



**UNITED  
NATIONS**



**Framework Convention  
on Climate Change**

Distr.  
GENERAL

FCCC/SBI/2004/6  
6 April 2004

Original: ENGLISH

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**SUBSIDIARY BODY FOR IMPLEMENTATION**

**Twentieth session**

**Bonn, 16–25 June 2004**

**Item 5 (a) of the provisional agenda**

**Financial mechanism of the Convention**

**Matters relating to the implementation of decision 5/CP.8**

**Implementation of decisions 12/CP.2 and 12/CP.3:  
determination of funding for the implementation of the Convention**

**Note by the secretariat**

*Summary*

This note outlines the process set out in the annex to the memorandum of understanding between the Conference of the Parties (COP) and the Council of the Global Environment Facility (GEF) on determination of funding for the implementation of the United Nations Framework Convention on Climate Change. It notes that the GEF Trust Fund has been replenished three times since the closure of the pilot phase in 1994 and describes the processes and approaches by which those replenishments took place. The replenishments were based on factors which are clearly described in this note.

The note also presents the timeline of the forthcoming fourth replenishment and a possible timeline for inputs by the COP. At the twentieth session of the Subsidiary Body for Implementation (SBI), Parties may wish to consider this note during their deliberations on the implementation of the COP guidance on the second review of the financial mechanism, and decide on the steps to be taken to assess funding needs as an input to the negotiations on the fourth replenishment of the GEF Trust Fund.

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## **I. Introduction**

### **A. Mandate**

1. The Conference of the Parties (COP) by its decision 5/CP.8, requested the secretariat, in consultation with the secretariat of the Global Environment Facility (GEF), to prepare for consideration by the Subsidiary Body for Implementation (SBI) at its twentieth session a report on the implementation of decisions 12/CP.2 and 12/CP.3 in accordance with Article 11 of the Convention on the determination of funding necessary and available for the implementation of the Convention.

### **B. Scope of the note**

2. This document outlines the arrangements for the determination of funding necessary and available for the implementation of the Convention as contained in the annex to the memorandum of understanding (MOU) between the COP and Council of the GEF adopted by the COP at its third session. It also summarizes the process adopted by the GEF to replenish its Trust Fund in 1995, 1998 and 2002. It further presents the timeline of the forthcoming replenishment and a possible timeline for inputs by the COP so that the funding needs assessment can be taken into consideration during the negotiations on the fourth replenishment of the GEF Trust Fund.

### **C. Possible action by the Subsidiary Body for Implementation**

3. The SBI may wish to agree on the steps to be taken to assess the funding needs for the implementation of the Convention, prior to the fourth replenishment of the GEF Trust Fund.

## **II. Agreement between the Conference of the Parties and the Council of the Global Environment Facility**

4. Article 11.3(d) of the Convention specifies that arrangements must be put in place to determine in a predictable and identifiable manner the amount of funding necessary and available for the implementation of the Convention and the conditions under which that amount shall be periodically reviewed. The COP, by its decision 12/CP.3, approved and brought into force the annex to the MOU on the determination of funding necessary and available for the implementation of the Convention. The text of this annex is contained in document FCCC/SBI/1996/14, annex I. The COP and the Council of the GEF will jointly determine the aggregate GEF funding requirements for the purpose of the Convention in accordance with the procedures outlined in the annex to the MOU.

5. The annex to the MOU prescribes that in anticipation of a replenishment of the GEF, the COP will make an assessment of the amount of funds that are necessary to assist developing countries, in accordance with the guidance provided by the COP, in fulfilling their commitments under the Convention over the next GEF replenishment cycle. It outlines information that should be taken into consideration in determining the amount of funding necessary and available for the implementation of the Convention. These include:

- (a) The amount of funds necessary to meet the agreed full costs to be incurred by developing country Parties in order to prepare their national communications under Article 12.1 of the Convention on the basis of the guidelines for national communications of non-Annex I Parties adopted by the COP at its second session, and the information communicated to the COP under Article 12 of the Convention;

