Designing Fit-for-Purpose National Climate Funds

A Guidebook for Decision-Makers

UNDP

CLIMATE POLICY LAB

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The Climate Policy Lab is an initiative at the Fletcher School, Tufts University, to better understand which energy and climate policies work, which don't and why. The Lab is a source of independent and objective advice for governments contemplating new climate policies as they implement new domestic policies consistent with the Paris Agreement on Climate Change.

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Purpose of This Guidebook

The purpose of this guidebook is to assist decision-makers at national levels in designing, establishing, operationalizing, or reforming a National Climate Fund (NCF) in a flexible and non-prescriptive manner. It leverages UNDP and the Climate Policy Lab's experience with funds at the global, regional, national, and sub-national levels and shares lessons learned at national levels about NCFs. The guidebook also aims to illustrate how NCFs can support national policies on climate change, serve as a key interface to access and channel climate finance, and be a hub of expertise and stakeholder engagement. Apart from drawing out the links between national climate funds and the Paris Agreement, this guidebook also captures how national climate funds can support the 2030 Agenda.

Target Audience

The principle audience for this publication are decision-makers at the national level tasked with designing, establishing, operationalizing, or reforming NCFs, as well as domestic and international experts involved in assisting governments and other entities at national levels in establishing or reforming institutions and mechanisms to support the management and delivery of climate finance. The publication may also be useful to individuals interested in how strengthening national management of climate finance can enhance the planning, accessing, delivering, and measurement of climate finance, including through the Green Climate Fund, Global Environment Facility, Adaptation Fund and other multilateral, bilateral public and private sources.

Acronyms and Abbreviations Used in This Publication

AE	Accredited Entity
AF	Adaptation Fund
CO2	Carbon dioxide
COP	Conference of Parties
CSR	Corporate Social Responsibility
DAE	Direct Access Entity
EE	Executing Entity
ESS	Environmental and Social Safeguards
GCF	Green Climate Fund
GEF	Global Environment Facility
INDC	Intended Nationally Determined Contribution
IT	Information technology
MRV	Monitoring, reporting, verification
NCF	National Climate Fund
NDA	National Designated Authority
NDC	Nationally Determined Contribution
NGO	Non-governmental organization
NIE	National Implementing Entity
OECD	Organization for Economic Co-operation and Development
PCM	project cycle management
SDGs	Sustainable Development Goals
SPV	Special purpose vehicle
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
USD	United States Dollars

Figure 1: Establishing a National Climate Fund

Chapter 1: **Overview of National Climate Funds**

1.1 CLIMATE FINANCE LANDSCAPE

As countries around the world put forward their national pledges on climate change, the questions on climate action have shifted from *if* and *when* to *how*. The impacts of climate change threaten to undo progress made towards poverty reduction and are a major challenge in achieving the 2030 Agenda and Sustainable Development Goals (SDGs). Yet countries are also motivated by the opportunities afforded by a transition to a low-emission, climate-resilient development trajectory, one that alters production and consumption processes and promotes sustainable development. Countries are now increasingly focused on how to design national systems that are best equipped to address climate change.

The Paris Agreement, adopted in December 2015, captures this universal commitment to tackle climate change. As a part of the Paris Agreement, countries have submitted national actions in their Nationally Determined Contributions (NDCs). Finance is an essential to turn these climate actions into reality. In Copenhagen in 2009, developed countries made a pledge to mobilize USD 100 billion annually by 2020 in the context of meaningful mitigation actions and transparency on implementation. Climate finance has indeed started to flow. The UN Framework Convention's Standing Committee estimates that USD 58 billion in international public finance flowed to developing countries in 2015–2016 (2018 Biennial Assessment and Overview of Climate Finance Flows).[1] In Paris, countries agreed to revisit this collective goal and to set a new quantified goal by 2025.

Finance provided and mobilized through international public sources, however, is just one resource. Given the sheer scale of the climate change, domestic resources will also be instrumental. Strengthening domestic resource mobilization is a key part of the Addis Ababa Action Agenda, for example. National climate funds provide an opportunity to bridge this focus on domestic resource mobilization, supported and enabled by international public finance, with country ownership, which is emphasized by the Paris Agenda for Aid Effectiveness.

Similarly, private finance is another major source. A key challenge for governments is to use available public funds to support adopted policy, but also to attract and leverage private investment. Public funds — including those under the UNFCCC — must be used in strategic ways to leverage new resources and investment from the private sector and engage the private sector in supporting policy goals.

The multitude of sources and delivery channels of climate finance can be an important opportunity for countries to devise a portfolio of programs and projects based on their needs. Blending finance from different sources can allow countries to leverage and scale finance in quantities that are not possible with a single instrument or source. Similarly, creating the 'right' blend of instruments will also greater sensitivity to the conditions that will lead to success in implementation.

1 https://unfccc.int/sites/default/files/resource/2018%20BA%20Technical%20Report%20Final%20Feb%202019.pdf

This significant increase in opportunities to access climate finance is matched by increasing complexity. Requirements often vary across climate finance mechanisms and navigating such a complex structure can be a challenging task for many countries. The differing requirements, processes, and reporting associated with the many climate finance mechanisms can be overwhelming and sometimes even confusing.

Similarly, while there has been a significant increase in climate finance, the distribution of climate finance has not necessarily been even. Not all countries have the same level of access to climate finance and those who need climate finance the most many not be receiving it. Therefore, there is a clear need to consider methods that can help steer climate finance in a more directed way and, in this guidebook, we argue that national climate funds can play such a role.

This guidebook intends to help decision-makers at national levels deepen their understanding of the design choices that are critical to successful NCFs. It is UNDP's hope that this guidebook will support decision-makers at national levels to make the most out of the expanding climate change finance landscape. A key lesson learned from UNDP's experience in administering over 750 funds around the world, and in providing trustee and administrative agent services for over USD 5 billion in multi-donor trust funds, is that a NCF must be carefully designed to align with best international practices, national objectives, and available capacities. To accomplish this, the design, establishment, and administration of an NCF can demand extensive time, effort, and resources.

1.2 WHAT ARE NATIONAL CLIMATE FUNDS AND WHY ARE THEY NEEDED?

A National Climate Fund (NCF) is a dedicated instrument that mobilizes, channels, and tracks climate finance to support the achievement of objectives on climate change. Nationally driven, NCFs offer a useful tool to accelerate climate action across sectors and geographies.

Well-designed NCFs can better equip countries to improve delivery of climate finance, increase climate finance at the national level, systematically develop climate finance capacities at national and sub-national levels, and blend domestic and foreign, as well as public and private finance. In this way, NCFs can help countries achieve results faster, more sustainably, and more efficiently, and therefore more effectively support the transition toward low-emission and climate-resilient development.

National climate funds have many shapes and sizes, and can vary depending on the demands and needs of the local context. While some NCFs may be comprehensive, such as the Bangladesh Climate Change Trust Fund that focuses on all aspects of climate change, others may have a sectoral approach like the Amazon Fund in Brazil that addresses forest-related issues in the Amazon. Similarly, the level of complexity of the fund structure can vary. Certain funds like India's National Clean Energy Fund are designed to receive and disburse earmarks from a coal tax while others such as China's Clean Development Mechanism Fund is a legally independent institution equipped to handle complex financial operations.

Major features of NCFs include:

Catalyzing Climate Finance

An NCF can be designed to offer financial instruments for maximum catalytic impact. For example, an NCF can leverage public resources to attract and channel private finance to projects and programs at a scale that would not be possible otherwise.

An NCF can also be the main entry point for international access to climate finance. For example, NCFs can become accredited to the Green Climate Fund to channel its resources. We explore the relationship between NCFs and the GCF's modalities for finance in the Chapter 3.

Achieving Policy Priorities through Nationally Owned Modalities

Given the central role played by the national government in its management, NCFs provide a major opportunity to align programs and projects on the ground with national policy priorities.

While national climate funds can be designed to support projects, either as entities that directly implement these projects themselves or as facilitating and enabling access to executing entities, they can also directly support the government's policy priorities. That a national climate fund is so intricately tied to a country's climate policies is what makes it such an attractive vehicle to support.

An NCF also builds the capacities of actors relevant to climate change on design, preparation, implementation, and evaluation of climate change-related interventions. Building capacity on climate-related actions is critical as climate change is a cross-sectoral challenge and the capacity to engage in climate-sensitive planning and implementation is vital to addressing climate change comprehensively.

Figure 1.1: Policy implementation process

Similarly, as a nationally-driven fund, it also provides international partners with the opportunity to support a nationally owned institution that is dedicated to supporting the objectives of climate change. Investing in an NCF is also a visible and tangible effort by the host country to align national priorities with climate change.

Mainstreaming and Learning

A key recurring function of NCFs is their contribution in mainstreaming climate change into sectoral planning. NCFs can be designed to build the capacity of sectoral ministries to incorporate climate dimensions. By providing an opportunity to design climate-related projects and programs, the NCF paves the way for integration of climate objectives into sectoral plans and programs. Experience with project and program design is essential. Furthermore, NCFs can help build a constituency of climate advocates across line ministries, increase their capacities and experience in programming on climate change, and pave the way for a pipeline of programs and projects that support sectoral policies.

Coordinating and Tracking

An NCF can be an integral part of a larger institutional architecture on coordinating climate action across government and with stakeholders. The NCF's capabilities to mobilize and provide finance can be an important means to achieve coordination. Similarly, an NCF also provides an opportunity for development partners to engage directly in coordination activities with the host government and support country owned programs on climate change.

An NCF can build institutional knowledge and expertise that will be useful not only for stakeholders wishing to engage with international agencies on climate change but also in the design, development, monitoring, and evaluation of climate-related interventions.

Furthermore, as an entity mandated to work with the entire spectrum of stakeholders on climate change, an NCF may also be well positioned to track climate finance expenditures. It is crucial for countries to understand how the climate-relevance of their public expenditures and to regularly assess the extent to which such expenditures are helping to meet goals and targets on climate change.

Targeted Delivery

A major advantage of designing a national climate fund can also be the ability to target delivery of essential climate services to those who need them the most.

Similarly, climate finance can also be targeted toward key technologies or interventions in the spirit of vertical funds in the health sector that focus on specific diseases. Such a targeting approach can be seen through the presence of sector-specific funds. It can allow for experimentation with innovative approaches and projects, and encourage greater integration of climate considerations in subsequent sectoral and development plans.

Designing an NCF requires a careful consideration of its intended objectives and operational niche. Chapter 2 discusses objectives and niche assessment in greater detail. It is important to underline that NCFs reflect their local context and national priorities, and that NCFs are diverse in their focus areas, their legal forms, the instruments they use, the sources of their revenue, and the governance arrangements that provide the structure.

1.3 NCFS IN THE POLICY CONTEXT

Countries have put forward their plans to address climate change as a part of the Nationally Determined Contributions (NDCs) for the Paris Agreement. Many countries have already engaged extensively in formulating plans such as Nationally Appropriate Mitigation Actions, National Adaptation Plans, Low Emissions Development Strategies, and more. As countries shift from translating the goals and targets as contained in these plans into sectoral strategies and investment plans, NCFs can play a crucial role. NCFs are well poised to match sources and instruments of climate finance with needs as expressed plans, strategies, and investment plans.

As countries mainstream climate change into their sectoral plans, linkages with the 2030 Agenda and Sustainable Development Goals (SDGs) will also become clearer and more concrete. Addressing climate change is one of the Sustainable Development Goals (Goal 13) and working towards the SDGs

also provides opportunities to pursue development trajectories that are low carbon and climate resilient. In Figure 3.2, we show how the portfolio of Ethiopia's Climate Resilient Green Economy Facility has direct linkages with the Sustainable Development Goals. The SDGs, therefore, are an important opportunity to view climate change not in isolation, but rather in the broader frame of the country's objectives and goals on sustainable development.

While the Figure 1.1 is a linear arrow moving from plans to implementation via targets, investment plans pipelines, and financing, the role of an NCF is not only in bridging the difficult hump from investment plans to implementation. NCFs can also play a major role throughout this planning cycle by facilitating greater integration of climate considerations into plans and policies and working directly with relevant sectoral ministries to build pipelines that can be attractive to a wide range of stakeholders.

Furthermore, the role of NCFs is not only in financing actions on climate change. It will be important to assess the range of policy incentives needed to steer the country towards low-carbon, climate-resilient development against the set of functions that an NCF is expected to engage in. NCF designers will need to have a clear-eyed view of the barriers to successful implementation of relevant policies. Such barriers can include: lack of integrated sector planning, weak sustainability of projects, a project-based aid landscape, low amounts of financing dedicated to climate change, and capacity constraints that prevent acceleration of implementation.

While NCFs are designed to support policy processes, they are also shaped by the overall policy context. NCF designers need to be cognizant that factors that influence the opportunities and challenges for the fund may also be beyond the fund's control. We refer to the country's enabling environment in which the NCF is expected to operate in. It is important for the NCF designers to display a sensitivity to the general business and political context of the NCF.

For example, the general business environment will shape the appetite of domestic and foreign investors to invest in the country. This has a direct bearing on NCFs that intend to work with the private sector as a co-financing partner to deploy clean technologies. Related issues include the regulatory environment, track record of contract enforcement, and the quality of public services.

Similarly, the macroeconomic and fiscal situation of a country is also an important factor and shapes the choices and opportunities for an NCF's sources of finance and the range of instruments it is able to deploy.

Furthermore, the integrity of the public financial management systems will also be critical. In some cases, a gap analysis of public financial management systems may be necessary. A trustee-held trust fund may be suitable where the enabling environment is challenging but there is an immediate need to build capacity for engagement of actors on climate change.

1.4 HOW THIS GUIDEBOOK IS ORGANIZED

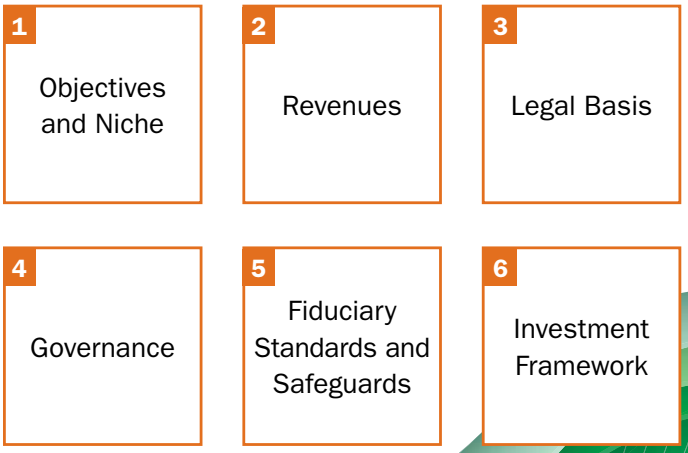
In Chapter 2, we identify six building blocks that are essential to designing a national climate fund. For each of these building blocks, we highlight key decisions that the NCF designers need to grapple with. First, one of the most crucial steps in the NCF design process is clarifying the objectives of the NCF and where the NCF fits within the larger policy context. Second, how exactly will the NCF be financed? Identifying sources of finance for capitalization and replenishments are key. Third, the legal form of the fund will be key to shaping the range of actions that it can undertake, the range of financial instruments it can offer, and its ability support government priorities. Fourth, NCF designers need to identify institutional arrangements that can best ensure an effective governance structure. Fifth, as a finance vehicle, sound expenditure is critical to ensure that objectives of the fund are being met. Third, effective fiduciary management protects the integrity of the fund and ensures that funds are fully accounted for. The building blocks sections have been written with an eye to the criteria for accreditation as direct access entities with the Green Climate Fund.

