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FUNDS AND TRUST FUNDS

Contents

I: INTRODUCTION

1. In October 1996, Council approved two proposals for global investment funds and one for a conservation trust fund. These projects were:

- *Global*: Small and Medium Scale Enterprise Program Replenishment ($15.5 million)
- *Global*: Photovoltaic Market Transformation Initiative ($30.0 million)
- *Regional*: Central American Fund for Environment and Development: Account for the Global Environment ($15.0 million)

2. In reviewing the Work Program, Council raised a policy concern[1] on "funds":

> With regard to project proposals that include GEF financing for funds/trust funds, the Council requested the Secretariat to ensure that the sub-projects developed under such funds would be consistent with the GEF operational strategy and policies, including the incremental costs approach.

3. Council also requested an issues note for its consideration on trust funds, including information on the lessons that are emerging from the funds that have been financed by the GEF.[2] This note responds to Council's request, and is based in part on an accompanying information note prepared by the Monitoring and Evaluation Unit concerning experience with conservation trust funds[3] as well as on operational experience in fund proposals.

II: OPERATIONAL ISSUES

4. The GEF Project Cycle anticipates that proposals would be for *specific projects* in *identified countries*. Such "standard" projects can be reviewed within the project cycle procedures to ensure that they would be consistent with GEF policies and criteria. For example, if the proposal is for a specific project, it is possible to analyze the extent to which it is cost-effective, conforms to an Operational Program, and requires GEF financing based on incremental cost. Likewise, if the country is identified it is easy to determine whether or not it is an eligible recipient, to verify that the operational focal point has endorsed the proposal, and to discuss the extent to which the proposal is truly country-driven. Where proposals differ from such a "standard" form, however, it is necessary to ensure policy consistency by other means.

5. This paper concerns the means by which the policy consistency of the *non*-standard proposals, i.e., "funds," can be ensured. These are proposals for which the subprojects (i.e., the specific, discrete, time-bound activities they finance) would not be identified at the time of Council approval.

6. Although "funds" have this one commonality – use of subprojects – they differ fundamentally in other ways. Two broad types of "fund" are discussed here:

- The non-profit fund (conservation trust funds and small grants programs are of this type), generally makes grants to the ultimate beneficiaries and its governance typically reflects a mix of private, public, and civil society stakeholder interests. These funds could be either national or regional, but the participating countries are known so it is usually easy to establish country

[1] *Joint Summary of the Chairs*, GEF Council Meeting October 8-10, 1996 GEF/C.8/3, 10(d)
[2] *Ibid*. Appendix, paragraph 3.
[3] *GEF Evaluation of Experience with Conservation Trust Funds*, GEF/C.12/Inf.5

ownership by the origin of the proposals and the proposed governance structure. Non-profit funds are usually much more than mere financial mechanisms and provide a range of other technical and program services as well. The *GEF Small Grants Programme (SGP)* is implemented by UNDP, while the conservation trust funds have so far been implemented by either UNDP or the World Bank.

- The investment fund is a for-profit private sector environmental fund that receives grant and/or non-grant funding from GEF and generally provides commercial or quasi-commercial financing to ultimate beneficiary subprojects, with a possible return on GEF capital. Some global investment funds, by their nature, either do not identify the countries in which the subprojects would be financed, or cannot provide evidence of subproject country ownership in advance, as countries and projects are determined only later by the market. The investment funds have so far been implemented by the World Bank/IFC.

Advantages of funds

7. Both types of "fund" proposal are worth developing because of the advantages they may bring the GEF. The potential advantages of the non-profit funds include low processing costs for small projects, operational flexibility, broad-based participation, and the provision of technical assistance to community groups protecting the environment. The potential advantages of investment funds are an ability to reach smaller projects which often lead innovation in a sector, major leverage of private sector resources,[4] financial innovation, and sustainable and replicable examples for the private sector, which can unleash the power of the market in helping protect the global environment. But to generate such advantages, it is important to seek ways of appropriately structuring funds/trust funds to ensure that GEF objectives will be met.

Evaluations

8. Because non-profit funds are still a relatively new modality, their ultimate impacts on the global environment have yet to be determined. There have however been two very useful and timely independent evaluations: one on experience with conservation trust funds and one on the first phases of the *SGP*. These have identified the major advantages and some ways to improve design and operation of such funds. The evaluations show that the unique and innovative approaches of the conservation trust funds and the *SGP* have served the GEF well. The identified deficiencies are now well understood and can be corrected using criteria to ensure that the GEF Operational Strategy and policies would be applied to the subprojects (paragraphs 18 to 26).

