



## PACIFIC ISLANDS FORUM SECRETARIAT

PIFS(23)FEMM.10

### FORUM ECONOMIC OFFICIALS MEETING

8 August 2023

### FORUM ECONOMIC MINISTERS MEETING

9-10 August 2023

## AGENDA ITEM 8: PACIFIC RESILIENCE FACILITY (PRF)

#### Purpose

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This paper seeks the approval from this Forum Economic Ministers Meeting (FEMM) for the review and reframing outcomes of the Pacific Resilience Facility (PRF), for endorsement to the Pacific Leaders meeting in November.

##### Summary

In 2022, FEMM mandated the review and reframing of the design of the PRF, to take into account the post-COVID 19 operating context and address the concerns raised by development partners.

Under the oversight of the PRF Technical Working Group, an extensive review and re-design of the PRF was undertaken and consulted through the members, as well as the Audit and Risk Sub-Committee (ARSC) of the Secretariat.

The review affirms that a Pacific-led, member-owned, member-managed regional climate and disaster community resilience financing vehicle remains relevant and urgent. It further affirms that a PRF is valuable at this time given (i) the intensity and frequency of the calamities Members face; (ii) limited fiscal space; (iii) disarray of the global climate financing mechanism; and (iv) the unique opportunities arising from geopolitical fluidity.

In addition to the reframed and expanded scope of the PRF itself, the review recommends 18 key re-designed elements for the consideration of the FEMM. Members views on the 18 elements, and in particular the issues outlined in paragraphs 9 and 34 of the paper, are sought.

In relation to the immediate next steps following FEMM's consideration, the paper proposes the following: (1) the country of domicile and sub-regional offices selection process to proceed; (2) the finalisation of the draft legal establishment documents; (3) the finalisation of the PRF set-up funding from Australia and the United States in order for work to proceed.

It is anticipated that once the country of domicile process is concluded and the draft legal documents for the PRF are finalised in the proposed regional legal workshop, both draft recommendations will be circulated to FEMM for out-of-session consideration ahead of the 52<sup>nd</sup> Pacific Islands Forum Leaders Meeting in Rarotonga, Cook Islands on 6 – 10 November 2023.

#### A. Problem/Opportunity Identification

In its meeting in August 2022, the Economic Ministers acknowledged the recommended re-framing of the PRF, taking into account a post-COVID 19 environment and urged renewed consultation efforts with development partners to understand and address existing and new design concerns with the facility itself.

2. Specifically, the Economic Ministers<sup>1</sup>: (i) reiterated the importance of the PRF and noting the recommended next steps on the PRF, endorsed the deferment of the pledging event to a later date; (ii) urged renewed efforts to understand and address PRF concerns from development partners prior to the establishment of the PRF transitional arrangements; (iii) acknowledged New Zealand's confirmation of a contribution to the capitalisation of the PRF; and (iv) directed the urgent submission of a funding proposal on the interim administrative arrangements for the PRF, following the consultation process.

## **B. Context**

3. Consistent with the above, the terms of reference for the review of the PRF sought to achieve three main goals:

- i. reframe and redesign the PRF, in terms of its purpose, design and positioning;
- ii. review the PRF set-up and governance arrangement options, and timelines; and
- iii. review the PRF financial feasibility and funding scenarios.

4. The PRF review and re-design adopted a consultative co-design approach to: (i) provide stakeholders with assurance regarding the integrity of the process and outcomes; (ii) meet Members' needs, (iii) address development partner concerns; and (iv) while also adhering to ARSC recommendations endorsed by the Forum Officials Committee (FOC).

5. The PRF-TWG<sup>2</sup> has oversight over the review, supported by the PIF ARSC and the Pacific Economic Sub-Committee (PESC), which has strengthened the integrity of the process. Both the TWG and ARSC Chairs have driven progress culminating in a Joint ARSC/TWG/FOC Sub-Committee on Prioritisation and Resourcing (FSPR) meeting on 27 July 2023 to clear PRF issues<sup>3</sup>.

## **C. The Reframed and Re-Designed PRF Community Resilience Financing Profile**

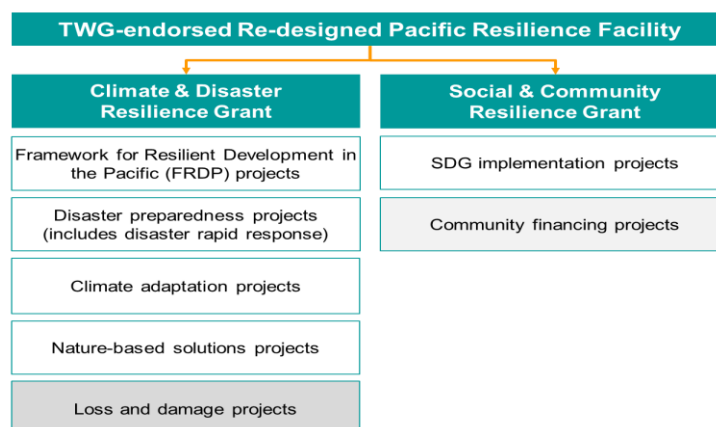
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<sup>1</sup> Outcome 27: Forum Economic Ministers acknowledged the deferment of the PRF pledging event in light of the shifting global circumstances, and the update on funding support from Australia and New Zealand, and technical issues on the PRF. The meeting acknowledged the recommended re-framing of the PRF against this backdrop and urged renewed consultation efforts with development partners to understand and address existing and new concerns. The Ministers also considered the establishment of the Caribbean Resilience Facility (CRF) and sought to understand the competitive edge of the CRF, in order to make PRF work, and to avoid duplication with similar resilience funds in the region. Outcome 28: Forum Economic Ministers: (i) reiterated the importance of the PRF and noting the recommended next steps on the PRF, endorsed the deferment of the pledging event to a later date; (ii) urged renewed efforts to understand and address PRF concerns from development partner prior to the establishment of the PRF transitional arrangements; and administrative arrangements for the PRF, following the consultation process. (iv) directed the urgent submission of a funding proposal on the interim (iii) acknowledged New Zealand's confirmation of a contribution to the capitalisation of the PRF; and (iv) directed the urgent submission of a funding proposal on the interim administrative arrangements for the PRF, following the consultation process.

<sup>2</sup> The TWG consists of Secretaries of Finance from Pacific member countries, namely Australia, Cook Islands, Fiji, Vanuatu, Nauru, New Zealand, Palau, Samoa, Tuvalu, chaired by Cook Islands.

<sup>3</sup> The last TWG meeting was held on 25 July 2023 to clear the key PRF review outcomes for FEMM. Subsequently, a joint meeting between ARSC/TWG/FSPR took place on 27 July 2023 to clear Phase 1: the due diligence phase of ARSC's PRF recommendations to FOC and endorse to proceed to Phase 2: Set-up.

6. The reframed and re-designed PRF has been expanded to a strategic two-pillar integrated resilience eco-system focus, using a modular design approach. The re-designed PRF consists of climate and disaster resilience<sup>4</sup>, and social and community resilience<sup>5</sup> pillars per below.



7. **The Climate and disaster resilience pillar** can fund projects for climate adaptation, disaster preparedness, nature-based solutions can support early disaster response, including related projects in the Framework for Resilient Development in the Pacific (FRDP) which demonstrates how the PRF can finance existing frameworks. The PRF can also fund loss and damage projects subject to ongoing regional and global dialogue and the region's decision on a preferred vehicle.

8. **The Social and community resilience pillar** integrates resilience aspects of Sustainable Development Goals (SDGs) projects and community resilience projects to address systemic risks especially considering mixed regional SDG performance.

#### D. Key Elements of the PRF Re-Design

9. The redesigned PRF features 18 key elements that spans the issue of facility structure, contributions, dividends for disbursements, legal establishment, governance and oversight, portfolio governance, budgets and benchmarking. The detailed elaboration of the re-designed elements are provided in **Annex 1**.

##### a.) PRF Re-Designed Fund Profile

10. The summary of the proposed re-designed fund profile for the PRF below has been modelled extensively and proposes a USD500m starting capital base for the PRF, with 5-year periodic top-ups of USD100m for the next 30 years to 2054, which will build up an expected total fund size of USD1.3b in 30 years. To mitigate funding shortfall risk, it is projected that 50% of USD500m will be raised by 1 January 2025, and the balance by 1 January 2026.

<sup>4</sup> The climate and disaster resilience pillar consists of disaster preparedness projects, disaster rapid response projects, and climate adaptation projects. This also includes relevant adaptation and disaster response projects in the Framework for Resilient Development in the Pacific (FRDP), and nature-based solutions projects, and loss and damage (L&D) projects as well.

<sup>5</sup> The social and community resilience pillar consists of Sustainable Development Goals (SDGs) projects that are either SDG goals directly relating to climate and disaster resilience, or that have resilience as a cross-cutting theme across all other SDGs. This may also include community resilience projects, relating to any of the above themes and that can support community capacity building, education and awareness, governance mechanism strengthening, etc.