- (b) Financial resources needed by the developing country Parties to meet the agreed full incremental costs of implementing measures that are covered by Article 4.1 of the Convention and that are agreed between a developing country Party and the international entity or entities referred to in Article 11 of the Convention;
  - (c) Information communicated to the COP from the GEF on the number of eligible programmes and projects that were submitted to the GEF, the number that were approved for funding, and the number that were turned down owing to lack of resources;
  - (d) Other sources of funding available for the implementation of the Convention.
6. The GEF replenishment negotiations will fully and comprehensively take into account the assessment by the COP.
7. On the occasion of each replenishment, the GEF is expected, in its regular report to the COP, to indicate how it has responded during the replenishment cycle to the previous assessment by the COP. The GEF is also to inform the COP of the conclusion of replenishment negotiations and indicate the amount of new and additional funding to be contributed to the GEF Trust Fund in the next replenishment cycle. In deliberating on the reports submitted to it by the GEF, the COP may consider the adequacy of the resources available for implementation of the Convention.
8. The reiteration of this process on the occasion of each replenishment will present the opportunity to review the amount of funding necessary and available for the implementation of the Convention in accordance with Article 11.3(d).
9. It may be desirable for the SBI to initiate the process of the assessment of the amount of funding at its twentieth session in order to facilitate the discussion by the COP at its tenth session. To this end it may be useful to refer to the previous guidance provided by the COP on matters relating to the operations of the financial mechanism. A list of the relevant decisions is given in the annex to this document.

### **III. Global Environment Facility Trust Fund replenishment: approaches and processes**

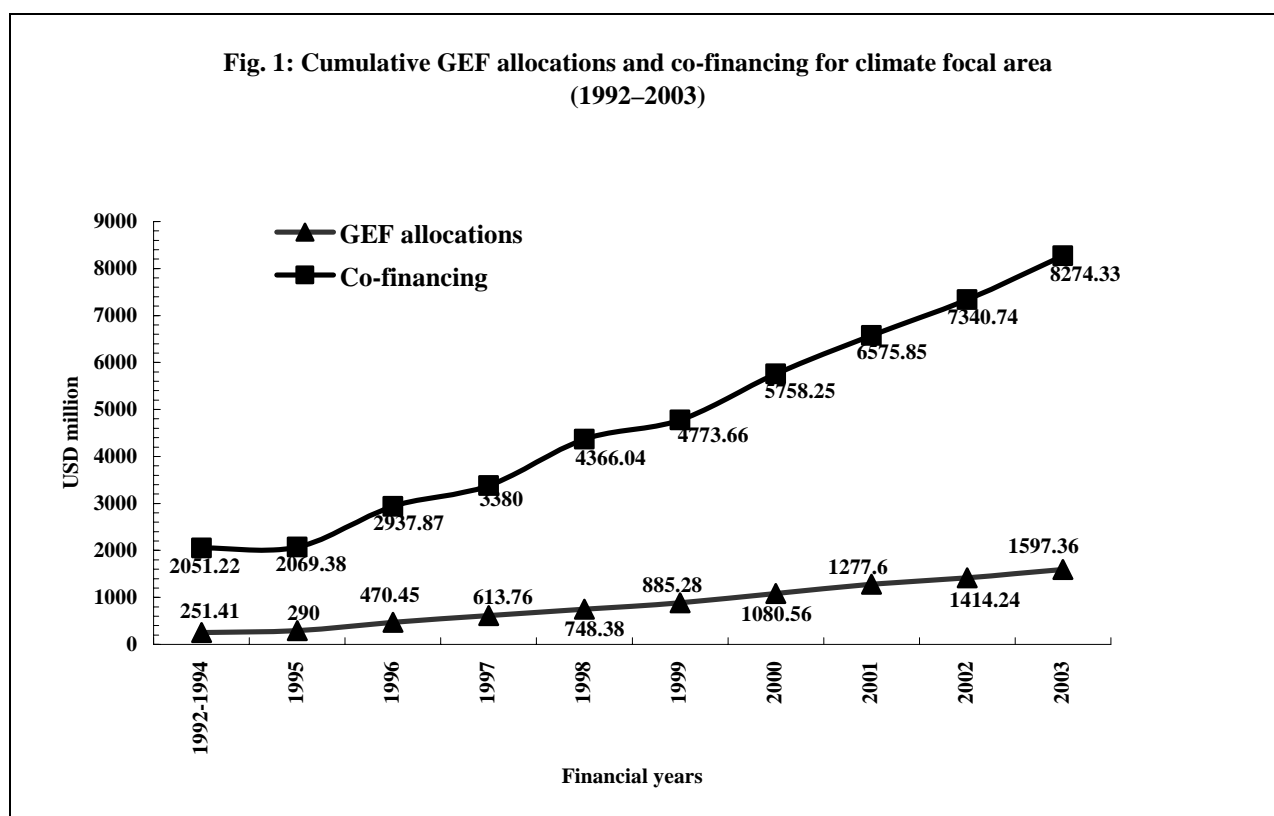
10. The GEF was established in March 1991 as a three-year pilot programme in the World Bank, by resolution of the executive directors of the World Bank and by related interagency arrangements between the United Nations Development Programme (UNDP), the United Nations Environment Programme (UNEP) and the World Bank. Since the end of the pilot phase of the GEF and its restructuring in 1994, the GEF Trust Fund has received three replenishments (see table 1). The trend of cumulative GEF allocations and the resources leveraged by means of co-financing for climate change activities for the financial years 1992–2003 is shown in figure 1.

