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Agenda Item 8

REVIEW OF THE GLOBAL ENVIRONMENT FACILITY EARTH FUND

(Prepared by the GEF Evaluation Office)

Recommended Council Decision

The Council, having reviewed the documents "*Review of the Global Environment Facility Earth Fund*" (GEF/ME/C.39/2 and GEF/ME/C.39/Inf.1) and "*Management Response to the GEF Earth Fund Review*," (GEF/ME/C.39/3) requests the Secretariat to prepare for the May 2011 Council meeting a revised strategy for enhancing engagement with the private sector that includes a plan for the implementation of the second phase of the Earth Fund. This plan should take into account comments made during this Council meeting and should move the revised Earth Fund away from a business-as-usual, project-by-project approach and towards a partnership with the private sector at the strategic level. It should also present (1) objectives that are realistic given the funding level, (2) a strategy and modalities in which management and governance are strengthened, including the involvement of the private sector in fund-governance and in raising capital; (3) a communication strategy to disseminate the establishment and operations of the new Fund and (4) expanded access to the Fund.

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EXECUTIVE SUMMARY

1. The status of the GEF Earth Fund (Earth Fund) as an expression of GEF's long-standing intent to engage more with the private sector has made its pilot phase of execution a subject of intense interest, despite its small size. The Policy paper for the GEF5 replenishment negotiations recommended an evaluation of the structure and operations of the Earth Fund, following which the Council should consider the proposal to further capitalize the Earth Fund with an infusion of additional resources during GEF5. The GEF Evaluation Office has undertaken an independent review of the efficiency and relevance to the GEF of the Fund rather than an evaluation of its effectiveness and results, given the early stage in the implementation of the Fund.

2. The review concentrated on four areas: (1) compliance with Council decisions establishing the Public-Private Partnership Initiative (PPPI) and the Earth Fund; (2) review of the Earth Fund activities from platforms to their projects; (3) engagement with the private sector; and (4) efficiency as defined by the Earth Fund's processes (particularly the "project cycle) and the roles and responsibilities of different stakeholders. It was conducted from June until August 2010. The full review is provided to Council as an Information Document (GEF/ME/C.39/Inf.1).

3. The Earth Fund was presented to the Council as a "catalyst", to encourage private sector investment in environmental protection. The Earth Fund, as set up in GEF4, and the private sector have templates that do not fit together well, which makes it difficult if not impossible to achieve the catalytic role envisaged. The review has one over-arching conclusion:

1) **The Earth Fund did not achieve its purpose.**

4. It did not attract private funding at the Earth Fund level nor did it establish partnerships with the private sector although all five platforms are considered relevant to the GEF mandate. The platforms and projects being proposed by the Earth Fund include roles for private sector organizations, but not as expected. Several factors have limited the achievement of the purpose of engaging the private sector. For example, the objectives of the Earth Fund were not derived from an assessment of the GEF's comparative advantage, nor were they clearly articulated internally or externally. There were weaknesses in the organizational and administrative structure established for the Earth Fund, particularly during implementation.

5. Too many times in the past has the GEF dropped targeted efforts to engage with the private sector for further reflection and for rethinking its approach. In GEF-5, the Earth Fund should be reconstituted to learn from past experiences, to ensure that engagement with the private sector is continued and more importantly enhanced. Because funding has been set-aside for a second phase of the Earth Fund, the Evaluation Office requests Council and CEO to consider the following conclusions and recommendations, which are aimed at making the second phase of the Earth Fund a success by refocusing attention on original intent:

2) **Although the Earth Fund was intended and expected to be set up as a Fund, over time it became a granting mechanism.**
3) **The Earth Fund committed the allocated $50 million in five platforms in just over two years, but did so by falling back on GEF business as usual.**

4) **Engagement with the private sector, the purpose of setting up the Earth Fund, was relegated mostly to the project level.**
5) **Expectations regarding co-financing and reflows were unrealistic.**
6) **The Earth Fund did not clearly communicate its purpose internally or externally, nor was there a plan for learning from its experience, that of the broader GEF or that of others.**
7) **The Earth Fund governance and management structure had several weaknesses, revealed during implementation.**

6. The review formulates one over-arching recommendation:

1) **The Council should request the GEF Secretariat to revise the Earth Fund for its second phase.**

7. For this second phase, the following more specific recommendations were formulated:

2) **Redefine Earth Fund objectives, niche and market barriers**
3) **Clarify access to the redefined Earth Fund**
4) **Strengthen the management of the Earth Fund**

8. The operational management of the Earth Fund should remain with the GEF Secretariat and be strengthened. The financial management of the trust fund to be established for the second phase of the Earth Fund could either:

- Remain with IFC, acting on behalf of the World Bank, the GEF Agency of the Earth Fund; or
- Move to the GEF Secretariat. This would provide full clarity of the GEF ownership of the Earth Fund and will give full accountability and responsibility to the GEF Secretariat. The GEF Trustee could create the same set up that has created for IFC but with the GEF Secretariat as the executing agency.

