



*Empowered lives.
Resilient nations.*

National Climate Funds

**Learning from the experience
of Asia-Pacific countries**



Authors: *Silvia Irawan, Alex Heikens, and Kevin Petrini*

Reviewers: *Cassie Flynn, Isabel Kreisler, Angus Mackay, Paul Steele (UNDP), Li Chunyi (China CDM Fund)*

Acknowledgements: Over 250 practitioners from Asia-Pacific governments, fund managers, experts, development partners and Civil Society Organizations have contributed to the development of these productions through their participation in the e-discussions, regional clinic and case studies. We therefore would like to take this opportunity to thank all of them for their valuable contributions.

Contact Information: Alex Heikens (alex.heikens@undp.org) and Kevin Petrini (kevin.petrini@undp.org)

Disclaimer: the views expressed in this paper are those of the authors and do not necessarily represent those of UNDP, the United Nations or its Member States.

Citation: Irawan S, Heikens A, Petrini K (2012) National Climate Funds: Learning from the experience of Asia-Pacific countries. UNDP Discussion Paper.

National Climate Funds

**Learning from the experience
of Asia-Pacific countries**

Acronyms

ADB	Asian Development Bank
AusAID	Australian Agency for International Development
BCCTF	Bangladesh Climate Change Trust Fund
BCCRF	Bangladesh Climate Change Resilience Fund
BTFEC	Bhutan Trust Fund for Environmental Conservation
CCCA	Cambodia Climate Change Alliance
CCDMF	China Clean Development Mechanism Fund
CDM	Clean Development Mechanism
DEDE	Department of Alternative Energy Development and Efficiency
DFID	Department for International Development
ESCO	Energy Service Company
ENCON Fund	Energy Conservation Promotion Fund
EPF	Environmental Protection Fund
FSM	Federated States of Micronesia
GCF	Green Climate Fund
GEF	Global Environment Facility
GIZ	Gezellschaft für Internationale Zusammenarbeit
ICCTF	Indonesia Climate Change Trust Fund
LDCs	Least Developed Countries
KPI	Key Performance Indicator
MCT	Micronesian Conservation Trust
MDGs	Millennium Development Goals
MDTF	Multi-donor trust fund
NCF	National Climate Funds
PIFS	Pacific Islands Forum Secretariat
PSF	Peoples Survival Fund
SGP	Small Grants Programme
SIDA	Swedish International Development Agency
SREP	Secretariat of the Pacific Regional Environment Programme
SMEs	Small Medium Enterprises
TEERF	Thailand Energy Efficiency Revolving Fund
TTF	Tuvalu Trust Fund
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
USAID/RDMA	United States Agency for International Development / Regional Development Mission for Asia
WB	World Bank

Table of Contents

Introduction	4
Positioning NCFs within the overall national climate finance	7
Research methodology	9
Feasibility Criteria of NCFs	11
Design Features of National Funds	13
Different types of funds	13
Legal Arrangements	15
Governing Body.	15
Beneficiaries	16
Management features of NCFs	17
Project cycle: transparency and efficiency	17
Working with beneficiaries at the local level.....	18
Performance based monitoring	19
Ensure effective programs	19
Recommendations.....	20
Annex 1	24

Introduction

Addressing challenges posed by climate change requires significant financial resources. In the growing literature of climate change, “climate finance” refers to financial resources required to cover the costs of climate actions and investments². Climate finance is complex because of the diversity of sources of funds, agents and channels to distribute the funds to intended beneficiaries at different levels and scales. The expected scale of climate finance is also significant. Developed countries have committed to mobilize new and additional resources for climate investments. It has been agreed at COP 15 in Copenhagen that as much as US\$ 30 billion for 2010-2012 and US\$ 100 billion by 2020 is to be mobilized to assist developing countries to cover the costs of climate mitigation and adaptation. The committed resources, however, are much lower than the estimated amount required to finance mitigation and adaptation actions. Estimates vary from around US \$140-175 billion and \$70-100 billion per year for the period of 2010-2050.³ Uncertainties remain on how the funds will be raised, managed and disbursed. One of the mechanisms to manage and channel international finance is the recently created Green Climate Fund (GCF). The GCF is expected to support projects, programs, policies, readiness and other activities in developing countries. The operational policies and modalities, including how countries can access the fund, are currently being negotiated.

Despite the uncertainty over the level of funding likely to become available internationally, developing countries are currently building their capacity to better access and deliver climate finance. UNDP’s paper on “Readiness for Climate Finance” defines readiness for climate finance as the capacities of countries to plan for, access, deliver, and monitor and report on climate finance, both international and domestic, in ways that are catalytic and fully integrated with national devel-

opment priorities and achievement of the MDGs.⁴ Such readiness to develop an enabling environment is required to ensure that public finance is effectively allocated at national and local levels to leverage private and public investments and facilitate a transition to a low emission and climate resilient development pathway.

In Asia-Pacific, some countries have established national funds to access and manage climate finance (Box 1). The UNDP Guidebook on National Climate Funds⁵ defines National Climate Funds (NCFs) as a mechanism that supports countries to direct finance towards climate change projects and programs. This paper looks at NCFs in Asia-Pacific that manage climate finance outside government budget (extra-budgetary)⁶, apply certain accounting standards, and may have their own governance structures and independent legal status. National funds for accessing and managing climate finance, however, must be carefully tailored to national circumstances. As can be seen from existing funds in the Asia-Pacific, the establishment of national funds requires time and investment in building human and institutional capacity to manage a fund effectively and transparently.

Establishing extra-budgetary funds to manage financial resources for specific purposes (such as environment, health, education and development in general) is not new. In middle-income countries, extra-budgetary funds (Box 2) are commonly established to earmark government budgets to finance specific purposes such as education and health. In Thailand, for instance, around ninety-five revolving funds were established to finance specific purposes as of

² In this paper, climate finance is interpreted broadly including public and private finance from domestic and international sources, unless otherwise specified.

³ <http://siteresources.worldbank.org/INTWDR2010/Resources/5287678-1226014527953/Chapter-6.pdf>

⁴ Vandeweerd V, Glemarec Y, Billett S (2012) Readiness for Climate Finance - A framework for understanding what it means to be ready to use climate finance. UNDP Discussion Paper.

⁵ This paper makes a number of references to the “Guidebook for the Design and Establishment of National Funds to Achieve Climate Change Priorities”, which will be referred to as the “NCF Guidebook” henceforth. It can be accessed at http://www.undp.org/content/dam/undp/library/Environment%20and%20Energy/Climate%20Change/Capacity%20Development/Blending_Climate_Finance_Through_National_Climate_Funds.pdf

⁶ The term ‘extra-budgetary fund’, however, is not well-defined, and covers a variety of institutional arrangements. An extra-budgetary fund can be defined as government transactions that are not included in the annual national budget (appropriations) law and may not be subject to the same level of scrutiny or accounting standards as the government budget (which could be higher or lower than government account standards).

Box 1: National climate funds in Asia-Pacific

Over the past few years, there has been a growing trend to establish National Climate Funds as a means of managing climate finance from domestic and international sources. Indonesia and Cambodia established Indonesia Climate Change Trust Fund (ICCTF) and Cambodia Climate Change Alliance (CCCA) Trust Fund to pool international climate finance and distribute to relevant stakeholders in respective countries. Both Trust Funds are multi-donor trust funds, with UNDP as the interim trustee. Bangladesh established two climate funds: Bangladesh Climate Change Resilience Fund, which is managed by the World Bank, and Bangladesh Climate Change Trust Fund managed directly by the Government of Bangladesh. The Philippines is currently establishing the Peoples Survival Fund (PSF), which aims to finance adaptation programs and projects that are directly supportive of the objectives enumerated in the Climate Change Action Plans of local government units and communities. The design of the PSF is currently being developed.

Several countries are also considering about creating a specific window within their existing national funds for environment or biodiversity conservation to address the issues of climate change. For instance, there is an on-going discussion to create a specific window for climate change under the Lao Environmental Protection Fund, while the Micronesian Conservation Trust has applied to be accredited to serve as the National Implementing Entity for the Adaptation Fund in FSM.