In Chapter 3, we harvest lessons from existing national climate funds and offer insights on how to best design a national climate fund that is fit-for-purpose. First, we highlight the multitude of ways in which a national climate fund can be linked with the Green Climate Fund. Second, a national climate fund can offer special windows to ensure a match between the needs of the beneficiaries with the fund's modalities. Third, national climate funds can be important tools in the larger toolbox to implement actions in nationally determined contributions. And, fourth, national climate funds can also support the implementation of the Sustainable Development Goals. And, finally, to bring together the building blocks and make key decisions, a niche assessment can be an important tool to provide policymakers with the necessary input.

Chapter 2: **The Building Blocks of a National Climate Fund**

Given the diversity of design and reform options, there are a number of important decisions that must be made in order to ensure that an appropriate and effective NCF structure is established that maximizes the delivery of climate finance to support national priorities.

Based on UNDP's experience in supporting the establishment of NCFs, the administration of over 750 trust funds, and more than 40 multi-donor trust funds, six common components have been identified that provide the building blocks for any NCF: objectives and operational niche; revenues and capitalization; legal basis; governance, fiduciary management; and investment framework.



These building blocks form the basis of the major choices facing NCF designers. Some of the major questions that NCF designers will have to consider under each of these topics are provided at the beginning of each of the following six sections. They should be considered in conjunction with the three main design questions for NCFs laid out in Chapter 3. These questions are:

1. What are the opportunities and challenges in establishing an NCF?
2. How does an NCF fit within the existing set of policy instruments and institutions designed to help address climate change?
3. How can an NCF promote the achievement of national priorities and plans on climate change and sustainable development? What barriers to ambitious climate action would the NCF help tackle? What incentives would it have to provide?

2.1 BUILDING BLOCK 1: DEFINING THE OBJECTIVES AND OPERATIONAL NICHE

1

Objectives and Niche

National climate funds display remarkable diversity in their design, size, scope, and salience in the policy context. The overriding consideration is that NCFs are designed with varying objectives in mind. Clarifying the objectives for the national climate fund is a vital decision that policymakers face. All of the building blocks that this guidebook discusses directly point to this decision, as the objectives shape the choices under each building block. Furthermore, it is important for policymakers to assess how a dedicated financial instrument on climate change strengthens the existing suite of policy instruments at the disposal of government.

1. What goals and objectives should the NCF pursue?
2. What are the national policies and priorities that the NCF should support?
3. Which financial instruments and co-financing arrangements are needed to support such priorities?
4. Which sectors and thematic priorities should the NCF focus on?
5. How does the NCF complement existing policies and instruments designed to mobilize climate finance? What gaps does can it fill?

One of the most important decisions facing NCF designers will be identifying the objectives of the NCF and selecting its operational niche. As a newly created NCF will enter a landscape that already has considerable activity taking place on climate change, identifying an area where the NCF can add value will be critical. The design of the NCF should reflect the nature of activities necessary to function in such an *operational niche.*

An NCF is an instrument that can designed to pursue a range of objectives, including:

Foster national ownership and build capacity
As nationally driven funds, national climate funds provide an opportunity to align activities of the fund with the country's policy priorities. Strong country ownership is essential for achieving effective implementation, ensuring the sustainability of the activities, and meeting the needs of the beneficiaries.

National climate funds can play a major role in facilitating the development of expertise on how to incorporate a climate-lens into the activities of a broad range of stakeholders. Building on such capacity, a country may be able to achieve deeper levels of integration of climate change objectives in national, sectoral, and local plans and actions.

Mobilize finance
NCFs can support climate mitigation and adaptation projects and programs at the national and sub-national levels by accessing finance from a variety of national and international sources, blending and leveraging the NCF's resources, and ensuring sound management.

Coordinate, track and pool
Given the multitude of climate finance sources and channels, NCFs can help foster synergies and interlinkages between various climate change finance activities. NCFs can also pool knowledge and expertise on climate finance that can be accessed by governmental and non-governmental stakeholders.

Deploy
National Climate Funds can reinforce low-carbon, climate-resilience-supporting technologies that need public backing to achieve adoption and use at a scale supported by the market.

Each of these areas is further discussed below.

2.1.1 Foster National Ownership and Build Capacity

National ownership is intrinsically tied to capacity development. As the capacity of actors to engage in climate-sensitive planning and implementation is built, with the help of an NCF, countries will be able to exercise greater national ownership. With greater capacity, actors will be better enabled to articulate national needs and priorities in the context of the opportunities and challenges of addressing climate change. NCFs provide for an institutionalized opportunity to systematically build a critical number of well trained and experienced national experts to design, manage, and implement complex climate change projects and programs, and integrate climate considerations into wider policy processes at the sectoral and national levels.

An NCF can facilitate the development of local expertise and capacities at multiple levels. Within the NCF, the staff will build their capacity to develop and manage the fund's activities in line with relevant NCF policies and procedures. Similarly, by virtue of its activities, an NCF will also support a larger ecosystem of experts, developers, and implementers inside and outside of government.

By designing an NCF to meet international fiduciary standards and safeguards, such as those expected of Green Climate Fund direct access entities, the NCF can gradually build a coterie of domestic experts who will have the skills to manage projects and programs that receive finance from international sources. The NCF's dependence on external experts and consultants may go down. As local experts are often more in tune with local needs and priorities, national ownership would also be stronger in such situations. Furthermore, by building a robust entity that meets international standards, the NCF may also become an attractive vehicle to manage sources of finance beyond the Green Climate Fund. The relationship between NCFs and the Green Climate Fund is discussed in Chapter 3.

2.1.2 Mobilize Finance

Often, the primary objective of an NCF is to provide financial support to climate change projects and programs prioritized by national policies, whether at the national or subnational levels. One of the major attractions of setting up an NCF is the dedicated and focused attention to supporting climate change programs and projects that it is able to provide. An NCF can finance projects that would not be viable using unsubsidized, market-based finance. An NCF will co-finance interventions with market-based finance to make them viable. By targeting its expenditures towards such interventions, an NCF will not crowd out or compete with unsubsidized, market-based finance.

In particular, NCFs can be instrumental to facilitating and catalyzing co-finance from national sources which otherwise may be more difficult to mobilize, such as state budget allocations, commercial finance from banks and insurers, as well as private sector resources. Such effects can also be enhanced by complementing national policy instruments, such as CO2 taxes, tariff and tax differentiations, negotiated voluntary agreements, emission standards, and technology standards.

The fund's allocation of resources may reflect the national objectives and goals as identified in various policy documents. It will be essential to identify how the NCF fits into the existing landscape of national and sectoral policies. Development policies may include, for example, five-year development plans. Sectoral policies may include, for example, renewable energy policies and energy efficiency policies. Climate change aspects may also be prominent in policies relating to agriculture, the environment, forestry, industry, infrastructure, fisheries, and maritime affairs. Dedicated climate change policies can include national emissions reduction targets and goals as contained in nationally determined contributions (NDCs), nationally appropriate mitigation actions (NAMAs), low emission development strategies, national adaptation plans, and related investment plans stemming from these multi-sectoral plans.

Box 2.1 The Climate Resilient Green Economy Facility

Ethiopia launched its ambitious plan to achieve middle-income status by 2025 while maintaining greenhouse gas emissions in 2030 at 2010 levels. The plan, the Climate Resilient Green Economy (CRGE) Strategy, forms the anchor for all climate change actions in the country. The CRGE Facility is an instrument to support the CRGE's objectives. This national climate fund not only accesses and channels climate finance but also has been given the mandate to track and coordinate climate finance. The CRGE Facility offers two channels to maximize flexibility for potential contributions. Fund contributors may contribute directly to the government account or may use the UNDP-managed trust fund to channel their resources.

National Ownership	The facility is rooted in the CRGE Vision and Strategy
Mobilize Finance	Nationally managed window and UNDP-hosted trust fund for contributions from development partners
Coordinate, Track and Pool	Mandate to track climate finance and support officials in sectoral ministries on climate programming
Deploy Low-Carbon, Climate-Resilient Technologies and Services	Supports projects on the basis of period calls for proposals

2.1.3 Coordinate, Track, and Pool Finance and Expertise

NCFs can play an important role in coordinating country-wide climate change activities. As a key, central hub of the government's climate actions, an NCF will be well positioned to assume a coordinating role to support the development of nation-wide and sector-wide investment plans and project pipelines. The NCF can also be instrumental in helping different line ministries generate synergies, avoid redundancies and facilitate implementation of national policies and plans. Such a coordinated approach can lead to more predictable national policy implementation and more efficient and effective use of domestic and international climate finance.

Given the institutional linkages between an NCF and relevant line ministries, an NCF can also track climate-relevant expenditures made by the government along with expenditures that are off budget. Such expenditure tracking is a crucial part of an overall framework to understand a country's progress towards meeting its goals and objectives on climate change, as climate-relevant expenditure is an intermediate indicator to assess progress.

An NCF can also be an important pool of knowledge and expertise on the technical aspects of climate change as well as climate finance. In-house knowledge of the procedural and operational requirements of the different sources of climate finance will be useful to sectoral ministries that wish to tap into international sources. Similarly, an NCF's expertise in program and project conceptualization, development, resource mobilization, implementation, delivery, and reporting will be useful to other ministries and stakeholders.

As one of the most visible interfaces of the government on climate change, an NCF can also provide the convening space to bring together multiple stakeholders and development partners to coordinate actions on climate change. Such a steering role of NCFs encourages harmonization of actions and better support of national policies, ultimately making NCFs a key instrument to increase national ownership of the climate agenda.

2.1.4 Deploy Low-Carbon, Climate-Resilient Technologies and Services

The transition to low-emission, climate-resilient development necessitates commercialization and deployment of mitigation and adaptation technologies, infrastructure, services, and other solutions at significant scale. An important objective of an NCF can therefore include supporting these innovative technologies through experimentation, piloting, and financing at scale.

Depending on the national context, an NCF can choose to fill pertinent gaps. For example, gaps may include the lack of finance available for early stage, pre-commercially viable technologies or appropriate financial incentives to scale up commercially viable technologies. What the NCF decides to focus on, of course, will be determined by an assessment of the fund's operational niche and its evolving role in supporting climate policy.

2.2 BUILDING BLOCK 2: FUND CAPITALIZATION AND REVENUES

2

Revenues

National climate funds can collect, channel, access, and mobilize finance from a variety of sources. Each source of finance comes with its own set of opportunities and challenges. Fund designers and subsequently fund managers need to contend with the trade-offs that they are willing to make. For example, receiving development expenditure allocations may entail the fund being subject to a range of reporting regulations. Apart from resources for funding allocations, fund designers also need to be clear-eyed about the resources required to build capacity to manage the fund.

1. How should the national climate fund be capitalized? What are the sources of revenue for the NCF?
2. Do the sources of revenue identified support the objectives?
3. How can the revenue sources be secured? What are the enabling legislations, revenue collection agreements, and reporting requirements necessary?
4. What are the features of the revenue sources? How do the concessionality, tenor, predictability, and source of the revenue affect how the NCF is able to program its resources?

An essential function of an NCF is to identify, collect and channel revenues to climate change programs and projects. Sources of revenue may be varied: they may be domestic or international, public or private, repayable or non-repayable, ad hoc transfers or recurring earmarks. As the nature of the NCF's revenue will determine the financial instruments it can use, NCF designers will have to assess whether the NCF is capitalized in manner that is supportive of its objectives. The enabling legislation of the NCF will also determine how the NCF is able to use its resources. By providing the NCF with the necessary institutional and legal underpinnings, NCF designers can allow a direct engagement between the private sector and the NCF through co-financing, equity, and insurance-based modalities. This section discusses key sources of revenue and associated implications and their channeling and reporting.

2.2.1 Identifying Revenues

An NCF's revenue sources can be categorized domestic vs. international, public vs. private, repayable vs. non-repayable, recurring vs. not recurring, predictable vs. not predictable. The

following table lists potential revenue sources that can be realized by NCFs. The list is of course not necessarily complete and each NCF may utilize one or several of these revenue sources.

Revenue generated from a **carbon tax or auctioned emissions allocations** can be earmarked for the fund. Such revenues may be substantial, recurring, and predictable. If the decision to earmark revenue to the NCF is legislated, it will provide the NCF a measure of stability. Such attributes allow an NCF to plan ahead. For example, India levies a tax on coal. The government channels the revenue collected from this tax to the National Clean Energy Fund, a window under the Ministry of New and Renewable Energy. The volume of finance raised has been substantial. For the fiscal year 2016-2017, the fund was allocated almost 1 billion dollars from the revenue generated from the tax [1 USD = 70 Indian Rupees].[2] These resources have been collected with the intention of supporting clean energy projects.

State budget allocations will typically be subject to parliamentary approval and therefore require renewed justification each year. While budget allocations are typically made on an annual basis, it is possible to provide the NCF with a larger multi-year envelope, with transfers from the treasury to be authorized every year. NCFs relying heavily on state budget allocations for their operating expenses can be exposed to the changing political circumstances and be subject to strong political influence. On the other hand, initial state budget allocations to the NCF may be vital to cover overhead costs and operating expenses before the NCF is able to tap into other revenue sources. The Bangladesh Climate Change Trust Fund, a domestic trust fund, receives allocations by the government. As the allocations were made as multi-year blocks, they formed a part of the non-development expenditure. As the BCCTF does not spend its entire allocation every year, it has also been able to earn revenue and use the budgetary allocations as a form of an endowment.

Box 2.2 Revenue Sources

	Domestic	International	Public	Private	Repayable	Not repayable	Recurring	Not recurring	Predictable	Not predictable	Potential size*
Revenues from carbon/eco taxes	x		x			x	x		x		M – L
State budget allocation	x		x			x		(x)		(x)	M
Revenues from fines for violating climate change / environmental law	x		x			x	x			x	S
Debt swaps	x	x	x			x	x		x		M – L
GCF contributions if NCF is DAE		x	x		x	x		x		(x)	L
Contributions from international climate finance mechanisms (other than GCF, or, through GCF IAEs)		x	x	x	x	x		x		x	M
Contributions from bilateral development agencies and climate finance mechanisms		x	x		x	x		x		x	M
Profits/revenue from endowment capital provided by the government, donors, and NGOs		x	(x)	x	x	x	(x)			x	S
Philanthropic contributions	x	x		x	x	x		x		x	S

**Potential typical/indicative order of size of revenue is defined as follows: S – Small; M – medium; L – Large.*
Please note that indicated revenue potentials may differ in countries, depending on the specific circumstances in a country.

2 https://doe.gov.in/sites/default/files/NCEF%20Brief_post_BE_2017-18.pdf

There are many **international, multilateral, and bilateral climate finance mechanisms** and an NCF can focus on accessing one or several of these. Each source comes with its own requirements and unique characteristics. Apart from contracting with individual contributors, an NCF can encourage contributors to pool their contributions. The management will make decisions on how to program such allocations. Similarly, instead of pooling at the fund level, contributors may co-finance activities at the project level.