BACKGROUND

9. The status of the GEF Earth Fund as an expression of GEF's long-standing intent to engage more with the private sector has made its pilot phase of execution a subject of intense interest, despite its small size. The Policy paper for the GEF5 replenishment negotiations recommended an evaluation of the structure and operations of the Earth Fund, following which the Council should consider the proposal to further capitalize the Earth Fund with an infusion of additional resources during GEF5.[1] The GEF Evaluation Office prepared and circulated for comment a note on how to conduct an independent review of the Earth Fund.[2] Following interviews with key stakeholders in the GEF Secretariat and GEF Agencies, it was concluded that given the early state of implementation of the Earth Fund and its platforms the Office would conduct an independent review of the efficiency and relevance to the GEF of the Fund rather than an evaluation of its effectiveness and results.

10. The main objective of the review was to respond to the request from the fifth GEF replenishment process. The review is expected to provide donors, Council members, GEF Secretariat and other key stakeholders with an assessment of the Earth Fund activities implemented so far as well as a report on the way the Earth Fund has functioned and its interactions with the private sector.

11. The review concentrated on four areas: (1) compliance with Council decisions establishing the Public-Private Partnership Initiative (PPPI) and the Earth Fund; (2) review of the Earth Fund activities from platforms to their projects; (3) engagement with the private sector; and (4) efficiency as defined by the Earth Fund's processes (particularly its project cycle) and the roles and responsibilities of different stakeholders.

12. The review was conducted from June until August 2010 by a team of Evaluation Office staff and one senior consultant with expertise in Public-Private Partnerships (PPPs) and the role of the private sector in economic development, environmental protection and renewable energy. The review consulted as many of the GEF stakeholders as could be contacted during the period of the review and reviewed a large number of GEF and other documents to reconstruct the antecedents and progress of the Earth Fund. Information was gathered through August 31, 2010. The full review is provided to Council as an Information Document (GEF/ME/C.39/Inf.1).

CONCLUSIONS

13. The Earth Fund was presented to the Council as a "catalyst", to encourage private sector investment in environmental protection.[3] A catalyst is to chemical processes, as an enzyme is to biological processes: the templates of both parties to the interaction must fit together for the interaction to succeed. In this analogy "template" refers to organization structures and decision-making criteria and processes. The Earth Fund, as set up in GEF4, and the private sector have templates that do not fit together well.

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[1] GEF, 2010. *Policy Recommendations for the Fifth Replenishment of the GEF Trust Fund* (GEF/R.5/26; February 12, 2010).
[2] GEF, May 13, 2010. *GEF Evaluation Office Review of the GEF Earth Fund*.
[3] GEF, April 2008. *Request for CEO Endorsement of the GEF Earth Fund.*

Conclusion 1: The Earth Fund did not achieve its purpose.

14. It did not attract private funding at the Earth Fund level nor did it establish partnerships with the private sector although all five platforms are considered relevant to the GEF mandate. The platforms and projects being proposed by the Earth Fund include roles for private sector organizations, but not as expected. The pilot phase of the Earth Fund has become a granting mechanism, with all funds committed and therefore cannot be re-tracked to better engage the private sector.

15. Several factors have limited the achievement of the purpose of engaging the private sector. For example, the objectives of the Earth Fund were not derived from an assessment of the GEF's comparative advantage, nor were they clearly articulated internally or externally. There were weaknesses in the organizational and administrative structure established for the Earth Fund, particularly during implementation. Given the nature of the Earth Fund as a pilot, the GEF Council, GEF management and Earth Fund Board should have provided more follow up and guidance, rather than presupposing that the GEF Secretariat had the skillset, mindset and networks required to make the Earth Fund a success.

16. The development of the Earth Fund from its inception to the current status of full commitments has been a difficult one, due to both internal and external reasons. The most serious shortcoming of the Earth Fund has been that it has not lived up to expectations. However, this review should not lead to the conclusion that for a better engagement with the private sector the GEF should go "back to the drawing board". There are many elements in the experience so far that can be incorporated into a second phase of the Earth Fund. For that purpose the recommendations section will focus on the changes that could be made to the Earth Fund structure to allow it to become an effective agency for engaging with the private sector, focusing on how current obstacles can be removed and how the good elements can become even better.