11. The investment return assumptions in the re-design are also more conservative than the original design, assuming a real rate of return of 3% (excluding inflation), compared to the real rate of return of 5% previously assumed. This is based on a 60:40 equities to fixed income split.

#### b.) PRF Re-Designed Facility Structure

12. The re-designed PRF facility structure envisages an Operations and Disbursement Fund and an Investment Fund for main fund flows, and two buffer funds – a Contingency Fund to ensure reserves equivalent to 3 years of annual dividends for members to mitigate portfolio income volatility, and a Disaster Response Fund, a separate liquidity pool to support rapid post-disaster response costs. A 90% pay-out ratio is assumed from the Investment Fund. An important re-design feature is that non-investable grants have been capped at 20%, to enable a greater portion of grants to be invested to grow the PRF portfolio.

#### c.) Member Dividends for Disbursements

13. The re-designed PRF aims to pay-out annual disbursements from the investment income of the PRF to member countries, compared to the 3-year periodic pay-outs in the original design. The disbursements are proposed to remain fixed for 3-years, then stepped up every 3-years thereafter based on inflation. This allows for medium-term predictability in PRF receipts that can be recorded in Government budgets. Based on current modelling assumptions, an initial annual disbursement of USD17m is envisaged. The disbursement will depend on community projects pipelines submitted to the PRF for funding and undrawn balances can be rolled over to the next project call cycle.

#### d.) Member Contributions

14. Members are encouraged to demonstrate ownership by paying in contributions consistent with existing practices for regional member-owned organisations. Contributions by members are 0.5% of grants and will occur 5-yearly in line with periodic capitalisation cycles and are proposed to be allocated using the same PIFS tiered allocation approach used for disbursements. In return, members will receive annual dividends for project disbursements as well as resilience investment support services (formerly, technical assistance facility).

15. As the PRF is envisaged to be globally benchmarked, member solidarity on the core governance principles of the PRF to stand it up after 7 years of collective endeavour is key. Like contributions to multi-lateral member-based organisations in order to receive funding, or to contributions to our national superannuation funds in order to earn a return, the same standard applies to the PRF to assure donors/investors of the region's commitment to the PRF as a key and credible resourcing mechanism for the 2050 IP.

16. Members views are sought on the sensitive matter of pay now versus pay later/netting off contributions. The re-design recommends access to the disaster response fund as a possible differentiated benefit tied to fee status, albeit noting that after the re-distribution of Australia and New Zealand dividends to top-up contributions, actual member contributions are very low compared to the dividends members will receive from the PRF. Hence, the principle of paying dues upfront is recommended to be part of the requirements to have access to the PRF in order to strengthen ownership and send a strong and positive signal to the development partner community.

#### e.) Australia and New Zealand Dividend Re-distribution

17. Members will note that Australia and New Zealand have indicated that they do not intend to receive their portion of dividends for community projects from the PRF and that how it is to be allocated is up to Members.

18. In this regard, a proposed strategic approach for the redistribution of Australia and New Zealand's share of the dividends has been recommended as follows: 70% to top-up disbursements to members; 10% to assist, but not fully subsidise, Members payment of contribution fees; and 20% to be re-invested to grow the PRF portfolio, to be reviewed every 5-years.

f.) Allocation Formula and Membership

19. Member contribution and disbursement is recommended to be split using a regionally accepted tiered allocation approach used by the Pacific Islands Forum Secretariat (PIFS) for Member dues as of 2021. It is further recommended that the re-distribution benefits to Associate Members be capped at 3-years only to differentiate benefits, which is a full project cycle and to incentivise full membership.

g.) Re-Designed Legal Establishment Passage

20. The proposed re-designed PRF legal establishment passage offers an innovative alternative to Parliamentary ratification by all Members and proposes a 3-step path to legally stand up the PRF:

- i. through a definitive Finance Ministers and Leaders political declaration;
- ii. followed by an Act in a domicile country to create the PRF; then
- iii. to be recognised as an international organisation by all members, through Ministries of Foreign Affairs.

21. The PRF is also proposed to operate with sub-regional presence due to the different climatic and disaster risk profiles across the region.

h.) Country of Domicile and Sub-Regional Representative Offices

22. The process and criteria for the selection of a domicile and sub-regional offices is proposed to be based on four main criteria with the weightings as follows:

- i. regional membership compliance (10%);
- ii. legal and taxation (40%);
- iii. member contribution to the PRF (20%); and
- iv. ease of doing business and connectivity (30%).

23. In terms of process, an independent panel of 3 is recommended, with independent legal vetting to allow for the process to proceed to short-listing 4 countries - 1 country of domicile plus 3 sub-regional representative offices, with recommendations to be completed in time for Leaders' meeting.

i.) Tax Considerations

24. The tax considerations for the tax-exempt status for the PRF in Member States will be a significant discussion with Members legal officials is critical for the feasibility of the Facility.

j.) Re-Designed PRF Governance Structure

25. As the supreme governance body, the Council of Members is proposed to be renamed to PRF Council and is proposed to consist only of Member countries and not to include donors as in the original design. The PRF Board of Trustees is proposed to be renamed to be Board of Directors, and to comprise of Chair plus 6 members (maximum 7 board seats), more than the Chair plus 4 in the original design. The recommended Board split is 5 seats for Members including the Chair and potentially the Secretary General of the PIF and 2 seats for donors/investors. This is tabled for further discussion and guidance from Members.

26. The oversight of an independent Chair and Board is a strong re-design feature for Ministerial consideration in accordance with the same international fiduciary and fit and proper principles used for financial institutions, and our superannuation, insurance and unit trust funds regulated by our central banks. This is also critical to safeguard the management of the fund from ourselves. The role of the PIF Secretary General during the transition remains critical and an board seat is recommended to assure coherent regional network coordination in line with our 2050 aspirations.

k.) PRF Transition Board Mix

27. The re-designed PRF governance structure has also been strengthened to re-position the PRF as an independent institution in relation to PIF to limit Members liability, with a maximum interim hosting period of 3 years to transition into a formally established entity. Considering the complexity and timelines for implementation, the mix of the transition board is recommended to be a mix of officials and independent members to drive member ownership and continuity to meander regional and national processes, as well as attract the correct competencies to successfully stand-up the PRF. This transition board will be activated once the transitional agreement is signed, and once the PRF is legislated and the PRF Council is formed, the transition to the permanent board will need to take place before pledging.

l.) PRF Legal documentation and Legal Drafting Workshop

28. Members will note that the above legal re-design features captured in the attached draft declaration, draft act, and draft revised transitional agreement, as well as the country of domicile and sub-regional representative offices, and taxation treatment process, seeks Ministerial endorsement in principle, subject to finalisation by legal officials in a legal drafting workshop proposed for 28-29 August.

29. The final legal documents are proposed to be cleared by the Secretariat to the pre-Forum FOC, and the PRF-TWG and the PESC for endorsement and circulated out of session for Forum Economic Ministers endorsement, incorporating any outstanding items for the PRF and resolutions from this meeting, to finalise the PRF paper for the Leaders meeting in November.

m.) Re-Designed Investment Portfolio Governance

30. To provide donor capital assurance on the investment portfolio governance, the World Bank Treasury team has been approached for the Reserve Advisory & Management Partnership (RAMP) similar to the service Kiribati receives for the Revenue Equalisation Reserve Fund (RERF). The World Bank has indicated the possibility of providing bespoke asset management solutions for the PRF for a fixed period. **Members support is sought as World Bank Governors to formalise the same for the PRF at the upcoming October 2023 World Bank Meetings, to support imminent Pacific Leader's PRF declaration.**

n.) Globally Benchmarking the PRF

31. The re-designed PRF is recommended to be globally benchmarked by Standard and Poor's (S&P) through a second party opinion of the PRF's policy governance framework, using a Cicero Shades of Green assessment of use of proceeds. This is recommended to be finalised just before the pledging event.

o.) PRF Re-Designed Project governance

32. The PRF agenda is intended to be transformative and is underpinned with a theory of change that acknowledges that Member systems are under stress and that the perpetual climate and disaster risks our communities face are exacerbated by systemic risks that impede the resilience building process. While any funder can install a water-tank, the PRF will concentrate on closing the resilience feedback loop to support community resilience through improved solutioning, decisioning, systems and mechanisms design. These outcomes are embedded in the PRF risk-informed project management cycle. These will be tested in the first 3-years of the PRF as a proof-of-concept pilot stage.