9. For the same reason, the ultimate impact of the investment funds has also yet to be determined. Nevertheless, there has been considerable strategic evolution and operational learning, as evidenced in the changing forms of resource mobilization and operation proposed. The first evaluation of a GEF-financed investment fund will only begin later this year, with the mid-disbursement evaluation of the *SME* replenishment. That evaluation will have to work with only a limited amount of operational information.

COUNTRY OWNERSHIP

10. GEF resources are mobilized in an intergovernmental process expressly to help recipient countries satisfy specific commitments made in international environmental conventions. For this

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[4] In the five GEF financed funds approved so far – *REEF, Terra Capital, SME I, SME II, and PVMTI* – IFC expects to leverage GEF resources with funding from other sources by five to twelve times, not counting the likely return on funds to GEF from non-grant financing arrangements.

reason, it is important to ensure that the activities financed by GEF are genuinely driven and owned by those recipient countries. The Operational Strategy makes this very clear. One of its ten operational principles is that GEF will fund projects that are country-driven and based on national priorities designed to support sustainable development, as identified in the context of national programs. This, as well as all other principles, needs to be applied to projects and to subprojects under funds/trust funds alike.

Non-profit funds

11. The evaluation team found that all the conservation trust funds reviewed were indeed very much country-driven. The governance structures of trust funds, as well as the national committees of the *SGP*, reinforce country ownership in a way that traditional project implementation arrangements do not.[5] These funds can be designed to ensure that subprojects are consistent with national action plans and priorities.

Investment funds

12. Working with the private sector is very important, not merely because private sector activities have the potential of causing damage to the global environment, but also because it can play a major role in any sustainable development solution through innovation, technology transfer, and resource mobilization. It is therefore important to find a way of developing and structuring environmental investment funds to satisfy the essential objectives of country ownership.

13. To be operational, all these funds would have to pass a "market test" of country demand for the concessional GEF resources. In every use of GEF resources, in both projects and subprojects alike, IFC insists – just as in the use of its own resources – that the funding be used to catalyze private sector capital, which normally makes up the vast majority of a venture's financing. This resource mobilization represents a strong commitment by in-country entities.

14. Until now though, investment fund proposals have not been directly "driven" by any recipient country institution, whether private or public. Instead they are conceptually developed by the Implementing Agency based on market signals from private companies, NGOs, and government officials.

15. It has been possible to show that the subprojects accord with "national priorities designed to support sustainable development, as identified in the context of national programs," only insofar as the fund proposal ultimately receives endorsement from the recipient country operational focal points. This step however is taken later in the project cycle for investment funds than for "standard" projects and is thus more likely to come to the attention of the GEF Secretariat and indeed to be on the 'critical path' for project implementation. There are procedural problems in obtaining advance government endorsement for market-driven proposals. For example:

- There was some difficulty in obtaining endorsement from the proposed host country for the regional *Terra Capital Fund*.[6]

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[5] *Op. cit*. paragraph 46.

[6] When this point was raised in the *Overall Performance Study of the GEF*, IFC offered the following explanation: "In the case of the *Terra Capital Fund* (originally named the Biodiversity Fund for Latin America), the initiative began as a regional project without clear domiciliation. As no direct GEF co-financing was contemplated, (GEF funds are only to be used to supplement the fund managers' costs and not for co-financing of subprojects) IFC assumed that the normal government "no objection" process used for IFC investments would suffice for the Fund's

- For the expansion of the global *Small and Medium Scale Enterprise Program (SME)*, two rounds of letters were sent out (the first by the World Bank; the second by the Secretariat) in an effort to secure the advance endorsement from each country's GEF operational focal point. When a number of focal points did not respond to these letters, it was agreed among IFC, the World Bank, and the Secretariat that if an SME project were identified in a country which had not responded, endorsement would be sought at that time from the relevant country focal point.
- The *Photovoltaic Market Transformation Initiative (PVMTI)*, originally developed as a general fund for photovoltaics (i.e., without identifying the recipient countries in advance), was subsequently developed with specific countries identified (Morocco, India, and Kenya) so that their endorsements could be sought in advance.
- The proposed *Solar Development Corporation (SDC)*, however, now faces the same issue, since the countries that will receive support through the *SDC* are not yet known.