17. Too many times in the past has the GEF dropped targeted efforts to engage with the private sector for further reflection and for rethinking its approach. In GEF-5, the Earth Fund should be reconstituted to learn from past experiences, to ensure that engagement with the private sector is continued and more importantly enhanced. Because funding has been set-aside for a second phase of the Earth Fund, the Evaluation Office proposes that Council and CEO consider the following conclusions and recommendations, which are aimed at making the second phase of the Earth Fund a success by refocusing attention on original intent.

Conclusion 2: Although the Earth Fund was intended and expected to be set up as a Fund, over time it became a granting mechanism.

18. Normally in a Fund there would be a legal and management structure that reflects responsibilities, accountabilities and procedures that support the integrity of the investment philosophy being pursued as well as protect fiduciary responsibility. In the GEF Earth Fund, ownership is not defined and risks and returns are not clearly allocated. Alignment of economic interest and clarity of purpose are needed to be able to define workable investment regulations.

19. The characteristics that defined a Fund for the establishment of partnerships with the private sector disappeared or became just GEF business as usual. Reasons for this are many and partly related to the influence of institutional characteristics of the GEF itself, such as the lack of legal status, which requires acting indirectly through others. The Council approved a project that left several items open but the GEF Secretariat did not take full advantage of them, in particular the authority to allow any entity to become a Platform Managing Agency for the Earth Fund, if they fulfill the GEF fiduciary standards and Council approved their status. The GEF could have communicated the administrative needs of the Earth Fund more effectively to its GEF Agency partners.

20. Changing the name from PPPI to "Earth Fund" created confusion. In the world of financing social and physical infrastructure, the term "PPP" refers to ownership, execution and financial structure and flows, whereas the term "Fund" implies that the Earth Fund *qua* Earth Fund was either going to make direct investments, act as a Limited Partner in existing investment funds, or act as a Fund of Funds. This is not a matter of semantics. A Fund can reasonably be expected to be financially self-sustaining. A grant making "mechanism" such as the Earth Fund could more accurately be described, is less easily made financially self - sustaining. The Earth Fund thus became not a Fund, but a granting facility or mechanism with a limited set of grantees.

21. Relevant information on possible ways on how to do this are provided, although on a different scale, in the various publications of the Climate Technology Fund: CTF Governance Framework, CTF Private Sector Operational Guidelines, and CTF Financing Products, Terms and Review Procedures for Private Sector Operations.

Conclusion 3: The Earth Fund committed the allocated $50 million in five platforms in just over two years, but did so by falling back on GEF business as usual.

22. From approval of the Earth Fund in May 2008 until the CEO endorsement of the fifth platform (expected by September 2010) took the Earth Fund just over 2 years. The Earth Fund accomplished this objective by relying heavily on business as usual practices, and for example, moving two regular GEF projects into Earth Fund platforms. Not all the platforms envisioned in the foundation documents survived the implementation process, which is to be expected. The private sector has not shared responsibilities or accountability, management was not visionary and strategic, and administration has not been adapted to meet Earth Fund needs.

23. The objectives and work proposed by the platforms is all in all consistent with the GEF mandate. The concept of Earth Fund "platforms" seem to work, albeit not in the way originally intended. The five platforms approved are within the GEF mandate and propose a reasonable set of projects to be undertaken over the next four years, however rather than being co-owned or operated with private sector organizations, the platforms are owned and operated by GEF Agencies, some of which have entered into grant agreements with NGOs. While it is possible that some private sector organizations prefer that a GEF Agency serve as a "buffer" with the GEF system, it is equally possible for a GEF Agency to serve this role and share operating responsibilities.

Conclusion 4: Engagement with the private sector, the purpose of setting up the Earth Fund, was relegated mostly to the project level.

24. The modalities of the engagements used and proposed by Earth Fund platforms are not particularly innovative, as many of them had been done within the GEF Trust Fund. Another special characteristic of the Earth Fund was to have been the approach of engaging the private sector through Public-Private Partnerships, or PPPs. This approach was lost at the Earth Fund level as well and also relegated to the platform level. The change in name from PPPI to Earth Fund was more than that.

