund would function a bit like the GEF's SCCF or the Strategic Climate Fund (SCF) of the Climate Investment Funds (CIFs) in that it would have the ability to accept earmarked contributions and in that it would have multiple windows. It would differ from these funds in that the programming objectives of the windows could change over time in response to the decisions of the CoPs, the GEF Council, and donors and the windows would all be established with clear sunset provisions and rules for reallocating any money left over when the window would close.

19. The GEF Council would manage and govern either the multiple new funds or the standing trust fund, and the fund objectives would remain in line with the GEF Instrument. However, even if contributions to this fund were to end up rolling over into the GEF Trust Fund upon closure of the fund or of a window in the fund, the contributions would not confer additional voting rights to the donor.

20. The decision of the GEF Council to create or open a new fund or a window of a standing fund would be guided by an articulated set of criteria. The criteria would be carefully constructed to address the legitimate concerns of Council Members not to overwhelm the GEF with multiple new funds and not to undermine the GEF Trust Fund. They would include:

- a. **CRITERION 1:** (to avoid a proliferation of trust funds at the GEF and to avoid earmarking in the GEF Trust Fund and to ensure that donors would not reduce their pledges to the GEF Trust Fund to fund interim funds or fund windows): An initial criterion could be that any new trust funds or windows be established only in response to new CoP guidance for which there are no specific provisions in the current GEF programming. These conditions would inhibit an uncontrolled proliferation of funds. First, a specific CoP decision would be a condition precedent for any action. Then the initial step would be to try to respond to the new guidance within the limits of the GEF programming agreement. Only failing that would the establishment of the fund/window be pursued.

In addition, this condition would not allow the establishment of new trust funds/fund windows associated to the GEF at the whim of any individual donor or small group of donors with a purpose of earmarking for specific pet activities. Individual replenishment Participants would not be able to earmark contributions narrowly to their own priority issues as part of a replenishment, since new guidance from the CoP would be a condition for establishing any interim trust fund/fund window. The CoP would provide overall guidance to identify program priorities, and the GEF would prepare the operational strategy to effectively implement the guidance.

- b. **CRITERION 2:** (to avoid a proliferation of trust funds at the GEF): To further address concerns over the proliferation of funds within the GEF, the Council could agree that new funds/windows would be interim in nature, with a requirement that the Council review each new fund/window prior to the end of the replenishment cycle. With this review, the replenishment Participants could reconsider the rationale for the creation of the trust fund/fund window in question to determine whether to integrate its programming objectives into the programming framework of the next GEF Trust Fund replenishment cycle. A decision to do so would obviate the need for the new trust fund/window, allowing the Council to dissolve/close it. Of course, the Council might dissolve/close the new trust fund/window without integrating its objectives into

the GEF Trust Fund programming. Alternatively, the Council might decide that the programming priority, while important, is not one that fits well within the GEF Trust Fund, yet wish to keep the new trust fund/window open for an additional period. To address the concerns over the proliferation of funds within the GEF, it would be important, however, that these new windows be decisively time limited; therefore, an exceptional extension of the life of a window should not be allowed to extend more than beyond one additional replenishment cycle. Moreover, any decision to extend the life of a window would have to be accompanied by pledges of additional contributions adequate to warrant the continuation of the window. The Administrative agreements establishing the trust funds/standing fund and windows would have to clearly spell out the interim nature of the funds/windows, as well as rules for allocating any left-over resources.

- c. **CRITERION 3:** (to avoid drawing money away from the GEF Trust Fund). Another rule or practice could serve as an additional safeguard against the concern that the new funds/fund windows might bring new programming areas to the GEF that would divert resources from the existing GEF focal area objectives. Donors will have to contribute to any new trust funds/fund windows in addition to honoring their pledge commitment under the GEF replenishment. It will be simple to distinguish between the GEF Trust Fund contributions and the contributions to new funds/windows, as the pledges to the GEF Trust Fund will already have been made, since these trust funds/fund windows will only be created between two replenishment periods.

21. When considered in light of these criteria, the option of employing new funds or a standing fund with multiple windows offers an attractive means to respond in a timely fashion to innovations and fresh priorities of GEF convention CoPs throughout the entire replenishment cycle. The conditions imposed by these criteria protect the integrity of the GEF Trust Fund and maintain the practical efficiency of GEF operations while allowing the GEF to serve as a more responsive financial mechanism to its conventions.

22. The standing trust fund option compares more favorably than does the option of creating multiple new funds. Perhaps the greatest benefit from establishing a standing trust fund over and above creating new trust funds lies in the *significantly* reduced cost and greater efficiency of establishing the standing trust fund. The administrative effort and associated costs required to establish a trust fund are considerable. These would be substantially reduced if the effort were directed to establishing new windows within an existing fund.

23. In addition, the standing fund will establish within the design of the fund itself the criteria articulated above to limit the uses of this financing vehicle to financing new convention CoP programming priorities within a limited time frame. These criteria could be built into the design of the standing fund and reflected in its foundational documents.

