Legal and technical implications of converting the AF as an Operating Entity of the Financial Mechanism

Guiding Question:

What are the legal, political and governance implications of designating the Adaptation Fund as an operating entity of the financial mechanism of the Convention[1]?

There are discussions among some developing countries concerned with the lack of resources available for the AF, as well as in the Adaptation Fund Board. One theoretical option might be to re-designate the AF as an operating entity of the financial mechanism, which has been discussed during COP18. In response to the query, this paper briefly describes the available options how to do this and its potential merits and limits, both in terms of its practicality but also the political desirability and implications on the governance arrangements related to the AF Board. It would also be useful to understand whether or not such a political process would unlock greater resources for adaptation finance.

Background

The Adaption Fund was established on the basis of Article 12 (8) of the Kyoto Protocol and by Decisions 5/CP.6 and 10/CP.7. The Adaptation Fund "*shall be financed from the share of proceeds on the clean development mechanism project activities and other sources of funding"* and it was decided that the "*share of proceeds shall be two per cent of the certified emissions reductions issued for a clean development mechanism's project activity".* In Decision 28/CMP.1, it was decided that the Adaptation Fund *"shall function under the guidance of, and be accountable to, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol".* In Decision 1/CMP.3, it was decided that *"the operating entity of the Adaptation Fund shall be the Adaptation Fund Board, serviced by a secretariat and a trustee"*, and that the Global Environment Facility (GEF) provides secretariat services to the AFB and the World Bank serves as trustee of the Adaptation Fund on an interim basis.

The Kyoto Protocol (KP) is entitled Kyoto Protocol to the United Framework Convention on Climate Change (UNFCCC). In other words, the KP is part of the UNFCCC and at the same time a Protocol, which is by nature a legally autonomous treaty regime. This means, despite the independence of the KP by its nature, it is established to implement specific parts of the Convention. In fact, a protocol is negotiated by Parties to a convention to implement specific obligations/commitments of this convention. This is the

[1] This paper was issued as response to the discussion among Parties on potential relocation of the AF as Operating Entities of the Financial Mechanism. Some of the information contained in the document may be outdated, but still it could serve as thoughts to stimulate the discussion in the SCF. The paper will be updated for the next meeting of the AFB.

same relationship that exists between the Biosafety (Categena) Protocol and the Convention on Biological Diversity, and now its Nagoya Protocol on Access and Benefit-sharing, as well as between the Montreal Protocol and the Vienna Convention on Substances that deplete the Ozone Layer among other things.

Designation of the AF as an OE could be understood as either a) keeping it under the KP and designate it in addition under the COP, or b) relocating the AF under the FM of the COP by detaching it from the KP. None of "potential scenarios" considered by the Adaptation Fund Board in its *Strategic Prospects for the Adaptation Fund (AFB/B.19/5 (13 November 2012), para.11)* goes as far as having the Adaptation Fund completely relocated under the Convention, however.

With regard to the options, there are different levels to take into account:

- Decision-making options: whether a decision is only taken by the COP or the COP and the CMP;
- Designation options and associated questions: 1. pure designation as OE under the Convention, 2. relocation as OE under the Convention (detachment from the KP);
- De-facto designation through integration into the GCF as an or the adaptation window.

Decision-making option 1: Parallel considerations by the COP and the CMP, both relevant for a "pure designation" and a "relocation" scenario

- COP and CMP would both engage on the designation of the AF as an operating entity under the FM of the Convention. It is expected that both decisions would have similarities, but also distinct issues to cover.

Procedural implications:

The process would have to consist of a set of decisions to be taken one by one by both the COP and the CMP in order to designate the AF as an OE of the FM. There have been enough precedents where both bodies have adopted almost identic decisions, e.g. on joint agenda items such as capacity building (see e.g. decisions 13/CP.17 and 15/CMP.7). One of the bodies (COP/CMP or its subsidiary bodies) or the AF Board would have to kick-start the process by expressing the need to explore and pursue the option of a designation. The starting point could be for instance that the AF makes a recommendation on this regard, in its report to the CMP. Or, Parties in adopting the report of the AF at the CMP, request the COP to explore ways of designating the AF under the Convention. The COP in turn, could request the Subsidiary Body for Implementation (SBI) to explore appropriate ways. The discussion on this matter could take place under the agenda item of the SBI related to the AF.

Decision-making option 2: The COP as the supreme body of the Convention will take the decision

In this option, the COP will take by its own the decision with regard to the designation of the AF as an OE under the COP. This is based on the understanding that the COP being the supreme body of the Convention has the mandate to "*keep under regular review the implementation of the Convention and any related legal instruments that the Conference of the Parties may adopt, and shall make, within its mandate, the decisions necessary to promote the effective implementation of the Convention*" Art 7.2.

Everything in the KP is rooted in a similar provision of the Convention. This also applies to the provisions on finance contained in Art 11 of the KP and which is related to Art 11 of the Convention that established the financial mechanism. The AF, emanating from Art 12.8 of the KP, is however not an OE entrusted with the FM of the Convention. This means that the COP by its own could trigger and undertake the process of designation.

Procedural implications:

This option might be regarded as easier since only one body would have to take decisions. A procedural entry point could be the fifth review of the FM, which will be undertaken at the same time as the second review of the AF. As result of the review process the process of designation of the AF as an OE of the FM could be induced. The review is meant to be finalized by COP20 next year, based on the guidelines that the Standing Committee on Finance is currently revising.

Further implications of options 1 and 2:

Both in options 1 and 2, Parties who have not been engaged in the set-up of the Adaptation Fund, namely those who are a Party to the Convention but not to the KP, would have to agree to the designation of the AF. This may increase an important barrier for finding agreement.

