

GEF Council Meeting
November 16-18, 2010
Washington DC

Agenda Item 8

MANAGEMENT RESPONSE TO THE REVIEW OF THE GLOBAL ENVIRONMENT FACILITY EARTH FUND

(Prepared by the GEF Secretariat)

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INTRODUCTION

1. This is the management response to document GEF/ME/C.39/2, *Review of The Global Environment Facility Earth Fund*, undertaken by the GEF Evaluation Office. The GEF Secretariat has prepared this management response, with input received from the GEF Agencies. We have indicated issues where particular GEF Agencies have alternative views or disagree with the conclusions of the GEF Secretariat.
2. The review has highlighted many of the difficulties experienced in implementing the Earth Fund over the past three years. The GEF Secretariat agrees with the emphasis in the review in examining how the Earth Fund evolved from the initial proposal for a Public Private Partnership Initiative (PPPI) presented to the GEF Council as part of the June 2007 work program. This is the critical point from which subsequent discussion of engagement with the private sector began in GEF-4. Measured against the expectations set out in this initial proposal, we agree that the Earth Fund's performance does not measure up well.
3. When first conceived in late-2006 and early-2007, the PPPI/Earth Fund was meant to be a transformative initiative that enabled a full partnership with the private sector at multiple levels – at the level of a central trust fund, at the level platforms, and that the level of projects. It was meant to be much more than a "pilot project." It was designed to give the private sector a lead role in governance.¹ This was seen as critical for interesting private sector investment in the PPPI trust fund. It was also designed to enable direct collaboration between the GEF as a whole, rather than through the traditional "project-by-project" relations intermediated by individual GEF Agencies.
4. The review of the PPPI and Earth Fund demonstrates the difficulties faced in attempting to undertake such a transformative initiative. Rather than the strong private-sector led Board and Platform Steering Committees that the Secretariat envisioned, after negotiations with Council Members and GEF Agencies, a board with only an advisory function was established. Projects were to be approved under streamlined approval procedures, but after objections from some Council Members, a less streamlined approval procedure was adopted. Similarly, the GEF Secretariat had sought to establish a central trust fund for the PPPI with the GEF Trustee, but after concerns expressed by Council Members and the Trustee (due to the linkages with the private sector), the Secretariat made arrangements with the International Finance Corporation (IFC) to serve as the trustee.
5. Another evolution was that although the Secretariat envisioned that NGOs or foundations could become Earth Fund Platform Managing Agencies, the IFC and World Bank had a different understanding. We discuss these views below, but ultimately, two NGOs that were interested in serving as Platform Management Agencies were required to partner with two GEF Agencies on platforms that they had developed. Whereas the Secretariat saw the PPPI/Earth Fund as a transformative initiative, more akin to a corporate-wide program, Council Members, the World Bank, and IFC believed it was approved as a "pilot project." The Council should also recall that it took almost a year of negotiations to move from the point of Council approval of the PPPI Project Executive Summary (June 2007) to CEO endorsement of the initiative in May 2008. The

¹ The PPPI was to be governed by a PPPI Board whose membership was to be one-half private sector. The Platform Steering Committees were to be comprised of private sector investors at the platform level.

end result is less a full partnership with the private sector than a mechanism to provide funding to individual private-sector projects of the GEF Agencies.

6. While GEF has not made sufficient progress to a full partnership with the private sector, there are some achievements under the Earth Fund that can be recognized, particularly when measured against previous experience within the GEF. The Earth Fund represents the first GEF-wide initiative to focus on engaging the private sector. It was able to allocate the fully \$50 million in Earth Fund resources to platforms in a range of sectors, some of which were quite innovative. The Earth Fund Board represents the first time in the GEF's history where representatives of the private sector were given a role, though limited to an advisory function, in GEF programs and projects. To understand the challenges faced by the Earth Fund, the Council should also take into account the challenges created by the global financial crisis over the past 2 1/2 years in working with the private sector.

CONCLUSIONS

7. Overall, the GEF Secretariat agrees with conclusions of the review that implementation of the Earth Fund did not achieve the full set of ambitious goals in terms of building a transformative partnership with the private sector.