COST EFFECTIVENESS

16. Another operational principle is that GEF will ensure the cost-effectiveness of its activities to maximize global environmental benefits. Although no overall assessment of the cost-effectiveness of funds/trust funds has yet been undertaken, any such assessment would need to relate the overall impact to the total cost incurred. The total cost is the sum of

- grants for subprojects (including any non-recoverable portion of loans and investments, if these modalities are used);
- expenses incurred in producing other program outputs (e.g., unreimbursed technical assistance or business advisory services provided by fund staff to proponents to help them develop good proposals, capacity building to strengthen proponents' institutions, dissemination of experience, awareness raising and outreach); and
- costs of administration (namely, the direct costs of subproject grant-making or investment and of subproject supervision, the indirect costs of program and policy coordination to build effective demand and a quality portfolio,[7] and overheads such as fund raising costs, financial management and control, bookkeeping, office rental, communications, and equipment).

The expenses and administrative costs together are often referred to as "operating costs," although such an undifferentiated classification may obscure the differences between funds and the opportunities for cost control.

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operations as a regional entity. During the pre-appraisal process, the Fund evolved in the direction of a Brazil-focused entity with strong support (evidence of country drivenness) from local private sector firms, institutional investors, business foundations and a number of NGOs. Brazil was also chosen to be the headquarters of the fund management team for what was still a regional fund. Thus, based on guidance from the GEF Secretariat, IFC began the process of securing the endorsement of the Government of Brazil. The Government of Brazil did then provide its endorsement[and] remains involved in the project through its role in selection of a member to the Biodiversity Advisory Board and its approval of the Fund's biodiversity guidelines. The Fund's management is coordinating its efforts closely with those of [the conservation trust fund in Brazil] FUNBIO and IFC has every expectation that the two vehicles will be complementary in Brazil."

[7] Funds also have the ability to influence the policy environment, to feed information back into strategic plans and program improvements, and to work closely with recipients and other organizations to ensure a quality portfolio that complements other activities in their areas of focus. These broader roles will be reflected in the funds' costs, but many such costs would not be attributable directly to individual subprojects they finance.

17. There are two general issues concerning administrative cost: transparency and the benchmarking to judge the level of such costs.

- It is important to estimate administrative costs accurately and present them fairly. This will require disclosure not only of the Implementing Agency costs that are currently reimbursed through the GEF Corporate Budget, but also of all the costs of executing agencies that are financed from the project allocation approved by Council. At its meeting in New Delhi (March 30-31, 1998), Council required further efforts to make administrative costs transparent.
- Once the administrative costs are transparent in any given case, a judgment still needs to be made about the appropriateness of their level. This judgment requires some benchmarks. For GEF, one appropriate benchmark is cost of achieving similar objectives in some other way; full sized projects, medium sized projects, and funds may be reasonable benchmarks for each other (i.e., may be regarded as alternative modalities) when they can be structured to serve the same global environmental objective.

Non-profit funds

18. In the non-profit funds, little attention has been paid so far to distinguishing among the various applications of funds. This lack of transparency may have given the impression that administrative costs were higher than they really were and obscured opportunities for administrative cost reduction.

19. Good fund design, initial capitalization at a high enough level given the sources of revenue and the needs of the program, and sharing services and costs with other entities can keep the cost of operating conservation trust funds below about 25 per cent.[8] This level appears higher than that for full projects or medium-sized projects processed individually,[9] but is probably lower than for any other modality of processing *small* projects.

Investment funds

20. The administrative costs in investment funds, and particularly in the more innovative ones, are also not always transparent. Estimates are more complicated than they are for "standard" projects; these funds can involve multiple levels of administration (e.g., World Bank, IFC, as well as complex recipient and non-recipient country executing arrangements), management bonuses and incentives, and contingencies. In some cases, the administrative costs have not been easy to distinguish from actual project expenditures, requiring considerable additional work for clarification (e.g., *PVMTI*). It is also important to present data on administrative costs in relation to the whole operation and not just to the GEF financed portion. In the case of the investment funds where there are considerable leveraged funds, administrative costs that may appear high when expressed as a proportion of the GEF financing would appear much lower and more commensurate with industry norms when expressed as a proportion of the total funds under management. As in the case of the non-profit funds, it is necessary to distinguish true administrative costs from the costs of other services (such as business advisory services).