33. The original project sizes of USD50,000 to USD250,000 per project, have also been redesigned to be tailored to country and sub-regional needs as well as local currency community project sizes and landscape, and lower and upper limits will be set after consultation with Members.

p.) PRF Set-Up Budget and Funding

34. A conservative USD3.5m budget is needed to fund the set-up phase from August 2023 to December 2024. This will be funded with the combined pledge from Australia and the United States (US). The costs will be front-footed by Australian funding, with a tentatively indicated range of AUD\$2-3m; to be supplemented by the United States pledged funding of USD\$2m, ear-marked to be received in 3rd-4th Quarter 2023. Based on consultations with the PIFS ARSC, Forum Sub-Committee on Prioritisation and Resourcing (FSPR) and Chair of the PRF-TWG, it has been recommended that the recruitment of a suitable interim CEO for the PRF is expedited as part of the Phase 2 work programme once endorsed by Ministers.

q.) PRF 5-year Operational Budget

35. Assuming capitalisation of USD500m, the PRF operational budget for the first 5 years from 2025 to 2029 has been cast on a full cost recovery basis to operate at a total estimated budget of USD21m over 5 years. PRF performance has been benchmarked against a conservative peer group and indicate a competitive inaugural PRF. The cost of community project implementation for remote communities and islands is a challenge and the PRF pilot stage is vital to monitor cost to deliver.

r.) Forum Sub-Committees purview over PRF review process

36. To reinforce FEMM's mandated review, the PRF-TWG together with the ARSC have shepherded the PRF review with the support of a co-design team<sup>6</sup>. ARSC's report to FOC in December 2022 on the PRF governance concerns were incorporated into the review in a 3-phase process (due diligence, set-up, pledging). In its meeting on 27 July 2023, ARSC approved Phase 1, the due diligence phase and for the work to proceed to Phase 2, set-up, and the FSPR in its meeting on 28 July, endorsed the interim resourcing request for FJD200,000

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<sup>6</sup> Co-design team had 2 work streams: legal and financial re-design, and consisted respectively of PRF review lead, PIFS economics and legal team, legal and actuarial technical experts, Australia, New Zealand with updates to the TWG Chair.

for the PRF legal drafting workshop and location selection process, while the Australian funding arrangements are being finalised to be received by the end of August 2023 to proceed with the work.

## **E. Linkages to 2050 and Implementation and Resourcing Plans**

37. The PRF is well aligned with the 2050 Strategy for the Blue Pacific Continent. The resources and economic development thematic area of the 2050 Strategy articulates clearly the region's dual challenges of fiscal sustainability risks in the short term and the resilience financing gaps that we continue to face in the region, increasing the urgency to consider innovative financing instruments and mechanisms.

38. The PRF is a critical resourcing mechanism for the 2050 IP and is an important clog in the regional financial architecture as an integrated regional climate, disaster and SDG financing platform to address a gap in the global climate financing disarray. Subject to FEMM's endorsement, the PRF is recommended to be endorsed as one of the 2050 resourcing mechanisms for the investment of development partners, in support of the 2050 strategy.

## **F. Audit and Risk Sub-Committee and FOC Sub-Committee on Prioritisation and Resourcing endorsements**

39. The ARSC and FSPR have endorsed Phase 1 of the PRF due diligence to FOC and has endorsed for the work to proceed to Phase (2) for the set-up work.

40. In commencing Phase (2), ARSC and FSPR has recommended that Phase 2 commence on 31 October 2023, to allow for a 90-day window to (1) finalise the agreement on set-up and operational funding arrangements for the PRF, (2) Finalise the Phase 2 timeline for implementation, and (3) finalise the initial commitment indication from Australia, New Zealand, other PIFS members for longer-term pledging.

41. ARSC requests that urgency be placed on working with Member countries and the United States, to undertake the following:

- i. Firming up budget for phase (2) - set-up budget of US\$3.5m;
- ii. Resolve or clarify any unanswered questions pertaining to the PRF (structure, governance, risk, modelling);
- iii. Ascertaining funding commitments for Phase (2);
- iv. Establish an expectation from these donors of what pledging can be expected for when the PRF seeks full pledging commitments under Phase (3); and
- v. Determine the location for long term establishment of PRF;

42. The FSPR has also considered the PRF review status update and endorsed the same, with the remediation update on the PRF issues raised by ARSC. To support the legal drafting workshop and legal support work required for the domicile selection process, FSPR has endorsed the proposed maximum budget of FJD200,000 for the legal drafting workshop and extended legal services, subject to budget availability, which has been confirmed by ARSC. Both ARSC and FSPR have also endorsed the outcomes of the joint TWG, FSPR and ARSC meetings on the PRF.

## **G. Next Steps**

43. Subject to FEMM's endorsement of the PRF review outcomes and reframe and re-design, the immediate next steps for the PRF work are as follows:

- a. Draft country of domicile selection process to proceed;
- b. Draft legal documents to be finalised during the legal drafting workshop, for circulation out of session for endorsement to Leaders; and
- c. PRF set-up budget to be funded by Australia and US for the work to proceed.

Pacific Islands Forum Secretariat  
3 August 2023

## ELABORATED ELEMENTS OF THE PRF-RE DESIGN

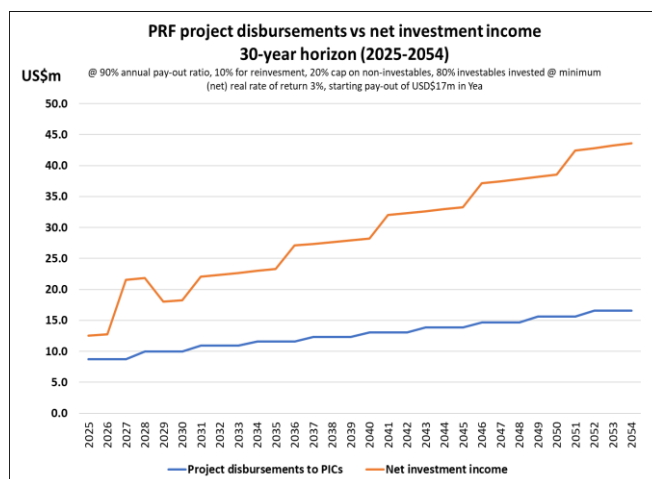
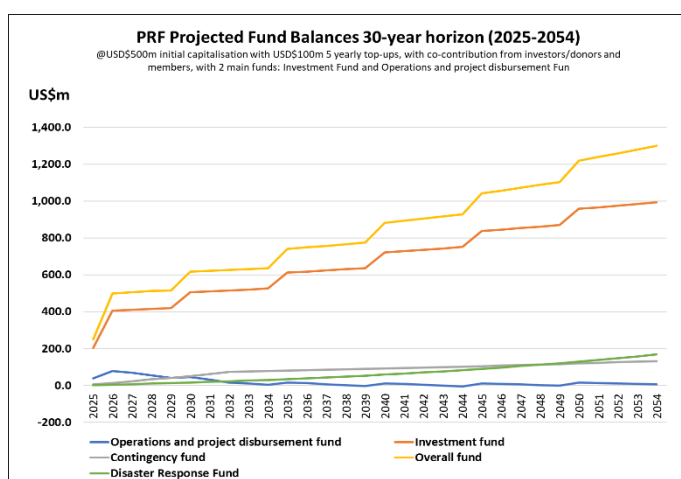
### H. The Re-Designed PRF Fund Profile

The summary of the proposed re-designed fund profile for the PRF below has been modelled extensively and proposes a USD\$500, starting capital base for the PRF, with 5-year periodic top-ups of USD\$100m for the next 30 years to 2054, which will build up an expected total fund size of USD\$1.3bn in 30 years. To mitigate funding shortfall risk, it's assumed that 50% of the USD\$500m will be raised by 1 January 2025, and the balance by 1 January 2026.

PRF Re-Designed Fund Profile		
	Original PRF Design	Re-Designed PRF
<b>Fund capitalization</b>	USD\$1.5b	<ul style="list-style-type: none"> <li>✓ <b>USD\$500m</b> starting capital with top-ups of <b>USD\$100m</b> every 5 years starting in 2030.</li> <li>✓ Expected total PRF balance after 30 years <b>USD\$1.3b.</b></li> </ul>
<b>Funding type</b>	Grants - No distinction between grant types.	<ul style="list-style-type: none"> <li>✓ Grants are distinguished between investable and non-investable.</li> <li>✓ Non-investables capped at 20%.</li> </ul>
<b>Fundraising</b>	All in one go	<ul style="list-style-type: none"> <li>✓ <b>Initial capital, 50% raised by 1 January 2025, 50% raised by 1 January 2026</b></li> <li>✓ <b>With future top-ups every 5 years.</b></li> </ul>
<b>Investment Returns</b>	Real rate of return of 5% (excluding 2% Inflation).	✓ <b>Real rate of return of 3% (excluding inflation)</b>
<b>Asset allocation</b>	Not provided	✓ Assumes 60:40 Equities/Fixed Income.
<b>Pay-out rate</b>	Initial 90% pay-out <sup>7</sup> , stepped up thereafter to 95% of average net income every 3 years.	✓ <b>90% pay-out into the operations and disbursement fund, and 10% re-investment split.</b>
<b>Member contributions</b>	\$20m contribution, netted from first disbursement, one-off. Contribution allocation unclear.	✓ <b>0.5% of capitalisation funds</b> (\$1.3m prior to 1 January 2025, \$1.3m prior to 1 January 2026) with top-ups of \$0.5m every 5 years.
<b>Member Dividends</b>	3-yearly dividends, split amongst countries unclear.	✓ <b>Annual disbursements starting at USD\$17m in total.</b> Fixed for 3-years, with 3-year step-up with inflation.
<b>Member Allocation Methodology</b>	16 Forum countries – equal distribution	<ul style="list-style-type: none"> <li>✓ Base dividends to be allocated using tiered PIFS 2021 allocation formula, 20 countries, including 2 associates.</li> <li>✓ <b>Redistribution for Aus &amp; NZ allocation</b> proposed to top-up disbursements, contributions, reinvestment, <u>to be reviewed every 5-years.</u></li> </ul>

<sup>7</sup> Based on USD\$200m first year pay-out, USD\$180m for distribution, netted for USD\$20m members equity contribution.