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

8. The Secretariat agrees that the Earth Fund did not achieve important aspects of its initial purpose, as originally proposed to the Council.² The GEF had to scale back its initial ambitions in terms of private sector involvement in the governance of the Earth Fund and involvement of entities beyond the 10 GEF Agencies as Platform Managing Agencies. It also did not prove to be possible, at least in the time available, for the Earth Fund to attract private sector contributions or investments at the trust fund level. It is not likely, however, that private sector entities would be willing to contribute to the Earth Fund given the limitations of its Board.

9. The initial reason why the Secretariat proposed focusing on platforms was to promote direct collaboration with important private sector actors in a strategic manner that would allocate resources to particular themes or emerging technologies. The Secretariat wanted to move away from the project-by-project focus of the past. While some of the platforms focus on single industries or themes (e.g. the Inter-American Development Bank (IDB) water funds project and the United Nations Environment Program (UNEP) cocoa industry project) they still largely resemble individual projects. The IFC platform was also more open-ended than the original platform concept.

² The World Bank and IFC note that the review would have benefited from a clear presentation of what purpose it refers to. As mentioned earlier, there were significant changes from the 2007 PPPI proposal to the actual shape and form of the Earth Fund that was approved by the Council in 2008, prior to CEO endorsement. These changes may have resulted in misperception or differing expectations, which, had they been cleared up, could have enhanced the effectiveness of the Earth Fund. Given the review's finding that the Earth Fund's objectives were not clear, the World Bank and IFC believe that the conclusion that the Earth Fund did not achieve its purpose is somewhat overstated.

10. The allocation of \$50 million in Earth Fund resources to five platforms can be seen as an accomplishment, as should the engagement of the private sector as represented by the Earth Fund Board. We recognize that these do not measure up to the initial ambitions. That the GEF was not able to move further from its traditional agency-focused engagement to full, more direct engagement with the private sector only demonstrates the institutional difficulties the GEF faces in this regard.

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

11. The GEF Secretariat largely agrees with this conclusion. Although there are differences in interpretation as to how one defines a "fund," it is clear that the eventual outcome of the Earth Fund differed substantially from the initial vision, which entailed more direct partnership with the private sector and included a fund that would accept contributions from private sector entities and foundations and make investments largely using non-grant instruments. Clearly no private sector contributions to the fund were received.

12. The IFC platform accounts for almost all of the investments using non-grant instruments. This platform invests using direct equity and subordinated instruments and in a clean technology venture capital fund. The World Bank/Conservation International platform also includes investments in a fund that will enable reflows. Other platforms, however, rely on grant financing. In total, grant financing makes up about one-half of the financing provided by the Earth Fund. More concerted effort will be needed to make greater use of non-grant instruments in the future.

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.

13. Given the significant delays encountered in negotiating aspects of the Earth Fund, and the financial crisis, which reduced investment demand, we believe greater recognition should be given to the fact that the GEF was able to program Earth Fund resources to five platforms. We also believe that some of the platforms are quite innovative. As noted in the review, the IFC portfolio invests in frontier markets and creates new risk assessment, mitigation, and management tools. The IDB-Nature Conservancy platform combines conservation easements with public-private sector water funds in a new and innovative way, and is designed to be replicable throughout the IDB's region of operation.

14. The review is correct that Earth Fund operations focused largely around the operations of the GEF Agencies. The GEF Secretariat saw the Earth Fund as an opportunity to forge more direct partnerships with private sector actors, including NGOs and foundations. The Secretariat agrees with paragraph 109 of the review that such direct partnerships could have been forged. The *Rules of Procedure of the GEF Earth Fund Board*, approved by the GEF Council in 2009, clearly defined "Platform Managing Agency as a "GEF Agency, NGO, or foundation with fiduciary standards that meet GEF requirements and has been identified in a Council-approved Platform as responsible for managing all investments within the Platform in accordance with Strategic Priorities, Governance, and Operational Procedures of the GEF Earth Fund." The

World Bank and IFC did not agree with the Secretariat on this issue.³ Two NGOs that put forward platforms were required to partner with two GEF Agencies.