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[8] *Op. cit*. paragraph 96.

[9] Yet this may not always be the case: for example, the evaluation team, on the basis of experience in Mexico, suggests that the traditional government ministry approach to overseeing project implementation was actually less cost-effective than carrying out the same project through a trust fund. So while traditional projects may appear on the surface to have lower administrative costs, they may not be as effective as organizations that can bring more of a private sector management perspective to these oversight tasks.

21. Likewise, although administrative costs may also appear high in some investment funds, IFC ensures that the administrative costs are consistent with private sector norms for which IFC's normal operations provide ample benchmarks. Actual costs cover a range however. For example the first GEF investment fund, *SME*, operated with administrative costs around 9 per cent of the project allocation, whereas some subsequent funds (*Renewable Energy and Energy Efficiency Fund -- REEF*, and *PVMTI*) will incur costs in the 17 to 37 per cent range. The multicountry project, *Efficient Lighting Initiative (ELI)*, will incur lower costs and might also serve as a benchmark.

Conformity with Operational Programs

22. The Operational Strategy sets out ten Operational Programs (OPs), designed according to a program logical framework in order to manage the portfolio for maximum impact. Conformity with an Operational Program is therefore an essential criterion in every *project* review. Ensuring that *subprojects* also conform to an Operational Program, while equally necessary, is more problematic though. This is because:

- subprojects are not known at the time the Work Program is approved by Council (nor at the time the fund or trust fund is endorsed by the CEO); and
- the review of subprojects is typically not done by the Secretariat or even the Implementing Agency, but by an executing agency which may be less familiar with GEF policies.

Non-profit funds

23. The conservation trust funds that were evaluated all supported activities[10] within the ecosystems covered by the OPs, even though most had been approved before the Operational Strategy came into effect and were thus not specifically required to do so. To achieve impact though, the OPs do require somewhat more than an ecosystem association – the subprojects and any complementary activities must together address the causes of biodiversity loss, produce sustainable results, and complement the activities of other organizations working in the same ecosystem. But it is clearly possible for conservation trust funds to incorporate these elements as well: conservation trust funds are generally regarded as vehicles for achieving positive impact on biodiversity conservation and sustainable use, and appropriate impact indicators are being developed. Although it does not matter whether a trust fund targets one OP or more than one OP, it may be an important practical point how many separate ecosystems it covers. Working in fewer ecosystems may allow fund staff to deepen their understanding of ecosystem dynamics and threats, concentrate their available resources, and coordinate better with the organizations that operate there.

Investment funds

24. While ensuring conformity with an OP is one of the necessary challenges in undertaking any innovative project, it is a special challenge for the global investment funds (e.g., *REEF*, *SME*, *SDC*) because neither the project nor the country is known at the time of fund approval. It is therefore necessary to ensure this conformity by obtaining assurances on the country selection criteria and the subproject criteria[11] that would be used subsequently. These criteria need to

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[10] Some, for example, focused much more on demonstrating the trust fund mechanism than on generating impact -- *op. cit.* paragraph 18.

[11] The *type* of project (e.g., photovoltaics) can of course be specified in advance in the fund proposal, but this information alone is insufficient to ensure conformity with the OP because the barriers may be different in different

ensure, for the selected country market, that lack of *finance* is the key barrier and that no other major barriers threaten the projects sustainability or replicability. It is not yet known whether the use of such criteria has actually succeeded in ensuring conformity with OPs, because no global investment fund has been independently evaluated.[12]

INCREMENTAL COST

25. One policy that has been difficult to apply to subprojects is the incremental cost approach. This is because the fund structure introduces other layers of administration and because the transaction costs of demonstrating incrementality are relatively high for recipients of small grants

Non-profit funds

26. A simple "paradigmatic" approach to incremental cost has been taken in the so-called "parks" conservation trust funds: this requires that trust fund contributions be additional to, and not substitute for, resources that others (including the government) have already been providing for the management of globally significant areas. This is demonstrated in *Mexico*, although the record is less clear in *Uganda* and *Peru*.[13] For the "grants" trust funds, meeting the criterion is more difficult but still possible through subproject selection criteria, as in the case of *Brazil*. Incremental cost has been a problem area for *SGP*.[14]

Investment funds

27. In the global and regional investment funds, the incremental cost approach has been applied at the level of fund administration (*Terra Capital*), through subproject criteria (*REEF, PVMTI, SME*), or through the expedient assumption that all unrecovered funds are "incremental."