#### **A. First and second replenishments**

11. Negotiations for the first replenishment of the GEF Trust Fund took place between March 1993 and March 1994 in parallel with the restructuring of the GEF. Donors agreed to a target replenishment of USD 2 billion. The discussions took into account, inter alia: potential needs of the replenishment in terms of the anticipated requirements relating to the Conventions and institutional and absorptive capacities; financial modalities by which the new GEF Trust Fund would operate; burden sharing; and an independent review of the pilot phase of the GEF.

**Table 1: Pledged resource levels of the GEF Trust Fund since its establishment**

| Global Environment Facility Trust Fund | Pledged resources (USD billions) |
|--|----------------------------------|
| Pilot phase (1991–1994)                | 0.86                             |
| First replenishment (1995–1998)        | 2.00                             |
| Second replenishment (1998–2002)       | 2.75                             |
| Third replenishment (2002–2006)        | 3.00                             |



12. The second replenishment of the GEF Trust Fund was negotiated between May 1997 and February 1998. An independent evaluation of the overall performance of the GEF during the first replenishment period was prepared and considered during the replenishment discussions. Factors that influenced the decision of donors to agree on an amount of USD 2.75 billion for the second replenishment of the GEF Trust Fund were:

- (a) The strategic direction for GEF financing as defined through the operation programmes;
- (b) The rapid increase in the number of eligible recipient countries ratifying the Convention;
- (c) The existing large number of enabling activities;
- (d) The rapid development of the GEF projects pipeline.

### **B. Third replenishment**

13. Discussions leading to the third replenishment of the GEF Trust Fund commenced in October 2000 and ended in August 2002. The criteria taken into account for the third replenishment included:

- (a) The absorptive capacity of the countries;
- (b) The delivery capacity of the GEF implementing and executing agencies;
- (c) The amount of GEF financing within the context of trends in financing for the global environment;
- (d) The amount of financing provided by bilateral and the private sector;
- (e) The volume of resources required for operations and for administrative fees.

14. The total amount of the GEF grants for 279 climate change projects undertaken between 1999 and 2002 was USD 648.31 million (table 2). These grants attracted more than USD 3 billion in co-financing, corresponding to a co-financing ratio of about 4.7:1.

### **C. Absorptive and delivery capacities**

15. Absorptive and delivery capacity jointly determine the overall capacity of the GEF system to support global environmental initiatives, and this is quantified on the basis of bottom-up projections of financially unconstrained demand in each focal area.

### **D. Absorptive capacity and country demand**

16. Over the past few years several factors have greatly influenced country demand for GEF resources as well as the capacities of recipient countries to design and implement high quality projects that address global environmental objectives. These factors include increased country ownership of projects, successful implementation of GEF-funded investment projects, enabling and capacity-building activities, GEF project preparation experience at the national level, enhanced country level coordination, and an increasing awareness of GEF support for national programmes to protect the global environment.

