



Key messages

- The Fifth Review of the UNFCCC's Financial Mechanism provides an opportunity for Parties to consider improvements in climate finance in a comprehensive way.
- Lessons can be drawn from past reviews, but the scope of the Fifth Review is much broader and involves new institutions.
- The UNFCCC's Standing Committee on Finance (SCF) will lead the Fifth Review and should draw upon a wide range of inputs from processes across the UNFCCC.
- The Green Climate Fund (GCF) should anticipate and prepare to act upon issues that are likely to emerge in the Review, with a view to securing favourable results. These issues include: building on the best features of the existing funds and learning from their shortcomings; clarifying roles and responsibilities between the GCF and the UNFCCC's Conference of the Parties (CoP) to avoid varying interpretations; and anticipating the possibility that the SCF will initiate an independent review of the GCF.

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Towards the Fifth Review of the UNFCCC's Financial Mechanism

Introduction

Financial support for mitigation and adaptation actions in developing countries is at the core of the climate negotiations under the UN Framework Convention on Climate Change (UNFCCC). This is due to the legal obligations created by the Convention itself, and the critical role of finance in enabling developing countries to take ambitious climate action.

The Financial Mechanism (FM) contained in Article 11 of the UNFCCC provides the core framework. It calls for “pre-determined standards and procedures set by the CoP through which funding is mobilised and disbursed for the purpose of climate change mitigation and adaptation”.^{1,2}

The FM has been under constant development since the UNFCCC was signed in 1992. Most recently, developed countries committed US\$ 30 billion in funding during the so-called ‘fast-start’ finance period (2010–2012). They pledged to mobilise US\$ 100 billion per year in climate finance for developing countries, from 2020. New institutions have emerged, too: most notably, the Green Climate Fund (GCF) and the Standing Committee on Finance (SCF). The establishment of these new institutions aims to improve the coherence of the overall financial regime, which has often been criticised for being complex, fragmented and disorganised.³

The 18th Conference of the Parties to the UNFCCC (CoP18) initiated the Fifth

Review of the FM in Doha in December 2012. The Fifth Review is due to be concluded by CoP20 in 2014, four years after the Fourth Review.⁴ The timing of the Review could not be more important. Given that climate finance has an overarching and catalytic role in developing countries and is of critical importance to the negotiations on a future global climate agreement, this is the moment to restructure the institutional architecture for climate finance and to address past shortcomings. The Fifth Review is the key process within the UNFCCC that can achieve this transformation.

The decisions taken in Doha imply that the Fifth Review will be holistic and ambitious. Its remit is to assess the entire spectrum of climate finance processes under the UNFCCC, comprising fast-start finance, the work programme on long-term finance, and an initial review of the Adaptation Fund. The Review's findings will therefore be highly relevant for those who are shaping the nascent GCF. The scope and modalities of the Review form one of the key tasks of the SCF this year.

This briefing paper outlines the context of the Fifth Review of the FM and draws on lessons learned from past reviews. It outlines key issues for consideration by the Parties to the UNFCCC and the bodies mandated to prepare the Review, in particular the SCF. In so doing, this paper aims to inspire them, and the broader climate finance community, to forge a more effective support system to tackle climate change and promote sustainable development at the global level.

Financial Mechanism of the UNFCCC

The UNFCCC's Article 11 contains the key provisions for the Financial Mechanism (FM), although other articles⁵ of the Convention relate to the FM and have influenced its development. Article 11 defines the mechanism and sets the different modalities of what the FM should do and be, including that it "shall function under the guidance of and be accountable to the Conference of the Parties ... which shall decide on its policies, programme priorities and eligibility criteria related to this Convention".