		<ul style="list-style-type: none"> <li>✓ Associate member entitlement to re-distribution to be <u>only for first 3 years</u>, over full project cycle.</li> </ul>
<b>Project sizes</b>	Standard size US\$50,000-\$250,000 per project	<ul style="list-style-type: none"> <li>✓ Tailored to country and sub-region and needs to consider local currency community project sizes.</li> <li>✓ Lower limit: Minimum project size to be set to reduce transaction cost.</li> <li>✓ Upper limit: To be based on local context based on community grant landscape.</li> </ul>
<b>Fees</b>	PRF Management fees 2% of capital base <sup>8</sup> . Fund manager fees 0.75-1.25%	<ul style="list-style-type: none"> <li>✓ PRF Management fees 0.5% of all grants</li> <li>✓ PIFS Management fees (transition period) 5% of PIFS total operating costs.</li> <li>✓ PRF disbursement fees 10% of disbursements</li> <li>✓ Fund manager fees 0.5% + Custodian fees 0.15% of funds invested</li> </ul>



<sup>8</sup> Being 0.65% of PRF capital base+ 0.75-1.25% for fund management fees, capped at a total of 2%.

## I. The Re-Designed PRF Member Contributions and Dividends for Disbursements

2. Based on the initial capitalisation of USD\$500m, the cumulative net benefit<sup>9</sup> of the PRF to all Forum members to invest back into community resilience is estimated to be USD\$106.5m at the end of Year 6, or a 21% cumulative resilience dividend on the original capital.

PRF 6-Year Pro-forma for Member Dividends vs Contributions (Before Australia and New Zealand Re-Distribution) (USD\$m)							
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	
<i>PIFS Allocation Formula number of countries: 20</i>	<b>2025</b>	<b>2026</b>	<b>2027</b>	<b>2028</b>	<b>2029</b>	<b>2030</b>	<b>Total</b>
<b>Capitalisation</b> (50:50 stagger, 5-yearly top-up)	250	250	0	0	0	100	<b>500</b>
<b>Dividends</b> (3-year fixed, with 3-yearly step-up)	<b>17.0</b>	<b>17.0</b>	<b>17.0</b>	<b>19.5</b>	<b>19.5</b>	<b>19.5</b>	<b>109.5</b>
<b>Less: Total member contributions</b> (0.5% fixed)	1.25	1.25	0	0	0	0.5	<b>3.0</b>
<b>Net benefit for all Members</b> (note rounding off)	<b>15.8</b>	<b>15.8</b>	<b>17.0</b>	<b>19.5</b>	<b>19.5</b>	<b>19.0</b>	<b>106.5</b>

3. The initial total **annual dividends** projected from the PRF is **USD\$17m** in Year 1, to be distributed amongst 20 Forum countries. This is proposed to be an annual pay-out, fixed for 3 years, then with a 3-yearly step up based on inflation.

4. **An important point of clarification is that the dividends paid out of the PRF investment portfolio, are available for disbursement, subject to community project pipelines, and the draw-down for disbursements will depend on approved community projects, with undrawn balances to be rolled over into the next project call cycle.**

5. Member collective contribution is proposed to be 0.5% of total capitalization funds, to be paid **every 5 years**. As funding is projected to be staggered for the first 2 years, member contributions of USD\$2.5m will also be staggered over the same period and only the Year 1 contribution of **USD\$1.25m** will need to be settled before the dividend pay-out starts in Year 1. The next co-contribution is in Year 2 of USD\$1.25m, then in Year 6, with a reduced collective amount of **USD\$0.5m**.

6. In line with regionally accepted allocation methodologies, **the allocation of both members dividends and contributions are recommended to use the tiered PIFS 2021 allocation formula<sup>10</sup>.**

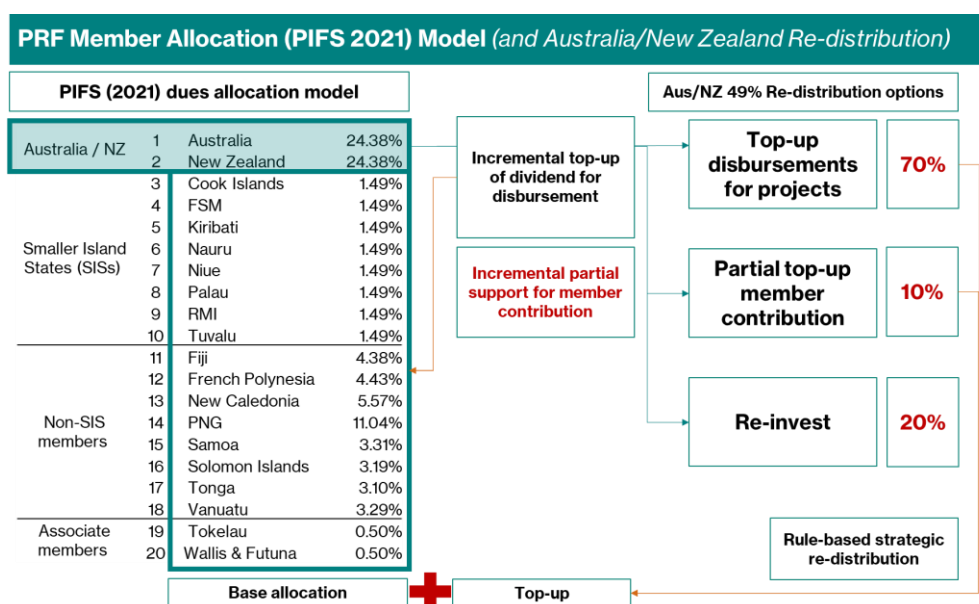
7. As both Australia and New Zealand have indicated that they do not intend to receive allocations for dividends for disbursements, a strategic re-distribution approach is recommended for the re-distribution of Australia and New Zealand allocations to catalyse and accelerate PRF goals.

8. The proposed redistribution of Australia and New Zealand's disbursement allocation is as follows: (1) 70% to top-up community resilience project disbursements, (2) 10% is to partially, not fully support member contribution to lighten but not alleviate the responsibility of member countries paying the required contribution fees in order to be eligible to receive

<sup>9</sup> The collective and cumulative net benefit of the PRF to members is based on options presented to the TWG on two capitalization scenarios, with the preferred option recommended based on a least cost – maximum benefit rule to maximize overall disbursements for projects while minimizing contributions from members.

<sup>10</sup> The PIFS 2021-tiered allocation formula: Australia & New Zealand (24.4% each); Small-Island States (SIS): 1.5% each (Cook Islands, Federated States of Micronesia (FSM), Kiribati, Nauru, Niue, Palau, Republic of Marshall Islands (RMI), Tuvalu); Non-SIS: Fiji (4.4%), French Polynesia (4.4%), New Caledonia (5.6%), Papua New Guinea (PNG) (11%), Samoa (3.3%), Solomon Islands (3.2%), Tonga (3.1%), Vanuatu (3.3%); Associate Members: 0.5% each (Tokelau, Wallis & Futuna).

disbursements for projects, (3) 20% is allocated to the investment fund for reinvestment, to accelerate the growth of the portfolio.



9. Based on the above re-distribution over 18 members excluding Australia and New Zealand, using the same allocation proportionality, **Pacific Island Countries (PIC) disbursements post-re-distribution increases by \$37.4m or 67% across the board for all countries.** Disbursements are increasing in spite of the reduction in the total dividends available for disbursements from USD\$109.5m to USD\$93.5m, as only 70% of Australia and New Zealand's dividends are being applied to top-up dividends. This is still a cumulative resilience dividend of 18% post re-distribution (compared to 11% pre re-distribution), on the original PRF capital that will directly be invested into communities at risk.