17. The GEF secretariat observed in its report on programming of resources for the third GEF replenishment<sup>1</sup> that both the absorptive capacities of countries and delivery capacities of the GEF entities have grown to the extent that neither would be a general constraint on operations under the funding scenarios that were being considered. The considerable growth in absorptive capacity of countries is evidenced by the growing engagement by countries in the processes of the international environmental conventions, the sectoral development programmes and policies with which the GEF funding is associated, and the results of the enabling activities evaluations.

### **E. Global Environment Facility delivery capacity**

18. The GEF implementing agencies (UNDP, UNEP and the World Bank) have undertaken several initiatives in recent years to enhance their capacity to support project preparation and implementation. They demonstrated their commitment to promoting global environmental action and enhancing the GEF's institutional effectiveness through:

- (a) Leveraging or mobilization of co-financing and direct co-financing for GEF projects, foundational support for GEF projects in their regular work programme, replication of

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<sup>1</sup> Programming of resources for the third GEF replenishment GEF/R.3/6, 12 April 2001.

**Table 2: Climate change project financing for the second replenishment period of the GEF Trust Fund (1999–2002)<sup>a</sup>**

| Year               | Type of activity     | Number of activities | GEF grants (USD millions) | Co-financing (USD millions) | Total financing (USD millions) |
|--------------------|----------------------|----------------------|---------------------------|-----------------------------|--------------------------------|
| 1999               | Project preparation  | 20                   | 5.65                      | 4.25                        | 9.90                           |
|                    | Enabling activities  | 21                   | 5.43                      |                             | 5.43                           |
|                    | Other projects       | 26                   | 104.12                    | 415.05                      | 519.17                         |
|                    | <b>Total</b>         | <b>67</b>            | <b>115.20</b>             | <b>419.30</b>               | <b>534.50</b>                  |
| 2000               | Project preparation  | 16                   | 4.23                      | 2.36                        | 6.59                           |
|                    | Enabling activities  | 18                   | 8.34                      | 0.69                        | 9.03                           |
|                    | Medium/Full projects | 27                   | 186.89                    | 1221.84                     | 1408.73                        |
|                    | <b>Total</b>         | <b>61</b>            | <b>199.46</b>             | <b>1224.89</b>              | <b>1424.35</b>                 |
| 2001               | Project preparation  | 23                   | 6.70                      | 4.17                        | 10.87                          |
|                    | Enabling activities  | 36                   | 5.67                      |                             | 5.67                           |
|                    | Medium/Full projects | 33                   | 184.67                    | 616.39                      | 801.06                         |
|                    | <b>Total</b>         | <b>92</b>            | <b>197.01</b>             | <b>620.56</b>               | <b>817.60</b>                  |
| 2002               | Project preparation  | 14                   | 4.52                      |                             | 4.52                           |
|                    | Enabling activities  | 17                   | 2.98                      |                             | 2.98                           |
|                    | Medium/Full projects | 28                   | 129.14                    | 764.89                      | 894.03                         |
|                    | <b>Total</b>         | <b>59</b>            | <b>136.64</b>             | <b>764.89</b>               | <b>901.53</b>                  |
| <b>Grand total</b> |                      | <b>279</b>           | <b>648.31</b>             | <b>3029.64</b>              | <b>3677.98</b>                 |

<sup>a</sup> See the GEF reports to COP 5, COP 6, COP 7 and COP 8 contained in documents FCCC/CP/1999/3, FCCC/CP/2000/3, FCCC/CP/2001/8 and FCCC/CP/2002/4, respectively.

GEF innovations in their regular work programme, following up recommendations and opportunities in their regular work programme, adoption of policies incorporating global environmental considerations, and the development of a regular programme of non-GEF financed activities linked to global environmental priorities;

- (b) Stewardship of partner agencies in joint project management, expanded opportunities for executing agencies and collaboration with the other implementing agencies;
- (c) Exploitation of their respective institutional comparative advantage, participation in strategic partnerships, and knowledge management and dissemination in respect of GEF and the global environment.