CONCLUSION

24. The establishment of a standing trust fund in which multiple windows can be created is recommended under the following specific conditions:

- any new trust fund windows should be established only in response to new CoP guidance for which there is not adequate provision in the current GEF programming;
- new windows must be interim in nature, with a requirement that the Council would review each window prior to the end of the replenishment cycle and the administrative arrangements for the standing fund and/or windows must reflect this fact;
- donors would be required to contribute to the fund over and above their regular contributions to the GEF Trust Fund.
- contributions to any window in the standing fund should be voluntary in nature.

25. The alternative scenario, where the GEF is not sufficiently flexible to respond to novel convention guidance, could have a negative impact on the GEF and on the general perception of its usefulness as a financial mechanism of the conventions. It would also likely lead to further fragmentation of international assistance for global environmental issues, as donors wishing to be responsive to the GEF conventions would establish alternative financial mechanisms to host required new funds. This would lead to a proliferation of funds; albeit, not a proliferation of funds *at the GEF*, but a proliferation of funds, nevertheless, with all the attendant inefficiencies. This outcome would undermine the fundamental premise of the GEF, to have a single, integrated financial mechanism for the major international environmental conventions.

26. On the other hand, if the GEF were to operate interim funds to respond to guidance of the GEF convention CoPs, the GEF Council would retain oversight over the future of these funds—their programming priorities could be folded into or kept separate from the GEF Trust Fund at the discretion of the GEF Council. In this way the fundamental premise of the GEF: to have a single, integrated financial mechanism for the major international environmental conventions would be maintained and even strengthened. And the number of trust funds dealing with global environmental issues related to the GEF Conventions could more readily be rationalized. The GEF Council would continue to exercise significant influence over the coherence of multilateral environmental financing.

27. Finally, the GEF has demonstrated efficiencies, both financial and programmatic, that are generated currently by its secretariat's managing other funds, including the SCCF, the LDCF and the Adaptation Fund. Fostering synergies across themes for higher impact and reducing the costs of providing the necessary technical screening of projects and programs proposed for funding are significant comparative advantages of the GEF.

Annex 1: Principles for Establishing a Standing GEF Trust Fund with Multiple Windows

The following summarizes guiding principles and procedures developed by the GEF Trustee for establishing a Standing Trust Fund to be managed by the GEF:

Guiding Principles:

- The objectives of the Standing Trust Fund should be aligned with the priorities of the GEF and its mandate;
- The Standing Trust Fund may have multiple Windows, each dedicated to a GEF focal area/convention/priority;
- The Windows should fund only those activities that cannot be funded through any existing trust fund managed by the GEF;
- Windows should be established only in response to new CoP guidance for which there is not adequate provision in the current GEF programming.
- The establishment of Windows must be approved by the GEF Council after a review and assessment of risks (financial, reputational, operational);
- The World Bank, as Trustee, reserves the right to decline the establishment of any new Window.

Governance and Organizational Structure:

- The GEF Council will have the overall authority and responsibility for governance of the Standing Trust Fund including Windows;
- The rules and procedures and governance structure of the GEF will apply to the Standing Trust Fund including its Windows, unless modified by the GEF Council in agreement with the Trustee;
- Roles and responsibilities of the GEF Trustee Secretariat, under the GEF Instrument will apply to the Standing Trust Fund;
- Eligible Implementing Agencies and Executing Agencies (including any new agencies through an approved accreditation process) will have the same eligibility to access funds as for the GEF, and their roles and responsibilities as defined under the GEF Instrument or its policies taken by the GEF Council will apply;
- The duties and responsibilities of the CEO/Chairperson of the GEF as defined under the GEF Instrument will apply to the Trust Fund.

Operating Procedures:

- The Standing Trust Fund will follow all policies and procedures applicable to the GEF Trust Fund under the GEF Instrument (as amended from time to time);
- The rules and procedures of each of the eligible Agencies apply to the use of funds;

- Allocation of resources will be proposed by the Secretariat and approved by the GEF Council;
- The Memorandums of Understanding entered into between the GEF Secretariat and the Agencies for the purposes of allocation of GEF resources shall apply to this Standing Trust Fund;
- The duties and responsibilities of the Trustee and the Agencies under the Financial Procedures Agreements between the Trustee and the Agencies will be effective for the Standing Trust Fund;

Standing Trust Fund Structure:

- Donors can designate their contributions to one or more Windows;
- Windows can co-exist concurrently but the activities to be funded should not overlap across Windows;
- Investment income will accrue to each respective active Window;
- Windows will have a finite life term and shall close at the end of the replenishment period in which they were established, unless otherwise agreed by the GEF Council, and the unallocated balances be moved to the GEF Trust Fund;
- Transfer of resources between Windows will not be allowed;
- Records and transactions for contributions to each Window and transfer of funds to recipients will be maintained;
- The Trustee will report to the Council on an annual basis the financial situation of the Standing Trust Fund;
- The Standing Trust Fund is expected to follow the single audit procedure of the World Bank.

Internal Approval in the Bank:

- Once the GEF Council approves the establishment of the Standing Trust Fund, the proposal will be sent for Senior Management Review and the World Bank Executive Directors for approval;
- The Standing Trust Fund will be established in accordance with the policies and procedures applicable for establishment of Trust Funds in the Bank.