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

15. We agree that the Earth Fund primarily engaged the private sector through projects that it supported. The GEF Secretariat solicited input from a wide variety of private sector entities in formulating plans for the PPPI/Earth Fund. The Secretariat actively sought to engage the private sector at the level of the trust fund and the platform level. Despite serious initial interest from private sector partners, given the delays in launching the Earth Fund (until mid-2008) and the changes to the Earth Fund structure requested by the Council and some GEF Agencies, the GEF came to adopt a more “business-as-usual” approach of engaging the private sector at the project level. Still, the GEF Secretariat was able to constitute the private sector Earth Fund Board, which represents a more direct engagement with the private sector.

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

16. We disagree with the conclusions regarding co-financing. While it is true that the Earth Fund did not attract co-financing at the Earth Fund level it did attract co-financing at the platform and project level. As indicated at the time of CEO endorsement, such co-financing could come from a variety of sources, including GEF Agencies and private sector entities. The review only seems to consider contributions from private companies as co-financing.⁴ It would have been clearer for the review to include a clear, consolidated table of co-financing commitments, but even using the review’s definition, co-financing exceeds the \$150 million that would be required under the 3:1 ratio agreed at the outset.

17. We believe that emphasis in the Earth Fund project document on reflows might have created what are seen as unrealistic expectations by the Evaluation Office. The truth is that the GEF never established a benchmark rate of return from the Earth Fund. The Secretariat understood that Earth Fund investments would be made on concessional terms and that expected reflows back to the Earth Fund would be rather minimal. The intent of the Earth Fund was to experiment. In cases where a concessional loan or an equity investment could be made, this was seen as advantageous since the reflow back to the Earth Fund could fund future investment and would lower the future recapitalization burden on the GEF Trust Fund.

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

³ The IFC, as the Earth Fund Trustee, and World Bank did not agree that NGOs could serve as Platform Management Agencies without explicit clearance by Council and based on the GEF’s fiduciary standards.

⁴ The World Bank and IFC feel that implementation of projects funded by the GEF Earth Fund are on-going, many in still very early stages. Therefore the conclusions on impacts, such as co-financing, reflows, learning, etc are premature and cannot be drawn. The reviewer also has misunderstood co-financing as defined in the Platform approvals, where each agency’s or entity’s contributions (at the platform and project level) were also counted as co-financing. The review leaves these figures out, and the result is that co-financing appears lower than it actually is.

18. Given the delays encountered in getting the Earth Fund approved, the GEF Secretariat focused its attention on identifying viable project opportunities in which the Earth Fund could invest and demonstrate its value. The GEF did engage in outreach to a wide variety of private sector actors, to GEF Agencies, and to NGOs on the Earth Fund. The fact that three significant NGOs were able to put forward private-sector oriented platforms is evidence of this.

19. We agree that a clear communications plan and improved knowledge management plan will need to be developed as key cornerstones of a second phase of the Earth Fund, if undertaken.

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

20. If the Earth Fund is to be reconstituted for a second phase, we agree that it will need an improved governance and management structure. The GEF Secretariat pushed for an initiative that was transformative, that would lead to closer engagement between the private sector and the GEF as a whole--not just engagement at the agency level. As set out in the 2007 documents, it was intended that the GEF Secretariat would operationally manage the Earth Fund. However, because it was approved as a project, the World Bank and IFC did not always see the undertaking in the same way as the Secretariat, which resulted in confusion over roles and responsibilities.

RECOMMENDATIONS

21. The GEF is at an important juncture in terms of its relations with the private sector. We believe that the Council faces an important decision. The Council can either commit itself to the type of partnership presented to the Council in June 2007 – with a central trust fund involving the private sector in governance, capable of attracting private sector resources; streamlined approval procedures; and a focus on transformative, thematic platforms – or it can pare back ambitions for the GEF and adopt a more traditional project-by-project approach.

22. The first approach would entail reconstituting the Earth Fund with a decision making board that included private sector representatives in its governance. The Secretariat would have authority to manage the fund, serve as the Secretariat of the Board, and solicit resources from willing private sector contributors.⁵ The Secretariat would collaborate with the GEF Agencies and any new partners that might be accredited under the proposed rules under paragraph 28 of the Instrument⁶ on the creation and management of Earth Fund platforms.