May 2009.⁷ These funds are usually managed by dedicated government agencies and in many cases they are financed by specific taxes or levies collected by the government. In low-income and least developed countries, extra-budgetary funds can present benefits such as receiving external finance and generating additional incomes, including from interest and dividends from investing the capital in financial markets. In the Pacific, trust funds serve a wide range of purposes that support development. The Kiribati Revenue Equalization Reserve Fund (established in 1956), for instance, was capitalized using tax revenue from

Box 2. Extra-budgetary funds from the Public Finance Perspective

In the Public Finance Literature, three commonly quoted purposes of extra-budgetary funds are:

1. Special funds (earmarking) – established for specified purposes and financed from special taxes or other earmarked revenue required usually by law such as social security fund, environment fund, and others.
2. Development funds (pool external resources) – funds established to support development programs usually using donor contributions and sometimes internal sources
3. Investment funds – funds established with specific investment objectives and component of stocks, bonds or other financial assets.

phosphate mining. The objective of the trust fund was to balance the government future recurrent budget, in anticipation of phosphate exhaustion.⁸

Decision-makers who are considering or establishing national climate funds can learn from the rich body of knowledge and experiences of Asia-Pacific countries on extra-budgetary funds for environment, climate, energy and development. To facilitate this knowledge sharing, this paper synthesizes the long-standing experiences of Asia-Pacific countries in the establishment and management of national funds, and builds on the UNDP Guidebook for the Design and Establishment of National Funds. The paper synthesizes findings of the research conducted through literature review,⁹ an e-discussion on NCFs, a case study analysis of seven funds in Asia-Pacific, and a regional clinic on the design and management of NCFs (See the “Methodology” section).

The objective of this discussion paper is twofold: first, it provides a clear overview of the key issues faced when

⁸ See ADB (2005) Trust Funds in the Pacific: Their Role and Future, ADB, Manila.

⁹ Two main reports provide a comprehensive background about national climate funds, namely: 1) reports produced by Conservation Finance Alliance, which have comprehensively documented the experiences of conservation trust funds established following the Convention of Biological Diversity in 1992 and; 2) a report by ADB (2005) that reviews comprehensively all public trust funds and their specific roles in the Pacific.

⁷ World Bank (2009) Public Expenditure and Financial Accountability, the Kingdom of Thailand.

designing, establishing and managing extra-budgetary national climate funds in Asia-Pacific. Second, it offers some practical examples from countries' experiences in Asia-Pacific. It should be noted that experiences of other regions with national climate funds may differ to those presented in this paper. However, it is beyond the scope of this paper to make a comparison with other regions. The paper starts with presenting different modalities, which countries can consider for accessing and managing climate finance. The Methodology section then outlines the activities undertaken to gather necessary information and the analysis conducted for writing this paper. The findings are classified into three phases: decision making, designing and managing NCFs. To assist decision makers to make an informed decision, a set of feasibility criteria is then proposed for assessing whether an NCF is a feasible option for a country. Finally, important design and management features of NCFs are presented, before lessons-learned and experiences from the Asia-Pacific region are synthesized.

Positioning NCFs within the overall national climate finance

Prior to making a decision about the establishment of an NCF, countries should first assess the overall climate finance landscape.¹⁰ Climate finance has many sources, including: government budget (a portion of government taxes or levies), international donors, lending agencies and interest and dividends. There are also a wide range of modalities available to access and manage climate finance, including: formal government budget systems, national (or regional and international) funds (within or outside state administration), and project-based approaches. While developing countries have a common position regarding the need to move away from managing climate finance through individual stand-alone projects, debates about whether to manage (international and domestic) climate finance through formal budget processes and/or national climate funds remain. Some commonly mentioned advantages and concerns regarding these modalities as briefly indicated below, with some more details provided in Annex 1. It needs to be recognized that opinions and experiences differ amongst practitioners in the region.

Possible advantages of managing climate finance through National Funds:

- Pool international climate finance
- Blend international, national, public and private finance.
- Ensure government funds are earmarked specifically for climate actions

- Channel funds to intended beneficiaries (including communities, civil society and private actors) at the national and local levels
- Provide a platform for multi-stakeholder coordination on climate finance.
- Able to sustain funding beyond the yearly budgeting cycle and its changing priorities, especially in countries without MTDFs.

Possible concerns about managing climate finance through National Funds:

- Disconnect with overall government budget processes – Managing climate finance outside formal government systems can compromise the discipline of the resource allocation process.
- Issues in transparency and accountability – Extra-budgetary funds are sometimes associated with the dilution of accountability and control and also problems in reporting and consolidating fiscal data.¹¹

A recent report identified that much climate related expenditure is already flowing through the formal budget system¹². Furthermore, the formal budget processes engages all government agencies led by Ministry of Finance, and involves parliament. The formal budget system disperses large volumes of finance, and in principle it can be used to “top-up” sector spending to support “mainstreaming” of climate. On the other hand, there are also potential concerns with climate finance in the formal budget system. For example, the formal budget process includes negotiations across the whole of the government and climate change is only one of many issues to be discussed and budgeted. Due to competing demands, there is thus no guarantee that sufficient financial resources will be allocated for climate change. Furthermore, whilst the formal budget system may be able to disburse large amounts of finance, there are commonly concerns about the quality of such expenditures.

10 Several useful references for countries when assessing modalities for accessing and managing climate finance are: Pacific Climate Finance Assessment Framework (Pacific Island Forum Secretariat, 2012) and Climate Public Expenditure and Institutional Review (CPEIR) conducted in five countries including Bangladesh, Cambodia, Nepal, Thailand and Samoa: <http://www.climate-finance-developmenteffectiveness.org/>

11 Allen and Radev (2010) Extrabudgetary Funds, OECD, Paris.

12 Climate Public Expenditure and Institutional Review (CPEIR) studies conducted in five countries including Bangladesh, Cambodia, Nepal, Thailand and Samoa: <http://www.climatefinance-developmenteffectiveness.org/>

The lesson learned is that countries will continue to explore and develop a combination of modalities and that emphasis should be on ensuring complementarity of these modalities and using the limited resources in the most effective and efficient manner. Regardless of the modality employed, accessing and managing international public climate finance poses specific challenges, including:

- Ongoing climate change negotiations under the United Nations Framework of Climate Change Convention (UNFCCC). Issues to be addressed include how and when climate finance committed under the framework will flow from developed to developing countries.
- Uncertainty of the modalities and absence of operational guidelines under the Green Climate Fund (GCF). Of particular interest in this context is the question of the scale and type of finance support that GCF will be able to provide to countries, what modalities countries can use to access it, and the criteria that countries / agencies would need to meet to do so.
- Lack of specificity of the impacts of climate change on some sectors and geographies. Decision-makers may be reluctant and/or not have the political will to put in place necessary climate policies, strategies and actions because of uncertainty associated with the direct effects of climate change on livelihoods, health and living conditions.
- Involvement of private actors. Addressing the challenges of climate change will not only require cross-sectoral coordination between government agencies but also the involvement of private actors. An important role (amongst others) is that limited public finance should be used to leverage private investments and drive transformational change in the behavior of different actors. This needs to be done through a combination of actions, depending on the country specific needs, such as issuing/adjusting public policies, regulations and providing the right set of incentives

Research methodology

To achieve this paper's objective, thorough research on the establishment and the management of national climate funds was carried out, involving three main activities: an e-discussion, a case study analysis focusing on seven national funds in the region, and a regional clinic on national climate funds. In each of the three activities, thorough discussions with relevant stakeholders (incl. fund managers, government officials, representatives from civil society and development partners) have been pursued to identify main considerations that decision-makers should be mindful about when deciding about the establishment and the design of an NCF as well as when managing an NCF.

The e-discussion on national climate funds was launched by UNDP on 27 February 2012 and carried out for 10 weeks. Facilitated by the UNDP Asia-Pacific Regional Centre, more than 150 members from the Asia-Pacific region participated, including government officials, civil societies, fund managers, and development partners. The e-discussion highlighted key issues faced, practical solutions, and helped identify peer-to-peer support on the establishment and management of national climate funds in the region. The e-discussions presented an opportunity for south-south dialogue and peer to peer learning in this rapidly evolving area of climate finance, where it is challenging for developing countries and individual institutions to stay abreast with the latest experiences and insights. Further, opportunities for the development of regional networks on topics of mutual interest were created.