25. The Earth Fund lacked transparent and efficient approaches and procedures for engaging the private sector. This stems from lack of a clear definition of the purpose and priority areas of the Earth Fund, and also secondarily from GEF and GEF Agency culture, which is different from that of private enterprise and NGOs.

Conclusion 5: Expectations regarding co-financing and reflows were unrealistic.

26. Some degree of private funding, referred to as co-financing, is the principal criterion used to distinguish private sector projects from others within the overall GEF portfolio. "Co-financing" has been a concept in the GEF that has created great confusion. There are mainly two types in this context. Co-investment, where the private sector would invest funds alongside the GEF in Earth Fund, or alongside Earth Fund in a platform, would occur at the beginning of a joint effort, and implies co-ownership. Cost-sharing, which is what has been proposed in each Earth Fund platform, occurs as costs are incurred, and does not imply co-ownership.

27. There is a mismatch between the GEF's expectations of co-financing – defining it solely as cash, for example – and the value placed by the private sector on collaboration with the GEF, especially under difficult global financial and economic conditions.

28. To date the GEF Earth Fund has not attracted co-financing at the level of the Earth Fund or its platforms. At platform level the individual platform proposals indicate that they will obtain non-GEF financing equal to 3x the money allocated to them by Earth Fund, as was envisioned for the Earth Fund as a whole. There are still some uncertainties in the co-financing figures, so it is not clear that this target will be met for each platform.

29. In addition to co-financing, Earth Fund founding documents make reference to anticipated reflows from investments. The expectation of reflows is unrealistic in view of the requirement that Earth Fund investments be made on concessional terms. Relatively limited private money flows on its own to environmental activities because of the low, or long, financial returns to those activities, even under market rates. Returns to Earth Fund-supported projects may be so low and long in coming that the amount of money that could flow back to a minority shareholder or holder of subordinated debt is minimal.

Conclusion 6: The Earth Fund did not clearly communicate its purpose internally or externally, nor was there a plan for learning from its experience, that of the broader GEF or that of others.

30. There was no framework or strategy to define how the Earth Fund was going to be presented to the general public, to the private sector or within GEF partnership, causing confusion regarding the Earth Fund itself, its management, operations and procedures, and limiting Earth Fund's ability to identify potential partners.

31. As a pilot activity the Earth Fund ought to have an established means for capturing lessons, but it does not. Furthermore, the GEF's prior experience with PPPs and working with the private sector was not tapped effectively. The originators of the Earth Fund did not build on the extensive lessons of the GEF with PPPs and otherwise engaging the private sector, nor did they adopt successful practices of others, outside the GEF partnership, working in the world of environmental finance.

Conclusion 7: The Earth Fund governance and management structure had several weaknesses, revealed during implementation.

32. Council approved the Earth Fund as a GEF full-sized project. It was supposed to be managed operationally by the GEF Secretariat. The World Bank was the GEF Agency and the IFC was the executing agency and also the manager of the Earth Fund trust fund account.[4] As manager of the Earth Fund, IFC was to disburse funding from the trust fund account under instructions of the GEF Council and the GEF CEO. The GEF Council was required to approve all platforms as well, including review and approval of platform governance, operating procedures and platform managing agencies, to be sure they fulfilled the GEF fiduciary standards. An Earth Fund Board was also established, to meet at least once a year, chaired by the GEF CEO and comprised of 3 representatives of the private sector. Earth Fund Platform Managing Agencies were defined as any entity that would propose a platform and then be responsible for managing it.

33. The review found that when this structure was implemented several weaknesses were revealed and several of the roles and responsibilities were confused and not fulfilled. There were too many partners, with no clear implementation roles, weakening the process. There was no clear accountability of who was in charge of the Earth Fund:

- The Council's role was limited to the approval of platforms (on a no-objection basis);
- The Secretariat only managed the remaining $20 million of the Fund since IFC had received $30 million for its platform as the first Earth Fund platform. The GEF Secretariat did not allocate sufficient resources to manage the development process of the Earth Fund, platform identification and development, monitoring and reporting to Council and the GEF;
- The World Bank was accountable to the Council as a GEF agency of the Earth Fund project and then became a Platform Managing Agency for one of the platforms;

[4] The IFC also was the manager of the IFC Earth Fund Platform, $30 million.

- IFC had several functions; it provided the trustee services as requested, acting on behalf of the World Bank and managed the biggest platform (60% of the Earth Fund). In the early discussions of the Fund IFC had expected to manage the entire Earth Fund; and
- The Earth Fund Board was established but its roles as an advisor to the Earth Fund and advocate for the GEF among the private sector were not fulfilled.