10. Whilst the overall member contribution remains the same at 0.5% of capital or USD\$1.3m in years 1 and 2 respectively, the 10% contribution support from the re-distributed dividends, reduces the pay-in share from members from 51% (USD\$0.6m) to 34% (USD\$0.4m), with a greater share of contribution balance to be supported by the re-distributed dividends of from 49% (USD\$0.6m) to 66% (USD\$0.8m) of contributions.

11. To be fair for full members of the Forum, the redistribution of top-up dividends for associate members is recommended to only be for the first 3 years, and to taper off to normal dividends without the top-up thereafter. This is recommended to apply to all associate members, and the grace period allows members to benefit from the PRF, and to incentivize budgetary allocation for full membership.

PRF 6-Year Pro-forma for Member Dividends vs Contributions (Before and After Australia and New Zealand Re-Distribution) (USD\$m)								
		Year 1 2025	Year 2 2026	Year 3 2027	Year 4 2028	Year 5 2029	Year 6 2030	Total
<i>Member Dividends (20 countries) consists of:</i>								
PICs disbursements pre re-distribution	51%	8.7	8.7	8.7	10.0	10.0	10.0	56.1
Australia / New Zealand dividends	49%	8.3	8.3	8.3	9.5	9.5	9.5	53.4
For disbursement top-up	70%	5.8	5.8	5.8	6.7	6.7	6.7	37.4
For member contribution top-up	10%	0.8	0.8				0.3	2.0
For reinvestment	20%	1.7	1.7	2.5	2.9	2.9	2.5	14.0
PICs disbursement (18 countries) post re-distribution		14.5	14.5	14.5	16.6	16.6	16.6	93.5
Increase in PICs disbursements post re-distribution		67%	67%	67%	67%	67%	67%	67%
<i>Member Contributions (20 countries) consists of:</i>								
PICs contributions pre re-distribution	51%	0.6	0.6				0.3	1.5
Australia / New Zealand contributions	49%	0.6	0.6				0.2	1.5
PICs contributions (18 countries) post re-distribution	34%	0.4	0.4				0.2	1.0
Australia / New Zealand contribution support	66%	0.8	0.8				0.3	2.0
Augmented Net Benefit to PICs (18 Countries)		14.1	14.1	14.5	16.6	16.6	16.5	92.5

## J. The Re-Designed PRF Investment Governance and Facility Structure

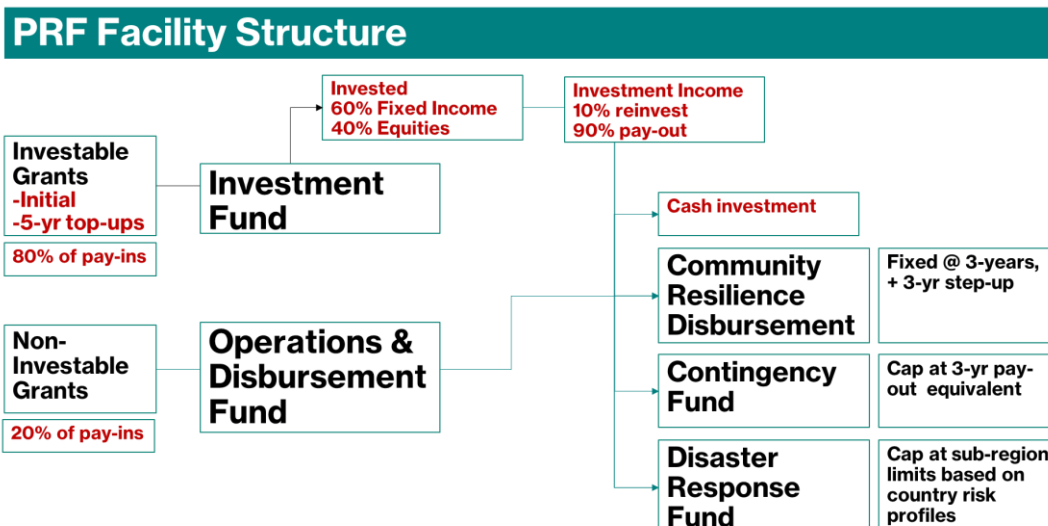
12. The re-designed PRF investment portfolio governance approach aims to provide capital assurance for donors who will be investing their funds into the PRF and to ensure PRF sustainability. With this goal in mind, the World Bank Treasury's Reserve Advisory & Management Partnership (RAMP) have been approached on the possibility to offer portfolio management services for PRF, and **preliminary indications are that they would be willing to provide bespoke asset management solutions for the PRF for a fixed period of time.** The Washington D.C. treasury team have referred PIFS to the Sydney office and whilst discussions are ongoing, Honorable Finance Ministers' support is sought as Governors to elevate this discussion in the upcoming World Bank meetings in October.

13. To strengthen funding integrity, a distinction has also been made for grants with and without conditionality from different donors/investors, as the initial modelling indicated that one-off capitalization with a 50% non-investable grant split dragged performance and is unsustainable. As a result, the PRF re-design limits non-investable grants to 20% of funding.

14. Non-investable grants are placed in the **Operations and Disbursement fund** directly for community resilience projects. While non-investable grants cannot be invested in risky assets, balances for the Operations and Disbursement fund are assumed to be held in interest-bearing cash accounts.

15. Investment governance has been strengthened for Investable grants, estimated at 80% of funding, to go into the **Investment Fund**. This fund is modelled to generate a blended short and long-term real rate of return<sup>11</sup> of 3% (net of inflation), based on an asset allocation of 60% (equities) and 40% (fixed income), moderating the original benchmark real return of 5% (net inflation).

<sup>11</sup> Blended rate of return is derived as follows: first 10 years, blended short and long-term rates for each asset class. Beyond 10 years, only long-term assumptions. Short-term/Long-term: Cash: inflation + 0.4% (ST), +0.7% (LT). Bonds: inflation + 1.3% (ST), +1.7% (LT). Shares: inflation + 4% (ST), 4% (LT).



16. The investment fund outflow has been streamlined to have a 90% pay-out into the operations and disbursement fund, and 10% to be re-invested. The original PRF re-design had an initial 90% pay-out, then stepped up thereafter to 95% of average net income every triennium. **The investment fund also allocates a portion of the net investment income to build up two specific purpose funds<sup>12</sup>.**

17. To mitigate the risk of portfolio income volatility to safeguards for members, the **Contingency Fund** aims to make planned uninterrupted disbursements in years with lower-than-expected investment returns and will maintain sufficient liquidity capped at 3 years' worth of disbursements and operating costs<sup>13</sup>, which will take the first 8 years of the PRF to build up.

18. To mitigate the liquidity and speed of access risk for early disaster response, the **Disaster Response Fund** aims to provide immediate payouts to countries following a qualifying disaster event to support rapid response costs. A cap has yet to be set for the Disaster Response Fund and will be designed in more detail in terms of the type and severity of disasters and risk profiles of members, and where and how this fund will add value in the range of financial solutions available to members. This will need to consider the disaster risk financing pathway that is being developed in tandem with the regional climate financing strategy.

19. Given the size of funding required to support members for pre, during, post disasters, leveraging funds in innovative ways to maximise community impact is critical. A contingency risk-based approach for a portion of the fund to provide much higher payouts to impacted member countries following a severe disaster event can also be supported subject to co-designing with members and stakeholders the most appropriate complementary structures for individual or group disaster insurance policy cover, with a commensurate amount of effort on pre-event preparedness efforts.

<sup>12</sup> 50% of net investment income goes to the contingency fund and 15% is allocated to the disaster response fund, with the balance allocated for the operations and disbursement fund. This is possible as the non-investable grants are already being disbursed, hence allowing the flexibility for investment income to be used to build up contingency and disaster buffers.

<sup>13</sup> Operating costs include the PRF management fee and project implementation costs to minimize delivery disruption.

## **K. The Re-designed PRF Legal Establishment Implementation**

20. The PRF legal re-design considered the original Prospectus approved by FEMM, and the related legal reports by Dentons Australia. The proposed legal re-design of the PRF covers 2 main areas,

- a. **The legal establishment steps to establish the PRF as an independent international financing institution, and**
- b. **The PRF governance structure.**

21. The original legal establishment concept was for the PRF to be established through a traditional approach, through which member countries ratify an international treaty through separate acts in member Parliaments. Given the PRF journey thus far, and the time that it would normally take to ratify the PRF in acts of Parliaments in all member states in order to allow participation in the PRF, which could be 2 years or more, the redesign exercise considered whether a streamlined approach could be taken to establish PRF, and one which would minimize consumption of funding that could otherwise be allocated to community projects.