19. The overall delivery capacity of the GEF has also increased as a result of the expansion of opportunities for executing agencies (Asian Development Bank, African Development Bank, European Bank for Reconstruction and Development and Inter American Development Bank) to access project preparation and development facility category B (PDF-B) resources to support project preparation. This is implemented on the basis of specific comparative strengths in matching GEF business needs. Delivery capacity is therefore not a general constraint to resource utilization.

#### **F. Information on existing pipeline of projects**

20. The GEF maintains a pipeline of project concepts being developed by its implementing and executing agencies. Project concepts enter the pipeline at an early stage in their development, and those entering the pipeline in the later stages of the third replenishment of the GEF are likely to come to the GEF Council for approval during the fourth replenishment period. Although the project information is

not very detailed at this stage of project development, the pipeline can give an indication of future funding needs, in terms of both incremental costs and full investment volumes.

### **G. Projects included in national communications**

21. Most developing countries included in their national communications, information on greenhouse gas emission reduction and carbon sequestration project ideas and concepts for financing in accordance with Article 12.4 of the Convention. The secretariat manages a database on these projects briefs and provides an updated list of projects to Parties.

22. At the end of 2003, the database included about 665 project ideas and concepts, 47 per cent of which relate to energy, 14 per cent to forestry, 14 per cent to industrial processes, 13 per cent to transport, 7 per cent to waste, and 5 per cent to agriculture.

23. Some of these project briefs provide estimates of emission reduction/sequestration and project costs but they do not provide an indication of the incremental costs of implementing any measures identified in the projects that may be covered in Article 4.1. Many, if not most, of the project briefs contained in the national communications would benefit from financial and technical resources for further elaboration. Even in their present form, these project briefs provide an indication of resources needed by developing countries to implement the Convention.

24. The COP, at its ninth session, requested the secretariat to prepare, in consultation with the GEF and its implementing agencies, an information document on possible means of implementing these projects, for its consideration at its tenth session.

### **H. Bilateral channels of funding available for the implementation of the Convention**

25. In August 2002, the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) published information on financial assistance extended by its members to developing countries to support the implementation of the UNFCCC for period the 1998–2000. The report revealed that the average annual contribution of these OECD members for climate-change-related activities for period 1998–2000 amounted to about USD 2.7 billion, making the total value of committed resources in the three years USD 8.1 billion. The report further indicated that the data used for the report do not permit any statements to be made on whether these commitments were “new and additional” as stipulated by the Convention.<sup>2</sup> The report noted that the overall climate-change-related aid represented 7.2 per cent of DAC members’ total bilateral ODA commitments in 1998–2000. In value terms, close to 90 per cent of climate-change-related aid was reported in the sectors of transport, energy, agriculture, forestry and general environmental protection.

### **I. Multilateral funding channels**

26. Financial flows from multilateral development banks, the World Bank, UNDP, UNEP and other United Nations agencies to support the implementation of climate change projects outside the framework of the financial mechanism of the Convention are known to be important. However, it was not possible to obtain updated information from the institutions early enough for it to be included in this document. Information on these financial flows is being compiled by the UNFCCC secretariat.

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<sup>2</sup> Aid targeting the objectives of the Rio conventions 1998–2000, an OECD information paper for WSSD, Paris 2002.



