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# Progress Report: NDF's Climate Change Mandate

May 2009 - April 2011

*Summary*

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Nordic Development Fund

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June 2011

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# Summary of Progress Report - NDF's Climate Change Mandate

## BACKGROUND

The *Progress Report - NDF Climate Change Mandate* was submitted to the NDF Board in May 2011 as a review of the institution's progress in achieving the operational objectives endorsed by the Board in May 2009. At that time, estimates were made of the number of projects that would be financed in 2009-2010, and the amounts involved, as well as the number of country profiles that would be prepared in order to respond to NDF's new climate change mandate. Other specified activities included enhancing project monitoring and evaluation, increasing knowledge of climate change issues among NDF staff, and using experience obtained from the new projects to determine the most effective financing modalities. Assessment of the progress made in implementing the new mandate should be seen in light of the other responsibilities and tasks undertaken by NDF, which include updating and modernization of a variety of policy, procedural, and financial measures, many of which are designed to facilitate the operational initiatives referred to above. In parallel with these developments, NDF has continued to manage and monitor its existing, but declining, portfolio of credit projects.

## OPERATIONS

**Projects:** In 2009, the expected number of projects to be supported was between 12 and 18 during 2009 and 2010, with expected grant commitments of EUR 35-50 million. Since the inception of the climate change mandate NDF has, as of April 30, 2011, approved financing for 23 projects with a total value of EUR 76.725 million. In addition there are seven projects in the pipeline with a total value of EUR 12.5 million. These projects have taken the form of either traditional co-financing or innovative financing mechanisms, as described below.

**Co-financing:** Nineteen projects, with a total value of EUR 49.525 million, are financed through traditional co-financing, 47% are joint co-financing and 53% are parallel co-financing. NDF's co-financing partner agencies include the World Bank/ IDA, the Asian Development Bank (ADB), and the Inter-American Development Bank (IDB). The regional distribution is as follows: Africa 45%, Asia, 30% and Latin America 25%. Of these projects, roughly half may be classified as mitigation, 30% as adaptation and 20% as mixed projects.

Support for climate change-related projects has typically been of a cross-sectoral nature. Thus, while a number of the projects can be defined as supporting a specific sector (e.g.

electric power, road transport, or municipal waste disposal), most of them relate to investments and/or capacity building affecting several sectors. While this is particularly apparent in the case of adaptation, it has increasingly been observed that there are many opportunities for synergy between mitigation and adaptation activities.

**Innovative Financing Mechanisms:** NDF has in addition approved five projects that may be classified as innovative financing mechanisms. These include the Nordic Climate Facility (NCF) 1, Nordic Climate Facility (NCF) 2, the ProClimate Facility (ProCF), the Energy and Environment Partnership (EEP) in Mekong, and GreenPyme in Central America. In total EUR 27.2 million has been approved for these facilities. The facilities are innovative in different ways. NCF facilitates the exchange of technology, know-how and ideas between the Nordic countries and low-income countries in the area of climate change. The EEP Mekong Program provides seed money for a variety of renewable energy, clean technology and energy efficiency activities in the Mekong region, thus facilitating the development of innovative ideas, approaches and concepts into sustainable and bankable investment projects. ProCF aims to support small and medium scale climate-friendly investment projects that often would not otherwise be realised due to lack of financing, perceived risk and/or size. ProCF will supplement already available financing and thus help to close remaining financing gaps. GreenPyme's objective is to encourage local banks to become involved and trained in energy efficiency.

**Substantive Role of NDF:** The mandate of NDF is to provide financial support for climate change and development projects. In order to satisfy this requirement, development and updating of country profiles, combined with rigorous project screening procedures has increasingly characterized NDF's project identification and selection process. However, NDF has endeavored to go beyond the minimum requirements implied in its formal mandate, by using its financial resources to influence the design of projects in which it participates, and exerting leverage to promote climate change-relevance. Often this is more likely to be achieved by up-stream participation, at the project concept or identification level, but experience to date shows that influence is also possible at the project implementation stage.