III. PROPOSED OPERATIONAL CRITERIA FOR NON-PROFIT FUNDS

28. Both the conservation trust fund modality and the *SGP* have been operationally evaluated. The following criteria have been proposed on the basis of that evaluated experience to refine and focus what are already recognized as successful programs. Clear criteria will, among other things, help to attract the cofinancing that is a critical element for the continued success of both.

29. In general, it is expected that:

- trust funds and national small grant programs should demonstrate (e.g., through simple action plans) how, among other matters, the GEF operational strategy and policies will be implemented so that programmatic benefits can be achieved;
- in particular, procedures will permit adequate levels of information disclosure and public involvement;
- conservation trust funds will be proposed only when four essential conditions[15] are present, when a "critical mass of other conditions of success"[16] are present, and when the fund is structured and managed according to "best practice." The four essential conditions are: (i)

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eligible countries; for example, a country does not need an investment fund solution if the main issue is lack of institutional capacity or distorted pricing.

[12] The *SME* was evaluated prior to its replenishment, but there were too few subprojects at that time for this aspect to be assessed. However, IFC is planning a mid-disbursement evaluation of *SME I* and *SME II*.

[13] *Op. cit.* paragraph 44.

[14] Evaluation of the Small Grants Programme.

[15] *Op. cit*. Recommendation 2, paragraph 134.

[16] See *GEF Evaluation of Experience with Conservation Trust Funds*, GEF/C.12/Inf.5, Section IV B, paragraph 125.

that the biodiversity conservation issue requires a long term commitment, at least ten or fifteen years; (ii) that there is active government support – not just agreement – for creating a mixed, public-private sector mechanism that will function beyond direct government control; (iii) that there is a critical mass of people from diverse sectors of society who can work together despite different approaches to biodiversity conservation and sustainable development; and (iv) that there is a basic fabric of legal and financial practices and supporting institutions (including banking, auditing, and contracting) in which people have confidence; and

- the Implementing Agency will demonstrate how the global environmental objectives that justified GEF support will still be pursued after formal *completion* of a trust fund project, a time when the influence they had during *implementation* would normally come to an end. This may be achievable through indicators of country commitment, conformity with national priorities, and stakeholder representation; through a continuing IA-country relationship on the regular work program; and through extending the supervision period beyond the Implementing Agency's nominal "completion" date.

COUNTRY OWNERSHIP

30. Country ownership shall be evidenced not only by the minimal requirement of advance endorsement from the operational focal point in each country, but also by one or more indicators of substantive involvement such as:

- Reasonable levels of local cofunding of, and in-kind support for, the trust fund or national grants program. These levels should be identified and justified case-by-case as a reasonable basis for demonstrating local commitment to the objectives of, and to the prudent management of, the fund or program;
- Policies that result in recurrent flows of resources to trust funds (e.g., tourist taxes and retention of park entrance fees) and/or government support for other innovative financing approaches;
- Country representation in governance structure;
- Beneficiary commitment, including in kind contributions to subprojects;
- In the case of conservation trust funds, linkage of the fund's action plan to a national biodiversity strategy and action plan or to the National Report to the Convention on Biological Diversity; and
- Use of local and regional experts and community groups.[17]

COST-EFFECTIVENESS

31. To maximize impact, fund management incentives shall be aligned with those of the GEF. For grants, managers shall be accountable for impact according to indicators agreed in advance.

32. Trust funds and grant programs shall be as transparent as possible about the application of funds to grants, expenses, and the various categories of administrative costs, in accordance with appropriate cost accounting standards. The recent evaluation of experience of conservation trust

[17] The New Delhi Statement of the First GEF Assembly referred (paragraph 2c) to the issue of "genuine country ownership of GEF-financed activities, including the involvement of local and regional experts and community groups in project design and implementation." Such involvement also finds a prominent place in the GEF Project Cycle.

funds will also act as a sourcebook of good practice. Administrative costs should be kept low through attention to such factors as the following where appropriate:

- Adequate capitalization;
- Sharing of costs and services with other organizations; and
- Streamlined structure and procedures.