For example, the Amazon Fund receives results-based finance from Norway. Norway made an initial USD 1 billion pledge. Brazil can make claims on the basis of demonstrable reductions in deforestation rates. The Amazon Fund, the NCF that receives the funds from Norway, calculates the claim on the basis of the CO2 emissions avoided multiplied by USD 5/tCO2. Apart from showing development partners that their funds are being used in a judicious manner, the results-based finance format of the Amazon Fund also affords substantial policy control to the Brazilian government, as it is up to Brazil to decide how to reduce deforestation. The finance it receives is based reduced deforestation rates and not policy inputs.

Revenue from endowment is a common practice among conservation trust funds around the world. Finding contributors to an endowment may be challenging, as contributors may be more driven by immediate and measurable impacts. In fact, the operations of an endowment-based fund are indeed limited by the earnings it generates. Large endowment sums are needed to allow for significant investment: for example, to allow for annual investments of 1 million USD, 25 million USD endowment capital is needed, assuming a 4% profit on investment. Given the ability to only invest profits generated, these NCFs tend to be risk-averse by design. While not necessary, there may be a trade-off between transformational impact of a fund and its risk appetite threshold. In addition, in some countries, the use of public funds for speculation in capital markets is not allowed. On the other hand, setting up an NCF as an endowment fund also offers major advantages.

As endowment funds have a layer of insulation from political control around them, they are able to generate revenue over long durations. Such stability may not be possible with state budget allocations and will be attractive to activities that require long periods of predictable finance.

Box 2.3 Revenue Management: Emerging Lessons

A number of countries have imposed taxes, fees, or penalties on carbon-intensive fuels such as oil and coal. These sources can raise substantial volumes of finance every year. Based on the experience of a range of countries, we highlight some of the salient issues here.

Fund Management Capacity While countries can take the political decision to allocate revenue from the national budget to the NCF, a crucial consideration for policymakers to keep in mind is the fund management capacity of those tasked with managing the fund. When governments allocate substantial amounts of finance to a fund, usually they prefer that such a fund be housed within the government where it can exercise direct management. While such oversight is necessary, however, it is also important to ensure that the host of the fund has the fund management capacity that is needed. Otherwise, disbursement will suffer and the fund will not be able to realize its potential.

Predictability National climate fund managers can make better allocation decisions if they can make accurate and sound financial projections. Predictability in the NCFs' finances therefore is vital. Furthermore, if national climate funds are to make investments with long tenors, predictability in receipts will be key. Unpredictable and discretionary financial contributors are less than likely to have meaningful and transformational impact.

Synergies with national plans It is important for governments to consider how funds raised from such earmarked sources will support existing policies and financial instruments already in place. Channeling resources directly to line ministries is an option. It is important for fund designers to assess how routing public expenditure through a fund can best contribute national policies and programs in a manner that builds on existing efforts.

Product taxes and revenues from fines for violating environmental law or for exceeding permitted industrial emission standards can also be earmarked towards the NCF. Product taxes include taxes on packaging, vehicle waste, or electronic waste. Revenues from such fines are typically small and unpredictable and revenues may already be earmarked for mitigation pollution.

Debt swaps agreements are negotiated with creditor countries. As a part of the agreement, the allocations may be set aside for a climate fund. While debt swaps have been infrequent and may pose institutional and political challenges, they may help provide substantial, recurring and predictable revenue and thus offer planning and institutional security to an NCF.

Philanthropic contributions to NCFs have typically been small. By their nature, they are not predictable nor recurrent. Donations from companies will typically come as part of their CSR programs, requiring the NCF to comply with the requirements of such programs and ensuring that such CSR requirements do not contradict the Fund's objectives or create conflicts of interest. Private charity allocations are more likely if an NCF meets international fiduciary and operational standards and can demonstrate its unique value added and niche.

2.2.2 Key Considerations on Revenue Raising

Several considerations may be taken into account in the process of identifying NCF revenues: linking NCF objectives and niche with corresponding revenue sources; raising sufficient resources; requirements of accessing international sources; the potential to leverage finance from the private sector; and reporting.

A key consideration is to link the NCF's objectives and niche with potential revenues that match. For example, if an identified investment priority is mitigation, the feasibility of a CO2 tax, including earmarking part or all revenues to the NCF, should be considered, since two incentives structures will be created to decrease CO2 emissions, pricing of fossil fuels and availability of subsidized finance to decrease CO2 emissions.

Another consideration is to ensure that an NCF will receive recurrent, predictable revenues. Earmarked fiscal transfers can provide stability by their recurrent and predictable nature, but it will also be essential to ensure a sound legal basis for such transfers. As Box 2.2 above outlines, there are two types of revenues that typically have recurring and predictable character: taxes (carbon, pollutant, and product) and debt swaps, both representing domestic revenues. Both types of revenues may be politically difficult to realize. The supporting legislation will need to identify which authority will impose the taxes, enforce the tax, collect revenues, and make the transfers to the NCF. Increased taxation is usually politically unattractive, and, if feasible at all, tax revenue, for example, from a carbon tax, may be used for other budgetary expenditures. Debt swaps, on the other hand, will require political negotiations with multiple parties.

Revenues from international climate finance mechanisms can be an important source of finance. Typically, such types of revenues will be bound to specific projects or programs and may not be sustainable sources of finance beyond the lifespan of the supported project or program. International financial institutions may require the NCF to have substantial operational experience. Therefore, capitalizing an NCF with domestic revenues to enable it to acquire a robust institutional profile would be a strategic decision.

Each possible revenue source for an NCF should also be assessed for its properties and potential to leverage co-finance from the private sector and other possible institutional co-financiers such as domestic banks. By enabling an NCF to leverage private sector resources, it will be able to scale its operations in a way that it would otherwise be possible. The choice of instruments, of course, again goes back to the objectives the NCF is designed to support.

One of the attractions of an NCF is being able to invite climate finance from different sources and support actions through blended packages. The NCF can negotiate directly with development partners to harmonize reporting requirements for maximum efficiency. Collecting revenues from development partners, including the GCF, will typically happen in line with agreed terms. Often, tranches of funds are released based on milestones. Results-based finance may also be an option with disbursements contingent on agreed results.

2.3 BUILDING BLOCK 3: CREATING THE LEGAL BASIS

3

Legal Basis

One of the key decisions facing policymakers is the legal basis for the national climate fund. The legal form of the NCF is important as it shapes the nature of financial instruments it can deploy, the range of stakeholders the fund engages with, the fund's programming and project planning, links with policy commitments, and ultimately, its longevity. Countries have a range of legal options to choose from. The overriding consideration is what the objectives of the national climate fund really are. The legal form of the fund will follow from that determination.

1. How does the institutional independence of the fund affect its ability to fulfill its objectives?
2. What should be the legal personality of the NCF (e.g., public company, trust fund, foundation, government agency, special purpose vehicle, etc.)? How does the legal form of the NCF affect: its lead-time to begin operations, applicable reporting standards, governance arrangements, and fiduciary standards?
3. What should be contained in the enabling legislation of the NCF? What is the division of responsibilities between different government agencies that the enabling legislation will codify?
4. If the NCF is set up as an independent trust fund, how will the trustee be selected? What kind of core competencies will the trustee need to have? And, what will be the division of responsibilities between the governing board of the NCF, the secretariat, and the administrative agent of the trust fund?
5. How can design of the fund best reflect the cross-sectoral nature of climate change and the large range of stakeholders that are engaged? Does their involvement introduce conflict of interest? If so, what safeguards will be necessary?

2.3.1. Legal Form

Choosing the legal form of the NCF is a key decision that NCF designers will have to consider. There is no strict requirement for an NCF to have a legal personality, supported by an enabling legislation. For example, an NCF can be organized to operate as a unit of a government ministry without any independent legal personality. The degree of institutional independence will have to correspond with the objectives and niche of an NCF. The advantages of creating a fund with a legal personality are numerous and can strengthen the ability of the NCF to catalyze the changes necessary to facilitate the transition to a low-carbon, climate-resilient economy.

Diverse instruments

One of the key rationales for establishing an NCF is to create a fund that is able to mobilize climate finance from all possible sources. When a fund is granted independent legal authority, it will be able to offer instruments that a fund otherwise would not be able to. For example, a fund housed in a ministry of finance, without independent legal personality, will not be able to offer the range of financial instruments that a legally independent NCF can. As discussed in the section on trustee selection below, an NCF can be housed in a commercial or national bank and still be under the overall authority of a governing board of the government.

Cross-cutting nature, multi-stakeholder approach

Climate change is **cross-cutting** in nature and extends to policy areas such as finance, environment, agriculture, infrastructure, energy, industry, fisheries, forestry, health, etc. Establishing an NCF within a ministry may have the unintended effect of creating a silo and not obtaining the necessary buy-in of all relevant sectoral ministries. Instead, if the NCF is granted legal personality and is governed by a board that consists of all of the concerned line ministries, it may be able to foster a more coordinated approach to its work. Designing an NCF with legal personality may also allow the fund to engage with non-governmental stakeholders such as members of academia, the private sector, and non-governmental organizations.

If an NCF is designed to channel budget allocations, public finance regulations may render it challenging for an independent entity to receive budgetary allocations on a regular basis. Similarly, in some countries, NCF designers may find it challenging to propose an extra-budgetary fund that is not under the control of a line ministry.

Accountability, transparency, and governance

An NCF with independent legal personality provides more visibility to the NCF, thereby also subjecting it to greater scrutiny. An appropriate division of authority and responsibility between the NCF and related line ministries will help to allay concerns about conflict of interest. While a ministry usually has a mandate to design and develop policy, it should not be directly responsible for implementing, enforcing, or financing such policy for reasons of conflict of interest. Therefore, in settings where an NCF is embedded in a ministry without legal personality, such governance concerns may be raised.

A legally independent NCF may also offer opportunities for a high degree of transparency and accountability in the fund's management such as allocation of resources. In other words, the transparency and accountability provisions of an NCF are not limited by regular governmental procedures when the NCF is legally distinct and such a distinction may engender greater confidence in the NCF's systems and processes.

Further, an NCF with legal personality may inspire more confidence from the private sector on legal matters such as disputes over contracting, allocation of funds, and procurement, compared to strictly public entities. A ministry-managed fund may be seen as more political, and therefore, more uncertain in nature.

In case it is decided to equip an NCF with legal personality and basis, typically one or several of the following options exist:

- **Public company / state owned enterprise**, typically regulated by a country's Law on Companies;
- **Trust fund**, typically regulated by a country's Public Finance Law;
- **Foundation**, typically regulated by the country's Law on Foundations;
- **Government agency**, typically regulated by dedicated Government regulation;
- **"Special Purpose Vehicle"** (SPV), typically not regulated by other legislation and used in cases where none of the previously mentioned options are feasible. SPVs will therefore require dedicated, new legislation.

The question of a legal basis for a fund is also intimately tied to the question of how a fund will lay its plumbing for operations. For example, will the NCF fund projects and programs or will it provide budget support to sectoral ministries to achieve defined outcomes? A hybrid approach of using sectoral ministries as implementers of NCF funded projects, in alignment of their respective sectoral plans, also exists.

2.3.2 Drafting Enabling Legislation

Once a decision is taken as to which type of legal personality an NCF should receive, it will be necessary to draft the enabling legislation in line with formal national requirements. One ministry or agency will have to take the formal lead to develop the legislation and defend it during adoption. Capable domestic legal experts will be needed to ensure that draft legislation meets all requirements.

One key consideration at this point will be which issues should be addressed in enabling legislation (and in which depth) and which in secondary regulation, e.g., an NCF Operational Manual. Typically, an Operational Manual will include detailed operational policies and procedures based on the minimum requirements for such policies and procedures as laid down in enabling legislation. Decisions will also have to be taken about which authorities will be entitled to modify the enabling legislation and Operational Manual, once these are adopted. Authority over content and modification should be well balanced, keeping in mind that it is desirable to provide the NCF with a stable institutional standing.

Typically, enabling legislation will be as short as possible, while regulating minimum requirements for governance and essential policies and procedures in an unambiguous way. Enabling legislation will be ideally enacted by an authority that provides institutional stability, i.e., changes to such legislation will not happen as a result of political changes or shortsighted interests. Operational Manuals will typically include all details regarding operational policies and procedures, and therefore represent possibly voluminous and practical regulation which will typically be enacted and modified by the NCF Board.

2.3.3 Selecting a Trustee

An NCF may decide to invite a third party to manage the fund as a trust. For countries that do not have institutions that meet fiduciary standards and safeguards, setting up an NCF as a trust fund held by a third party can be an attractive option. Third party management of the NCF may also be a suitable option instead of creating an entirely new trust fund, particularly when the third party has a strong track record in working on climate change issues and providing trust management services.

The trustee provides a range of services to the NCF. Most importantly, the trustee receives funds from various contributors, disburses those funds in line with the NCF board's decisions, and provides consolidated reporting to the NCF board and fund contributors. The trustee may invest funds that are not committed to projects and programs and generate investment income for the NCF. Trust funds can be national entities such as Bank Mandiri for the Indonesia Climate Change Trust Fund. They may also be managed a UN agency or the World Bank. For example, Ethiopia uses a hybrid model for its Climate Resilient Green Economy Facility whereby the Ministry of Finance and Economic Cooperation manages the domestic window and the UN Multi-partner Trust Fund Office manages the international component.

Box 2.4 Decision points for NCF designers and NCF management on trustee selection

Value addition of the trustee A government that would like to obtain fund management services will be faced with a number of options. The overriding consideration is how the trustee would support the objectives of the NCF. Locating the national climate fund in a bank would have the distinct advantage of having the option of utilizing the set of financial instruments that are offered by the bank. Similarly, if the focus of the NCF is on humanitarian aspects of climate change, such as disaster responses, a trustee that has experience in working with relief organizations may be more suitable.

Division of responsibilities The governance arrangements will be discussed in the following chapter; it is essential to clarify the respective roles and responsibilities of all parties engaged at the outset and to regularly take stock of how the arrangement is working out. While this form of collaboration can deliver tremendous benefits, it also requires patience and dedication to manage the relationships.

Transition plan Is the trust fund expected to sunset and will it be handed over to the national government? If so, which entity will host the fund when it is handed over? What steps will be put into place to ensure that a future trustee will have the necessary standards and safeguards in place to host the fund? Transferring the management of the trust fund from an international agency to a national one is a routine process, but care must be taken to ensure that the transition process is carefully managed.

Agency/management fees In exchange for services of the trustee, the NCF is likely to be charged management fees. This cost needs to be weighed against the benefits offered by the trustee's services. For details on Multi-Partner Trust Fund Office and its services, please refer to Chapter 4.

2.3.4 Key Considerations on Legal Form

Choosing the appropriate legal basis for the NCF will typically be complex and should ideally be discussed with stakeholders in detail. Key considerations include:

How will the legal basis best serve the objectives and resources of the NCF and provide for long-term institutional stability?

The nature of instruments that a fund is expected to use helps to determine the necessary legal form of the fund. Similarly, if the NCF is expected to work in close collaboration with a particular ministry or set of ministries, the cost of not instituting it as a legally independent entity should be assessed.

What legislative procedures will be necessary to establish the NCF?

What are the benefits and risks involved? How much time is needed? In many countries, the establishment of a public company will require an act of parliament. Such a process may be time-consuming with numerous potential political risks. Other forms, such a trust fund under a ministry of finance, may require far less time and procedural requirements.

What does the legal form of the NCF imply for its minimum governance standards?