Substantive dialogue at the project level is now characteristic of NDF's involvement with its partners. For example, in the Africa region, NDF has played an important role in cooperating with the World Bank in the design and appraisal of the Ghana Landfill Gas Capture and Utilization project. In Asia, the Greater Mekong Subregion's Climate-Friendly Bioenergy project (with ADB) was subjected to careful screening analysis, and NDF involvement in the project concept and preparation phases helped to ensure that the climate change focus was maintained in the technical assistance project. In Latin America, NDF has been involved from the earliest stages in the design of the Indigenous Peoples, Energy and Climate Change project for Honduras, participating in extensive discussions with the co-financier (IDB), and financing preparatory studies for specific climate change-related components of a larger development project.

NDF has also played a substantive role in the design and implementation of the innovative financing mechanisms so far underway. In the case of the NCF, NDF collaborated with the Nordic Environment Finance Corporation (NEFCO) in the initial design, project criteria establishment, and project selection. In contrast to NCF, NDF is not involved directly in the EEP Mekong project selection process, but has played an active role in issues related to climate change, for example in developing eligibility and project selection criteria and in ranking and selection of projects. With regard to GreenPyme, NDF came into the picture subsequent to pilot testing by the Inter-American Investment Corporation (IIC), which continues to manage the activity. NDF assisted IIC in developing and expanding the project concept, particularly regarding climate change issues. Finally, the ProClimate Facility was designed by NDF in collaboration with NEFCO and continues to be implemented jointly by both institutions.

**Project Identification and Screening:** Shortly after taking on the new mandate it became apparent that NDF would have to develop criteria for determining the eligibility of projects to be defined as climate change-related. Benefitting from project and policy level discussions with major partners, internal guidelines have been developed for project identification and climate screening procedures. The guidelines consist of quantitative screening criteria for both mitigation and adaptation projects. The criteria for mitigation activities set minimum requirements regarding greenhouse gas reductions, namely that the total value of greenhouse gas reductions from emissions or carbon sequestration, should be at least 10% of the project's investment costs. With regard to adaptation activities, NDF requires that at least half of the projects' total investment costs should be for adaptation-related activities. In addition, all projects should satisfy standard economic and social tests at the national level (or be expected to, if not easily quantified). The threshold levels for the criteria should be used to achieve a reasonable balance between the demand for NDF funds by co-financiers and project beneficiaries and the amount that NDF is able to supply. So far this seems to have been the case. Nevertheless, as awareness of the availability of NDF funding grows, the increasing demand for its support may require an upward revision of the threshold levels. Continual monitoring of the success of the screening mechanism as a means of efficiently rationing NDF funds will thus be required.

**Country Profiles:** The intention of the country profiles – which are internal documents - is to increase NDF's knowledge about its partner countries with special reference to climate change vulnerabilities and priorities within the climate change development agenda. The process is designed to highlight priority areas for potential NDF support. In terms of numbers, NDF has more than met the expectations stated in 2009, when between 6 and 9 country profiles were proposed over the following two years. In fact, NDF has prepared 14 country profiles, plus a regional profile for Central America.

**Specific Sectoral Issues:** Most sectoral and cross-cutting issues (e.g. poverty, environment, gender) do not need specific attention from NDF, which can generally rely upon the safeguards and other policies that have been developed over the years by partner institutions such as the World Bank as well as the Nordic donor community. Nevertheless, the NDF

management has clarified the institution's policies in respect of certain sectoral issues of critical importance for NDF's new mandate. Specific issues concerned NDF's stance toward energy subsidies and biofuels. Position papers on both these issues have been developed. The NDF management is also in the process of preparing a review of NDF's private sector investments under its old mandate, including an assessment of the development impact.

## **POLICIES AND PROCEDURES**

**Staffing and Internal Processes:** NDF staff presently includes only twelve persons, of whom eight are responsible for programming and project work and four provide support services. Implementation of the screening criteria and subsequent project monitoring requires in-depth understanding of climate change aspects of the projects financed. This has been addressed by recruitment of staff with specialized skills as well as an on-going staff training program. Complementing the staffing activities, NDF has gradually introduced new mechanisms to enhance the coordination of internal processes. New templates have been designed for project presentations to the Board, reflecting the change in focus of NDF operations. A staff Project Committee (PC) has also been established to review project proposals prior to Board distribution to ensure that they are in line with the new mandate and have undergone the screening procedures. The PC has also taken on more tasks such as reviewing other project documents, and more general policies.