The case study analysis was carried out to provide in-depth understanding about the design and management features of national funds in Asia-Pacific countries, and took place between March and August 2012. The seven national funds included in the analysis are the Bhutan Trust Fund for Environmental Conservation (BTFC), China Clean Development Mechanism Fund (CCDMF), Cambodia Climate Change Alliance (CCCCA) Trust Fund, Thailand Energy Conservation Promotion (ENCON) Fund, Lao Environmental Protection Fund

(EPF), Micronesian Conservation Trust (MCT) and Tuvalu Trust Fund (TTF) (Table 1). The case study analysis involved in-depth discussions with fund managers, beneficiaries, and government officials involved in the selected national funds. A case study report has been produced for each national fund and can be accessed on <http://www.snap-undp.org/elibrary/byfocus.aspx?Area=Energy>.

The regional clinic on the design and management of NCFs was jointly organized by the UNDP Asia-Pacific Regional Centre and the USAID/RDMA-funded ADAPT Asia-Pacific project, and took place on 6-8 September. A total of 65 participants consisting of fund managers, experts and government officials from 20 countries and representatives from DFID, USAID, AusAID, SIDA, World Bank, ADB, SPREP, PIFs, UNDP and GIZ had discussions on the feasibility, design and management aspects of NCFs. The workshop was effective in sharing experiences, insights and views on NCFs, learning from the experiences from existing national funds throughout the Asia-Pacific region, enriched with contributions from government officials and development partners. Workshop proceedings can be accessed on <http://www.snap-undp.org/elibrary/byfocus.aspx?Area=Energy>.

The discussions with stakeholders generated a wealth of information which have been gathered and analyzed. The discussions were structured according to three different phases: decision-making for establishing and NCF, designing of and NCF, and managing of an NCF. Practical solutions are also offered based on the synthesis of lesson-learned from countries' experiences with National Funds in the Asia-Pacific region. In the decision-making phase, this paper suggests feasibility criteria to assess whether an NCF is a feasible option for a country. Once a country has decided to establish an NCF, decision-makers will need to select the NCF design features. Various design features of national funds available in Asia-Pacific countries are listed to provide a comprehensive picture of a wide range of options for NCF design features. Finally, informed by experienced fund managers, important management features are presented.

Table 1: Funds selected for the case study analysis

Name of fund	Year of Establishment	Objectives
Bhutan Trust Fund for Environmental Conservation	1991	Supporting environmental conservation in Bhutan by providing grants for government agencies, local non-governmental organizations, grassroots communities and qualified Bhutanese individuals for conservation projects.
Lao PDR: Environmental Protection Fund	2005	Strengthening environmental protection, sustainable natural resources management, biodiversity conservation and community development in Lao PDR.
China Clean Development Mechanism Fund	2007	Managing government revenue from CDM projects to provide immediate supports for line ministries to conduct policy studies, international negotiation, capacity building and public awareness and to pilot innovative economic and financial instruments to reduce risks and remove market barriers of climate investments in China
Thailand: Energy Conservation Promotion Fund	1992	Managing government levies collected on petroleum products to finance the promotion of renewable energy and energy efficiency in Thailand
Cambodia Climate Alliance Fund (CCCA) Trust Fund	2010	Securing external funding for priority interventions to develop technical and institutional capacity at national and sub-national levels to address current and future climate related challenges.
Micronesia Conservation Trust	2002	Support biodiversity conservation and related sustainable development for the people of Micronesia by providing long term sustained funding
Tuvalu Trust Fund	1987	Contribute to the long-term financial viability of Tuvalu by providing an additional source of revenue for recurrent expenses of the Government of Tuvalu.

Feasibility Criteria of NCFs

Countries need to make a careful assessment prior to making a decision on the establishment of NCFs taking into account other options that are available for accessing and managing climate finance. A feasibility assessment will help decision-makers to make an informed decision about the establishment of an NCF and its most appropriate design. The following feasibility criteria are suggested below (Figure 1).

Strategic role. The most important step when making a decision about the establishment of NCFs is to define its policy objectives within the overall climate finance architecture in a country. An NCF should be strategically designed, aiming to fulfill an important role that achieves climate and development objectives that cannot or less effectively be achieved through other modalities.

One possible strategic role is leveraging private and public investments and drive transformational change towards low-carbon and climate resilient development. For instance, the CCDM Fund is an example of a national fund with a strategic role. The fund is capitalized mostly by levies collected from CDM projects in China. Although the fund manages only a small portion of financial resources (US\$ 1.6 billion) compared to government budgets allocated for energy efficiency, renewable energy and environmental protection (US\$ 26.9 billion), it aims to have significant impact on policy and research.

The CCDM Fund is established specifically to play strategic roles, including:

- 1) Financing immediate actions required to address the challenges of climate change, such as policy studies, public awareness, and international negotiations;
- 2) Testing or piloting financial/economic instruments to develop cost-effective measures for climate mitigation and adaptation in China.

The latter includes innovative approaches to leverage private sector investments. In the case of the Pacific

Figure 1:



where private investments is generally regarded as less realistic, a strategic role of a national fund could be to mobilize international public finance to drive transformational change or as a means of “parking funds” to then be implemented based on the absorptive capacity of the country. Another strategic role of a NCF could be to specifically reach out to marginalized and vulnerable groups at the community level.

Political feasibility. Establishing an NCF requires time and resources to gain political support. When a law (or act) is required for the establishment (and/or capitalization) of a fund, support from parliament may be necessary depending on the political and legal systems in a country. Although the process of gaining the political support may take longer, a fund that is established by a law (or act) will most likely be more sustainable. For example, the Thailand Energy Conservation Fund and the Bhutan Trust Fund for Environmental Conservation that were established in 1990s through a Law and a Royal Decree respectively. In addition, once a law is issued, the process of getting the fund operational can be accelerated based on the strong legal basis. Early experiences in Asia-Pacific countries show that expanding existing national funds (mostly environment funds) to access and manage climate finance will also require political negotiations. However, such a process could be less intense and time consuming than establishing a new national fund. For instance, the MCT and the Lao

EPF are currently considering expanding their scope by including climate change into their existing funds.

Institutional and human resource capacity. The time required for a fund to be fully operational and ready to disburse money to the intended beneficiaries is dependent on the institutional and human resource capacity within a country. After a fund is officially established, an operation manual should be developed to detail specific rules and regulations for the implementation and management of the fund. This can be based on manuals for existing funds or built off of government systems. Sufficient capacity to manage the fund effectively and transparently according to the established rules and regulations is therefore required. Depending on the existing capacity, the process of getting a fund to be fully operational can take several years. For instance, in the case of BT FEC, the fund focused mainly on building the human and institutional capacity in the first 10 years, while the CCDMF took five years before up-scaling the total grant projects from 14 projects to 125 projects.

Time and cost effectiveness. Establishing and getting a national fund operational takes time and resources. As discussed above, the process starts with political negotiations, building sufficient capacity and making sure the design elements are in place (which will be discussed in the next section). Political negotiations will involve time and efforts; and when capacity is lacking, investments in capacity development is necessary. The establishment process, from the negotiation process to getting a fund ready to disburse money to beneficiaries, may take 2-3 years. For example, for the TTF, the Government of Tuvalu had developed the concept of a "Reserve Fund" in 1984 and the agreement establishing the TTF was signed on 16 June 1987. In many cases, to overcome the issue of low capacity at the country level, a national fund can hire a service provider or a fund manager. This arrangement can be a temporary solution to allow the fund to be operational relatively fast taking into account this may incur higher costs. Managing a national fund on day-to-day basis will entail overhead costs, including staff salaries and other administrative costs which need to be covered. For example, MCT charges around 16 percent for a management fee of grants received from development

partners, while KEHATI (a national fund for biodiversity conservation in Indonesia) its overhead costs for the period 2008 - 2011 were around 14.7 percent.

Financial sustainability – Many national climate funds are established to initially manage a one-time contribution from donors which should be disbursed to intended beneficiaries within a specific time frame. Often, newly established funds do not have sustainable sources of finance to replenish its capital regularly. When financial resources are running out, these funds will be closed. Considering the amount of resources and time that are required for the establishment of NCFs, countries should be mindful about establishing a fund without a long-term and strong strategy on resource mobilization. An example of a fund found to be sustainable is the TTF which is an endowment fund useful for long-term planning and can earn investment income (capital appreciation and dividends); while the linked revolving fund provides more flexibility when a distribution from the main trust fund is paid. In addition to the capital appreciation, there have been AUD\$38.6 million in additional contributions. In the period since the Fund began to 30 June 2007, AUD\$65.7 million has been made available to the Government and the current value of the fund is a maintained value of AUD\$127 million as at March 2012.