The role of Operating Entities

The Convention entrusts the operation of the FM to "one or more existing international entities"⁶ without specifying the entities directly.⁷ Initially, the Convention mandated the Global Environment Facility (GEF) to serve as the FM's Operating Entity on an interim basis.⁸ Later, the GEF's status was upgraded to become a full Operating Entity.⁹ The GEF has subsequently funded climate change activities through its GEF Trust Fund (climate mitigation focus) and the Special Priority on Adaptation. It has managed the Special Climate Change Fund (SCCF) and Least Developed Countries Fund (LDCF).

At the 16th Conference of the Parties in 2010, it was decided to establish the Green Climate Fund (GCF) and to designate it as the second Operating Entity of the FM. One year later, at CoP17 in Durban, this Fund came into being.¹⁰ The GCF is meant to be

accountable to and function under the guidance of the CoP, to support projects, programmes, policies and other activities in developing countries.

The Adaptation Fund, established under the Kyoto Protocol, is also a key part of the FM, although it has not been formally designated as an Operating Entity. The Adaptation Fund Board functions under the authority and guidance of and is fully accountable to the Parties to the Kyoto Protocol.¹¹ It has played a pioneering role in realising direct access for developing countries to climate finance. The first review of the effectiveness and adequacy of the Advocacy Fund and its interim institutional arrangements was finalised in Doha.¹²

Bilateral, regional and other multilateral finance

The Convention¹³ stipulates that "the developed country Parties may also provide and developing country Parties avail themselves of, financial resources related to the implementation of the Convention through bilateral, regional and other multilateral channels." That means the FM as such also has a broader scope than just the institutions established by the CoP. Developed country Parties are expected to provide information on the bilateral and multilateral assistance they provide in their national communications under the Convention.¹⁴

A significant amount of what is claimed to be climate finance is flowing through channels outside of the Convention. However, the information provided by Parties has so far been inconsistent. Parties lack agreement on important definitions, such as the meaning of "new and additional funding". Key questions for debate include: How far should climate finance flows through 'outside' channels be counted towards climate finance obligations established by the Convention? and Who decides what is counted? Currently this is a one-sided process, with the donor countries communicating what they provide through their national communication, but without a system of verification by the recipient countries.

Previous reviews of the Financial Mechanism

The overall purpose of reviews of the FM is to evaluate: conformity with the FM's original objectives;¹⁷ compliance with the CoP's guidance; and effectiveness of the FM's activities, including its effectiveness in disbursing resources.¹⁸ The criteria for evaluating the FM's effectiveness should take into account "the level of transparency of decision-making processes; the adequacy, predictability and timely disbursement of funds ...; the responsiveness and efficiency of the GEF project cycle...; and the sustainability of funded projects".¹⁹

The Standing Committee on Finance

At CoP16, the Parties decided to establish the Standing Committee on Finance (SCF) to assist the CoP in exercising its functions in relation to the FM of the Convention.¹⁵ This involves:

- improving coherence and coordination in the delivery of climate change finance
- rationalisation of the FM
- mobilisation of financial resources and
- measurement, reporting and verification of support provided to developing country Parties.

The following year,¹⁶ the Parties further defined the SCF's roles and functions, composition and modalities. CoP18 approved the 2013–2015 work plan of the SCF.

Main results of previous reviews

Previous reviews of the FM have been poorly received by developing country Parties to the UNFCCC. This response has led, in turn, to calls for a restructure of the institutional architecture for climate finance through an 'enhanced financial mechanism'.

Until recently, the GEF was the only Operating Entity, and therefore its performance – including the specialised funds LDCF and SCCF – was at the core of the reviews. The larger landscape of climate finance, outside of specific Convention-mandated institutions, was mentioned in background technical papers but did not play a significant role in the review process itself. For instance, the Fourth Review recognised that although bilateral donors and multilateral lenders have been financing the design of developing country policies, it was not possible to determine what proportion of these funds addressed climate change issues, or adaptation issues in particular. It is likely that the current level of support channelled explicitly for adaptation purposes is far below requirements.²⁰