23. The alternative would be to not reconstitute the Earth Fund. The \$80 million allocated by the GEF-5 replenishment for private sector engagement could be used as an incentive mechanism for leveraging other GEF resources, including countries' STAR allocations, to fund private sector projects. We discuss aspects of these approaches in the responses to the recommendations.

⁵ In this case, the World Bank believes that the institutional and legal status issues that led to the current institutional set-up will need to be analyzed and re-considered.

⁶ See Document GEF/C.39/7 and Document GEF/C.39/8, which propose rules and a system for accrediting new partners as agencies under Paragraph 28. These documents propose calling these agencies "GEF Partner Agencies."

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

24. This is one of the two possible responses to the findings of the review, but the Secretariat believes that the Council should make a clear decision as to what it means to reconstitute the Earth Fund.⁷ The Secretariat supports reconstituting the Earth Fund if the Council agrees that it will be part of a bold initiative to build a strong and more direct partnership with the private sector. This kind of partnership with the private sector means more than thinking about it as a single pilot project. It will need to have its own trust fund and governing arrangement that includes the private sector and with streamlined approval procedures. We believe that potential private sector partners seek full engagement, a management team that listens frequently and carefully to private sector needs, and highly flexible and responsive implementation options.

25. If the Council does not support this approach, then it is not clear that a reconstituted Earth Fund will provide the strategic foundation that the GEF needs for furthering its engagement with the private sector. As an alternative, Agencies could propose private sector projects for funding, which would be approved by Council following a rolling, one-stop approval process similar to that used currently for Earth Fund projects. The Secretariat would devise rules for the use of the \$80 million private sector allocation as an incentive mechanism, aimed at leveraging indicative country allocations under the STAR.

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

26. If the Council approves a reconstituted Earth Fund along the lines of the first approach, the Secretariat would present a private sector strategy to the Council at its spring 2011 meeting that includes a comprehensive plan on the Earth Fund that clarifies its objectives, strategy, governance arrangements, and other rules. The Secretariat would systematically engage potential private sector partners during the development of the plan to solicit views and gauge commitment levels. If the Council decides that the second, alternative, approach should be taken, the Secretariat will present a plan for using the \$80 million designated for private sector activities as an incentive mechanism.

Recommendation 3: Clarify access to the redefined Earth Fund.

27. Under either of the options above, the GEF Secretariat recommends that new entities accredited as GEF Partner Agencies under paragraph 28 of the Instrument be able to access GEF resources designated for private sector activities.

28. If the Council decides to reconstitute the Earth Fund in the bold manner suggested in the first approach, the Secretariat would be favorably disposed to devising a system whereby private sector entities can submit expressions of interest for creation of GEF Earth Fund platforms. The GEF Secretariat would need to devise a way to match the platform proponents with GEF Agencies and/or Partner Agencies, who will be in charge of monitoring and supervising the use

⁷ The World Bank and IFC recommend that all of the options (the current arrangements, the options proposed in the review, as well as the Management response) should be fully considered by the GEF Council—especially with respect to practical constraints, capacities, costs, and the benefits of each option. The management and implementation arrangements should derive from the agreement on the new focus and niche.

of Earth Fund resources. It is possible that consortia of private sector entities and GEF Partner Agencies would be required to apply for implementation of GEF platforms.

Recommendation 4: Strengthen the management of the Earth Fund.

29. The Secretariat agrees with the recommendation that the operational management of a second-phase Earth Fund should remain with the GEF Secretariat and that management should be strengthened.⁸ Appropriate staff would need to be recruited; an adequate management budget allocated; and monitoring, evaluation, and knowledge management would need to be strengthened. The Secretariat, the World Bank/IFC, and the GEF Trustee will need to discuss and come to agreement on an appropriate financial management arrangement.

⁸ UNEP believes that the Evaluation Office review should have offered a third option on management of a second-phase Earth Fund for Council consideration – management of the Fund by a private sector entity. Close supervision by the GEF Council would be required to ensure that GEF objectives and standards of accountability were being met. Lessons learned could be drawn from existing funds managed by the private sector.