Design Features of National Funds

A fund, defined as a sum of money set aside for a specific purpose, is different than a trust fund. Both terms, however, are often used interchangeably. The “trust” component of a trust fund is a legal arrangement wherein one party, the **trustor**, gives control of assets to another party, the **trustee**, to be administered on behalf of a third party, the **beneficiary**. In public trust funds the trustors, trustees and beneficiaries can be individuals, groups of individuals, institutions or governments. Public trust funds, therefore, are “those established for public purposes by, with, or through governments by some form of enacting legislation (local, national, or international), which forms the trust, sets out its legal terms, and assigns respective rights and responsibilities to different parties”¹³. Under this definition, most extra-budgetary funds can be classified as trust funds, since they are established by law, managed by trustees, and channeling funds to beneficiaries. However, in literature, public trust funds usually refer to a specific type of fund, similar to a private trust fund, which preserves capital while income from that capital available to designated persons or purposes. “National funds” is a general term used in this report to refer to all types of funds established at the national level. The next section provides detailed explanation of different types of funds.

National climate funds can vary considerably in terms of objectives, legal status, type of fund, trustee arrangements, capitalization and beneficiaries. This section discusses design features of national climate funds and provides concrete examples from seven national funds that are analyzed in the case study analysis.

Different types of funds

There are three main types of national funds: endowment, revolving and sinking funds. The types of na-

tional funds will determine the capitalization process and the structure of the governing body.

Sinking fund. A sinking fund consumes the principle capital and investment income (if the fund is invested) over a fixed time period. This type of fund should be regarded as a short-term initiative and not sustainable in the long run because the capital of the fund will be disbursed entirely within a fixed period of time. An example of a sinking fund is a multi-donor trust fund, where it pools financial resources committed by various donors and channels them to intended beneficiaries through one gateway to ensure better aid coordination. The Cambodia Climate Change Alliance (CCCA) Trust Fund and Indonesia Climate Change Trust Fund are an example of a multi-donor trust fund for climate change.

Revolving fund. Revolving funds are those in which the principle capital and the investment income (if the fund is invested) are consumed entirely but a replenishment source (a tax or external source) exists and contributes regularly to the funds. The principal capital *can be further invested* in various types of risk-free financial instruments (such as in commercial bank deposits) to generate additional income (i.e. the CCDM fund) *or not invested* further (i.e. the ENCON fund).

Endowment fund. A fund is considered an endowment fund when the principal capital is kept in perpetuity and not consumed under any circumstances and only the investment income is used to provide grants. As there is no regular source to replenish the capital, therefore, an endowment fund depends on the interests or dividends generated from the investments and/or additional funds mobilizing by fund managers (i.e. the BTFEC and the TTF).

In many countries, it is common to find *a combination* of two types of funds in one institution, including:

- **An endowment fund and a sinking fund** (i.e. the MCT and the EPF). One of the reasons for combining an endowment fund and sinking fund is that many national funds in least developed countries (LDCs) depend on external sources and many times such funds come in the form of time-bound and earmarked grants. An initial endowment fund would at least help to cover the core administrative costs

13 ADB (2005) Trust Funds in the Pacific: Their Role and Future, ADB, Manila.

to ensure sustainability of a fund, while the sinking fund can receive and disburse the time-bound and earmarked grants when these come in.

- **An endowment fund and a revolving fund** (i.e. the TTF). The TTF is an endowment fund, which makes distributions to a revolving fund. These two funds draw on the comparative advantages of both types of funds, for instance, an endowment fund is useful for long-term planning and can earn investment income (capital appreciation and dividends); while a revolving fund provides more flexibility to distribute incomes generated from the main trust fund (or the endowment fund).

Sources of capital can come from international (bilateral and multilateral) and domestic sources including government budget, private sector (i.e. the EPF receives contributions from private companies) and individuals. The capitalization process can be built up over a certain period of time, or provided at the beginning (establishment) of funds, or a mix of the two options. Table 2 shows different sources of capital of the seven national funds mentioned before.

Government budget. For a revolving fund, the capital can come from a portion of government taxes or levies (i.e. on petroleum products in Thailand or on CDM projects in China) and loans. The ENCON fund and the CCDM fund provide examples for countries on how to identify potential sources of revenue for financing climate actions. Revenues can be collected from industries and sectors that are the main emitters of greenhouse gasses. The collected revenues can further be earmarked for activities that directly contribute to low carbon and climate- resilient development at the national and local levels.

External sources. The sources of finance can also be mobilized through development partners and vertical global funds.

Dividends and interests from investments. For an endowment fund, the initial capital can be invested in a financial market in instruments such as stocks and bonds with a greater risk involved or in bank deposits and other less risky instruments.

Table 2: Types of funds and sources of capital

Name of fund	Type of Fund	Capital	Total capital/assets managed
Bhutan Trust Fund for Environmental Conservation	Endowment fund	Grants from WWF, Government of Bhutan, GEF, Netherlands, Norway, Finland, Denmark, and Switzerland	Total assets as of 2010-2011: US\$ 42.3 million
Lao PDR: Environmental Protection Fund	Endowment and sinking funds	Grants and loans from the World Bank and ADB, contributions from businesses, and interests or benefits from the investments	Total incomes (2006-2010): US\$ 13.9 million
China Clean Development Mechanism Fund	Revolving fund	A portion of levies on CDM projects in China collected by the government, earnings from CDM Fund business operations, donations from international, domestic institutions, organizations and individuals	Total assets (end of 2011): US\$ 1.58billion (RMB 10 billion)
Thailand: Energy Conservation Promotion Fund	Revolving fund	Imposed levies on petroleum products	Annual income: US\$ 225 million (THB 7 billion)
Cambodia Climate Alliance Fund	Sinking fund	Grants from bilateral donors, including the European Union, Sweden, Denmark, and UNDP.	Committed donor contributions: US\$ 8.9 million
Micronesia Conservation Trust	Endowment and sinking fund	Grants from the US Department of the Interior, the Federal Republic of Germany, UNDP-GEF, Packard Foundation, SGP and The Nature Conservancy.	Total endowment: US\$ 11.2 million; Total donations for sinking fund: US\$ 7 million
Tuvalu Trust Fund	Endowment fund linked to a revolving fund	Contributions from the Governments of Tuvalu, Australia, New Zealand, United Kingdom, Japan, South Korea	Total assets: A\$127 million (Maintained Value as of 2012)

Potential sources of capital for national climate funds can be classified as follows:

Leveraging private sector finance. There is an urgent need to leverage private sector investments to finance climate initiatives. The private sector can provide climate finance in two ways, including through: 1) a direct (cash) contribution to a national fund in the form of voluntary contribution or corporate social responsibility programs (for example, voluntary contributions of several companies directly to the EPF); or 2) a contribution to private investments in projects that aim to lower greenhouse gas emissions and/or increase climate resilience. In the case of the CCDM fund and the ENCON fund, public finance is used to leverage private sector finance for energy efficiency and climate mitigation projects. Under both funds, a contract-based cooperation model with commercial banks is implemented, where the fund functions as seed capital to leverage private investment in bankable projects for energy conservation and greenhouse gas emission reductions.

Legal Arrangements

The establishment of a national fund requires a legal basis. The legal status of a national fund can be stipulated by a national act or law, which usually includes the governing principles of the fund (i.e. the BTFEC, the ENCON Fund, and the EPF). The governing principles are then detailed in an operation manual that will guide the financial and administration management of the fund as well as the fiduciary standards. Based on their legal arrangements, national funds can be classified as follows:

A fund that is an extension of government administration. The management of such a fund is mandated to a government agency (which is usually stipulated by a government regulation such as an act or a law). For instance, the secretariat of the ENCON Fund is currently within a relevant government agency (Energy Policy and Planning Office). The management of the fund is in compliance with the state financial management standards. The audit process, for instance, is conducted by the central government and is similar to the audit process for other government agencies in the country. This type of fund usually does not have commercial banking capacity. Hence, if any, soft loans and other financial instruments financed by such a fund are outsourced to commercial banks.