The CoP's guidance to the GEF has focused on: the operational rules and modalities of the GEF, simplifying the GEF's procedures, and improving access to funding, as well as clarifying the concept of 'additional cost' as applied to adaptation projects. This guidance tends to be repetitive.²¹ For instance, the draft guidance of the UNFCCC's Subsidiary Body on Implementation (SBI) to the GEF on funding for National Communications of 2008²² repeated the guidance provided in 2007,²³ although it was supposed to build upon the Parties' response to the 2007 guidance. Research also shows that the vagueness and ambiguity of the CoP guidance – which is partly a consequence of the need to find consensus – has led to a perceived lack of compliance.²⁴

In 2007, Wisner concluded that despite the terms of the GEF's various Memoranda of Understanding with the UNFCCC and other conventions, the



GEF is, legally and practically speaking, functionally autonomous from the conventions it serves. The CoPs do not have the means to exercise enforceable control over the entity that operates their financial mechanisms.²⁵ Hence, suggestions have been made to set out the relationship between the GEF and the conventions in a "legally binding treaty instrument".²⁶ This could, of course, recognise that the GEF needs sufficient autonomy and authority to promote synergies and avoid conflicts among competing interests and objectives of its Multilateral Implementing Agencies.

Parties to the UNFCCC have often noted that reviews of the GEF have been based on the Overall Performance Review of the GEF's monitoring and evaluation programme.²⁷ The GEF's Independent Evaluation Office can in theory provide an additional independent perspective. However, this means that the key basis for holding the GEF accountable as an Operating Entity of the FM is provided by the GEF's own structures. The objectivity of such a self-reporting process may be questionable.²⁸ The guidelines for the Review list existing sources of information that may be taken into consideration, but not the option of commissioning an external evaluation.

Overall, it is clear that the current oversight regime must be improved if the Parties continue to repeat the same guidance to the GEF on specific issues after almost two decades.²⁹ This practice, together with the developed country bias in the GEF's governance structure, has undermined its political acceptability, particularly with developing countries.

It is beyond the scope of this paper to assess the extent to which the performance of the GEF's implementing agencies has also contributed to such a lack of acceptability; this is a topic for further exploration. Overall, there is still a lack of any 'sense of ownership over the GEF among smaller, poorer and politically weaker developing countries'.³⁰

Towards the Fifth Review of the Financial Mechanism

Scope of the Fifth Review

The Fifth Review will be different from previous reviews because of the increased urgency for ambitious collective action on climate change, and because of recent institutional changes. The scope of the Fifth Review will be determined on the basis of previous CoP guidance, but must draw lessons from the limitations of past reviews. CoP18 already decided on a broader

scope for the Fifth Review, linking into the other processes such as the Adaptation Fund review or the long-term finance work programme.

Options for revising the guidelines for the Fifth Review include:

Improving coherence and coordination in the delivery of climate finance

The complex architecture of global climate finance is barely coordinated. The establishment of the Standing Committee on Finance (SCF) has been a first step toward addressing this. The review of the performance of the Operating Entities will be a crucial element, including review of how far they adhere to the CoP guidance, with regard to their access modalities, standards and guidelines for allocating finance, as well as the transparency and inclusiveness of their decision-making processes.³¹

The criteria for assessing the effectiveness of the FM³² should be elaborated by developing performance indicators for the different funds under the Convention. For example, in its annual reports the Advocacy Fund uses indicators related to the efficiency of the cost structure, project cycle efficiency, performance rating, reporting efficiency, and accreditation of national implementing entities. The Advocacy Fund is also discussing whether to use an indicator for “civil society organisations involved in project execution” as one of the performance indicators.³³ Further aspects could include performance criteria on good governance and inclusion of marginalised groups, gender, participatory processes and other elements of the Cancún Adaptation Framework.

Rationalisation of the FM

The nature of a rationalisation process is not yet defined and at the same time it is being contested. The Oxford Dictionary defines rationalisation as “to reorganise (a process or system) so as to make it more logical and consistent”.



