Feasibility Study of a Protected Areas Trust Fund

Sustainable Funding for the Nature Parks of the Netherlands Antilles

Part B – TRUST FUND DESIGN

February 2005

A I D E n v i r o n m e n t **Mr Barry Spergel** ***EcoVision***

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AIDEnvironment

Donker Curtiusstraat 7-523

1051 JL AMSTERDAM

The Netherlands

Tel. +31 20 6868111

Fax.+31 20 6866251

Email: info@aidenvironment.org

Barry Spergel

5203 Falmouth Road

BETHESDA, MD 20816

USA

Tel. +1 301 2290058

Fax. +1 202 6140528

Email: bspergel@aol.com

Ecovision

Margrietlaan 10

CURAÇAO

Netherlands Antilles

Tel. +599 9 7369533

Fax. +599 9 7366175

Email: ecovision@cura.net

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Abbreviations and Acronyms

BZK	Ministerie van Binnenlandse Zaken en Koninkrijksrelaties (Dutch) (Ministry of the Interior and Kingdom Affairs)
CI	Conservation International
DCNA	Dutch Caribbean Nature Alliance
GEF	Global Environment Facility
MINA	Afdeling Milieu en Natuur (Environmental Department)
NA	Netherlands Antilles
NAF	Netherlands Antillean Guilder
NC-IUCN	Netherlands Committee for IUCN
NPL	National Postcode Lottery
TF	Trust Fund
TNC	The Nature Conservancy (US)
USAID	US Agency for International Develeopment
VOMIL	Ministerie van Volksgezondheid en Milieuhygiëne (*former name*) (NA Ministry of Public Health and Environment)
VSO	Ministerie van Volksgezondheid en Sociale Ontwikkeling (*current name*) (NA Ministry of Public Health and Social Development)
WWF	World Wildlife Fund / World Wide Fund for Nature

1 Executive Summary

Combining Trust Fund and DCNA

The consultants propose (and VSO/MINA and DCNA agree) that the Trust Fund for the nature parks of the Netherlands Antilles should be established inside of the DCNA rather than as an independent charitable foundation, as had been proposed earlier. The reasons for this are as follows:

- DCNA has been designed to have the type of institutional structure recommended for conservation trust funds by international donors such as the GEF, USAID, WWF and CI.
- DCNA's general purposes include the Trust Fund's more restricted purpose (i.e., sustainable funding of the recurrent management costs of protected areas).
- Making the Trust Fund part of DCNA will substantially reduce administrative costs and complexity.
- There will be no need to wait until a target minimum capital is raised before the Trust Fund can be fully operational.
- Combining DCNA and the Trust Fund will avoid potential fundraising competition between the two.

Disadvantages

Housing the Trust Fund inside the DCNA could, however, raise one or more of the following concerns:

- The similarity in purposes between DCNA and the Trust Fund could confuse some potential donors.
- Donors may be concerned that funds which they have given for the narrower purpose of the Trust Fund, could be used to support some of DCNA's other broader purposes or its core operating costs.
- The fact that grant beneficiaries (i.e., park management agencies) are members of the same Board which decides on making grants to those agencies may initially seem like a conflict of interest to some people.

However, potential conflicts of interest will be prevented by specific provisions in the Articles of Incorporation of the DCNA that disqualify Board members from voting on grants to their own organizations, and that limit the park management agencies to holding 50% or less of the seats on the Board, which means that a vote of approval by some of the "outside" members of the Board will always be required for any decision.

Umbrella structure

The DCNA provides a common legal, financial and administrative structure for accomodating whatever separate accounts the Trust Fund may include. The proposed Trust Fund will consist of a core endowment to support the operating costs of the ten protected areas (one marine and one terrestrial park on each of the five islands). The Trust Fund could also include restricted sub-accounts established to support a single island, a single protected area or a particular nature management activity. These sub-accounts could either be endowments, sinking funds (i.e., funds that are for a limited period of time) or revolving funds based on a continual in-flow of new revenues from fees or taxes.