A fund that is managed by an independent body and established by a law (or a government regulation). The case of the BTFEC is an example of this type of fund. The trust fund is governed by the Royal Charter of the Trust Fund for Environmental Conservation 1996, which provides the governing principles for the BTFEC. The rules and regulations governing the day-to-day operations of the fund are detailed in the Operation Manual issued in 2009. Although established by the Royal Charter, the BTFEC is considered as an independent grant maker guided by strategic funding framework. The Director and the secretariat staff are non-civil service positions.

A fund that takes the form of a private corporation or a non-profit organization. The MCT can be classified as this type of fund. The MCT was granted a Non-Profit Corporation Charter by the President of the Federated States of Micronesia in November 2002. Subsequently, the MCT obtained its registration as a nonprofit corporation in the Federated States of Micronesia, through a Registry Certificate issued by the Federated States of Micronesia Registrar of Corporations. The MCT adheres to policies and standards set out in its Articles of Incorporation, By-Laws and Operation Manual as duly adopted and approved under the laws of the Federated States of Micronesia.

A multi-donor trust fund that operates like a program/project implemented by a multilateral agency. The implementation of a multi-donor trust fund (MDTF) is usually according to the rules and procedures of the host agency. For instance, the CCCA Trust Fund is managed according to the project implementation procedures of UNDP as the fund administrator. Each donor of the CCCA Trust Fund enters into a contractual agreement with UNDP. The operational and administrative specificities of the framework for the CCCA Trust Fund are detailed in its Operational Manual.

Governing Body

In national funds, a trustor (usually development partners and/or governments on behalf of their constituents) provides a legal responsibility to a trustee for the management and oversight of assets and financial re-

sources. The trustee should carry out the terms of the trust in the best interest of the beneficiaries. A trustee or the governing structure of a fund usually consists of the following bodies:

Board of Trustee.¹⁴ A Board usually has a mandate to oversee the overall management of a fund, including selecting and overseeing a Director for an executive office that is responsible for the day-to-day financial and administration management of the fund. Moreover, the Board also makes all policy decisions, including project selection, investment policies, as well as short- and long- term plans. The composition of a Board varies between national funds, which can be classified as follows:

- **Government representatives:** For instance, the board members of the ENCON fund and the CCDM fund are representatives from government agencies dealing with the issues of energy and climate change respectively.
- **Multi-stakeholders:** Involving representatives from government agencies, development partners, and civil society (i.e. the BTFEC)
- **International and national representatives:** International representatives sitting in a board of trustee can be for a temporary or indefinite term. They are usually representing development partners or donors providing financial support to a fund. Examples include the Boards of Trustees of the MCT, the Board of Directors for the TTF and the CCCA Trust Fund.

Executive Office.¹⁵ An executive office is a daily administrative body that is responsible for the administration and financial management under the guidance of a Board of Trustee. A Director is usually assigned to manage the executive office of a national fund. Depending on the legal status of a fund, staff of an executive office can be government officials or non-civil servants, although in most cases, it is the latter. In the case of multi-donor trust funds, such as the CCCA Trust Fund, the secretariat staff and a trust fund manager are hired directly by UNDP as the host agency.

Technical Committee. A technical committee is not necessary a permanent structure within the governing structure of a national fund. In most cases, the technical committee is only formed at the beginning of a project cycle to review and evaluate project proposals and provide recommendations to the Board whether a proposal can be awarded or declined funding. Technical experts serving as members of a technical committee are often involved for a certain period of time to render the services required.

Investment Committee. An investment committee is primarily responsible for overseeing the management of financial assets and formulating investment policies. The committee provides recommendations for general investment matters to the Board who will then make final decisions. An investment committee is a crucial body in the management of endowment funds (for instance the BTFEC), while for other types of funds, an investment committee can be embedded in an executive office (i.e. the CCDM fund). A fund can also hire a service provider (an investment firm) to help manage its financial assets (i.e. the TTF).

Beneficiaries

In the case of public (trust) funds, beneficiaries are individuals/groups, who are eligible to receive benefits from the fund (income or principle capital). The beneficiaries of national funds for climate change can include civil society, non-governmental organizations, local communities, sector ministries, local governments, and private actors. One of the advantages of NCFs is its ability to reach to stakeholders outside the government system, particularly considering the crucial roles of private actors and local communities in the efforts of addressing challenges of climate change. NCFs need to create specific instruments or programs targeting different stakeholders to achieve the policy objectives of the fund. Discussion on how to reach beneficiaries efficiently will be discussed in the next section of the Management of NCFs.

¹⁴ Alternative names include Board of Directors, Board, Management Board, or Programme Support Board; for funds with a multilateral agency as trustee such as in Cambodia, the terminology Steering Committee is commonly used.

¹⁵ Alternative names include a Secretariat or a Management Center.

Management features of NCFs

The management features of NCFs focus mainly on reaching intended beneficiaries and ensuring transparency, effectiveness and results-based implementation. Intended beneficiaries and programs to be financed by a national fund should be considered when developing the design features of NCFs. An operational manual usually includes a detailed description of the programs financed by the NCF and guidance on how intended beneficiaries can participate in the programs. Programs financed by an NCF should be refined over time considering the changing socioeconomic and political circumstances, and Operation Manuals regularly reviewed and updated as necessary.

Project cycle: transparency and efficiency

Different programs apply different procedures, rules and project selection criteria. For grant projects, project cycles are commonly started by a call for proposals. Another possible approach to solicit proposals is to invite specifically targeted (or accredited) beneficiaries. For instance, in the case of the CCDM fund that provides grants to line ministries dealing with climate change, the management center specifically invites project proposals only from those ministries. This approach is justified when beneficiaries are well-defined. Following the solicitation of proposals, executive staff will screen all project proposals received. Projects that meet requirements are forwarded to a technical committee for their reviews and comments. Their comments are compiled and shared to the Board of Trustees to help the board make final approval or disapproval of projects. Once the projects are approved, executive staff carry out a due diligence exercise to make sure the project proponent can manage the project funds with prudence.

For loan projects, the implementation can be outsourced to commercial banks, development banks or financial institutions depending on the capacity of the executive office managing a fund. The ENCON fund,

for instance, provides soft loans for enterprises to promote energy efficiency and renewable energy through eleven commercial banks. In the case of CCDM fund, loan (investment) projects are managed directly by the executive office (the CCDM fund Management Center). In the CCDM fund, investment projects are identified in cooperation with provincial finance bureaus, where potential applicants are invited to file their applications. Following the submission of project proposals, provincial finance bureaus will conduct the necessary due diligence, where the CCDM fund will provide management fees to the bureaus for the service. The Management Center will consider national economic, industrial and climate policies when reviewing investment projects. For an investment project that is larger than RMB 70 million (US\$ 11 million), approval from the Board is required as it is considered a strategically important project. Projects with a total value of less than RMB 70 million will be approved by the CCDM fund Management Centre.

Hiring a manager to implement each program financed by a national fund may be necessary to increase effectiveness of program implementation and reduce the burden of the executive office. To implement the TEERF, DEDE has been working with commercial banks to provide soft loans for businesses. Having commercial banks to manage the Revolving Fund is advantageous because of their capacity in managing loans and dealing with lenders. The program can also create awareness for commercial banks about the importance of providing loans for energy efficiency and renewable energy initiatives. In contrast, to manage the ESCO fund of the ENCON fund, two fund managers from non-profit organizations have been appointed. As previously discussed, the fund managers have been proactive in working with SMEs and ensuring the enterprises to access the ESCO fund.