33. Administrative costs should take account of the nature of fund operations, the program activities as well as direct subproject grants. However, as an approximate guide to the Implementing Agencies, it is expected that the administrative costs would fall within the following norms:

- Where the grants are typically "medium" in scale (say, of the order of $500,000 or more), administrative costs should be commensurately low, averaging 10 per cent or less of the total funds allocated to subprojects and program activities.
- Where grants are typically small (say $50,000), administrative costs should still be kept below 25 per cent of the total funds allocated to subprojects and program activities.

CONFORMITY WITH OPERATIONAL PROGRAMS

34. Subprojects shall satisfy the criteria of an Operational Program. This can be achieved through the monitored application of subproject criteria and of overall action plans that

- specify the global environmental benefits sought;
- identify the causes of biodiversity loss[18] and the expected actions of others in response;
- show how the funded action will "make a difference" to the conservation or sustainable use of biodiversity;
- link the subproject to national strategies and coordinate it with other relevant projects;
- provide evidence of innovation, justify expectations of catalytic action, and outline potential replication by others;
- set out indicators of effectiveness in advance.

35. The ecosystem is the context for programming GEF activities in biodiversity; full projects, medium-sized projects, small grants, and subprojects. To achieve a programmatic outcome, it is necessary that the root causes of biodiversity loss be understood and that any necessary complementary activities in the same ecosystem be undertaken. This is as true for small community-based activities as it is for larger projects. Because conservation trust funds alone cannot do all this, but would rely on the complementary activities, their interventions would be more effective in areas where management or action plans already exist. Conservation trust funds may be set up for a single OP (e.g., a "parks" trust fund for a park in an ecosystem covered by that OP), or for ecosystems in more than one OP. In either case, to justify the expectation that the funded activities would have an impact, a plan of action would be needed for the relevant ecosystem.

[18] Most subprojects in the *Small Grants Programme* are in the biodiversity focal area. Those in other focal areas should conform to relevant programmatic criteria.

INCREMENTAL COST

36. There are several ways the incremental cost criterion can be applied, and the proposed way should be set out clearly at the time of Work Program inclusion. Three alternative approaches are:

- "The incremental costs are the additional costs of establishing the fund" (e.g., setting up the legal framework for a conservation trust fund, negotiating the governance structure and participatory arrangements, training the staff, and designing a sustainable resource mobilization strategy).
- "The incremental costs are the additional costs of the program." Through the use of cofunding, the fund managers can make grants that cover both the incremental costs (using GEF funds) and the baseline expenditures for development (using other funds). This is the approach that would be taken in the replenished *SGP* – the individual grantees need not be overly concerned by incremental cost calculations, but the program manager will have to be able to make sound judgments and to report accordingly.
- "The incremental costs are the additional costs of each subproject and will be estimated at the time of subproject appraisal." Incremental cost criteria would be applied in a simplified pragmatic way, for example: (i) by reference to paradigm cases; (ii) by subproject selection criteria that ensure that the subproject itself is wholly additional and does not substitute for any "baseline" activity (e.g., certain park management activities). This requires adequate levels of cofunding to finance baseline costs – this cofunding can be (i) capital or endowment for the fund as a whole; (ii) beneficiary contributions for the subprojects; or (iii) government funding.

IV. DEVELOPING OPERATIONAL CRITERIA FOR INVESTMENT FUNDS

37. Detailed operational criteria to maximize the advantages of the investment funds and ensure their conformity to the GEF Operational Strategy and policies have not yet been developed. As with the non-profit funds, such criteria will be developed on the basis of an independent evaluation of experience. Among other matters, this evaluation will:

- outline the lessons derived from early funds and how these have been incorporated in later fund proposals as part of a dynamic process to leverage private sector funds for global environmental purposes;
- evaluate the degree of innovation achieved and the benefits of such innovation for GEF;
- determine how the level of administrative costs can be estimated and expressed in terms of the overall level of business including leveraged funds;
- estimate the leverage achieved for GEF objectives;
- identify best practice; and
- evaluate how the principles of country ownership and cost-effectiveness, the requirements of operational programs and policies (in particular the incremental cost approach) have been applied.

COUNTRY OWNERSHIP

38. Although the market test is an essential criterion for country demand where the private sector is to be engaged, criteria would also have to be developed to show subproject conformity with national priorities and programs. In future, to be truly country-driven, investment funds may need to be structured in direct response to the concepts developed by private and public recipient

country institutions. (The need to obtain advance endorsements from operational focal points, affects all projects and especially multi-country projects; it is a general streamlining issue.)