#### **IV. Possible future steps**

27. The third replenishment period of the GEF Trust Fund commenced on 1 July 2002 and will end on 30 June 2006; the fourth GEF replenishment period is expected to begin in July 2006. Discussions leading to the fourth replenishment are expected to formally start after the consideration by the GEF Council in May/June 2005 of the outcome of the Third Overall Performance Study of the GEF (OPS-3). The fourth replenishment discussions are expected to be concluded in the first quarter of 2006. In order for the outputs of the funding needs assessment to inform the fourth replenishment discussions, it is necessary that the assessment be completed by SBI 22 in June 2005. The results of SBI 22 deliberations on the funding needs assessment could be presented to replenishment negotiations for consideration. The COP could then adopt a decision on the determination of funding needs for the implementation of the Convention for the period 2006–2010 at its eleventh session in December 2005.
28. In order for the SBI complete the funding needs assessments in June 2005, for adoption at COP 11, the SBI at its twentieth session may wish to decide that an expert workshop be held in the autumn of 2004. The expert meeting could provide inputs towards an assessment of the amount of funds necessary to assist developing countries in implementing the Convention over the fourth replenishment period of the GEF for consideration at SBI 21.
29. The COP, at its tenth session, would be expected to take a decision on the procedures and timing of the submission of the assessment report. It may wish to request the SBI, at its twenty-second session, to complete the funding assessment, prepare a draft decision for adoption at COP 11 and forward the assessment report to the GEF secretariat for consideration by the GEF Council and participants of the fourth GEF replenishment negotiations.
30. The UNFCCC secretariat, in collaboration with the GEF secretariat, could prepare a report to the SBI, at its twenty-third session, on the progress on the fourth replenishment negotiations relating to climate change and the results of OPS-3.
31. The UNFCCC secretariat, in collaboration with the GEF secretariat, could then prepare a final report on the funding needs assessment for the implementation of the Convention for the consideration at COP 11 prior to the completion of the fourth replenishment negotiations in the first quarter of 2006.

Annex

**List of guidance from the Conference of the Parties relevant to the  
operation of the financial mechanism**

| <b>Decision</b>  | <b>Title</b>   |
|------------------|--|
| Decision 9/CP.1  | Maintenance of the interim arrangements referred to in Article 21, paragraph 3, of the Convention  |
| Decision 10/CP.1 | Arrangements between the Conference of the Parties and the operating entity or entities of the financial mechanism   |
| Decision 11/CP.1 | Initial guidance on policies, programme priorities and eligibility criteria to the operating entity or entities of the financial mechanism   |
| Decision 12/CP.1 | Report of the Global Environment Facility to the Conference of the Parties on the development of an operational strategy and on initial activities in the field of climate change  |
| Decision 11/CP.2 | Guidance to the Global Environment Facility  |
| Decision 12/CP.2 | Memorandum of Understanding between the Conference of the Parties and the Council of the Global Environment Facility   |
| Decision 13/CP.2 | Memorandum of Understanding between the Conference of the Parties and the Council of the Global Environment Facility: annex on the determination of funding necessary and available for the implementation of the Convention |
| Decision 12/CP.3 | Annex to the Memorandum of Understanding on the determination of funding necessary and available for the implementation of the Convention  |
| Decision 2/CP.4  | Additional guidance to the operating entity of the financial mechanism   |
| Decision 3/CP.4  | Review of the financial mechanism  |
| Decision 1/CP.6  | Implementation of the Buenos Aires Plan of Action  |
| Decision 5/CP.7  | Implementation of Article 4, paragraphs 8 and 9, of the Convention (decision 3/CP.3 and Article 2, paragraph 3, and Article 3, paragraph 14, of the Kyoto Protocol)  |
| Decision 6/CP.7  | Additional Guidance to an operating entity of the financial mechanism  |
| Decision 7/CP.7  | Funding under the Convention   |
| Decision 10/CP.7 | Funding under the Kyoto Protocol   |
| Decision 5/CP.8  | Review of the financial mechanism  |
| Decision 6/CP.8  | Additional guidance to an operating entity of the financial mechanism  |
| Decision 7/CP.8  | Initial guidance to an entity entrusted with the operation of the financial mechanism of the Convention, for the operation of the Special Climate Change Fund  |
| Decision 8/CP.8  | Guidance to an entity entrusted with the operation of the financial mechanism of the Convention, for the operation of the Least Developed Countries Fund   |
| Decision 4/CP.9  | Additional guidance to an operating entity of the financial mechanism  |
| Decision 5/CP.9  | Further guidance to an entity entrusted with the operation of the financial mechanism of the Convention, for the operation of the Special Climate Change Fund  |
| Decision 6/CP.9  | Further guidance for the operation of the Least Developed Countries Fund   |

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