The governing body of a fund, including the Board, the Executive Office and appointed Program Managers, owe a fiduciary duty to their beneficiaries. A fiduciary duty is a legal or ethical relationship of confidence or trust between the governing body and beneficiaries. Fiduciary standards, therefore, require the trustee to act in the best interests of their beneficiaries and to administer the trust with care and prudence. In the case

Box 3. Fiduciary Standards: the Adaptation Fund

The fiduciary standards of the Adaptation Fund cover the following aspects:

1. *Financial management and integrity*
 - a. accurately and regularly record transactions and balances in a manner that adheres to broadly accepted good practices, and are audited periodically by an independent firm or organization
 - b. Managing and disbursing funds efficiently and with safeguards to recipients on a timely basis
 - c. Produce forward-looking financial plans and budgets
 - d. Legal status to contact with the Adaptation Fund and third parties
2. *Requisite institutional capacity*
 - a. Procurement procedures which provide for transparent practices, including competition
 - b. Capacity to undertake monitoring and evaluation
 - c. Ability to identify, develop and appraise project – ex ante and ex post – technically, legally, financially, economically, socially and environmentally
 - d. Competency to manage or oversee the execution of the project including ability to manage sub-recipients, fit for purpose infrastructure and resource to support project delivery and implementation
3. *Transparency and self - investigative powers*
 - a. Competence to deal with financial mis-management and other forms of malpractice

Source: http://adaptation-fund.org/system/files/AFB.B.6.4_Fiduciary_Standards.pdf

of NCFs, fiduciary standards should: 1) ensure that allocated budget is used for the purpose for which it is intended; and 2) ensure that funds are managed (invested) and spent in an efficient and transparent manner as possible in order to maximize value for money. Donors and vertical global funds apply different fiduciary standards and requirements. For instance, the Global Environment Facility and the Adaptation Fund have different fiduciary standards, and the GCF will also have its own standards. Noting all these funds have their own standards, as an example, the fiduciary standards applied by the Adaptation Fund are provided in Box 3.

Working with beneficiaries at the local level

One of the strategic objectives of NCFs can be to ensure that sufficient financial resources are allocated and directly channeled to local communities and other potential beneficiaries. However, despite specific allocation of resources for local stakeholders, often it is difficult for them to access these resources due to several barriers, such as low capacity in developing project

proposals. Working with local beneficiaries requires NCFs to pursue strategies such as developing capacity of local stakeholders and building learning networks throughout project implementation. The Lao EPF, for instance, has been successful in reaching local beneficiaries as a result of continuous support provided by the executive office to potential beneficiaries in the form of training and other forms of capacity development. In the case of the MCT, training by experts from its two peer learning networks (Micronesians in Island Conservation and Pacific Islands Managed and Protected Areas Community) is provided when the needs for capacity development are identified.

NCFs should also have some flexibility to ensure that the right beneficiaries, especially the local stakeholders, will get a fair chance to access the fund. NCFs need to provide ample time for the potential beneficiaries to develop proposals and to have a meaningful discussion with the beneficiaries. Moreover, NCFs can also encourage project proponents to partner or to collaborate with more established entities. In the case of the MCT, when it is determined that project proponents, which are usually the community groups, do not have the capacity to manage the funds prudently, the MCT

will request participation of a more established NGO to function as the so-called fiscal sponsor.

Performance based monitoring

NCFs should perform both technical and financial monitoring. The financial monitoring includes scrutinizing the disbursement and the utility of the finances, while the technical monitoring requires the assessment of projects' progress and achievement of their intended purposes. It is also imperative to measure the impact of projects. Grantees need to submit progress reports, both financial and technical, to an executive office periodically. The Executive Office should keep the Board informed on the progress of its activities through regular progress reports. Annual reports covering technical progress and (externally) audited financial statements can also be put into the public domain.

Considering low capacity of local stakeholders to write a progress report, the monitoring and reporting system for local beneficiaries often needs to be simplified. The EPF, for instance, accepts oral submission for a progress report. The executive office of the EPF arranges a stakeholder meeting periodically at the provincial level, where all beneficiaries receiving funds from the EPF will be invited. In the meeting, which is usually chaired by the Vice Governor, all beneficiaries will verbally report the progress of their projects. A representative from the EPF will then prepare the minutes of meeting where details of the verbal discussion will be noted down. Following the meeting, the minutes will be circulated to all beneficiaries for them to agree on what is written, including the progress of the projects and their future action plans. Based on the agreed minutes, the EPF will conduct regular monitoring of project implementation.

The monitoring and evaluation of NCFs themselves need to focus on measuring the impacts of the programs. To enable the monitoring of results, quantitative targets and key performance indicators should be put in place. For instance, the impacts of funds spent on climate mitigation can be measured based on the total emission reductions achieved. The Revolving Fund, financed by the ENCON Fund, set a range of Key

Performance Indicators (KPI) to monitor the performance of the Fund. Participating banks are required to provide monthly reports to DEDE. Based on the reports, DEDE assesses the achievement or performance of the Revolving Fund, including the total of electricity and oil saving per year. For example, in 2008, the total revolving fund loan was US\$ 94.7 million, while the total electricity and oil saving were US\$ 31.3 million and US\$ 42.5 million respectively.

Ensure effective programs

Assessing the effectiveness of programs financed by a national fund periodically is necessary. Based on such assessment, an existing program may need to be revised or a new program should be created considering changing socioeconomic and political situations in a country. The ENCON fund provides a good example for the need and importance of reviewing implemented programs regularly. In 2002, the ENCON fund established a new program, called the Thailand Energy Efficiency Revolving Fund (TEERF). TEERF provides soft-loans to factory/building owners and private companies to promote energy efficiency and renewable energy. TEERF is implemented by eleven commercial banks and monitored by Department of Alternative Energy Development and Efficiency (DEDE). Following a review conducted by DEDE, it was found that it had been mostly large businesses that benefited from TEERF. Based on this review, DEDE considered the need to establish a specific program to attract investors for small projects, mostly implemented by small and medium enterprises (SMEs). To achieve the objective, the Energy Service Company (ESCO) fund was then introduced in 2008, where non-profit organizations were appointed as the fund managers.

Recommendations

Based on the analysis conducted on existing national funds in Asia Pacific, several lessons-learned can be synthesized to provide policy recommendations for decision makers on the three important phases: deciding about the establishment and the design of an NCF as well as when managing an NCF.

Prior to deciding on NCFs, a thorough analysis is required to: 1) assess the overall climate finance landscape; 2) consider the specific objective that an NCF aims to achieve and 3) how it can contribute to achieving national policies on climate change.

Building on the experiences with national funds in Asia-Pacific countries, this paper has proposed a set of feasibility criteria to guide conducting a feasibility analysis. Several questions that can guide decision-makers in conducting a feasibility analysis are proposed in Box 4.

Box 4: Questions to guide decision makers in conducting a feasibility analysis prior to establishing an NCF

Strategic Role:

1. *What is the strategic role of the proposed NCF in the context of financing the country's climate change policy objectives?*

Recommendation: NCFs can play the following (combination of) roles: earmark of government revenue, pool or blend resources, generate income from investments and achieve specific purposes (i.e. distribute financial resources to local communities; leverage private investments), to promote low emission and climate-resilient development.

Caution: A popular reason for establishing an NCF in Asia-Pacific is that a fund can play a role as a stepping-stone as coordinated planning and subsequent structured budgeting within the regular government system for climate change could be hard to achieve in the short-term. Many countries cannot wait to have all their processes and institutional arrangements in place to address the increasing pressure to act upon impacts generated by climate change. Hence, NCFs are expected to address urgent needs to start with, with high-level, cross-sectoral political representation. However, countries need to be mindful when establishing NCFs as a stepping-stone. Learning from the experiences in the region, the establishment of funds takes time and resources. For instance, the establishment of the CCCA Trust Fund, which has the simplest design features of a national fund, took 2 years from the negotiation process until the first call for project proposals. If a country decides to establish an NCF as a stepping-stone, a long-term plan should be agreed upon and put in place upfront to be clear upfront on the next steps beyond the NCF (see below on financial feasibility).

2. *What are other available options (alternative to an NCF) in your country?*

Example: If the main purpose of an NCF is to manage earmarked government revenue for climate change, decision-makers can consider issuing a regulation to set aside a portion of government budget for a specific purpose and channel it through the formal budget system. For instance, several developing countries (i.e. Indonesia), by law, set aside and spend a portion of its annual national and local expenditure for specific sectors, such as education.

Recommendation: A country should avoid establishing an NCF when there is no added-value that justifies the amount of resources to be spent for establishing it, particularly when other options are available (i.e. channeling through a formal government budget system or expanding an existing national fund to include a window focusing on climate change).