**Inter-agency Cooperation:** In the ten last years of the credit mandate (1995-2005), co-financing was done almost exclusively with the World Bank and the regional development banks where NDF funded parts of the multilateral development banks' (MDBs) prepared projects. The co-financing modality was parallel, and most goods and services were procured through Nordic competitive bidding. For NDF the MDBs acted as *lead agencies*. Under the climate change mandate, cooperation with partner agencies has changed significantly. First and foremost, NDF's role has altered from primarily being a provider of finance for social and economic development to being a provider of finance for the more narrowly defined area of climate change while also providing substantive inputs. As one way of achieving leverage, NDF now increasingly enters the project cycle at an early stage. This gives greater possibilities of making sure that climate change issues are indeed taken into account in project design. Having taken on more of an advocacy role has substantially altered the way NDF does business and implies a much more active and continuous dialogue with the *partner agencies* - a term that has largely replaced the use of the earlier *lead agency*.

The majority of the projects that were approved during the first two years of the climate change mandate are projects in cooperation with the traditional partners, i.e. the World Bank, the Asian Development Bank, and the Inter-American Development Bank, but cooperation with new partners has also been established. For example, NEFCO is co-implementing two projects (NCF, ProCF) and the Inter-American Investment Corporation (IIC) is co-financing the GreenPyme project.

**Nordic Interest:** With the arrival of the climate change mandate in 2009 the NDF owners decided that International Competitive Bidding (ICB) should be the method of procurement. However, the Board emphasized that the NDF administration must ensure that qualified Nordic companies had ample opportunity to participate in competition for NDF funded contracts. Together the change in the NDF mandate and the shift from National Competitive Bidding (NCB) to ICB have led to a situation where the concept of *Nordic interest* no longer only bears a narrow connotation of being an operational definition which relates to procurement.

Moreover, moving from the credit mandate of financing general social and economic development to the clearly limited niche of climate change investment has resulted in NDF becoming more of a sector and policy advocacy institution. Experience to date in implementing the new climate mandate suggests that NDF can effectively influence the projects it co-finances with the MDBs. In so doing it can add an important policy and strategy related dimension to the concept of *Nordic interest*. Work along these lines is underway on ways to promote Nordic interests within the ICB framework.

**Operational Policies and Guidelines:** *General Procurement Guidelines for Grant Financed Projects* have been produced. The new procurement policy abandons the previous aid practices and opens the eligibility for NDF-financed contracts to firms and individuals and, for goods, materials, services and personnel, from all countries, making ICB the preferred method for procurement of major contracts for works, goods and non-consulting services. In principle, procurement of goods, works and services under NDF grant funding will follow, with necessary modifications, relevant procurement guidelines of the MDB's.

In addition, NDF has adopted its first *Policy on Access to Information*. In line with the policies of other multilateral financiers, NDF strives for openness. Other new guidelines include new *NDF Procedures on Taxes*, referring to a more liberal and flexible tax policy that allows use of NDF grant funds to finance reasonable costs of taxes and duties associated with project expenditures. In addition, there are new disbursement instructions for grant financed projects. Updated policies have been incorporated into a new Standard Grant Agreement.

**Outreach:** With the new mandate NDF's outreach activities have grown rapidly. NDF maintains contact with authorities of the Nordic countries including embassies, co-financiers, partner countries, companies, institutions, and consultants through publications (annual reports, quarterly newsletters, special newsletters, and brochures), NDF's website, and by participation in meetings, workshops and seminars. Starting with the new mandate NDF has participated in a series of workshops and seminars as well as special meetings to present the NDF 2009-2011 Strategy and the development of new projects. NDF has attended - and frequently made presentations at - numerous seminars and workshops targeting government authorities, companies, institutions and NGOs. NDF made a presentation at a climate change seminar at the Swedish Parliament in April 2010. Another presentation was held at the Finnish Parliament in May 2011. Attention has increasingly been given to present and explain NDF's methodology for identification and screening of climate change projects, and in this

connection special meetings have been held with officials of the respective development assistance authorities in the Nordic capitals.