Despite the lack of definition in the UNFCCC context, there is no doubt that there is scope for the global finance architecture to be reorganised to improve coherence.

In the context of the FM discussions, this may mandate more substantive changes – a reorganisation – rather than just minor adjustments in some procedures. Given the fragmentation of the international climate finance landscape, this could result in a clearer division of labour among existing funding instruments or even a subsequent phase-out of specific funding instruments to simplify the architecture (for example, termination of one or some of the existing funds, whose functions could instead be performed by the Green Climate Fund). In addition, in fulfilling this function, the SCF needs to understand the set-up and interplay of funds under the Convention, as well as how to rationalise guidance to the Operating Entities.

Mobilisation of financial resources

Mobilising financial resources is critical to the Parties’ ability to implement the Convention. Although it is significant that CoP18 extended the UNFCCC’s work programme on long-term finance, criticisms of the scale of financial mobilisation abound.

These include widespread critiques of the way the fast-start finance commitments have been met,³⁴ and of the slow progress towards the US\$100 billion commitment made by developed countries for 2020. These debates highlight the challenges to delivery. The situation is made worse by the lack of quantifiable obligations from rich nations. Observers have argued for a system of ‘assessed contributions’³⁵ and the Convention itself calls for the “determination in a predictable and identifiable manner of the amount of funding necessary and available for the implementation of this Convention and the conditions under which that amount shall be periodically reviewed.”³⁶

While there are different procedures in place under the UNFCCC that try to assess the needs – such as Technology Needs Assessments and the NEEDS project³⁷ – the resources provided by developed countries are not yet determined on the basis of clear needs assessments, but rather, according to their own priorities. It would be beneficial to review the extent to which these different processes bring the FM closer to compliance with Article 11.3d, which relates to the determination of the funding necessary and available, building on the deliberations under the long-term finance work programme.

Measurement, reporting and verification (MRV) of support provided to developing country Parties

An MRV system for climate finance has started to emerge. In Doha, Parties adopted the Common Tabular Format (CTF) for UNFCCC biennial reporting guidelines for developed country Parties,³⁸ which pertains to public financial support through various channels. The CoP18 decision on the SCF also invited developed countries to submit information on methodologies and systems for measuring and tracking climate finance by May 2014; this input can inform the Fifth Review.

An important tool for the MRV system is the registry for Nationally Appropriate Mitigation Actions (NAMAs) – the projects and programmes formulated by developing countries under Convention guidelines that are centrally registered in order to seek funding support. The fully operational prototype of the registry will be launched in April 2013. Currently, the registry only contains information on countries seeking support for preparation and implementation of their NAMAs. Information on the supply side is still missing. The Fifth Review could scrutinise the effectiveness of this system and how to improve it.

Standing Committee on Finance in the driving seat

The CoP18 decision has put the SCF in the driving seat, providing it with the mandate to “amend the guidelines for the review of the financial mechanism”³⁹ as a first step to assessing the whole spectrum of climate-finance-related processes under the Convention. The SBI will only be consulted by the end of 2013, at SBI39.

In fulfilling this task, the SCF would benefit from referring to the sources of information used by the SBI for previous reviews and to contributions from other thematic bodies under the Convention – especially the Adaptation Committee and the Technology Executive Committee – which also did not exist at the time of the last review.

This year, it is vital that the SCF further develops its role in facilitating exchange of information among bodies and entities dealing with climate change finance. This will help to promote linkages and coherence as well as the generation of new and additional financial resources. Further, it provides an opportunity to inform these stakeholders about the Fifth Review and gather inputs, including for the Terms of Reference, in a collaborative manner.

In addition, the SCF could commission independent performance reviews and assessments of Operating Entities. Critically, such a measure would provide additional, unbiased input, including on adherence to the CoP guidance.