Based on how an NCF is constituted, it will be subject to different fiduciary standards and safeguards. In some countries, public finance law may require trust funds to be controlled by the ministry of finance with majority of members on the board from the ministry. Such a board may not reflect the desire of the NCF for broad, sectoral representation.

Further, the application of fiduciary standards may also need consideration. For example, an NCF receiving state budget allocations will be required to adhere to a set of standards that are determined nationally. These standards may not be in full conformity with international fiduciary standards. Similarly, when an NCF is not set up as an independent entity, international fiduciary standards may have to be applied at the appropriate institutional level, such as the entire ministry under which it is housed. NCF designers and managers will have to be cognizant of the gaps between the standards they are expected to adhere to nationally and as per the requirements of international institutions.

How does the legal form affect operational decisions such as staffing and overhead costs?

Government regulations may require that salaries of the NCF's personnel adhere to the government's policies on remuneration and benefits. Such a policy will have direct implications for the ability of an NCF to recruit and retain personnel. Similarly, there may also be restrictions on how overhead costs are financed.

Box 2.5 Indonesia Climate Change Trust Fund

Indonesia's national trust fund, the Indonesia Climate Change Trust Fund (ICCTF), was designed to support Indonesia's national goals of reducing emissions by 41% by 2030 with international support. With the launch of the Low Carbon Development Plan (PPRK), the ICCTF is embedded in a broader national plan. The ICCTF's experience helps illustrate how questions on legal form shape the trust fund's operations.

Transition to domestic management Initially, national climate funds may be managed by international organizations or international financial institutions until domestic fund management capacity of the prospective host institution is built. The ICCTF's example illustrates how a fund transitioned from its preparatory phase, PREP-ICCTF, whereby UNDP played the role of a fund manager from 2010–2014, and into direct management by Indonesia's planning ministry, BAPPENAS, with Bank Mandiri, a domestic bank, serving as the fund's trustee.

Flexibility to Contributors The ICCTF also helps to illustrate how national climate funds need not have uniform, blanket criteria for all kinds of contributions. For example, some fund contributors to the ICCTF support its operational expenditures while other contributors provide support to specific, earmarked activities. The modality of support is jointly arrived at between ICCTF officials and fund contributors.

Engaging with the private sector As a working unit of a government ministry, subject to ministry regulations, the ICCTF has managed to craft a role for itself in supporting the private sector. For example, rather than directly blend its resources with private sector entities, thereby leading to revenue risk for the ministry, the ICCTF intends to support the engagement of the private sector in energy by supporting feasibility studies, pre-commercial technologies, and energy technologies that have cross-cutting impact. As the ICCTF evolves into an independent trust fund, it will have greater latitude in terms of the funding instruments that it can utilize.

2.4 BUILDING BLOCK 4: INSTILLING EFFECTIVE GOVERNANCE

4 Governance

NCF designers can structure a fund so that the roles and responsibilities of actors engaged with the fund are clear. The fund secretariat and the trustee need oversight and guidance from decision-makers of the NCF. For example, the national climate fund can specify how funding allocations are made and the responsibilities of each part of the national climate fund in providing input to those decisions. While it is vital for the NCF to obtain the buy-in of the sectoral ministries, given the inherently cross-sectoral nature of climate change, the fund needs to ensure that there are no conflicts of interest between sectoral ministries and decisions taken by the fund. By articulating the division of responsibilities and lines of authority in a clear and transparent manner, the policymakers can help to ensure that the design encourages integrity in the fund's management. Clarity and agreement on the division of responsibilities between the NCF secretariat, the trustee that holds of the fund, the NCF's governing board, relevant ministries and fund contributing parties is vital.

1. Which composition, responsibilities, and organization of the NCF's Board will be most adequate to ensure efficient and effective operations of the Fund in light of the Fund's objectives, niche, revenues, capitalization, and legal basis?
2. How can the NCF best promote wide stakeholder participation in the operational and strategic decisions facing the fund?
3. What responsibilities should the NCF's secretariat be charged with to ensure efficient and effective operations of the fund?
4. An NCF will need essential guiding documents such as an Operational Manual, a business plan, a results framework, and a communications strategy. Who will be responsible for drafting these documents? What stage of the fund establishment process is the most suitable time to formulate these documents?
5. What are the administrative, financial, and reporting functions that the NCF needs to fulfill? Will the fund have an internal institutional integrity unit? What will its disclosure of information policy be?

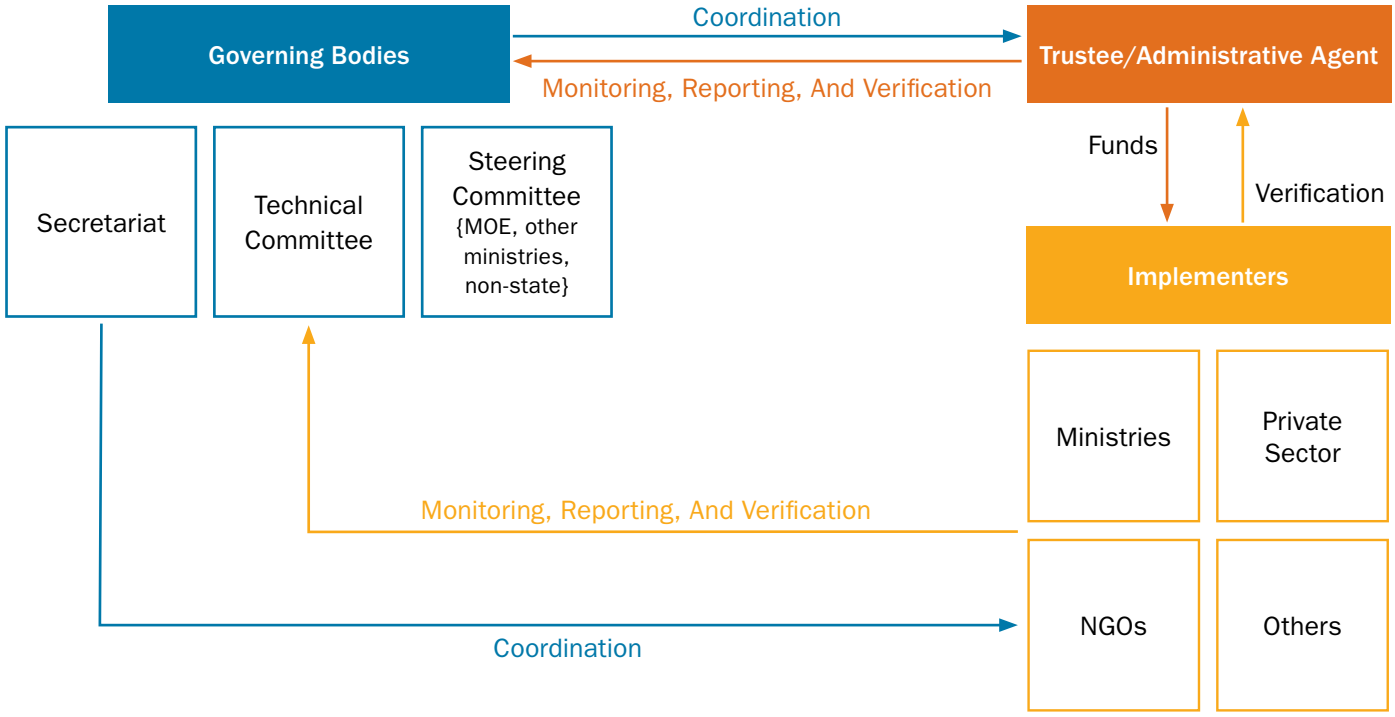
The governance arrangements of an NCF will be determined by the objectives of the NCF, its niche, legal basis, requirements stemming from the nature of its capitalization and revenue sources, and prevailing domestic practices and realities. An appropriate governance system that will optimize the Fund's performance and ensure necessary accountability and oversight needs to be designed. The governance system will include governing bodies, as well as decision-making and oversight procedures. The enabling legislation of an NCF can provide a clear articulation of responsibilities and lines of authority and planning. This governing arrangement can be captured in the form of an organizational chart and elaborated in an Operational Manual. The board of the NCF can be empowered to provide internal oversight over the fund's operations. The board can also establish, appoint, and terminate committees to conduct specific business.

2.4.1 Composition, Responsibilities, and Arrangements

The overall responsibility for the fund is usually vested to a board that has decision-making powers on fund management and strategic direction. The enabling legislation of the fund and subsequent directives will determine the composition, responsibilities, and organization of the board. Membership in the board will reflect the NCF's objectives, revenues, and expenditure focus and may include representatives from key stakeholder groups and institutions. For example, public sector members will typically be in the majority in cases where the NCF is to receive public sector revenues. As one of the key attractions of an NCF is its cross-sectoral focus, the board needs to reflect its scope of operations by engaging relevant ministries. The enabling legislation may define how board members are appointed and relieved, and their terms of engagement. The NCF's enabling legislation can also define the responsibilities of the board members, including a code of ethics and means to safeguard against conflict of interest. Further, the enabling legislation will determine how often the board will meet every year, how such meetings will be convened, and the decision-making procedures.

Based on the objectives that have been identified for the NCF in high-level policy documents, it can also be the responsibility of the fund's board to set objectives and ensure that the fund's activities support them. Tracking progress on how well the management of the fund is achieving the objectives can be done through by articulating measurable indicators for the objectives in the form of a management plan and issuing board-level guidance to the management to support the process.

Figure 2.1 Governance Arrangement of an NCF



The balance of work between the board and the secretariat (management) is set out in the enabling legislation and the supporting Operational Manual. The specific context of the NCF will shape the division of responsibilities. The board may convene committees for focused work, whether they be ad hoc or standing committees. For example, it may set up an evaluation committee to examine proposals for review before the entire board considers them. Similarly, it can establish a committee for financial reporting and auditing.

The chairperson of the board will typically be a high-level representative of the institution or ministry founding the NCF, that is, the ministry responsible for climate change, finance, or environment. In special cases, dual, rotating chairperson solutions could be pursued, to reflect that several institutions are leading climate change policy at the national level.

2.4.2 The Secretariat

The internal organization of the secretariat evolves over the course of an NCF's operation and will need to be commensurate with the scale of the NCF's operations. The secretariat of the NCF usually covers the following areas: administration, legal matters, finance, operations, and communications. These functional areas may be formalized in the form of units to be led by deputy directors with a fund director providing overall guidance and direction.

The department for administration, finance and legal issues can be responsible for: accounting; financial administration and reporting, including preparation and application of standardized pro-forma financial and administrative documentation; arranging and supporting internal and external audits; legal affairs; contracts administration; personnel administration; and IT systems and support services. A separate revenue department may also be set up to implement board and management decisions on the identification and realization of fund revenues and their necessary reporting.

The operations department may be responsible for project cycle management, such as procedures related to project identification, appraisal, selection, contracting, implementation, monitoring completion, evaluation, preparing expenditure plans and related budgets, coordinating the production of the annual reports, implementation of project risk management systems, and the NCF's Environmental and Social Safeguards Management System.

In addition, the director may have a director's office that includes functions such as public relations and external communications; fund marketing and promotion, including development of promotional materials and a dedicated, interactive NCF website; provision of administrative support and secretarial services to the fund director and, as may be required, the Deputy Directors.

A task force mandated with establishing an NCF may also consider the development and eventual inclusion of dedicated human resources (HR) and information technology (IT) policies into the NCF's Operational Manual. HR policies should be prepared in line with the NCF's enabling legislation and prevailing national standards and best practices. In some cases, due consideration should be given to solutions that allow for hiring best candidates for fund management and secretariat positions.

Regarding IT policies, consideration should be given to the fact that many of the standard procedures of an NCF can be rationalized in applying institutional software solutions, e.g., in the areas of financial management and project cycle management. In case of NCFs that are expected to be accredited as direct access entities, such software solutions will ideally be aligned to various software and internet-based procedures that are required and applied by the GCF.

A key element of any NCF should be proactive and open communications, reporting, and outreach. Ideally, minimum requirements for communications, reporting, and outreach policies will be stipulated in enabling legislation of NCFs and specified in an NCF Operational Manual. Such policies will ideally include at least four key elements: 1) a dedicated NCF website; 2) annual reports; 3) a communications and outreach policy; 4) a policy on access to and disclosure of information. The NCF should also articulate its policy on access to and disclosure of information.

Communicating the NCF's vision, needs, and impacts in a clear, accessible, accurate, and timely manner will be essential. An NCF may have a communications strategy delineating the roles and responsibilities for communication. A sample communications strategy is provided in the annex.

As one of the centers of climate change related activity in the government, the NCF will house considerable expertise on climate change. A knowledge management strategy can help to connect resources of the NCF with the requests from stakeholders. Similarly, a knowledge management strategy can also consider ways of filling gaps in technical skills and expertise.

2.4.3 Advisory Bodies Including a Technical Committee

An NCF may decide to establish advisory bodies to avail itself of expertise and resources beyond what is available within the fund. Advisory bodies may take the form of technical committees that can provide the fund with expertise on the NCF's strategy development, operational activities such proposal development and assessment, and technical input to inform management deliberations.

Advisory bodies may also promote and allow for wider stakeholder participation in operational and strategic decisions facing the fund. Such advisory bodies can, for example, regularly bring together NGO representatives, representatives from academia, and private sector representatives. Provisions authorizing the establishment of these bodies can be made in the enabling legislation.

Typically, such advisory bodies do not have decision-making powers, but instead support decision-making at the levels of Board and Director. Advisory bodies can also be used to appoint board members from a specific group of stakeholders, such as NGOs, academia, and private sector.

2.5 BUILDING BLOCK 5: FIDUCIARY STANDARDS AND SAFEGUARDS

5 Fiduciary Standards and Safeguards

The credibility of a fund rests in part on how it manages its finances, and it can strengthen credibility by demonstrating adherence to sound fiduciary standards. Environmental and social safeguards are needed to ensure that the NCF-funded activities do not generate negative effects. Demonstrating sound fiduciary standards and safeguards is also a requirement for the NCF to access finance from international sources such as the Green Climate Fund and the Adaptation Fund. Ultimately, the application of fiduciary standards and environmental and social safeguards helps to demonstrate the fund's effectiveness, display accountability for its actions, and acknowledge that the NCF has consequences for the populations and ecosystems it impacts.

1. What accounting and financial reporting standards should the NCF implement? Are national standards congruent with international ones? How can the fund best minimize its reporting burden while maximizing performance and accountability?
2. Do the audit, control, and procurement systems of the NCF match its objectives and operational mandate? At what level are these frameworks and policies implemented? For example, are they implemented at the level of the fund itself or the institution that houses the fund?
3. What kind of a project cycle management framework best supports the objectives of the NCF? The project cycle management framework involves procedures and practices that the NCF will apply in identifying projects and in their appraisal, selection, contracting, implementation, monitoring, and evaluation.
4. What policies and procedures should the NCF institute to manage environmental and social risks?
5. What is the gender policy of the NCF? What are the means by which the fund will institutionalize gender considerations?

Sound fiduciary management provides the foundation for the efficient movement and tracking of funds flowing to and from the NCF. If an NCF is expected to manage revenues from domestic and international climate finance, it must have a system of fiduciary management that accommodates the multiple standards as required by these sources.