**Performance Management:** Currently underway is the development of NDF's monitoring and evaluation practices. A new Project Performance Management System is being designed to: i) provide information to both the management and the country managers, ii) provide information on the quality of the portfolio, iii) be an early warning system for implementation related problems and de-railing, and iv) provide feedback and information on fulfilment of the intended project outcomes. The goal is to have all new grant projects rated with the new system by end of 2011.

**Anti-Corruption:** NDF developed an anti-corruption policy in 2002 and established an Anti-corruption Committee the same year. In total the committee has dealt with 13 cases since 2002 of which the majority have been related to procurement processes. In the last two years, the number of active cases has grown and the committee has met more frequently. So far, all cases have concerned credit projects. NDF has also started a dialogue with other international financing institutions. Meetings have been held with the Vice President for Integrity at the World Bank as well as with the Chief of Office of Institutional Integrity of the Inter-American Development Bank. This work will continue, and when completed, revised guidelines will be presented.

**Finance:** In order to accommodate demands implied by the new mandate, a series of reforms and changes have been made by the financial administration. These include updating of the existing database and disbursement tool for NDF financed projects to handle both the old credits as well as the new climate change projects. Similarly, NDF's income statement has been updated in order to take into account grant payments.

The climate change projects also impose new demands on NDF's reporting to the OECD-DAC. In order to get a more detailed analysis of the climate change projects, NDF started in 2010 to report its aid flows according to the Creditor-Reporting-System (CRS). However, the climate change aspects of the new projects were not adequately recognized in the CRS reporting and NDF, therefore, recently started to use the Rio Markers in the CRS in order to record the climate change aspects of the NDF's projects.

## **SUMMARY AND CONCLUSIONS**

NDF has exceeded the operational targets set out in May 2009 as defined by the number of projects financed and country profiles completed. This quantitative achievement is only a part of the overall positive picture. NDF's policies and practices have undergone a radical reorientation to meet the needs of the major change in its operational activities. Significantly, the new focus on climate change has resulted in a transformation in the relationships between NDF and its co-financing partners, and in the role NDF staff plays at various stages in the

project cycle. NDF has become more involved in, for example, the design stage of projects. The quantitative indicators, therefore, tell a part of the story, but equally important are the qualitative contributions of NDF staff.

As anticipated in 2009, the past two years have been to some extent an experimental period, but NDF now appears to have defined a niche. Its key role is to exert leverage with co-financiers to maximize climate change-relevance of projects – as noted, there is evidence that this is already happening. Particularly when interventions have taken place early in the project cycle, NDF has demonstrated an ability to exert significant influence on the design of its partners' projects. NDF's aim is to contribute to the mainstreaming of climate change issues. To achieve this, the traditional co-financing activities are completed by the innovative financing mechanisms, which are designed to encourage innovation and experimentation with potential for wider application.

During the two year period, existing partner institutions as well as potential new ones have displayed an increasingly keen interest in working with NDF. Partner institutions seem to be attracted not only by the availability of grant funds but also by a common interest in the practical and intellectual issues involved in determining project eligibility. This issue has been brought to the fore by NDF's mandate, which requires explicit evidence in each project to justify its support. Moreover, at the project level, the lessons learned by NDF in its efforts to ensure that grant funds for climate change activities are actually used for that purpose, may be of help to Nordic governments in determining the most effective modalities for providing financial support for targeted development objectives – of which climate change is of course only one.

It should be noted that in addition to the progress documented in this report there are other responsibilities that have continued to be fulfilled. NDF has kept on managing the existing credit portfolio, which had 29 active credits at the end of 2010.

In summary, NDF should continue to improve and advance its development assistance activities along the same lines as in the recent past. This would involve consolidating the gains it has made, refining and updating policies as required, while always remaining alert to the possible reorientation or expansion of its financial support to respond to changing development priorities and resource availability.