Designation option 1: Pure designation of the AF as OE

In this case the AF would be formally regarded as an OE of the FM under the Convention through a COP decision, by remaining tied to the KP. This would be in line with Art. 11.1 which says that the operation of the FM should be entrusted to one or more existing international entities. Since the AF is an existing, international institution there seems to be no legal barrier to this. Designating the AF as OE of the Convention would make it a subject of the Financial Mechanism and put it at the same level as the GEF or the GCF. Activities to strengthen the FM as well as procedures such as the regular review of the FM would in that case include the AF. However, this would not necessarily result in new and additional resources for the AF.

However, what might have to be adjusted are the eligibility criteria, both with regard to the governance as well as the eligibility to submit project proposals since these are only open to Parties of the KP (in the latter case only to particularly vulnerable developing countries).

However, since all KP Parties are also Parties to the Convention, this does not seem an insurmountable political barrier. Noteworthy in doing so, is also to question as how far the share of the proceeds from Certified Emission Reduction (CER) from CDM project could still be used. However, we do not see an impediment in case the AF still stays under the KP, except for political resistance by some Parties.

Designation option 2: Relocation of the AF as OE of the Convention by detaching it from the KP

The second option would be to relocate the AF under the Convention by detaching it from the KP. This has further implications in addition to those pointed out under “the designation option 1”.

A motivation to pursue this option lies in the recognition that as of today, it is still uncertainty about the future of the Kyoto Protocol beyond 2020, as well as the critical situation of the CDM as the major source of revenues for the Adaptation Fund. The 5th Review of the FM could be an entry point, either to decide on a relocation, or to initiate the process to explore it, potentially with the view to making it effective after the end of the 2nd commitment period in 2020.

This could for example be part of the 5th Review of the FM and a decision could result in its relocation after the end of the 2nd commitment period. However, since the future of the KP and its mechanisms is not decided yet and may continue to play a role in some form also in a future agreement to be negotiated under the ADP one can question whether there is the need for such a decision.

Most important to consider would probably be in how far the share of the proceeds from Certified Emission Reduction (CER) from CDM project could still be used, should the AF be detached from the KP. According to the advice on query Q95-12 provided by the Legal Response Initiative, “this special financing

from the shares of proceeds on CDM occurs only because the Adaptation Fund is a financing mechanism under the Kyoto Protocol with its CDM (Article 12). Thus, if the Adaptation Fund is completely detached from the Kyoto Protocol and put under the Convention, this special financing mechanism will no longer be utilized. It will no longer be an Adaptation Fund under Article 12 (8) of the Kyoto Protocol."

This would then also be the case for the use of additional revenue sources related to the flexible mechanisms of the KP. According to the decision 1/CMP.8 (para 21) a share of proceeds has also been imposed on the first international transfers of AAUs and the issuance of ERUs under the 2nd commitment period.

However, it stands to question if not the COP alone – or jointly with CMP – could take adequate decisions, which would allow the continued use of the share of proceeds from these mechanisms even if the Adaptation Fund would have to be taken out from the KP, bearing in mind that the COP as supreme body of the Convention, including its Protocol.

Another question is whether additional agreements with the interim Trustee World Bank and the GEF which provides secretariat services to the AFB would be required in the option of relocation. While the CMP would not have to ask these bodies for allowance, in change of such parameters it is likely that the current agreements would not be automatically applied and that the bodies could request changes in the agreements. However, the COP or CMP could initiate processes for seeking other institutional arrangements anyway, and the CMP is also able to just terminate the agreements with the other institutions (of course with certain implications).

Procedural implications:

The COP could request the SBI to look at procedures to terminate the operation of current Adaptation Fund under the KP and how this Fund will be placed under the authority of COP, without delinking from the CERs from CDM project activities. This should be based on Art 7.2 (h) of the Convention, which stipulates that Parties shall "seek to mobilize financial resources in accordance with Article 4, paragraphs 3, 4 and 5, and Article 11". In this case, Parties under the SBI would have to consider how to relocate the AF to the Convention as well as potential implications of shifting the AF under the Convention and how to ensure that the AF could as an OE of the Convention still remain tied to the KP's flexible mechanism.

It could be expected that this designation option might take substantially more time and investigation than option 1. In both cases the positioning of those Parties not Party to the KP are of course relevant since the COP in any way has to take one or more decisions.

Designation option 3: Designating the AF under the Convention, but as a window of the GCF

The AF Board's most far-reaching "institutional integration" scenario considers the possibility of a greater degree of integration with the Green Climate Fund (GCF) under the Convention (LRI Query 95-12).

Since the GCF is an OE of the FM it could de-facto lead to an application of the FM procedures to the AF, at least in its function as a GCF window. In addition it is also worth figuring out, whether the AF, by acting as a window of the GCF could still remain under the KP, but endowed with additional functions, that should enable the AF to do so. Also here the two options could be considered, keeping the AF under the KP and servicing the GCF, or relocating it under the Convention as an integral part of the GCF. Both options would likely face the resolution of similar issues as outlined above,

As mentioned above, according to the fact that the COP is the supreme body of the Convention and its protocol, it can initiate the closing, or conversion process of the AF from the KP to the Convention. Further, the GCF Board is the body authorized to add, modify or remove additional windows (Para. 39 of GCF Governing Instrument).

A potential conflict may be that the GCF operates under the guidance of, and accountability to, the COP, while the AF operates under the authority of, and accountability to, the CMP. Legally this puts the CMP in stronger position with regard to the AFB, than the COP with regard to the GCF Board. Whether this results in a big difference in practice, however, is unclear, since also in the case of the AF the AFB – as the governing body of the AF – takes most of its decisions in a mostly autonomous manner.

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