The policy objectives the NCF designers seek to achieve are varied and depend on the national context. Not all NCFs are designed with the intention of achieving Green Climate Fund accreditation. For example, if an NCF is to receive domestic public revenues that require compliance with public finance (state budget) fiduciary standards, and such standards are not compatible with international standards, the NCF will have to assess how these gaps will be filled. In such cases, discussions and solutions with ministries of finance should be sought, leading ideally to solutions by which an NCF can apply international standards for financial management of public resources. If such solutions are not possible, the NCF may have to institute two accounting and auditing systems at the same time.

Many existing NCFs do not have policies and procedures for some of these areas (typically including several aspects of the above-mentioned transparency and accountability framework) or outsource certain functions (e.g., procurement may be outsourced to state procurement agencies). Some existing NCFs also have trustees performing several of the above-mentioned functions.

We recommend that task forces entrusted with the design of a new NCF consider fiduciary safeguards of the GCF even if the NCF does not decide to pursue GCF accreditation for the following reasons. First, besides the GCF, the Adaptation Fund, the Global Environment Facility, and EU-DEVCO also have direct access modalities. Aligning the design of the NCF to meet GCF's fiduciary standards will also open the door to accreditation with these institutions. Second, by instituting the set of fiduciary standards, irrespective of the actual award of GCF accreditation, an NCF will be able to demonstrate its seriousness towards sound financial management. Strong fiduciary management is a no-regrets options and may further inspire fund contributors to use national institutions to channel climate finance. Third, the GCF fiduciary standards provide a menu of design possibilities. NCF designers and fund managers will have to weigh the costs and benefits incorporating the full set of fiduciary standards.

Box 2.6: Fiduciary Standards and Functions

Basic Fiduciary Standards	Key Administrative and Financial Capabilities Transparency and Accountability
Specialized Functions	Project Management Grant Award Mechanism On-lending/blending

The standards that we outline below are based on the fiduciary standards required for accredited entities to the Green Climate Fund and is meant to provide a snap shot of what is required. A detailed description of the required standards and how these standards will be assessed can be found on the GCF's website.

An NCF will require sound strategic planning in line with the fund's objectives, operational niche, revenue sources, and legal basis. Strategic planning will typically a key task of the NCF's Board and may involve both wider institutional as well as expenditure planning.

2.5.2 Key Administrative and Financial Capacities

Three principles under the standards on administrative and financial capacities: accounting, reporting, and administering financial inputs and outputs in accordance with relevant law and regulations; consistent, reliable, and complete information on the management and administration of the NCF; and demonstration of effectiveness and efficiency.

General management and administrative capacities

The NCF must be able to identify institutional arrangements of the NCF by identifying relevant actors of the fund, describing their roles and responsibilities, and demonstrating lines of authority and accountability between them. Such relationships between entities and bodies of the NCF may be captured in the form of an organizational chart. The fund must also demonstrate the capacity to: set objectives and align the fund's operations to meet them; articulate a management plan that allows tracking of progress on those objectives; and formulate indicators to assess progress on organization-wide objectives.

Financial management and accounting

Financial statements of the NCF will have to follow the Generally Accepted Accounting Principles (GAAP) and they must be prepared using wide accepted accounting standards such as the International Financial Reporting Standards (IFRS) or the International Public Sector Accounting Standards (IPSAS). Financial statements of the NCF must provide information on: assets, liabilities and fund balances, financial performance, changes in financial position or changes in reserves and fund balances, cash flows, accounting policies used, and any further information that provides a complete picture of how the accounting was carried out. The NCF's financial statements need to be reported on a periodic basis and should allow for comparability and consistency across time periods. The NCF should also demonstrate its experience in formulating and executing business plans, financial projections and budgets, and the capacity to monitor progress.

The NCF must meet the necessary legal and operational requirements to receive financial transfers from the GCF's trustee. Similarly, the NCF needs to demonstrate its capacity for regular disbursements and payments. The NCF should also have the necessary arrangements in place to ensure that it can carry out the required financial reporting regarding the funds received from the GCF.

Internal and external audit (independent audit committee, internal audit, external audit)

To oversee the work of the internal and external audits, the NCF needs to appoint an independent audit committee, or a comparable body, with a clear mandate.

Internal audit function The internal audit function needs to be independent and its duties should be performed objectively, in accordance with internationally recognized standards such as the Institute of Internal Auditors. The internal audit function should be provided with clear terms of reference by the management that delineate its purpose, functions, and accountability. The auditors of the NCF or those providing the services should be given functional independence and must follow the ethical principles of integrity, objectivity, confidentiality, and competency. The NCF should also have a process for formulating an annual audit plan, using a risk-based methodology, that spells out the priorities in a manner that is consistent with the objectives of the NCF. The internal audit function should disseminate its findings to relevant authorities and track the management's response to its recommendations. Overall, the NCF should also regularly visit the effectiveness of the internal audit function.

External audit The NCF should appoint an independent audit firm as an external audit. The external audit should conform to international accounting standards such as the International Standards on Accounting. The use of national audit institutions is possible, but the external audits should be independent and impartial. The NCF must also have provisions to make publicly available the external audit's opinion on its financial statements and resources received from the GCF. The external audit must also make observations on the financial accounting systems, internal controls, and administration and management on a regular basis.

Control framework

An NCF's control framework is designed towards steering the fund in achieving effectiveness and efficiency of operations, reliability on financial reporting, and compliance with existing laws and regulations. The control framework also guides the financial management framework of the NCF and institutes a risk assessment processes to identify, assess, and analyze risks and risks responses to all financial management areas. It also makes provisions for oversight over the NCF's procurement functions.

A control framework identifies the roles and responsibilities for the NCF's management, board, auditors, and other bodies, including the accountability of fiscal agents and fiduciary trustees. The latter part is of special importance to NCFs that have a trustee appointed to manage the fund. The control framework also extends to the control environment, risk assessment, internal control activities, monitoring, and information sharing. A control framework also ensures that incompatible duties are segregated, and duties are regularly reviewed by the management, with responses made when discrepancies are identified.

Box 2.7 Elements of a Financial Management Framework

Budgeting	Funds flow
Accounting	Financial reporting
Internal control	Auditing arrangements

Procurement

Procurement refers to both procurements in regards to the NCF's general operations as well as procurement in the context of utilizing funds received from the GCF. The NCF should have formal internal guidelines and policies that encourage economy and efficiency. Procurement guidelines should be specific to types of procurements and should make provisions for overseeing, assessing and reviewing procurement procedures of beneficiary institutions. The NCF should make provisions to track performance in procurement performance and ensure that procurement records are easily accessible and publicly disclosed. The NCF must also have transparent and fair procurement policies and procedures that include provisions such as: non-discrimination and equal treatment; dispute resolution provisions; conformance with tendering procedures; best value for money; and communication after tendering, including publication of beneficiaries.

2.5.3 Transparency and Accountability

The fiduciary standards for transparency and accountability reflect principles of protection and commitment against mismanagement and fraudulent, corrupt, and wasteful practices, disclosure of conflict of interest whether actual, potential, or perceived, and promoting full transparency and accountability.

Code of ethics

The NCF's code of ethics captures the expected ethical behavior by all employees, consultants, and independent experts associated with the NCF. The management needs to ensure that all individuals with functional and contractual relationships with the NCF are aware of the code of ethics. The governing arrangement of the NCF should also include an ethics committee.

Disclosure of conflict of interest

The NCF should have provisions for mandatory financial disclosures of possible, actual, perceived, or apparent conflicts of interest. The provisions should also specify prohibited personal financial interests and identify how conflicts of interest are reviewed and resolved.

Capacity to prevent or deal with financial mismanagement and other forms of malpractice

The NCF must have a policy of zero tolerance towards fraud, financial mismanagement, and other forms of malpractice by staff members or any party associated directly or indirectly with the NCF's operations. The NCF should also make provisions for how suspected ethics violations, misconduct, and malpractice are reported and make provisions for protecting whistleblowers and individuals reporting those violations. The NCF must also be able to demonstrate an objective investigation function for allegations of fraud and corruption and display a management culture that promotes fairness, accountability, and full transparency.

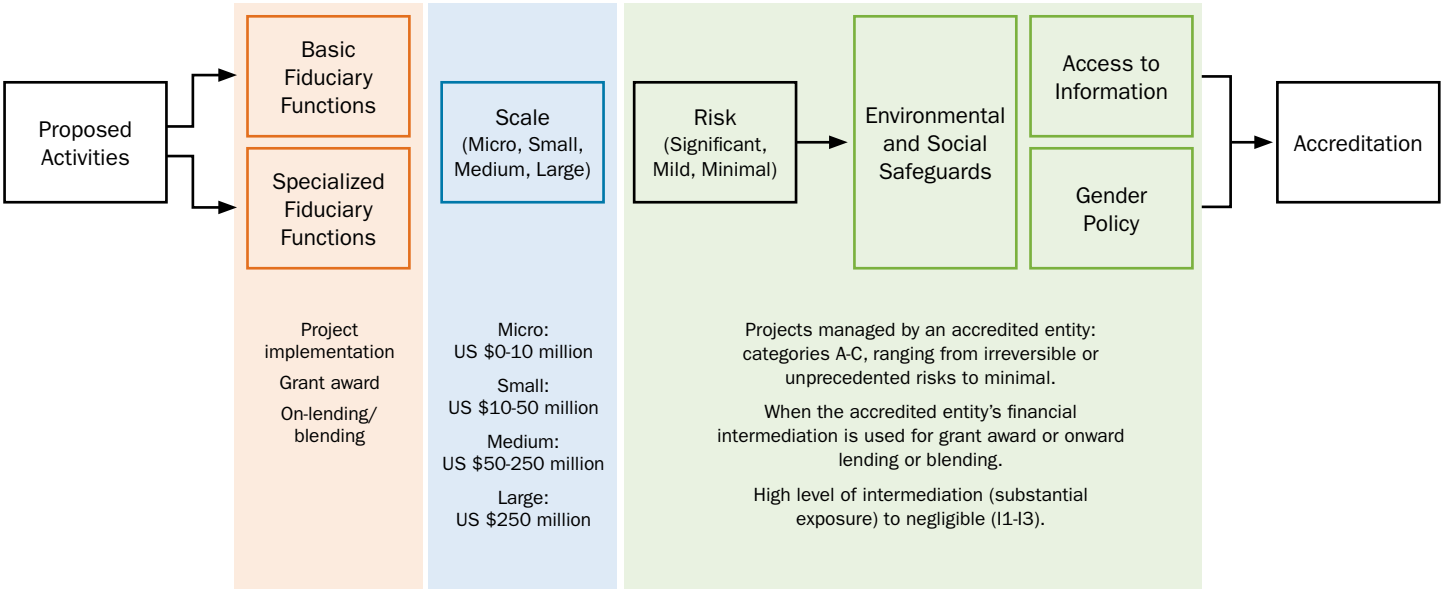
Investigation function

The NCF must also make provisions for an investigation function to investigate allegations of fraudulent and corrupt practices in an objective and independent manner. The investigation function's terms of reference should be publicly available and identify its purpose, authority, and accountability. The guidelines for processing cases and the procedures for handling cases should also be published. The investigation function of an NCF should be functionally independent and its officers should have reporting lines that best ensure the function's objective operation. The investigation function should also make case trends available on a periodic basis to the management.

Anti-money laundering and anti-terrorist financing

The candidate entity for accreditation needs to demonstrate that it complies with all applicable Anti-Money Laundering/Anti-Terrorist Financing (AML/ATF) regulations and laws. When the accredited entity is not the executing entity, the accredited entity still bears the responsibility to carry out necessary due diligence on AML/ATF and make those available to the GCF.

Figure 2.2 Green Climate Fund Accreditation Elements



2.5.4 Specialized Fiduciary Standards

Project management

Project preparation and appraisal The NCF will need to demonstrate its capacity in identifying and designing projects or programs. The project or program designs should include a statement of objectives and expected outcomes and key performance indicators with baselines and targets. The NCF must also be able to examine and incorporate technical, financial, economic, legal, environmental, social, and climate change aspects into the funding proposal at the appraisal stage. Fiduciary oversight procedures will also be necessary for the appraisal process and to guide implementation.

Project implementation, oversight and control The NCF will need the ability to prepare project implementation plans that include project budgets, reporting guidelines, and templates to be used by project sponsors. The NCF also needs oversight capabilities to regularly assess project expenditure against project budget while assessing opportunities to improve project performance. Project reporting capabilities, including publication of implementation reports, will also be vital. Project closure includes reporting on results achieved, lessons learned, and recommendations for improvement.

Monitoring and evaluation

Effective monitoring helps management ascertain and keep abreast of risks relating to funded projects and programs. A fund's evaluation function will assess the extent to which the projects, programs, and strategies achieved their goals. Evaluation provides a basis for accountability and enables the documentation of lessons learned.

Monitoring The monitoring function of the NCF must be equipped with organizational resources in a manner that is consistent with the NCF's guidelines on monitoring and evaluation. It is also important to articulate the responsibilities for the monitoring function at the project and NCF portfolio levels.

Evaluation Evaluations of the NCF, at the portfolio level and project level, should be conducted by following conventional professional standards and methods. Ideally, the evaluation body is independent from the NCF's operations and reports directly to the board. If such independence is not possible, transparency in the evaluation needs to be ensured. The NCF should also have in place an evaluation disclosure policy.

Project-at-risk systems and related project risk management capabilities

The NCF should have in place a process or a system that is able to identify in due time projects that may need attention to address issues that may affect results. The risk management function needs to be separate from the project implementation and project supervision functions. The risk management function should carry out risk assessments on financial, economic, political, and regulatory risks faced during the implementation stage and identify risk mitigation strategies for incorporation during the design and implementation phases.

Grant award mechanisms

It is important that the NCF possess its own policies and procedures for its grant award mechanism. Many funds tend to use the policies and procedures of funders, contributors, or other third parties. It is vital that the NCF be able to demonstrate its own grant award mechanism to receive accreditation.

Transparent eligibility criteria and evaluation
The grant award mechanism of the NCF needs to be transparent in a manner that ensures equal treatment and impartiality to all applicants. The evaluation process should be based on criteria as pre-announced in the call for proposals. An evaluation committee should be empowered to make recommendations for awards based on the pre-announced criteria and work in accordance with the NCF's rules of procedure. All stages of the evaluation process should be documented in a standardized manner.

Grant award decision and procedures Based on the recommendation of the evaluation committee referred to above, the NCF should prepare the grant award decision. In cases where the grant award decision is not in line with the evaluation committee's recommendations, a justification needs to be supplied. The grant award is made by the person or body who has the legal mandate to sign grant agreements. The grant decision should have the following components: rationale and total amount; name of beneficiaries, awarded activity, total amount awarded, and reason selected; and those rejected and reasons for their rejection. The NCF also must ensure that one and the same activity results in the award of one grant. Similarly, no grants are awarded retrospectively for activities already started or completed. All applicants, whether successful or not, are notified.

Public access to information on beneficiaries and results The NCF should make the grant award results public within a reasonable timeframe. The information made public should include the name, address, and nationality of the beneficiary, purpose of the grant, and the amount awarded and co-financing components if relevant.

Transparent allocation and implementation of financial resources The NCF should have systems in place to ensure that the funded activities are real, eligible as per the terms of the agreement, and legal. The NCF should also be able to recover unduly paid funds and prevent irregularities and fraud. The NCF should monitor the implementation of the funded activity, in part through on-site visits that can also be used to gather and disseminate best practices. Procurement rules of the grant should be clear. Should the grant receiving entity not comply with its obligations as per its agreement with the NCF, the NCF should have procedures in place to suspend, reduce or terminate the grant.