22. The proposed legal re-design 3-step process is for the legal establishment of the PRF:

<b>Re-Designed PRF Legal Establishment Passage</b>		<b>Proposed Legal Documents</b>
<b>Step 1</b>	Definitive declaration from FEMM, for Leaders <sup>14</sup>	Draft Declaration
<b>Step 2</b>	An Agreement to establish the PRF via legislative Act to create the PRF as a special purpose international legal entity in a member country	Draft Agreement to be embodied in a host-country legislative Act.
<b>Step 3</b>	Recognition of PRF as a special purpose international public-private financing organisation by Members Ministries of Foreign Affairs	Draft Memorandum Of Understanding or recognition agreement

23. The proposed Act to establish the PRF is to be based on the declaration and the agreement to establish PRF, to be supported by at least two countries signatories, constituting an international agreement that embodies a FEMM declaration.

24. The proposed recognition by other Members Foreign Affairs Offices of PRF's international status, enabled to provide development financing in each recognizing member country, is to be captured under the terms embodied in the FEMM declaration and host country Act establishing the PRF.

25. The Act of establishment is proposed to be accompanied by a Memorandum of Understanding or other recognition agreement with each Member Country, for appropriate endorsement by Member Country authorizing offices, that can endorse the recognition of PRF's international status.

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<sup>14</sup> To facilitate the legal establishment, this declaration is proposed to affirm that the PRF is a member-owned, inter-governmental international development financing organisation, that will be a community resilience investment and financing mechanism for members. The declaration will need to state the agreed location/country of domicile and the ensuing recognition by members, its tax-free status and privileges and immunities, with the approved set of re-designed characteristics, and the transition hosting arrangement through PIFS with an exit timeline to proceed to a stand-alone legal entity.

26. The proposed draft legal Agreement documentation for the PRF establishment, together with the draft declaration are kindly attached for Finance Ministers provisional endorsement. (Please refer to **Appendix 1**)

27. The terms of a final Agreement that can serve as the basis for a legislative Act, will be fully consulted for finalization with legal officials in a **face-to-face legal drafting workshop<sup>15</sup> proposed for 28-29 August, for an out of session circulation to Finance Ministers for endorsement to Leaders**. The process and form of MoU or recognition agreement acceptable to Member country foreign affairs or other government authorizing offices will be developed during this workshop as well.

28. The key considerations for the timelines for this process include the country parliamentary timelines and processes will also be consulted with legal officials for confirmation.

#### **L. PRF Country of Domicile (and Sub-Regional Offices) Selection Process and Criteria**

29. PRF re-design has considered the geographical footprint of the PRF as critical in its core business to provide climate and disaster resilience financing for Pacific communities at risk, hence the consideration for a country of domicile as well as a small sub-regional footprint due to the different sub-regional climate and disaster risk profiles.

30. In terms of recorded member interest, political declarations at FEMM and Leaders meetings made on the PRF to date indicate Samoa's expression of interest to host the PRF. In the Denton's report, the PCRIC legislation from Cook Islands were referenced as a point of consideration on regional precedence and existing legislative framework for setting up regional risk insurance structures.

31. The proposed process for the selection of a country of domicile are:

- a. FEMM to endorse the proposed selection criteria and process (*see Next Steps section*).
- b. The Terms of Reference for the selection panel to be endorsed by members.
- c. Nominations for the 3-member panel to be endorsed at the Pre-Forum FOC.
- d. Simultaneously, to issue call for Expressions of Interest (EOI) from members.
- e. Panel to be supported by legal expert on assessment to produce a short-list of 4 countries.
- f. Finalise recommendation submission for Leaders Approval.

32. The proposed selection criteria<sup>16</sup> and weighting for the country of domicile and sub-regional representative offices assessment consists of 4 main categories: Regional compliance (10%), Legal & Taxation (40%), Member contribution to PRF (20%), and Ease of Doing Business (30%). (Please refer to **Appendix 2**). The other considerations are also that there is a credible pipeline of community projects as well in the interested countries, and the sub-regional coverage of the sub-region members.

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<sup>15</sup> This is a follow up to the virtual legal co-design workshop held with legal officials on 18 July 2023, attended mostly by Foreign Affairs officials from PNG, RMI, French Polynesia, New Caledonia, Australia, and Cook Islands as TWG Chair.

<sup>16</sup> The proposed criteria have been derived using a mixture of the requirements from ARSC, discussion with PIFS legal and PRF legal expert and Green Climate Fund host country selection guidance adopted to the region.

## **M. PRF Tax Considerations**

33. As the PRF will be constituted as an international organization, providing development finance in the region, and inspired by and arising from the interaction of PIF members, PRF's legal attributes and capacities will be familiar to PIF members and their legal advisors, augmented by legal features that are fit for purpose and necessary to help facilitate PRF's financing objectives.

34. PRF will enjoy the same set of privileges and immunities which are utilized by PIFS. The privileges and immunities include tax exemption for PRF functions, staff and program financing transactions, in order to maximize the use of financial contributions to PRF programs. PRF's activities will not be subject to the national tax regimes that apply to commercial entities and financial transactions, since its status will be that of an international organization comprised of members states.

35. During the legal drafting workshop, the scope of privileges and immunities will be discussed, including the scope of tax exemptions. Broadly speaking, tax exemptions within privileges and immunities frameworks, will need to apply to the institution's dues or membership fees, investment income on assets under management, grants or other disbursements to member states, (PRF funds will be grant funds in character), personal income for PRF staff etc.

36. The legal drafting workshop proposed above will provide a collaborative platform to co-create and design the foundational documents for PRF. Those provisional documents will then require national procedures to review the PRF's rights, obligations and legal capacities and the mechanisms to complete finalization, adoption and to establish PRF membership subscription steps. Those steps will be informed by national processes, but normally include consultation with Foreign Affairs, solicitor general or attorney general offices, relevant institutions such as Crown Law and similar bodies, in some jurisdictions. In many countries, if an institution is recognized as an international organization which is governed by the rules adopted by the members and operating in public international law, then Foreign Affairs offices advise the various ministries of the entity's status; including taxing authorities. This provides clarity to taxing authorities, for example to customs/border tax authorities that shipments of goods shipped by or funded by the international organization, are exempt from taxation at the border/point of entry.

37. One area to be discussed in depth at the legal drafting workshop will be the exemption from Value Added Tax (VAT) of funds spent at the community-level on projects and similar tax on goods and services necessary to implement a given project. PRF members will be encouraged to also provide tax exemption from expenditures on capital purchases, goods and services purchased with PRF funds, in order to maximize the application of PRF funding to achieve community projects. If VAT taxes were to be levied at the project level, the financial value for the project will be reduced by the amount of tax, thus diminishing the impact that PRF project funds can provide. These matters will be consulted with members legal officials and afterward through national processes necessary to establish PRF and to join its membership.

## N. The PRF Re-Designed Governance Structure

38. The original governance structure of the PRF consisted of Council of Members consisting of 18 members and 5 donors, and Chaired by the FEMM Chair. The re-designed PRF recommends that the **Council of Members be renamed to PRF Council, and consist of 18 Members only, and the Council to nominate its Chair by rotation.** The Council also has the option to have an independent trustee service such as a reputable accounting firm to serve as trustees of the PRF funds, overseeing asset management functions on behalf of the Council as well.

39. The original PRF board structure consisted of a Board of Trustees, made up of the Chair plus 4 members, with the Chair being the Secretary General of the PIFS, who was also to be the Secretariat to the Council. The re-designed PRF recommends that the **Board of Trustees be renamed to Board of Directors, with the number of Board seats be increased from 5 to 7, including the Chair.**

40. **The re-designed PRF Board Chair is recommended to be independent, and for the Secretary General to be an honorary Board member during the transition, with PIFS to be the Secretariat to the Council during the transition period.**

41. The key elements of the proposed governance re-design are outlined below, and will be finalised in the legal drafting workshop with legal officials.

PRF Governance Re-Design		
Original name	Council of Members	Board of Trustees <sup>17</sup>
Proposed Name	PRF Council	Board of Directors <sup>18</sup>
Membership	<u>Original:</u> 18 members + 5 donors <u>Re-designed:</u> 18 Forum members only.	<u>Original:</u> Chair + 4 <u>Re-designed:</u> To consist of members and donors representatives - Independent Board members. A transition board will be needed prior to the permanent independent board, and the proposed board mix is officials and independents
Voting	One member, one vote.	One seat, one vote <sup>19</sup> . Chair - no veto power.
Composition	<u>Original:</u> Any Minister, member's discretion <u>Re-designed:</u> To be Finance and/or Climate/ Disaster Ministers or reps.	<u>Original:</u> Chair + 4 <u>Re-designed:</u> Proposed to be 5 to 7, including Chair <sup>20</sup> . Chair + 6 = 7 (Maximum)
Representation		Chair +4 = 5 for members <u>independent</u> representatives. (70%). 3 of which to

<sup>17</sup> This will avoid confusion with other trustee oversight roles within the PRF such as Fund trustees or investment trustees. The Council has the option to have an independent trustee body such as a reputable accounting firm to be trustees on behalf of members, similar to a unit trust structure, where trustees represent unit holders.

<sup>18</sup> Board of Directors is recommended as the Board will have a fiduciary duty to members.