Finally, the SCF has included the preparation of a biennial assessment and an overview of climate finance flows in its work plan from next year onwards. This must include information on the geographical and thematic balance of such flows, drawing on a range of available sources of information. This should be provided by CoP20, alongside the Fifth Review of the FM. The information in the above-mentioned Common Tabular Format will be amended and improved after the first biennial assessment.

The profile of the GCF in the Fifth Review

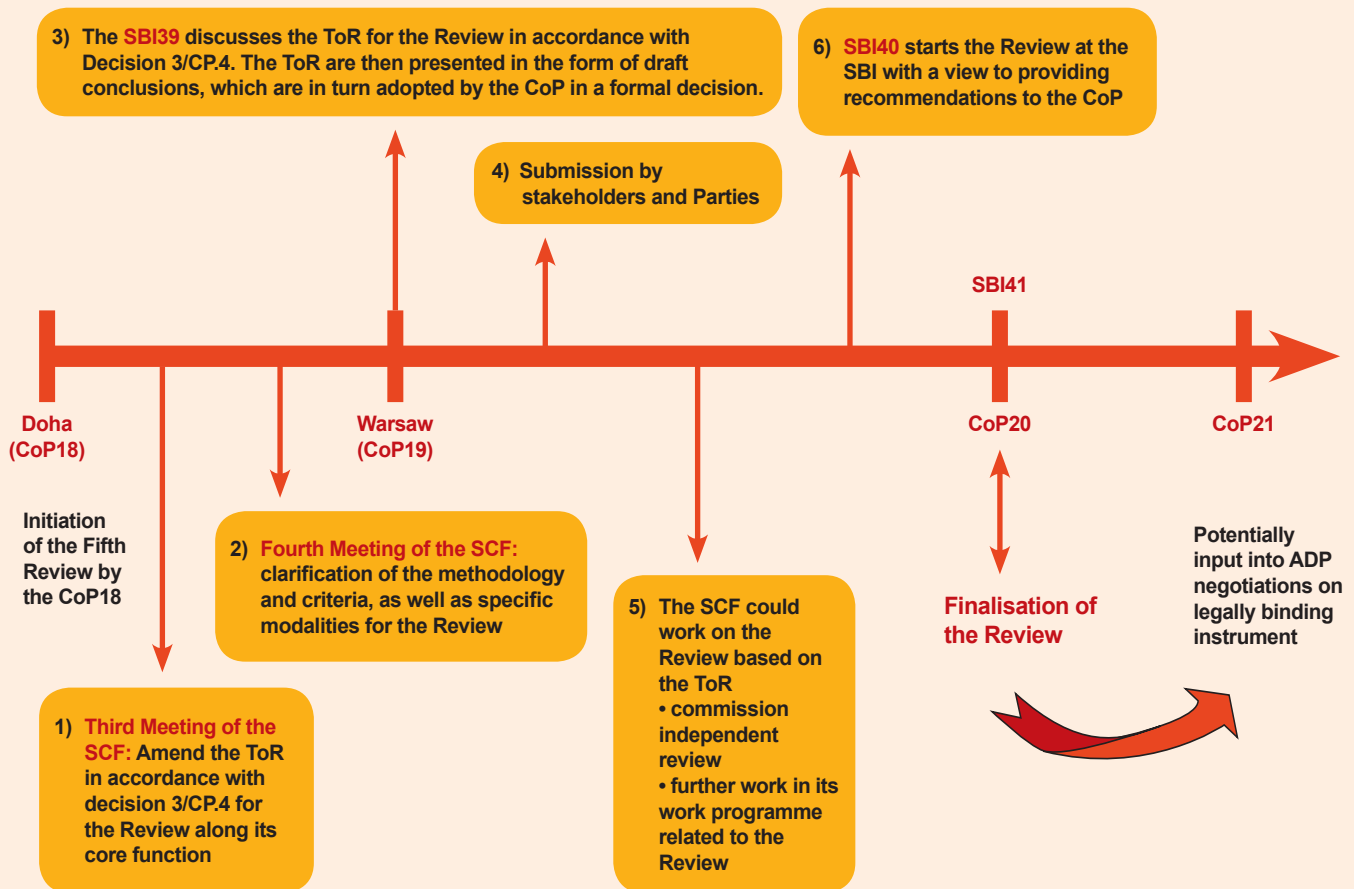
As outlined above, the performance of the Operating Entities and their degree of adherence to CoP guidance is likely to be a key element of the Fifth Review. The Green Climate Fund (GCF) is potentially the most powerful Operating Entity but it is new and is still being shaped. The GCF's profile in the Review will to some extent depend on how far it has been operationalised in 2014. The further the GCF is developed, the better the Review can recommend how to rationalise and advance the FM around the GCF's central role.