3. *Who are the main beneficiaries?*

Recommendation: NCFs can be established to ensure that necessary channels are available to reach those who need the funds most, such as the most vulnerable at the frontline of climate adaptation and private actors in the case of climate mitigation. These beneficiaries are often excluded when financial resources are channeled through a formal government system.

¹⁶ It varies between countries. In Thailand, for instance, the Bureau of Budget under the Prime Minister office has the authority to compile the expected revenue and expenditures of government agencies and state enterprises and develop state budget documents.

Caution: if the main beneficiaries are government agencies, an NCF should avoid duplicating the function of ministry of finance who is responsible for allocating budget to government agencies.¹⁶ For instance, the ENCON fund provides grants for government agencies, non-governmental organizations as well as research institutions and also finances several financial instruments to promote energy efficiency. The amount of fund allocated to provide grants for government agencies are rather a significant portion of the total ENCON fund. This portion of the fund is managed by a directorate within the Ministry of Energy. Managing hundreds of grant projects has caused a very high workload for the directorate, which performs a rather similar function to the Bureau of Budget and the Ministry of Finance. NCFs need to avoid playing a role that is similar to a government system, and focus on strategic roles that cannot be performed by a regular budget process.

Political feasibility

1. Is there any existing mechanism that can be expanded for accessing and managing climate finance (which may be more cost effective rather than establishing a new NCF)?
2. Who are the main stakeholders that will need to make the decision on establishing an NCF? Who will support and oppose to the idea of establishing an NCF? Why and what can be done to influence their positions?
3. What is the legal framework that will be required to establish an NCF or to expand the mandate of the existing national fund to address the issues of climate change? If a regulation is required, who can/should issue it?
4. Do the government/donors have political commitment to provide sustainable source of finance? If not, how can financial resources be mobilized and sustained?

Human and institutional capacity

1. What is the existing capacity for establishing and managing an NCF (i.e. financial management and fund operations)?
2. Are there existing (national/international) institutions that meet international fiduciary standards? Can these institutions be involved in the management of an NCF? Or can the mandates of these institutions be expanded to access and manage climate finance?
3. Is there any human resources capacity available in managing a fund according to the required fiduciary standards? If yes, can they easily be recruited? If not, how much investment should be allocated to develop the capacity before a fund can be fully operationalized?

Cost and time consideration

1. How quick do you expect an NCF to be operationalized?
2. How does this timeframe take into consideration the complexity of the funds design (type, beneficiaries, capacity, etc.)?
3. How much resources are you willing to invest prior to the establishment of the fund? How much resources are you willing to invest in developing human and institutional capacity to manage an NCF?

4. Who will cover the costs of establishing the fund?

Financial Sustainability

1. If the main purpose of an NCF is to pool external resources, how committed are donors in providing finances? Is the finance provided as a one-time contribution or is a source for regular replenishment for capital available?
2. If the main purpose of an NCF is to ensure sustainable income from investments to provide grants for financing climate actions, how much upfront capital is required to generate the expected amount of interests/dividends?

Recommendations: An endowment fund may be very useful for least developed countries where the contribution of external finance is often higher than government resources in financing climate actions. For middle-income countries, an endowment fund may be useful if an NCF aims to provide sustainable income for providing small grants to local communities.

After a country decides to establish of an NCF, specific design features should be selected according to the NCF proposed objectives. The selection of design features should also take into account the political com-

mitment of government/donors that can be secured (in providing capital), the resources required (or willing to be invested) to establish the fund, and the target time when the fund should be operationalized.

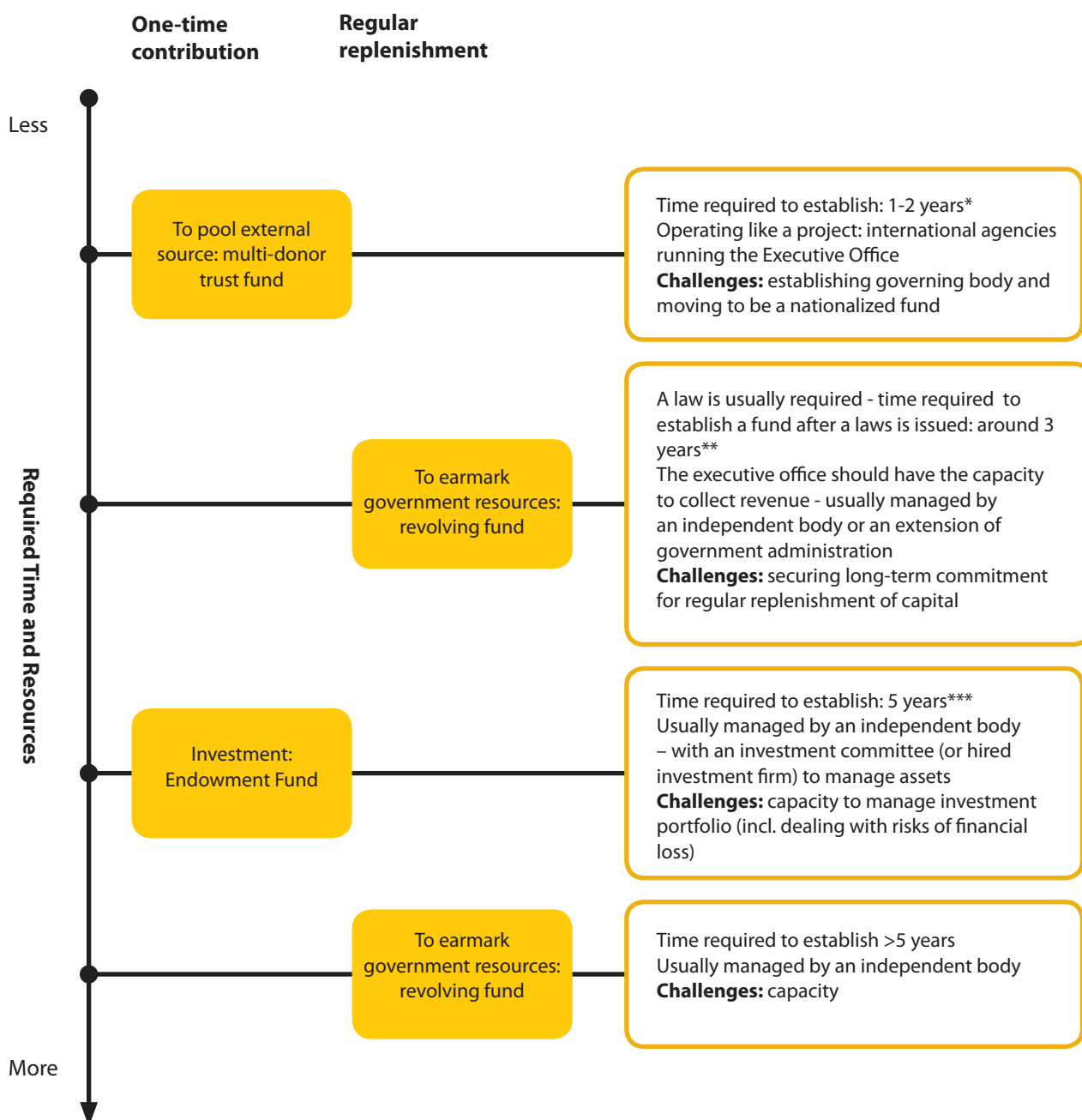
When the objective of NCFs is to pool external financial resources and channel them to immediate beneficiaries, a sinking fund may be considered as an option to access and manage climate finance. A sinking fund is the simplest type of a national fund (Figure 2). Depending on the legal framework of a country, establishment of a sinking fund does not require an approval from parliaments nor an issuance of a government regulation, particularly when a fund is operating like a traditional project/program of development partners. A multilateral agency (i.e. UN agencies and development banks) can be assigned to administer the fund in the interim until the institutional and human resource capacity in a country is developed. This arrangement should be seen as an immediate and temporary solution. A detailed workplan on how the fund will then shift to a more sustainable country system should be developed and agreed upfront.