<sup>19</sup> Consensus decision-making approach is encouraged.

<sup>20</sup> This gives scope for various skill sets required for the PRF and to have enough directors to sit at the sub-committee level.

		represent each sub-region. 2 <u>independent</u> representatives for donors/investors. (30%)
	All independent directors subject to Board qualification criteria (unchanged), strengthened to include fit and proper standards (new)	
<b>Chair</b>	<u>Original:</u> Chaired by FEMM Chair <u>Re-designed:</u> Chair by rotation of Council Members.	<u>Original:</u> Chaired by PIFS SG <u>Re-designed:</u> Independent external Chair. PIFS SG to be honorary member/advisor during transition. SG can represent one of sub-regions.
<b>Chair Tenure</b>	<u>Original:</u> Annual <u>Re-designed:</u> Annual/ tbc.	<u>Original:</u> 5-7 years. <u>Re-designed:</u> Maximum of 2 terms of 3 years (1 renewal). <sup>21</sup>
<b>Members tenure</b>	<u>Original:</u> Annual <u>Re-designed:</u> Annual/2-3 years	Subject to independent performance review prior to rotation
<b>Appointment of Chair + Board members</b>	All Board nominations still need to be acceptable to and elected by the Council (unchanged). Process for Council and Board nominations to be developed (new) Council appoints Chair (unchanged)	
<b>Secretariat</b>	PIFS for the transition period and hand-over to Board.	PRF CEO or designee serves as Secretary to the Board.
<b>Observers</b>	Allowed with consent of Council	Not Allowed
<b>PIFS Hosting</b>	Transition period 3 years. Exit notice period of 12-months.	

42. In addition to the above, some important governance features that have been strengthened is the increase in the decision-making threshold from 51% to 75% for majority voting and quorum for special resolutions, with clearer definition of special resolutions<sup>22</sup>, and fit and proper and independent performance reviews for the board, second line of defence audit functions, and other governance fasteners are proposed in the draft Agreement to Establish the PRF.

43. The revised draft transitional agreement between PIFS and PRF: (Please refer to **Appendix 3**)

- a. Identifies the hosting governance areas that require coordination with PIFS legal and institutional processes.
- b. Clarifies the authority of PRF Board members and executive and engagement with PIFS staff during the transition.
- c. Outlines the multiple roles that PIFS will play during the transition period as **the legal host of the PRF, Secretariat to the PRF Council, PRF Board members representative, shared service provider to the PRF, and a trustee of PRF funds.**

<sup>21</sup> This is unless the Council requests additional years of service to ensure rotation, Board service staggering or in other special circumstances designated by the Council.

<sup>22</sup> Key considerations for special resolution items include the following which will be subject to final drafting workshop with members: any amendment to the founding documents or PRF mandate, any amendment to the key/core governance operational policies, appointment or removal of Board Members, creation of additional or subsidiary governance or operational units in the organizational chart, establishment of a new “segregated” finance program, if required, criteria for financing participation of donor or private sector funders and/or new funding types or instruments to be received by PRF, wind-down the organization, change in membership.

44. As the PRF work is currently overseen by the TWG, the transition to the PRF transition board is critical to ensure the continuity of the work, momentum in member buy-in, and to drive the implementation of the PRF through regional and national processes before the permanent board is appointed once the PRF is legally established.

45. The composition of the transition board is therefore proposed to contain the same maximum proposed number of 7 board seats, **however with a different initial mix of members, to consist of 4 current custodians and champions (recommended to be the TWG Chair + 3 TWG members, to include 1 representative from Australia or New Zealand, plus two PICs) and 3 independent board members, with the right competencies to oversee the implementation of the key workstreams.**

46. **This transitional board is triggered once the transitional agreement is signed, and will oversee the PRF implementation to the point of legal establishment of the PRF and the PRF Council is established, which then activates the process to establish the permanent board, to run the preparation to pledge.**

Governance Oversight Transition in PRF Legal States			
	Current	Transition	Permanent
<b>Current oversight mechanism</b>	▪ TWG	<ul style="list-style-type: none"> <li>▪ Transitional – Interim Board</li> <li>▪ Once the PRF is legally established, Council formation process commences, can be earmarked for endorsement in FEMM 2024 for endorsement to Leaders</li> </ul>	<ul style="list-style-type: none"> <li>▪ Permanent Board</li> <li>▪ PRF Council</li> </ul>
<b>Trigger</b>	▪ FEMM decision	<ul style="list-style-type: none"> <li>▪ Leader’s decision</li> <li>▪ Once Transitional Agreement is signed – Transition Board is formed</li> </ul>	▪ Legislative act and recognition by PRF Members
<b>Oversight period</b>	▪ To Leaders declaration & signing of transition agreement with PIFS by 30 Nov 2023	<ul style="list-style-type: none"> <li>▪ Transition board selection process to be completed by 31 Dec 2023</li> <li>▪ Transition board effective from 1 Jan 2024 to Council formation</li> </ul>	▪ Projected to be from 1 Jan 2025 or from PRF go live date
<b>Composition</b>	▪ TWG consists of Finance officials	▪ To consist of mix of current custodians and independent members: 4 active custodians/champions (TWG Chair + 3), plus 3 Independent members	
<b>Additional oversight</b>	PIFS Senior Management Team (SMT) oversight to continue and Forum sub-committee oversight (ARSC/ PESC) as well as the Forum Officials Committee (FOC) continues throughout the transition period		

## O. PRF Set-Up and Operational Budget, Funding and Implementation Plan

47. The estimated budget to set-up the PRF is USD\$3.5m, for the 17-month period from August 2023 to December 2024.

PRF set-up budget and timeline			2H23	1Q24	2Q24	3Q24	4Q24
			Aug-Dec23	Jan-Mar24	Mar-Jun24	July-Aug24	Sept-Dec24
Key Phases	Budget		FEMM /Leaders Endorsement	Go/No-Go Checkpoint #1	Go/No-Go Checkpoint #2	Go/No-Go Checkpoint #2	Pledge
Phase 2: PRF Set-up	<b>\$2.59m</b>						
2.1	Advanced transition groundwork	\$0.40m					
2.2	Legally stand-up the PRF	\$0.24m					
2.3	Engage PRF team and service providers to commence set-up	\$0.97m					
2.4	Set-up – policy groundwork	\$0.98m				Standard & Poor SPO	
Phase 3: PRF Pledging	<b>\$0.33m</b>						
Phase 4: Projects pilot stage	<b>\$0.58m</b>						
<b>Total PRF set-up budget estimate</b>	<b>\$3.50m</b>		Australian funding (AUD\$2-3m)			U.S. funding (US\$2m)	

48. The following high-level assumptions underpin the budget, subject to FEMM endorsement to Leaders and all the supporting groundwork needed to achieve these milestones:

- That the set-up budget will be mostly funded by the end of August 2023.
- That the PRF will be legally established in 3rd Quarter 2024.
- That there will be a pilot project pipeline, before pledge.
- That the PRF will be assessed by Standard & Poor, before going to pledge.
- That the PRF pledging will take place by 4th Quarter 2024.
- That pledges received will be no less than USD\$250m.
- That the PRF will be ready for operations by 1 January 2025.

49. The set-up budget is broken down into these key components,

- Phase 2: PRF Set-up - USD\$2.59m (74% of total set-up budget)**
  - 2.1: Advanced transition groundwork** is critical to get the PRF ready for Leaders' declaration in November 2023, with finalised legal instruments, country of domicile and sub-regional offices set-up, refreshed PRF branding visibility, final Information Memorandum and to commence policy groundwork.
  - 2.2: The legal standing up of the PRF** is activated once Leaders make the declaration and is the legal leg work to support the country of domicile law-making process, and the sub-regional set-up and country visits needed to stand-up the PRF.
  - 2.3 and 2.4: The contracted support budget to set-up the PRF** are inter-related and covers the drafting of all Terms of References for services needed, procurement phasing and delivery management for all the various pieces of work to set-up the PRF. This policy work will be the backbone for the Standard and Poor assessment and the investment portfolio management arrangements with the World Bank, hence will need to be very well-managed. This also includes investing into the PRF to be ready for operations and eventually stand-alone after the transition period,
- Phase 3: PRF Pledging - USD\$0.33m (9% of total set-up budget)** is to support donor and investor fund-raising roadshows for the PRF leading up to the pledge and to support pledging activities. This budget line assumes that the pledging

event will be coinciding with other funded global events that will be attended by Leaders.

- c. **Phase 4: PRF Project pilot stage USD\$0.58m (17% of total set-up budget)** is to ensure the PRF project on-line platform, processes and templates are in place, that country community financing mechanisms, risk-profiles and landscape are mapped out, that implementing partners are in place, that community outreach has taken place and that a call for project proposals has taken place with a credible pipeline of initial pilot projects prepared and ready for funding.