The GCF's rules require it to be evaluated periodically by the GCF's independent evaluation unit, which has yet to be set up. Furthermore, the CoP may commission independent assessments of its overall performance. The latter activities would likely be undertaken by the SCF, in accordance with the CoP18 decision.

The GCF should consider how to adopt the best features of the existing funds (and should learn from their shortcomings), including the replication or adaptation of useful performance indicators. This would help position the GCF as one of the relatively more ambitious of the existing funds. Such



Figure 1: Timeline for the Fifth Review of the UNFCCC's Financial Mechanism



Legend: ADP, Ad-hoc Working Group Durban Platform for Enhanced Action; CoP, Conference of the Parties; SBI, Subsidiary Body for Implementation; SCF, Standing Committee on Finance; ToR, Terms of Reference.

a high ambition is already contained in the GCF's stated objective to contribute to a paradigm shift towards low-carbon and climate-resilient development.

The CoP guidance already provided to the GCF (and further guidance likely to emerge at CoP19) and the GCF's adherence could be subject to the Fifth Review, whereas it is less likely that the GCF's performance in funding actual activities to address climate change will be advanced enough by the end of 2013 to be included.

The COP and the GCF are still to conclude an agreement on their specific working relationship. The SCF has been mandated to play

a leading role in this as well. The Global Environment Facility's (GEF's) experience implies that the clearer these agreements are, the less scope there is for varied interpretation leading to charges of non-adherence. The incentives and underlying dynamics of the GCF's relationship with the CoP may differ from the GEF's relationship, because the GCF's Board and decision-making guidelines were directly established by the CoP whereas the GEF's were not. It remains to be seen whether this relationship ensures better compliance with CoP guidance, while at the same time allowing the GCF to evolve into a powerful and effective institution.

Recommendations

The negotiations on the new climate architecture are at a critical juncture. Climate finance as a principal driver of the global climate negotiations is as important as ever. A comprehensive Fifth Review of the Financial Mechanism has the potential to lay the foundations for collaborative action by the global community, leading to a positive transformation of the global financial architecture.

Key steps include:

- updating the guidelines of the Review to address past deficiencies and meet the challenges of appraising the new institutions that are now included in the Financial Mechanism

- clarifying the methodology and criteria, as well as specific modalities for the Review
- commissioning performance reviews of the Operating Entities by strictly independent evaluators, as part of the Review
- engaging with key climate finance actors in the Standing Committee on Finance's Forum to generate input for the design of the Fifth Review
- designing the specific operational relationship between the CoP and the Green Climate Fund (GCF) so as to avoid the shortcomings identified in the MoU between the CoP and the Global Environment Facility (GEF)
- expediting the operationalisation of the GCF so that it can be meaningfully included in the Review.

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About CFAS

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The Climate and Development Knowledge Network (CDKN) aims to help decision-makers in developing countries design and deliver climate compatible development. We do this by providing demand-led research and technical assistance, and channeling the best available knowledge on climate change and development to support policy processes at the country level.

About Germanwatch

Germanwatch is an independent non-profit environmental and development organisation. It has been following the UNFCCC negotiations since their inception and has built up particular expertise on climate finance.

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