On-lending and blending

For those NCFs that wish to utilize the financial instrument of on-lending and blending, the NCF must have commensurate capacities. The NCF should possess appropriate registration and necessary licenses from relevant financial oversight bodies as necessary and should be creditworthy. The NCF must also possess the track record and existing arrangements for on-lending/blending with resources from other international or multilateral sources. The NCF should have in place financial resources management, investment management, and financial risk management, including asset liability management. The fund needs to be able to channel funds transparently and effectively and to transfer the GCF's funding advantages to the final beneficiaries. The organizational relationship between the treasury functions and the operational functions must be defined. The NCF should allow public access to information on beneficiaries and results. For blending grant awards, the NCF needs clear procedures that the implementing partner is required to apply, or a minimum set of requirements if the implementing partner will use its own.

2.6 BUILDING BLOCK 6: MAKING SMART INVESTMENTS FOR IMPLEMENTATION

6

Investment Framework

The core business of a national climate fund is making smart investments. Ultimately, these investments will be the testament to the NCF's effectiveness and value addition. How fund managers decide to allocate resources will hinge on the sources and types of finance available, its assessment of gaps in the climate finance landscape, and the capacity of itself and partners to execute these programs and projects. The ability to track, monitor, and learn from the NCF's portfolio is vital.

1. What are the minimum requirements for the NCF's annual operating plan and longer-term spending strategy?
2. How will the NCF allocate its resources? Which financial instruments shall the NCF utilize? How can the instruments be designed and implemented to best capitalize on synergies with national and international institutions, such as through innovative financing models?
3. If the NCF is expected to implement its own projects, what organizational resources are needed? What kind of project management procedures will these projects be subject to?
4. What is the range of options for implementation? Which activities are best carried out by the fund itself or through public agencies? And which ones are best implemented by partner agencies and organizations?
5. How can the NCF support mainstreaming of climate change objectives into the work and functions of sectoral ministries?

The NCF is an instrument designed to support national objectives, goals, and policies related to climate change. The NCF's investments, whether made in the form of projects, support for sectoral policies, or results-based interventions, should be geared towards shifting the country to a low-carbon, climate-resilient trajectory.

2.6.1 Spending Strategy and Investment Framework

Based on the objectives of the NCF and its operational niche, an NCF may elaborate an investment framework and spending strategy. This framework provides guidance on the fund's focus areas and priority investments. The board may form an investment committee to elaborate the NCF's investment framework, or it may choose to provide input to a secretariat-driven process before formally adopting it. The NCF's appetite for financial risk, captured in the financial risk management framework, will guide the investment framework of the NCF as it sets boundaries on the risk exposure the NCF is willing to tolerate. Elements of the investment framework may include: the thematic focus areas of the NCF, the geographic target regions, the range of stakeholders expected to be engaged, and the overall balance of financial instruments used (more below).

Spending strategies are also helpful to demonstrate how the NCF plans to achieve priorities and provide assurances to the NCF's stakeholders about the direction of the NCF's operations. Through an NCF's investment framework, the NCF's long-term spending strategies link to the national climate change policies and programs. Often, these long-term spending strategies are broken down into annual plans. These annual plans will represent the main short-term planning instrument of the NCF and will contain necessary details regarding the NCF's spending strategy in a given fiscal year. Note that a longer-term spending strategy document can also be merged with a NCF Business Plan document. The NCF may also wish to create a pipeline based on the investment framework and long-term spending strategy to ensure that it builds a robust portfolio.

A task force mandated with the design of the NCF may also be asked to elaborate the NCF's investment framework. The NCF designers should remain cognizant of the GCF's investment framework, and, at the national level, the country investment programs that are prepared under the authority of the NDAs with the contribution of direct access and international access entities.

Institutional planning as part of the NCF's corporate governance system will include aspects such as:

- A consistent and formal process to set specific short- and mid-term objectives and to ensure that these objectives support and align with the overall objectives of the fund stated in the fund's enabling legislation.
- Indicators to measure defined specific objectives and internal documents demonstrating that organization-wide objectives provide clear guidance on what the Fund wants to achieve;
- A general management plan that also includes processes to monitor and report on the achievement of set objectives;
- How the specific objectives will be addressed as part of the fund's governance structures.

The basis for such institutional planning can be an NCF business plan to be elaborated by the NCF director and secretariat and approved by the NCF board. An initial draft business plan may be elaborated ahead of formal foundation of the fund and can be adopted by board in one of the board's first meetings, e.g., together with the NCF's Operational Manual. If such a strategy is deemed useful, the task force mandated with the design of the fund would ideally coordinate the elaboration of the NCF's initial draft business plan.

As the NCF evolves, business plans should be updated on a regular basis (e.g., every 2–5 years) to reflect evolving and changing circumstances. The content and function of the business plans should also be aligned with content and function of expenditure strategies as discussed in section 2.6.2 below. Depending on legal requirements and country practice, the business plan and expenditure strategy may be merged into one document.

2.6.2 Financial Instruments and Risk Management

Financial instruments commonly used in climate finance today include: non-repayable grants, loans, loan guarantees, equity, and insurance. An NCF will typically offer subsidized finance and therefore should ensure that it does not compete with or crowd out such commercial finance. Different climate technologies and solutions will require different levels of subsidization and different types of financial instruments. Such differentiation will ideally be reflected in annual and longer-term spending strategies outlined in section 2.6.1 of the present report. An NCF can gradually shift to commercial terms of finance for technologies as they enter commercialization and are competitive in the market.

As a part of the NCF design process, the designers need to collect information on the domestic sources of climate finance that are available in the market. Depending on the outcome of the assessment, and in line with the NCF's investment framework, the NCF can determine the types of financial instruments needed to fulfill its objectives. For example, if commercial banks in a country already offer loans or equity for green technologies or solutions, there may be no case for an NCF to offer loans or equity. Rather, it can focus on co-financing such loans or equity with grants, if necessary at all, to enable investments to deploy investments at a larger scale. If, however, no commercial products are available in the market, an NCF may consider offering soft loans or equity. It will ideally offer such products in close cooperation with commercial providers, in order to enable a shift to commercial financing at a later stage.

As an NCF gains experience, it may offer more complex financial products. In fact, a number of NCFs have initially implemented projects that are funded by climate finance contributors. For new NCFs, it may be wise to start with grant awards only. Managing grant-based projects and programs is simpler than managing soft loans, guarantees, equity, and insurance programs, not only because of the additional policies and procedures required internally for the NCF but also because credit- and equity-based financial products are often regulated and the NCF will have to ensure its compliance with necessary obligations. In addition, the risk of competing with and crowding out commercial finance is much higher if an NCF provides soft loans, loan guarantees, equity finance, and/or insurance products.

Rather than offering soft loans, loan guarantees, equity finance, and/or insurance products itself, an NCF can also negotiate and implement joint financial products and co-financing agreements with domestic commercial financing companies. For example, a credit line or an equity program managed by one or several domestic banks and subsidized by an NCF with grants can be more desirable than an NCF offering a credit line or equity program by itself. One key advantage of such cooperative solutions is that an NCF can utilize the abilities of commercial financial institutions in credit and risk management. If such cooperative solutions are a fundamental part of the NCF's business model, it will not have to invest in the capacity to acquire those skills. Instead, the NCF can focus on areas where it brings value such as the technical and substantive nature of projects and programs and their alignment with national and international policies and procedures. In the NCF's selection of a trustee, the ability of the trustee to offer complementary financial instruments that help to leverage the impact of the NCF will be key (See the section on trustee selection in the Key Decisions chapter).

As different climate technologies and solutions will require different types of financing solutions, the NCF must determine the exact conditions of financial instruments offered. Apart from the technical merits of any proposal, in the case of non-repayable grants this NCF will have to determine what percentage of total investment costs can be co-financed with a grant, the currencies in which grants can be provided, and the associated service fees and commitment fees. In case of soft loans, for example, additional conditions will include interest rates, maturity and grace period.

2.6.3 Project Cycle Management and Implementation

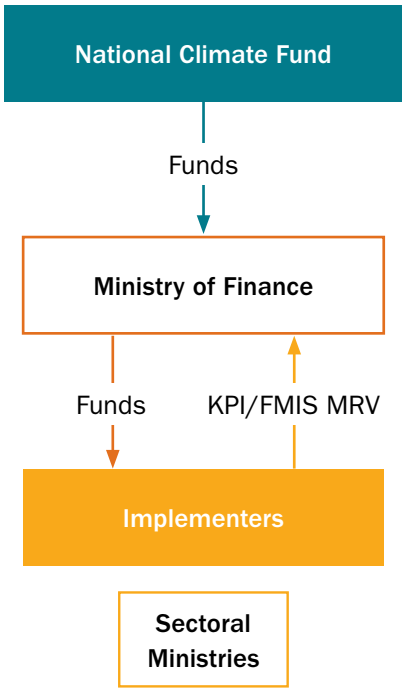
Project cycle management (PCM) means the set of management procedures and practices an NCF will apply for each project seeking support from the fund during project identification, project application, project appraisal, project selection, project contracting, project implementation, project monitoring, project completion, and project evaluation. PCM therefore represents a core NCF policy and should be designed and implemented well, ideally considering experience of other NCFs. The section on fiduciary standards discusses the processes and systems that need to be in place for effective and accountable project cycle management.

Throughout PCM, the NCF will ideally also implement cross cutting policies and procedures related to environmental and social safeguards, gender considerations, and project risk management. Some NCFs use their revenues to finance prioritized mitigation and/or adaptation projects meeting fund policies. National climate funds can also receive funds from external sources and extend those funds to executing entities that will design and implement projects. Other NCFs are expected to coordinate and implement their own mitigation and/or adaptation projects, i.e., without extending project funds to third parties or EEs. In particular, this option will be pursued by NCFs that are to be accredited for the GCF's specialized fiduciary standard on project management.

While the integrity of a project cycle is essential and fund managers need to ensure that the standards for project cycle management are adhered to, NCF designers also need to be cognizant about the costs and benefits associated with a project-based model for the NCF. The most important consideration will be the intended objectives of the NCF and the niche that NCF is intended to fill.

A project-based approach can be particularly attractive if the learning from project design and implementation can be captured and used to build capacity. Often, officials working in sectoral ministries may not have the necessary skills or the capacity to reflect climate considerations into the sectoral ministry's plans and programs. By engaging with the NCF and designing projects and programs for its consideration, officials will start to build their capacity and become more aware of the linkages between their areas of work and climate change at large.

Figure 2.3 Sectoral Integration of NCFs



2.6.4 Budget Support for Sectoral Policies

While project cycle management is a key function of many NCFs, an NCF can also be designed to support integration of climate change objectives into sectoral plans by using the national financial management information system. The funds that are mobilized by the NCF would be provided as budgetary support to relevant sectoral ministries using existing governmental budgetary processes. The primary advantage of the budget support modality of support is the possibility of creating long-term, systemic transformations by directly supporting national policies and goals. To do so, however, entails that a number of intermediate actions be taken. Relevant sectoral ministries will need to incorporate the country's existing climate policies. Further, the key performance indicators or relevant indicators that are used to track the progress of the ministries will also need to incorporate climate considerations. A key consideration of providing funds through budget support for policies is the process necessary to integrate climate considerations into sectoral plans. The budgetary support approach has the advantage of minimizing duplication lines of reporting, monitoring, and evaluation.

A hybrid approach would combine the project-based approach with the budget support approach for sectoral policies. Sectoral ministries would identify projects based on their sectoral plans and policies. They would receive funds directly through the regular channels from the ministry of finance or a similarly empowered ministry. The project implementing entity would report its key performance indicators.

Chapter 3: **Designing a Fit-For-Purpose National Climate Fund**

3.1 CONDUCTING A NICHE ASSESSMENT

The building blocks this guidebook discusses in Chapter 2 are the basic ingredients of a national climate fund. A niche assessment is a strategic exercise that involves examining each of the building blocks in the national context. Therefore, the building blocks of Chapter 2 form the overall scope of a niche assessment. With the goal of identifying a range of potential options for the design of a national climate fund, a niche assessment will involve understanding the actors involved, their capabilities and expertise, resources, and need. Selecting the most appropriate design will involve a careful weighing of the benefits and costs of each of the national climate fund's features and aligning those choices in support of national goals and priorities. Most importantly, a niche assessment will generate vital information that will allow decision-makers to ensure that the fund is designed to fill unmet needs, complement the existing set of institutions and policies, and reflect policy priorities of all stakeholders involved.

The niche assessment will be an opportunity for the NCF designers to gather information on the policy context, identify and engage stakeholders, and chart a path forward towards NCF establishment if the assessment suggests doing so.

NCFs in the policy context

NCFs are attractive instruments because they help to further national priorities and goals. Understanding how national climate-related policies can be best pursued is vital background information that will help guide the design of the national climate fund. It will be important to understand the barriers to mobilizing climate finance so that the NCF can offer instruments that can help remove those barriers. The precise nature of those instruments will be influenced by the type of financial contributions made to the fund. Depending on the expected source of contributions, the NCF will have to display design features that best match with the source. For example, a consequence of receiving state budget allocations would be compliance with state budget procedures and related fiduciary standards, which may differ from international fiduciary standards required by the GCF, GEF or other international climate finance mechanisms.

Stakeholder mapping

Who are the most relevant stakeholders? The NCF designers will have to identify and engage with a broad range of stakeholders. Stakeholders are both governmental actors and non-governmental ones. Engaging with stakeholders allows the niche assessment to generate information on: the needs of the stakeholders and how an NCF can facilitate meeting those; the synergies that have not yet been captured but could be with the help of an NCF; thematic areas, geographic regions, and demographics that have remained unaddressed thus far; and where the NCF's value addition may be the greatest.

The niche assessment can conduct a survey that maps public and private financial mechanisms operational in the country providing climate finance, including their current and expected future focus and role in climate finance. The survey can also consider the tools that are being used by these actors, for example, grants, loans, guarantees, and equity. For countries with well-established private sector actors, policymakers will need to consider the possibility of subsidized finance crowding out private investment.

We can distinguish two kinds of stakeholders: those that would be involved in the governance of the NCF including in the process of establishment, and those that would be engaged with the NCF as implementing actors. Furthermore, civil society organizations, research institutions, and similar groups also have an important role to play as sources of expertise and additional accountability and oversight.

Establishment process

Based on all factors assessed above, NCF designers need to carry out a legal assessment/mapping as to which type of enabling legal basis would be most adequate and feasible, e.g., law/act to be passed by parliament, regulation to be adopted by cabinet, regulation to be adopted by the responsible minister, etc. Typically, time needed and complications to be expected will guide such a legal assessment. Different options for legal bases of an NCF (e.g., public enterprise, state agency, trust fund, foundation, unique status) should be examined.

We recommend three central questions guide the niche assessment study:

1. What are the opportunities and challenges in establishing an NCF?
2. How does an NCF fit within the existing set of policy instruments and institutions designed to help address climate change?
3. How can an NCF promote the achievement of national priorities and plans on climate change and sustainable development? What barriers to ambitious climate action would the NCF help tackle? What incentives would it have to provide?

3.2 GREEN CLIMATE FUND

The Green Climate Fund is relevant for national climate funds in at least three aspects. First, national climate funds can serve as direct access entities. Second, they can implement actions as executing agencies. Third, the readiness support program of the Green Climate Fund may help to integrate the NCF into the policy mix of the country and be a source of funds to make the NCF operational. The safeguards and standards that direct access entities need to conform with are discussed in Chapter 2.