**50. The PRF set-up has confirmed funding from the Governments of Australia (AUD\$2-3m) and the United States (U.S.) (USD\$2m). This is approximately USD\$4m, and covers the PRF set-up and project work kick-off. The Australian Government funding proposal was submitted before FEMM and is ear-marked to be received by the end of August, whilst the US funding will likely be accessible by 3<sup>rd</sup> Quarter 2024.**

51. Based on USD\$500m capitalisation, the total estimated budget to run the PRF for 5 years from 2025 to 2029 is **USD\$21m** on a cost recovery basis. This consists of two main components,

- a. Core operational budget of USD\$12.2m (average annual operational cost of USD\$2.6m) fully covered by the PRF management fees, which has been revised upwards slightly from 0.4% to 0.5% of all grants received.
- b. Project implementation budget of USD\$8.8m (average annual project implementation cost of USD\$1.8m) fully covered by the PRF project implementation fees of 10% of disbursements, which remains unchanged. The cost of community project implementation for remote communities and islands is a challenge and the PRF pilot stage is vital to monitor cost to deliver.

52. For Honourable Ministers kind noting, to mitigate the risk of a funding shortfall, two operational budget scenarios were analysed for the PRF based on the 2 initial capitalisation scenarios of USD\$250m and USD\$500m. The total budget options are USD\$12.2m in the worst-case scenario and USD\$21m in the best-case scenario, respectively.

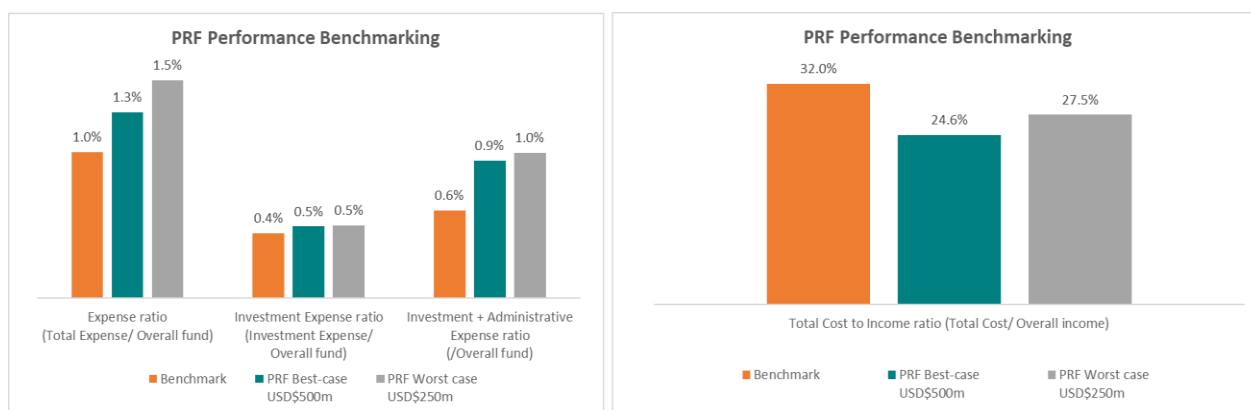
53. This is a practical and proactive approach to ensure an agile PRF delivery model to mitigate downside funding risk, without compromising quality of implementation, on a best effort basis. The PIFS administration fee is assumed at 5% of total Secretariat costs in the best case, excluding rent and shared services, whilst in the moderated worst case, it is recommended that all PIFS managed services costs be folded into the 5% fee. The PRF cost recovery model is not sustainable with the usual 10% PIFS administration fee.

PRF 5-Year Optional Budget (Cost Recovery)	FY25 Year 1	FY26 Year 2	FY27 Year 3	FY28 Year 4	FY29 Year 5	5-Year Total Budget
<b>PRF - PORTFOLIO LEVEL</b>						
Overall Fund	517,675,010	530,386,055	538,407,184	544,027,541	<b>544,464,062</b>	
Overall Investment Income	31,007,010	31,141,036	26,960,837	27,389,595	22,708,878	<b>139,207,355</b>
Disbursements (Fixed For 3-years, Then Step Up)	17,000,000	17,000,000	17,000,000	19,492,200	19,492,200	<b>89,984,400</b>
<b>PRF - FACILITY LEVEL - OPERATIONAL BUDGET</b>						
PRF Management fees (0.5% total funds)	2,588,375	2,651,930	2,692,036	2,720,138	2,722,320	<b>13,374,799</b>
Core Operational Costs	2,343,300	2,338,300	2,523,300	2,445,300	2,506,300	<b>12,156,500</b>
<b>Management Fee (Surplus/Shortfall) Before Project Costs</b>	<b>245,075</b>	<b>313,630</b>	<b>168,736</b>	<b>274,838</b>	<b>216,020</b>	<b>1,218,299</b>
% cost recovery coverage	110%	113%	107%	111%	109%	
<b>PRF - PROJECT LEVEL - PROJECTS BUDGET</b>						
Project Implementation costs (10% disbursements)	1,700,000	1,700,000	1,700,000	1,949,220	1,949,220	<b>8,998,440</b>
Project Cycle Costs	1,660,000	1,660,000	1,660,000	1,929,376	1,929,376	<b>8,838,752</b>
<b>Project Costs (Surplus/Shortfall)</b>	<b>40,000</b>	<b>40,000</b>	<b>40,000</b>	<b>19,844</b>	<b>19,844</b>	<b>159,688</b>
% cost recovery coverage	102%	102%	102%	101%	101%	
<b>PRF - COST RECOVERY AND FUNDING</b>						
Total Fee Income (PRF Management & Implementation Fees)	4,288,375	4,351,930	4,392,036	4,669,358	4,671,540	<b>22,373,239</b>
Total Expenses (To Run PRF & Deliver Projects)	4,003,300	3,998,300	4,183,300	4,374,676	4,435,676	<b>20,995,252</b>
<b>Net PRF (Shortfall)/Surplus</b>	<b>285,075</b>	<b>353,630</b>	<b>208,736</b>	<b>294,682</b>	<b>235,864</b>	<b>1,377,987</b>

## P. Benchmarking the PRF Performance

54. To strengthen the integrity of the financial re-design and add certainty to investors on the financial feasibility of the PRF, the PRF pro-forma performance has been benchmarked against carefully selected comparators in a conservative peer group<sup>23</sup> based on 4 key ratios: 3 ratios that measure investment management and operational efficiency in relation to the size of the fund (expense ratio, investment expense ratio, investment + administrative expense ratio), and 1 ratio that looks at operational efficiency in relation to investment income generated (cost to income ratio).

55. The best-case budget above translates to an expense ratio of 1.3% and a cost to income ratio of 24.6%, indicate a competitively placed inaugural PRF and will need discipline to be maintained as these will also be assessed if the PRF is to be globally benchmarked.



<sup>23</sup> Key benchmarks used (1)': Av. Expense Ratios (1996-2021) between long-term mutual funds (hybrid), hybrid mutual funds, and funds of funds, averaging 3 methods asset-weighted average, simple average and median. Sources: Investment Company Institute, Lipper, and Morningstar. (2)': Av. Aggregate Asset Management Fees (%) - 5 Pacific sovereign trust funds for 2019. Source: Analysis of Pacific National Funds Investment Strategies and Results: Regional Comparative Study (World Bank). (3)': Av. Investment & Administrative costs for FSM and RMI - FY18 & FY19. Sources: FSM & RMI Annual Report - 2019. (4)': Av. GCF total expense to income ratio for 2020 & 2021, GCF Annual Report 2022.

**Q. Re-Designed PRF Project Governance**

56. The initially proposed project size range of USD\$50,000 to \$250,000 is recommended to be tailored to country and sub-region and local currency community project sizes, with a minimum project size to reduce transaction cost, and an upper limit based on the local community grant landscape context.

57. The small ticket size community projects will need to be managed via simple on-line systems easy for communities to access, supported with strong community outreach with member Governments and implementation partners, to build a strong project pipeline and to improve processing, turn-around time and decisioning.

58. The transformative PRF agenda is underpinned with a theory of change that acknowledges that member systems are under stress and that the perpetual climate and disaster risks our communities face are exacerbated by systemic risks that impede the resilience building process.

59. While any funder can install a water-tank, the PRF needs to also concentrate on **closing the resilience feedback loop** to support community resilience through improved solutioning, decisioning, systems and mechanisms design.

60. These outcomes are to be embedded in the PRF risk-informed project management cycle that intends to (1) use under-harvested data for data-driven insights, (2) derive community behavioural and cultural insights to understand factors that impede or enable sustaining community resilience, (3) reinforce the convergence of multiple vertical and lateral lessons learnt feedback loops, (4) use a risk-based approach to pool projects into consolidated thematic portfolios, (5) strengthen inclusive consultations in project co-design, (6) strengthen community capacity through practical learning and teaching methods and micro-credentials qualifications. These will be tested in the first 3-years of the PRF as a proof-of-concept pilot stage.