34. Furthermore, many changes were taking place in the GEF as an institution during the gestation and development of the PPPI and Earth Fund, increasing confusion in the purpose of the Earth Fund and the roles and responsibilities of the different actors.

35. The private sector and the GEF Focal Points were not assigned specific roles and responsibilities.

RECOMMENDATIONS

Recommendation 1: The Council should request the GEF Secretariat to revise the Earth Fund for its second phase

36. The second phase, for which an allocation of $80 million has been set aside in the replenishment agreement, should meet the following conditions:

- The objectives, niche and market barriers to be addressed by the GEF Earth Fund need to be defined and then broadly disseminated.
- Access to the new trust fund to be created for the Earth Fund II needs to be clarified.
- The management of the new Earth Fund needs to be strengthened.

Recommendation 2: Redefine Earth Fund objectives, niche and market barriers

37. The Earth Fund is only one way in which the private sector may engage the GEF and the general environmental and sustainable development "space." Therefore, there is a need to define the niche of the Earth Fund, in particular the market barriers and failures within the purview of the GEF and that are recognized by the private sector. This definition should be commensurate with the level of funding allocated to the Earth Fund for its second phase: expectations should match the funding. The GEF Council should provide strategic guidance to the GEF Secretariat on how to narrow and focus the scope of the Earth Fund.

38. In particular, the GEF Secretariat, in collaboration with GEF Agencies and private sector representatives, should:

- Identify areas of work where the Earth Fund can act as a credible technical partner and act as a liaison between private and public sectors, that is, identify what the GEF has to "offer" to the private sector that it cannot get from other sources.
- Establish a program to regularly scan the broader environmental finance space, so as to be able to identify potential partners – technical and financial – from inside and outside the GEF system. Scan with a view toward learning not only "who does what to whom" but also, how they do it and to be alert to what they are not doing that the GEF could do.

- Rethink expectations of financial sustainability.
- Based on the prior steps, define the products, services and markets where the second phase of the Earth Fund can be targeted.
- Create incentives for drawing lessons from experiences from GEF, GEF Agencies and others of working with the private sector.
- Devise and implement a communication strategy for the Earth Fund that clearly communicates to the public, the objectives, niche and market barriers expected to be addressed as well as the procedures of operation (see below).

Recommendation 3: Clarify access to the redefined Earth Fund

39. The GEF Secretariat should prepare an international call for expression of interest in partnering with the GEF in the second phase of the Earth Fund. The short-listing resulting from this call could then be invited to make formal proposals to operate Earth Fund platforms, through a defined Request For Proposals process. Private sector entities whose aims overlap with those of the GEF, singly or in consortia, should be sought after and encouraged to apply.

40. The Earth Fund as presently established had several weaknesses, in particularly with regards to direct engagement with the private sector. The GEF is presently discussing how to further engage with new partners, so some of those decisions could be applicable to the second phase of the Earth Fund. It is important to clearly establish who would have access to the fund and how. As was envisaged in the original Earth Fund project proposal, which was approved by Council, all entities that fulfill the GEF fiduciary standards should be able to access the Earth Fund directly. These entities, to be termed "Earth Fund Platform Managing Agencies," should be proposed to the Council by the GEF Secretariat, for Council review and approval.

Recommendation 4: Strengthen the management of the Earth Fund

41. The operational management of the Earth Fund should remain with the GEF Secretariat and be strengthened such that:

- Appropriate financial resources are allocated by GEF Council;
- Staff with experience working with the private sector in the GEF focal areas is recruited and assigned adequate management authority;
- A monitoring and evaluation system is established at the Earth Fund level (M&E at the platform and project levels should remain with the Platform Managing Agencies);
- A knowledge sharing mechanism with links within the GEF and to organizations outside the GEF is developed and installed;
- A communications strategy is designed and implemented.

42. The financial management of the trust fund to be established for the second phase of the Earth Fund could either:

- Remain with IFC, acting on behalf of the World Bank, the GEF Agency of the Earth Fund. IFC has the previous experience, a global reach and a mandate to interact with the private sector; or

- Move to the GEF Secretariat. This would provide full clarity of the GEF ownership of the Earth Fund and will give full accountability and responsibility to the GEF Secretariat. The GEF Trustee could create the same set up that has created for IFC but with the GEF Secretariat as the executing agency. The present experience and lessons learnt in the process of setting up the trust funds for national communications and national business plans (GEF/C.38/6/Rev.1) would be useful.