Accrediting national climate funds as GCF direct access entities: key considerations

The Green Climate Fund's accreditation process is based on the 'fit-for-purpose' principle. Such a principle is intended to accommodate a range of entities that desire to be accredited to the GCF based on what the entity desires to do with GCF resources. In other words, by avoiding a uniform accreditation process, the fit-for-purpose model demands more elaborate procedures from entities wanting to manage larger projects with greater risk profiles.

Legal status

One of the key decision points for NCF designers is the legal nature of the fund (Chapter 2). In certain national contexts, NCF designers may deem it more appropriate for a fund to exist as a window in a ministry rather than as a stand-alone entity with independent legal personality. The Green Climate Fund requires the entity that it accredits to have legal personality. If a fund is housed within a ministry, accreditation will be provided at the level of the ministry and not the level of the fund. This precedence was established when Ethiopia's Climate Resilient and Green Economy Facility was accredited at the level of Ministry of Economic and Financial Cooperation.

Track record

Often, national climate funds are newly established entities with a limited track record of operations. Candidate entities are expected to display a track record of at least three years of operations. For candidate entities with limited experience, the GCF Board has stipulated that there be increased reporting requirements for the first two years, after which the increased reporting requirements can be relaxed. Establishing a new entity may be an opportunity to ensure that the fund is designed to ensure compliance with internationally recognized fiduciary standards and safeguards.

Entities holding accreditation with the GEF, Adaptation Fund, and EU-DEVCO If an entity already holds accreditation with the Global Environment Facility, the Adaptation Fund, or the European Commission's Directorate-General for International Cooperation and Development (DG-DEVCO), such entities are eligible for fast-track procedures. While they will still have to undergo accreditation formalities, they can directly enter Stage 2 depending on the proposed scope, size, and risk profile of activities.

Box 3.1 Opportunities and challenges in establishing an NCF

Opportunities	Challenges
Facilitating climate finance • Increased climate finance at national level • Improved blending of climate finance available • Access to finance that would otherwise not be available, e.g., access to certain foreign climate finance sources including GCF/AF/GEF Direct Access	**Institutional niche** • Focus on climate finance 'only', or, focus on wider areas additional/complementary to climate change, including environment, water/waste infrastructure, biodiversity & nature protection • Integration with existing institutions and financing mechanisms
Ownership and capacity enhancement • Increased ownership in climate finance (sometimes coupled with decreased dependence on foreign partners) • Systematic development of climate finance capacities and markets at national level • Enhancing sustainability and depth (local level outreach; vulnerable communities) of climate finance – due to national ownership	**Fiduciary standards, capacity requirements, Direct Access requirements** • Ability to provide a sufficient degree of institutional independence and stability • Ability to comply with international fiduciary standards; compatibility issues between fiduciary standards at national and international levels • Ability to finance significant overhead costs and to respond to capacity requirements
Improved delivery of policy priorities • Improved coordination of financing of policy priorities • Enhanced mix of policy instruments • Improved coordination between and cooperation among key stakeholders	**Public finance compatibility** • Compatibility with budget integrality & comprehensiveness, as well as allocative efficiency & cost effectiveness requirements • Issues related to earmarking of tax revenue
Other • Possibility to learn from experience with NCFs in other countries	**Other** • Ambition of approach, e.g., start with non-repayable grants only or offer more complex financing instruments from scratch, e.g., loans, guarantees, equity, insurance.

Note that actual opportunities and challenges may differ in the specific circumstances of a given country.

Scope

National implementing entities (NIEs) must display that they have the necessary fiduciary standards and safeguards in place. The GCF distinguishes between basic fiduciary standards and specialized fiduciary functions (project management, on-lending/blending, grant award). The NIE must determine which set of functions is most appropriate given the nature of its proposed activities for funding by the GCF. (Please see Chapter 2 Building Block 5 for details on fiduciary standards and safeguards.)

Implementation

An NCF may serve as an executing agency of institutions that receive GCF support for implementation. Such entities may be national implementing entities, or regional or multilateral implementing entities. Under this scenario, the NCF does not need accreditation with the GCF as a direct access entity.

Through **direct access**, the NCF can gain accreditation with the GCF as a national implementing entity. As an NIE, the NCF may directly submit proposals to the GCF Board for consideration without having to work through intermediary organizations. The NCF may implement activities directly, or it may rely on other executing entities for implementation. The modality of work needs to be clarified as the NCF goes through the steps for accreditation, as the nature of fiduciary functions proposed will determine the accreditation procedures.

The GCF has piloted **enhanced direct access**. EDA is a further step in devolving decision-making to the level of the accredited entity. The decision-making body for entities wishing to utilize enhanced direct access models will need to include civil society, the private sector, and other relevant stakeholders, and be sensitive to gender considerations. The direct access entity will have to specify, among others, the financial envelope sought, the multi-stakeholder engagement process to be set up, approval process and selection criteria, and a pipeline of sub-projects.

Readiness support

Through the GCF's Readiness and Preparatory Support Programme, NCFs may be able to receive resources and/or technical assistance to build the necessary capacity to engage with the GCF. The full list of indicative activities is available

on the GCF's website. The most pertinent ones for NCFs are as follows: charting out investment priorities based on relevant national policies, identifying programs and projects in line with the GCF's results management framework, supporting private sector participation through advisory services and preliminary studies, institutional gap analysis against the requirements of the GCF for accreditation, and building capacity post-accreditation on ESS, gender policy, and monitoring and evaluation. This readiness program also supports national designated authorities and focal points- their relationship with the NCF is a key element to support national oversight. The program also provides support for the formulation of national adaptation plans and the activities contained therein.[3]

3.3 SPECIAL WINDOWS

To better cater to the needs of the NCF's beneficiaries, an NCF may decide to create special windows for targeted programming. For example, a number of climate funds, such as the Amazon Fund and the Bangladesh Climate Change Trust Fund, have special windows through which they engage with NGOs. NGOs help to bundle smaller projects and obtain finance through the NCF. Such an arrangement offers numerous advantages. The transaction cost of the NCF engaging with many small projects may be high. In the spirit of cost efficiency, it would be easier to work through an NGO. Similarly, national climate funds that are housed in banks have found that while they have a strong track record in dealing with loans and other commercial products, they lack experience in grant finance. Through an NGO set-aside, the NCF can fill in this gap in experience. Furthermore, by increasing the modalities by which the fund can operate, the fund will be more responsive to the needs of its beneficiaries.

Both the Bangladesh Climate Change Resilience Fund and the Bangladesh Climate Change Trust Fund enlisted the support of the Palli-Karma Sahayak Foundation, a microcredit agency, to manage their NGO set-aside programs. With its substantial experience in implementation of grant and concessional lending programs, the BCCRF and the BCCTF were able to use the experience of the PKSF to design programs and reach communities that they otherwise may not have been able to on their own. Furthermore, the advantage of using an organization that can bundle projects is that it saves transaction costs to the NCF by reducing the number of projects it needs to process.

A window that serves as a project preparation facility may also be useful. A key challenge that many sectoral ministries face lies in translating national and sectoral plans and policies into bankable projects. A project pipeline preparation support facility will provide a direct interface for governmental and non-governmental stakeholders of the NCF and will help to ensure that those lacking the capacity or the skills can receive support directly from the NCF to design projects and programs.

Box 3.2 Building Green Climate Fund – National Climate Fund linkages in Fiji

The GCF Readiness Programme in Fiji exemplifies the close interlinkages and synergies between national climate funds and international institutions such as the Green Climate Fund. Three key areas of support help to illustrate how empowering national institutions to implement climate actions and increase their reach to international sources of finance go hand in hand.

Accreditation Support A major focus of this program was to enhance the capacity of domestic institutions so that they have the necessary capacity to access international resources through, among others, direct access modalities of the Green Climate Fund. Strengthening national institutions is vital to enhancing country ownership and fostering long-term sustainability so that domestic institutions can become accredited entities of the Green Climate Fund, as the Fiji Development Bank did.

Feasibility Study This study identified a range of options that Fiji policymakers could use to set up a national climate fund. An extensive stakeholder engagement process was carried out. Stakeholders identified the importance of mobilizing the private sector to support Fiji's ambitious goals in its Nationally Determined Contribution. Fiji's Climate Public Expenditure and Institutional Review identified a national climate fund as an opportunity that would allow for a coordinated approach to climate finance delivery, enhancing collaboration between actors, and enhanced accounting of climate finance receipts and expenditures. (# is there a stable link for Fiji's CPEIR?)

Project Pipeline The GCF Readiness Programme also provided support to identify potential projects that could be submitted to the Green Climate Fund for implementation via direct access. Having a pipeline of projects, with varying levels of design maturity, helps to ensure that accredited entities have actionable projects in place. An existing pipeline of projects also helps the accredited entity to make a more convincing case in its fund mobilization efforts.

3 https://www.greenclimate.fund/documents/20182/104167/Readiness_and_Preparatory_Support_Guidebook.pdf/9eea580f-a109-4d90-b2

Engaging in an effort to build a pipeline of projects and programs will also enable the fund to lay the groundwork for a portfolio that is impactful and reflective of the objectives that it is trying to achieve. Stakeholder engagement is vital to ensure that the projects and programs are fully owned and reflect the needs and priorities of the implementing entities.

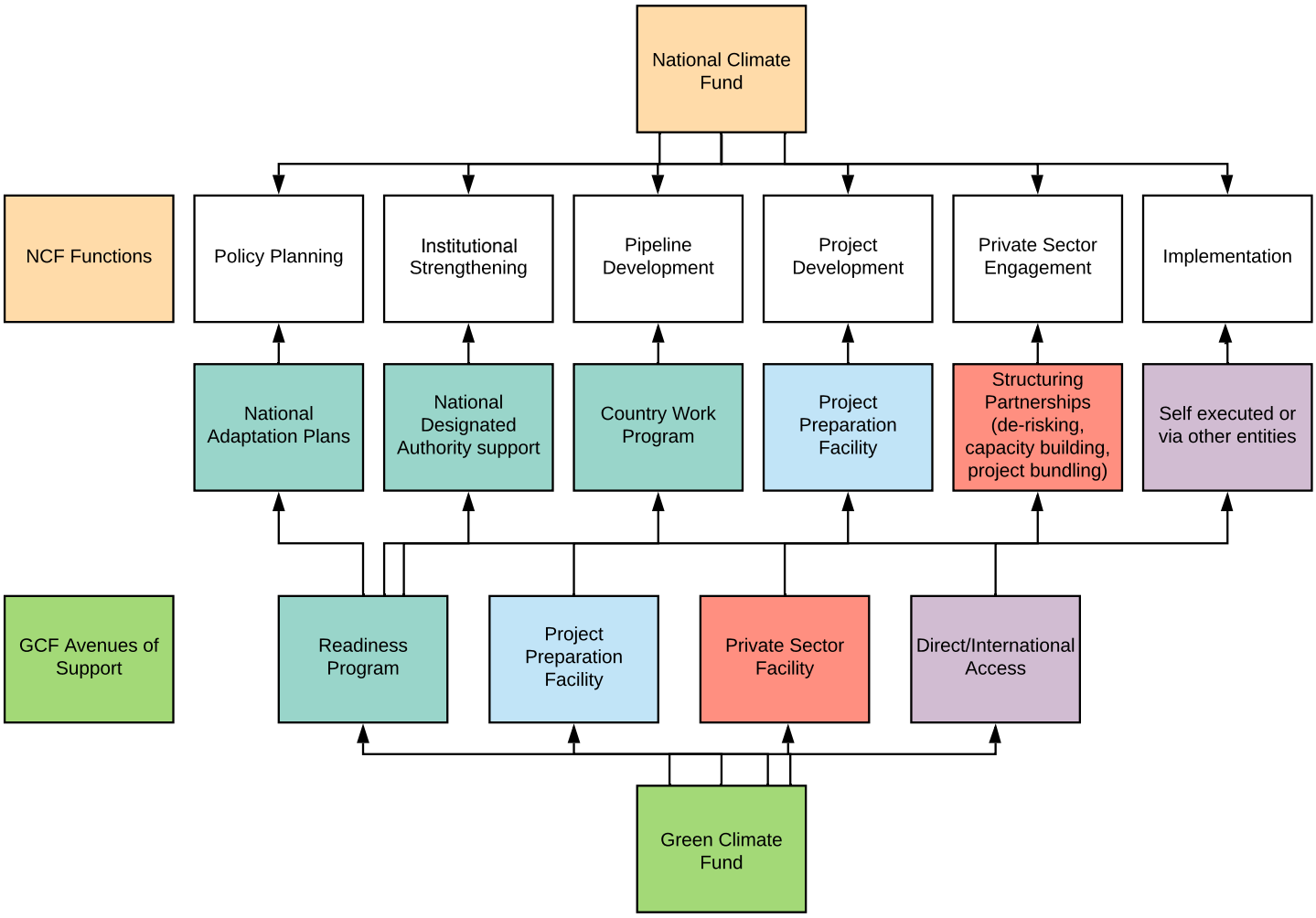
For example, the National Bank for Agriculture and Rural Development (NABARD), an entity that has accreditation with both the Adaptation Fund and the Green Climate Fund, received support to build a project pipeline. Areas for support included: development of a methodology to conduct climate vulnerability assessments; project appraisal tools; and support to NABARD's executing entities in project proposal submission.[4]

3.4 NATIONALLY DETERMINED CONTRIBUTIONS AND THE 2030 AGENDA FOR SUSTAINABLE DEVELOPMENT

Governments have put in place a range of policy measures to implement actions in their pledge under the Paris Agreement, the nationally determined contributions (NDCs). National climate funds can be an important lever that support the achievement of NDC goals in the ways we identify below.

Bankability We can view nationally determined contributions as a potential business plan for activities related to climate change. National climate funds can play an important role in helping to translate goals, targets, and policies into a pipeline of projects that can be financed through a variety of sources. As countries move forward with

Figure 3.1 Potential National Climate Fund Linkages with the Green Climate Fund



4 http://pdf.usaid.gov/pdf_docs/PA00M1MD.pdf

implementing their NDCs, turning policies into *bankable* projects will require expertise. NCFs can offer this essential service as it can pool expertise on climate finance.

Complementing policies When national climate funds work to fill gaps in existing policies and complement the range of instruments deployed by the government, they can have catalytic impact. In fact, to understand the value addition of a national climate fund, we must view it in the context of alternative options. If the government did not establish a national climate fund, how would it pursue the same goals? A key question for designers therefore involves identifying the gaps that NCFs are uniquely capable of filling and determining how a national climate fund can complement policies, such as those that form the basis for an NDC.

Coordination By anchoring the national climate fund firmly in the NDC, countries can steer domestic and external resources to support NDC actions. Furthermore, a tight coupling of the NDC and the NCF can also support policy alignment via donor harmonization. As national climate funds can play an effective role in bringing together development partners, such coordination can in turn allow for greater country ownership. Similarly, national climate fund can further reinforce policy priorities by tying its resource allocation framework explicitly to the national climate policies.

Tracking Given that national climate funds can host substantial expertise and given their cross-sectoral engagement, they may be suited to track and assess climate finance. Tracking of climate finance can take place through the estimation of climate-relevant budgetary expenditures (see UNDP's work on CPEIRs) as well as a tracking of climate finance received from external sources. For example, Ethiopia's Climate Resilient Green Economy Facility has the mandate to track climate finance. Its placement in the Ministry of Finance and Economic Cooperation allows it play this role.

