

**ecbi** policy brief

# The Reformed Financial Mechanism of the UNFCCC

## Architecture and Governance

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## Introduction

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

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

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

## A. Institutional Architecture

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

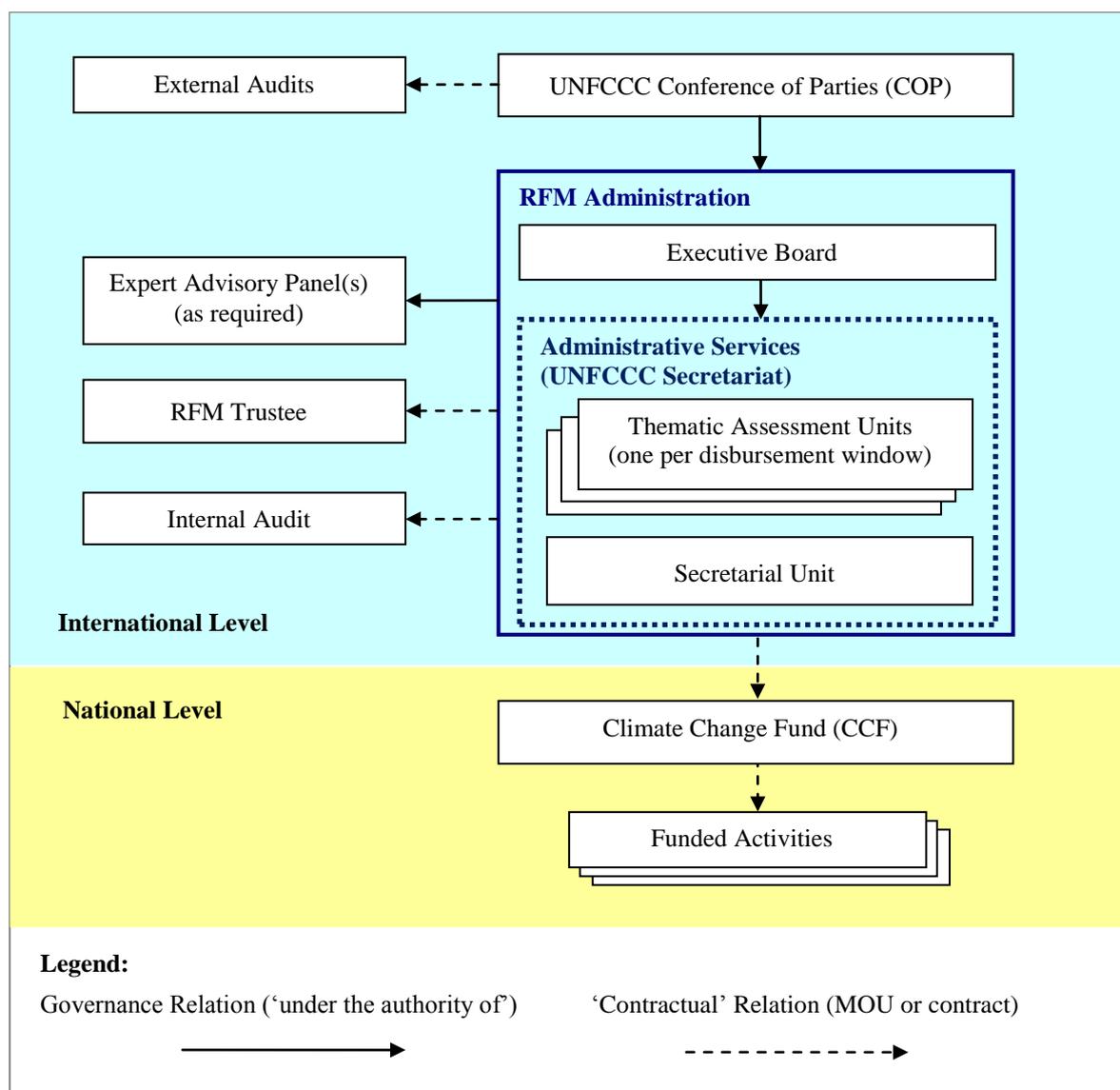
The key question is how to combine these two categorizations. Should all decisions be political, or should they all be non-political, or should ‘normative’ be identified with ‘political’ and ‘operational’ with ‘non-political’? Are there precedents for any of the three simple models? One system being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

The institutional architecture of the RFM is based on a fundamental distinction between the Conference of the Parties (COP) as ‘legislative branch’, and an executive *Administration* headed by an *Executive Board* (‘Board’) *under the authority of the COP*. A number of other entities – such as an RFM *Trustee*, a *Board of Auditors* and national *Climate Change Funds* – are used to outsource some of the RFM activities.<sup>1</sup>

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

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



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

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

## B. Governance

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

### B.1. REVENUE

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

## B.2. DISBURSEMENT

### B.2.1. ASSESSING COUNTRY NEEDS

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

### B.2.2. THE MRV REGIME

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

## B.3. OVERSIGHT AND OUTREACH

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

### B.3.1. INTERNAL OVERSIGHT

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

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

### B.3.2. EXTERNAL OVERSIGHT

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

- (i) to have their RFM-funded activities externally audited – by the relevant national Supreme Audit Institutions (‘national audit offices’) in the case of the CCFs – in accordance with guidelines set up by the UN Board of Auditors and approved by the COP; and
- (ii) to grant the right of spot check access to either the external auditor of the RFM (UN BOA), or to a mutually acceptable third party.<sup>4</sup>

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

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

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

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

Outreach activities and complaints procedures are to ensure that

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

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

## **C. Institutions**

### **C.1. EXECUTIVE BOARD**

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

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

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

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

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

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

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

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

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

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

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

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

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

## C.2. SUPPORT SERVICES

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

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

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

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

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

### C.2.2. EXPERT ADVISORY PANELS

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

### C.2.3. TRUSTEESHIP

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

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

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

- (i) following the subsidiarity principle, it provides in-country **direct access** to funding and relieves the international bodies, in particular the RFM Administration, of an otherwise unmanageable number of operational decisions, not only with regards to activity approval, but also to monitoring and fiduciary accountability,
- (ii) it enables a degree of RFM **oversight** which might be difficult to achieve under a decentralised model, and

- (iii) it enables the harnessing of *synergies*, say by funding cross-thematic (e.g. mitigation and adaptation) activities,
- (iv) it leaves the option for both *off-budget* and *on-budget* ('budget support') funding streams.

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

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

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

## D.1. THE DESIGN FRAMEWORK

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

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

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

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

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

## D.2. DESIGN OPTIONS

There are a number of options for the overall operation of the RFM financing regime, which may not be suitable to all national circumstances, at least initially. However, given sufficient capacity building by United Nations agencies and other entities, they should become requirements.

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

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

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

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

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

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

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

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