COST EFFECTIVENESS

39. To maximize impact, fund management incentives need to be aligned with those of the GEF. Partners must share the risks of financial loss in some appropriate way with the GEF. It is necessary to catalyze financially sustainable solutions by demonstrating replicable approaches: GEF should underwrite only the additional risk of choosing the globally environmentally friendly new technology or method but should not subsidize other risks as this would distort market incentives and lead to unsustainable approaches.

40. Criteria and definitions need to be developed to make administrative costs much more transparent. Benchmarks, such as multicountry projects, need to be established for reasonable levels of administrative cost for GEF purposes. To provide assurances of prudent financial management and commitment, GEF resources should not comprise too great a share of the total resources, and criteria would need to be developed for this.

CONFORMITY WITH OPERATIONAL PROGRAMS

41. It may be necessary to require an action plan at the country level, perhaps at the time of endorsement by operational focal points, to outline the type of projects that would qualify under the fund. The challenges are to show that the biodiversity subprojects were appraised in the required ecosystem context and that renewable energy projects were funded only in situations where all key market barriers were being addressed and where GEF resources were strictly needed. Subproject criteria, or paradigm cases, may be needed to assist fund managers. Criteria would need to be developed so that the GEF financing would catalyze a *sustainable* private sector response – for example, the non-GEF resources may need to be put at risk in the same manner as the GEF resources.

INCREMENTAL COST

42. As is the case for non-profit funds, there are several ways the incremental cost criterion can be applied. The way proposed for any given investment fund should be set out clearly at the time of Work Program inclusion. Three the approaches that could be evaluated are:

- "The incremental costs are the additional costs of establishing the investment fund, training its staff, or administering its grants for the global environmental objectives." The incrementality would be judged by comparing the costs of the fund with those of otherwise comparable commercial funds that do not incorporate such global environmental objectives. This was the approach in the *Terra Capital* project, where the GEF resources are used for technical assistance and administration but not for capitalizing the fund itself.
- "The incremental costs are the additional costs of each subproject and will be estimated at the time of subproject appraisal." Incremental cost criteria would be applied by the fund manager in a simplified pragmatic way, for example: (i) by reference to paradigm cases; (ii) by subproject selection criteria that ensure that the subproject itself is wholly additional and does not substitute for any "baseline" activity.
- "The incremental costs are temporary, and primarily due to a funding gap for the specified type of activity." In this case the GEF funds are expected to be returned to the GEF Trust Fund.

ANNEX 1: *GEF* FUNDS AND TRUST FUNDS

Project	**GEF ($mil.)**
<u>Non-Profit Funds</u>	
(a) Conservation Trust Funds	
Regional: Central American Fund for Environment and Development: Account for the Global Environment (FOCADES)	15.0
Regional: Foundation for Eastern Carpathian Biodiversity Conservation	0.3
Bhutan: Trust Fund for Environmental Conservation	10.0
Brazil: Brazilian Biodiversity Fund (FUNBIO)	20.0
Malawi: Mulanje Mountain Conservation Project – small trust fund component	0
Mexico: Fund for the Conservation of Nature (FMCN)	16.5
Mongolia: Biodiversity Conservation and Sustainable Livelihood Options in the Grasslands of Eastern Mongolia -- small trust fund component	0
Papua New Guinea: National Conservation Trust – in current Work Program	0
Peru: National Trust Fund for Protected Areas (FONANPE)	5.0
Seychelles: Biodiversity Conservation and Marine Pollution Abatement – small trust fund component	0
South Africa: Cape Peninsula Biodiversity Conservation Project – Table Mountain trust fund component	5.0
Uganda: Mgahinga-Bwindi Impenetrable Forest Conservation Trust Fund	4.3
Total: Conservation Trust Funds	**76.1**
(b) GEF Small Grants	
Global: Small Grants Programme	24.00
Global: Small Grants Programme	1.94
Global: Small Grants Programme	13.00
Total: Small Grants	**38.94**
<u>Investment Funds</u>	
Global: Renewable Energy and Energy Efficiency Fund	30.0
Global: Small and Medium Scale Enterprise Program	4.3
Global: Small and Medium Scale Enterprise Program (replenishment)	16.5
Regional: Photovoltaic Market Transformation Initiative	30.0
Regional: Terra Capital Biodiversity Enterprise Fund for Latin America	5.0
Total: Investment Funds	**85.8**