The Paris Agreement, under its transparency provisions, encourages parties to submit information on both actions taken as well as support received (and provided). As a result, national climate funds can form a key part of the reporting infrastructure at the national level and provide crucial input to the global stocktake to understand the gap between actions undertaken and goals.

Stakeholder engagement NCFs provide a visible interface for a broad range of stakeholders to engage with actions on climate change. When the NCF is designed to support the country's NDC, the NCF can be another opportunity to broaden the base of support for climate actions. NDCs that are rooted are able to gain the support of a robust base of stakeholders, which can provide an essential ingredient to ambitious and sustainable policy choices.

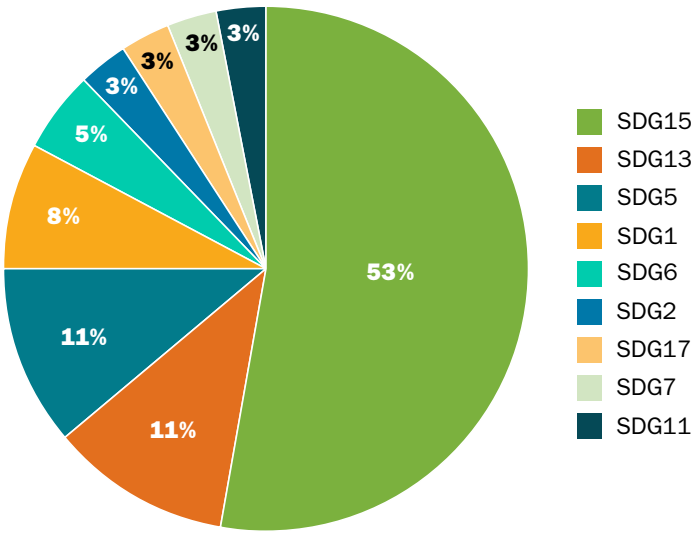
Furthermore, as the Paris Agreement encourages developing countries to move towards economy-wide targets and goals, NCFs can play an important role in creating the broad constituency of governmental and non-governmental stakeholders that can pave the way for ambitious policies.

NCFs and SDGs

While NCFs are often discussed primarily in the context of climate change alone, they can be important instruments to support the implementation of SDGs. There are three basic levels at which the synergies between NCFs and the SDGs operate: the fund's portfolio, mainstreaming climate, and supporting global partnerships (SDG17).

NCF's portfolio The Climate Resilient Green Economy Facility, the financing arm of Ethiopia's ambitious climate policy, illustrates how NCFs work at the interface of climate and sustainable development. A rapid portfolio analysis of the CRGE Facility shows that the fund, through activities it has funded, has direct impacts on multiple SDGs as illustrated by the pie chart below.*

Figure 3.2 SDGs and the CRGE Facility



*Please note that this information serves to illustrate the linkages between NCFs and the SDGs. It is not an evaluative assessment of the CRGE Facility's portfolio and does not assess the scale and magnitude of the impact of CRGE Facility funded projects towards the SDGs.

Global partnerships (SDG17) The CRGE Facility is where SDG17 meets the Addis Ababa Action Agenda. The CRGE Facility exemplifies a number of targets under this goal. The design of the CRGE Facility is to mobilize resources from multiple sources. It works closely with sectoral ministries to build capacity to implement national plans related to sustainable development. As the central coordination body on climate change, it steers national policy coherence. The CRGE Facility also intends to track climate-relevant expenditure, thereby improving data, monitoring and accountability.

Mainstreaming climate change (SDG13) The CRGE Facility supports the *integration* of the CRGE strategy into national planning. The Government of Ethiopia has incorporated the CRGE strategy into its current development plan – the second Growth and Transformation Plan. Further, sectoral ministries such the Ministry of Agriculture and Ministry of Water, Irrigation and Energy have produced their sectoral plans to *strengthen resilience and build adaptive capacity.*

The holistic approach of the SDGs also means that instruments that were designed to further goals related to climate change can also be used to achieve climate-related objectives. For example, many countries have established conservation trust funds to promote goals related to conservation such as protecting biodiversity and promoting forest conservation.

The Peruvian Trust Fund for National Parks and Protected Areas (PROFONANPE) was established with the mandate of promoting biodiversity conservation in 1992. It is one of the few entities that has been accredited to both the Adaptation Fund and the Green Climate Fund. PROFONANPE's experience not only demonstrates a close inter-linkage between the goals of conservation and addressing climate change, but it also underscores the importance of designing robust institutions that can serve as instruments to channel finance from different sources. PROFONANPE's experience with climate finance highlights three emerging lessons as conservation trust funds proactively address linkages with climate change.

Institutional independence As many conservation trust funds are constituted as legally independent entities, they often already have key governance systems in place that allow them to meet international fiduciary standards and safeguards. One of the reasons for PROFONANPE's success in obtaining accreditation as a direct access entity is that these systems were already in place. Furthermore, their institutional independence also provides credibility and certainty to the fund's stakeholders of the fund's objectives and programs. At the same time, as PROFONANPE's case helps to demonstrate, its legal independence also means that it is ineligible to receive direct transfers from the government.

Agility The landscapes of both conservation finance and climate finance are fast changing and can often track political attention cycles. At its core, the linkages between biodiversity and climate change mitigation and adaptation are clear and concrete. PROFONANPE has displayed an ability to make use of these interlinkages, thereby allowing it to retain its focus on its priority areas. A key element that has allowed PROFONANPE the space for such agility is a robust monitoring system that is revised and updated.

Middle income country status As countries graduate into the status of a middle-income country, they find that their channels for highly concessional and grant finance start getting limited. Peru has faced a similar challenge as it graduated into middle income status but with a continued need to address poverty and vulnerability to the effects of climate change. PROFONANPE has long been engaged with the private sector and other stakeholders. Relying on a diverse base of stakeholders has allowed it to be flexible and adjust its delivery instruments as the nature of financing instruments also change.

3.5 SUB-NATIONAL CLIMATE FUNDS

The guidebook has largely focused on funds at the national level. We have witnessed a growing tendency for sub-national units to establish their own climate funds. While these funds may be linked and nested in the larger, overarching climate finance architecture of the country, it may not necessarily be so. The scale at which the climate fund operates has to be commensurate with the objectives of the fund.

Needs-driven Sub-national or local climate funds are closer to the beneficiaries of climate finance. Such proximity allows the funds to better incorporate local needs in their programming and finance allocation decisions. Climate finance needs can be highly context-specific. This is particularly the case of adaptation and resilience interventions. A subnational climate fund affords the opportunity to tailor programs and projects to take into account the contextual richness.

Accountability While it is possible for sub-national funds to be accountable to national or central level authorities directly, we define a sub-national fund as a fund with devolved authority that is accountable to its corresponding sub-national authority. A sub-national fund will have to be accountable both for its

results and stakeholders, governmental and non-governmental, which are better able to keep track of the fund when they are able to engage with the fund directly as a part of its governing structure and by monitoring its actions. The need-driven nature of a sub-national climate fund and the potential for its accountable and sound governance go hand in hand. Paying attention to design features that instill accountability in the fund's governance would also help the fund be more effective. Better accountability means that climate policies are seen as more legitimate by key stakeholders, thereby providing climate actions with a robust anchor.

Capacity A climate fund at the subnational level can also be an opportunity to bolster the capacity of local level officials in climate programming. This capacity in turn can facilitate the articulation of climate plans and priorities at the local level, the translation of national policy documents into local level guidance, and the incorporation of a climate lens into regular planning processes. As operating a climate fund entails familiarity and competence not just with designing and assessing climate-related interventions, but as fund managers, the officials will also be responsible for maintaining fiduciary standards, ensuring integrity in fund management, and engaging with a range of stakeholders.

Integration An NCF's beneficiaries may engage with sub-national climate funds to access different kinds of services. For example, a sub-national climate fund may support solar home systems and thereby provide energy access services. Such concrete points of interaction are an opportunity for the government to deliver integration between various policy objectives. From the viewpoint of those accessing services, whether a certain intervention fulfills development, climate, or broader sustainable development objectives is less relevant. Therefore, sub-national climate funds offer an opportunity to put the focus on the needs of beneficiaries first, and devise programs and projects accordingly. By doing so, policy integration will move from a rather abstract idea discussed in policy documents to concrete, implementable actions that meet peoples' needs.

Network of funds A national climate fund can devolve decision-making authority to its local level counterparts. In this model, the national climate fund would in effect be a network of subnational climate funds. Akin to enhanced direct access by national entities to international financial institutions, a network of funds approach would enhance the reach of sub-national funds into national planning and treasury-related policies.

3.6 EMERGING LESSONS

Clarity in division of labor One of the biggest advantages of setting up a national climate fund lies in its ability to bring together multiple actors. However, the engagement of many actors also entails clarifying the roles and responsibilities of each party. For example, it is important to delineate the division of labor between the trustee, the fund management and/or secretariat, and contributing partners. In this regard, a results framework can be an essential tool. Previous experience suggests that a results framework can bring all actors into dialogue about their expectations for the fund and ensure that the fund can operate smoothly on the basis of such a common understanding. Absent a results framework or similar documents that capture the expectations for the fund and chart out a path forward, the fund will have a less credible basis to illustrate how it is delivering on results that matter to the fund's champions.

Finding sustainable resources National climate funds have mostly relied on public contributions from domestic or international sources. The experience of a number of national climate funds shows that a key limitation to using innovative sources of finance has been a mismatch between such anticipated sources and the design of the fund. There are two key aspects to this. Does the NCF have the legal mandate to use the range of sources and instruments that it wishes to deploy? And, do the resources match with the nature of the projects the NCF wishes to undertake? For example, past experience has shown that the revenue sources that a fund expects, such as corporate social responsibility contributions in some countries, may not be eligible revenue streams when the NCF is embedded in the government. Therefore, in the assessment on where to house the NCF, designers need to consider the opportunities and challenges of receiving revenue from different sources in conjunction with options for housing the fund. Similarly, if regulations require a low level of risk tolerance for the fund, fund designers will have to appropriately select the nature of instruments that the fund can use to engage with the private sector.

Engaging relevant actors When policymakers design a national climate fund to be a central lynchpin of climate policy implementation, the national climate fund needs close engagement and buy-in of the most relevant line ministries. Evidence shows that when the fund designers do not engage directly with the most relevant line ministries, the national climate fund is not able to utilize substantial climate finance inflows that are directed towards those sectors. Despite the mandate for financing climate actions in general, the national climate fund will bear the risk of being a marginal actor. Conversely, the sector that is attracting finance may not have a national climate fund in place, thereby depriving it of the benefits that an NCF can offer. Therefore, during the design process, policymakers need to pay special attention to relevant stakeholders and ensure that the NCF provides a basis for their engagement.

Fund management capacity In a number of instances, countries have earmarked revenue from taxes and fees for a national climate fund or a similar institution. However, when fund management capacity of actors involved in managing the fund is not built, the revenue can go unspent. Capacity building therefore is critical. Ministry officials, particularly those in ministries that have regulatory mandates, may not have prior experience in managing funds, allocating resources, and evaluating projects. The consequence of unspent funds is that it becomes progressively harder to make a case for resources when those with capacity do begin to manage the fund. The delivery of results is the national climate fund's greatest asset and can serve as the primary basis by which it mobilizes further funding.

Transition management Countries may choose to appoint international financial institutions as trustees and fund managers of their national climate funds until domestic actors become capacitated to take over fund management. Such a transition design necessitates an action plan, with clear identification of responsibilities, to ensure that prospective fund managers can take full control. Experience shows that capacity gaps may not be understood by those who are tasked to build capacity. Similarly, there may be conflict of interest in requiring interim fund managers to build capacity for a handover. However, designers can put in place safeguards to ensure smooth operation and transition.

Evolving niches The international climate finance landscape has gone through substantial evolution in the last ten years. National climate funds have had to adapt and adjust to this changing context. Through the UN Framework Convention on Climate Change, countries have established the Green Climate Fund, the major funding vehicle for climate finance globally. Though this guidebook, we have illustrated the numerous linkages that NCFs have with the Green Climate Fund to allow the NCFs to build on the resources and opportunities the GCF offers. Similarly, at the national level, with a thrust towards mainstreaming climate considerations into the overall budget of the country, national climate funds will need to carefully assess the role they can play in such an evolving context. This is a strategic question that all national climate funds will have to wrestle with as climate mainstreaming truly goes mainstream.

Chapter 4: **Conclusion**

The evolving landscape of climate finance presents immense opportunities for countries to help achieve their national climate change objectives. Mobilization of climate finance is not an automatic process but needs careful and concerted steering. Bringing together public and private sector institutions, including non-governmental organizations, can unleash the transformative potential of partnerships to facilitate the transition to low-carbon, climate-resilient trajectories. To realize such a goal, national institutions must be equipped with the skills to access and channel funds towards their priorities. They will need to carefully balance the increased number of actors involved in climate finance and associated climate finance flows with the ability to collect, blend, coordinate, manage, and account for climate finance. NCFs can be an effective instrument to achieve just that.

As this guidebook demonstrates, National Climate Funds (NCFs) can be a useful mechanism that can allow national level entities to optimize their access to and management of climate finance. NCFs can allow for managing international climate finance completely at national levels and therefore put national decision-makers in the driver's seat for transforming their economies and achieving zero-emission, climate-resilient sustainable development.

Based on more than 20 years of worldwide experience in operating National Climate and Environmental Funds, as well as UNDP's experience in the administration of over 750 trust funds at the national, global and regional levels, and 40 multi-donor trust funds around the world, there is a set of key decisions that a country must consider when designing and establishing an NCF: defining the objective and the operational niche, identifying revenues, and crafting the legal basis. The NCF must also be built with three building blocks: effective governance, sound fiduciary management, and smart investments.

It is important to learn from the experiences of established NCFs and build on lessons from their design and establishment process. A key lesson applicable to all countries designing an NCF is to be very clear about what the NCF should accomplish. Countries must realistically assess their needs: in some cases, the NCF should be very broad, attract many different types of funding sources, and finance a broad range of projects; in others, a more targeted NCF is necessary to focus on key priorities for the country.

Importantly, NCFs are not one-size-fits-all. Each NCF must be tailored to country priorities and realities. They should be firmly rooted in, and aligned with, existing national strategies, frameworks, financing mechanisms, and other initiatives on climate change. While the framework that this guidebook offers reflects cumulative learning, the precise design of the NCF will have to reflect national priorities in the best possible manner.

An NCF is not one-size fits all. Countries face many kinds of barriers and challenges to mobilizing climate finance. When designed well, an NCF can be effective in addressing many of these barriers. However, policymakers will also have to ensure that the NCF is supported by complementary actions that will support and amplify the work of the NCF in particular, and the policy environment more generally.

Establishing and operating an NCF offers important opportunities for stakeholder engagement in the country's climate policies at the national and sub-national levels. Not only does broadening the base of engagement facilitate a comprehensive mobilization of resources to support the design and implementation of climate policies. Ultimately, an NCF can equip a country to seize the opportunity to pursue low-carbon, climate-resilient development by building its capacity to align international resources with national needs, sustaining momentum by building a robust constituency, and ensuring that those who need climate finance the most are empowered to meet their needs.

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