When the purpose of NCFs is to channel earmarked government budget to intended beneficiaries, a national fund can be created in the form a revolving fund (i.e. to manage a portion of government taxes or levies earmarked for climate change). Establishing a revolving fund will require a stronger legal basis, and often a longer political process, compared to a sinking fund. The political process may take longer because governments should be committed to earmark a portion of their taxes or levies for an indefinite period of time. The establishment of a revolving fund is often legalized by a government regulation or an act. The ENCON Fund, for instance, required around three years to be operational after the issuance of the ENCON Act, although it was unclear about the length of the political process required to pass the Act. Moreover, the collection of revenues is often under the responsibility of an executive office of a national fund. In the case of the CCDM fund, the management center is responsible for the collection of the levies on CDM projects in China and the management and distribution of the collected revenues. The principle capital of a revolving fund can also be invested in a financial market to generate interest or dividends. However, in most cases, the investments are in the form of risk-free financial instruments. The capacity to manage such investments is generally lower compared to the management of an endowment fund.

When the purpose of NCFs is to generate sustainable income from investments and channel it to intended beneficiaries, an endowment fund would require a more sophisticated arrangement and capacity, particularly in the management of assets or funds that are invested in financial markets. An endowment fund is common in Least Developed Countries as an innovative option to generate sustainable income from the returns of investments. However, returns generated from endowment funds are rather small in scale. To ensure that endowment funds generate sufficient returns to finance climate actions, it would require more capital upfront. In the management of an endowment fund, investment losses can occur, therefore, a sophisticated system should be put in place to manage such a fund. When capacity is lacking, a national fund can hire an investment manager to oversee the investment. In the case of Bhutan, an investment manager was first hired, before slowly moving to be a fully Bhutanese committee (with an international consultant hired to provide investment advice on a regular basis).

Finally, capacity building is an important element in the establishment and the management of an NCF. Sufficient capacity is necessary not only for the governing body of a fund (including trustees, executive offices and investment committees) but also the intended beneficiaries of a fund so that they can access financial resources allocated for them. A strong capacity development strategy, particularly in financial management and fund operations, should be developed as an integral part of the NCF design to ensure that it obtains sufficient attention and resources.

Figure 2: Potential NCF designs



* The process includes political negotiations with relevant stakeholders (particularly donors) and setting up necessary rules and regulations, until a fund is fully operationalized

** The process does not include the time required for political negotiations for a law to be issued.

*** The process includes political negotiations with relevant stakeholders (particularly donors), resource mobilization, and setting up necessary rules and regulations, until a fund is fully operationalized.

Note: time frame is indicative only, highly dependent on the country specific situation and based on the 7 funds that were analyzed for this paper.

Annex 1

Views from practitioners about advantages and concerns on managing climate finance through formal budget systems and National Climate Funds that emerged from discussions in preparation for this paper.

Possible advantages of managing climate finance through formal government budget systems:

- **Much climate expenditure already flows through national budget** – Climate actions are currently financed mostly by national budgets and the contribution of external finance is expected to be smaller, particularly in middle-income countries.¹⁷ Hence, external finance would be best channeled through formal budget processes. External funds can be treated as external “revenue,” that is raised internationally rather than domestically. So as with any fiscal revenue, the funds should be captured in the national budget process.
- **Formal budget processes engage all government agencies led by Ministry of Finance** – Using formal government budget systems will ensure a comprehensive fiscal framework for climate expenditure because of the comprehensive nature of the budget government process involving all government agencies. This will reduce duplication and fragmentation in climate relevant public expenditure.
- **Budget can disperse large volumes of finance** – Due to the scale and nature of climate finance, which will be in higher magnitude than the previous environment finance, there has a strong argument to use the formal budget system to access and manage climate finance as it can handle large volumes of finance.
- **Allows funds to “top-up” sector spending to support “mainstreaming” of climate** – In many developing countries, the government budget system

has established mechanisms for channeling finance for development activities in different sectors. Climate finance managed through the formal government system can allow the government to top-up sector spending to move towards low carbon and climate-resilient development.

Possible concerns about managing climate finance through formal government budget systems:

- **Issue of earmarking:** The allocation of government budget involves political negotiations during the budget process that provides no guarantee that sufficient financial resources will be allocated for climate change, particularly when government need to prioritize scarce domestic resources.
- **Potential limited outreach to non-government beneficiaries:** Channeling climate finance through formal government systems may limit opportunities to reach out to beneficiaries who have no direct access to the systems, particularly civil society, private actors and local communities to finance climate actions on the ground.

Possible advantages of managing climate finance through National Funds:

- **Pool international climate finance** – In a number of cases, a national fund is established at the request of donors who need to highlight to their constituencies that they spend their financial assistance on climate change. Donors therefore wish their finances for climate change to be insulated from other financial flows in the receiving government its general budget, so that money can be easily tracked from source to beneficiaries. At the same time, there is a shared responsibility on international climate finance: For example, developed countries should make international climate finance available in a timely and predictable manner which is important for the sustainability of NCFs. Aid effectiveness principles should be used as guidance.
- **Blend international, national, public and private finance.** An NCF with banking functions can blend various sources of international, national, public and

¹⁷ See reports on Climate Public Expenditure and Institutional Review (CPEIR) conducted in five countries including Bangladesh, Cambodia, Nepal, Thailand and Samoa, on <http://www.aideffectiveness.org/CPEIR-Workshop2012>

private finance together. In this way, an NCF can catalyze further finance toward a country's climate and development objectives. This can be particularly effective at the project level, where NCFs can bring together loans and grants to increase the volume and impact of its work.

- **Ensure government funds are earmarked specifically for climate actions** – When climate finance is channeled through the formal budget system, the allocation of financial resources will be decided through political negotiations in the government budgeting process. There is no guarantee that sufficient budget will be allocated for climate change, unless it is being earmarked legally by a government regulation. Channeling government budget through national climate funds can serve as a clear signal of government commitment to the issue of climate change. An NCF may be a way to ensure climate change actions are prioritized without compromising other development priorities of the government (with domestic budget and ODA).
- **Channel funds to intended beneficiaries (including communities, civil society and private actors) at the national and local levels** – Formal budget systems often fail to recognize the needs of local communities in the allocation of resources.¹⁸ NCFs are often considered in a better position to reach beneficiaries that have little/no access to financial resources channeled through a formal government system. Having an NCF with a clear mandate focusing fully on climate financing could ensure funds to be channeled to support climate actions initiated by civil society, the private sector and local communities.
- **Provide a platform for multi-stakeholder coordination on climate finance.** When a multistakeholder platform is not in place in a country, NCFs can provide such a platform for dialogue and coordination amongst stakeholders (ministries, civil society, development partners and private sector) on climate policy, financing and priority setting.

Possible concerns about managing climate finance through National Funds:

- **Disconnect with overall government budget processes** – Managing climate finance outside formal government systems can compromise the discipline of the resource allocation process. There is a real risk that national climate funds may manage financial flows not in conjunction with the national budget process. As funding sources become fragmented, there is a danger that the benefit of a unified approach of how government resources are being allocated is lost, which can lead to gaps and overlaps in expenditure. The findings of the Bangladesh CPEIR are indicative in this regard: there is a proliferation of funding mechanisms within the country, each with their own institutional arrangements, through which sector Ministries could potentially request additional financing.¹⁹
- **Issues in transparency and accountability** – Extra-budgetary funds are sometimes associated with the dilution of accountability and control and also problems in reporting and consolidating fiscal data.²⁰ National budgets should be transparent so that decision makers have all relevant issues and information before them when they make decisions. It is difficult, for example, for the Ministry of Finance to allocate resources strategically to climate change programs if it does not have information on the allocations of national climate funds. On the other hand, there are also in a number of countries serious concerns about transparency and accountability of government systems, and national funds have been used in various cases to bypass such systems, ensuring the beneficiaries will be reached in the most effective manner. Whether an NCF can improve or decrease transparency and accountability depends on how its governance structure is designed and how well Government's structures function.

18 Allen and Radev (2010) Extrabudgetary Funds, OECD, Paris.

19 Miller (2012) Making Sense of Climate Finance, UNDP Asia Pacific Regional Office, Bangkok.

20 Allen and Radev (2010) Extrabudgetary Funds, OECD, Paris.



*Empowered lives.
Resilient nations.*

For more information:

Mr. Alex Heikens
Regional Policy Advisor Climate Change
UNDP Asia-Pacific Regional Centre
Email: Alex.Heikens@undp.org
Tel: +662 3049100
Fax: +662 2802700
asia-pacific.undp.org/
www.aideffectiveness.org/ClimateChangeFinance