Trust Fund governance

The Trust Fund's core endowment, and each particular sub-account, will be managed by the DCNA's Board of Directors in accordance with the DCNA's Articles of Incorporation. However, a specific Grant Agreement between the DCNA and a particular donor can establish a separate decision-making body for the sub-account or specific voting rules, veto rights or approval authority.

Board members

The DCNA's Board (which will also serve as the Trust Fund's Board) consists of up to thirteen voting members. Five voting members are nominated by the park management NGOs of each of the five islands of the Netherlands Antilles, plus one more for Aruba if it joins the DCNA. These voting members can then appoint a maximum of eight additional voting members to the Board, consisting of:

- up to two members from the Nature Forum who are not serving as an officer or board member of any of the organizations already represented on the Board;
- up to three members representing international nature conservation organizations which provide support to DCNA.
- up to three members with significant financial expertise who have held senior-level positions in public or private sector organizations in the Netherlands Antilles.

In addition, the Environmental Department of the Ministry of Public Health shall appoint one non-voting member of the Board. DCNA Board members cannot vote on grants to their own organizations.

Council of Patrons

In order to give the Trust Fund the highest possible profile among potential donors, well-known and influential people will be invited to join a Trust Fund "Council of Patrons" or become Trust Fund "Honorary Board Members". Their primary mission will be to appeal to national and international political and business leaders to give political or financial support to the Trust Fund.

Finance Committee

The DCNA's Board is to elect a Finance Committee that includes the Treasurer and other board members who have been selected for their financial expertise and experience in financial management. This Committee also oversees and reviews all matters related to financial asset management, including investment strategy and oversight and management of any third parties involved in managing the Foundation's and/or the Trust Fund's assets (i.e., the DCNA may have other financial assets besides those which comprise the Trust Fund).

Target capital

The Consultants estimate that a **target size of NAF 42 million** (equivalent to approximately EUR 18,9 million or US$ 25 million) is required to capitalize the Trust Fund core endowment up to a level that the 'basic' financial requirements for managing the average park can be met. This estimate is based on certain particular assumptions about the rate of return on investments, and about the size of an annual contribution to the DCNA by the Dutch Postcode Lottery. These assumptions will be discussed in detail later in this Part B of the Feasibility Study. Changing these assumptions could change the target size of the endowment to as little as NAF 6,5 or as much as NAF 69 million (see also Part A).

Revenue distribution keys

There are basically three conceivable approaches for the distribution of funds that have to be shared between the islands, such as the revenues from an unrestricted Trust Fund:

1) equal shares: simply divide the total annual amount by the number of islands (5 or 6).
2) proportionate shares: divide the total annual amount between the islands by predetermined percentages, regardless of each protected area management agency's budget deficits, or based on some other fixed "entitlement" criteria used in other countries.
3) allocate parts of the annual grant in successive 'rounds' of disbursements according to predetermined formulas for each round, based on a combination of equality (equal amounts) and solidarity (islands with larger gaps between available income and basic requirements get a larger share than islands with smaller gaps).

Any of these formulas will also need to allocate a share to cover the operating expenses of the DCNA itself.

Professional asset management

The Trust Fund's capital should be invested and managed by independent professional asset managers, rather than by the DCNA Board or by a Trust Fund Finance Committee, which could lead to conflicts of interest. The role of the DCNA Board (and/or Finance Committee) with respect to investing the Trust Fund's assets is to establish general investment policies and guidelines, and to appoint an asset manager to implement those policies and guidelines, and monitor his performance.

An asset manager should invest the Trust Fund's assets in a highly diversified mix of categories based on "Modern Portfolio Theory". This usually involves investing in a variety of different mutual funds which are each the most consistently top-performing in their respective category.

Location of asset manager

From a legal and a tax perspective, it makes no difference whether the Trust Fund's assets are invested by an asset manager located in the U.S., in the Netherlands or in the Netherlands Antilles, since none of these countries impose any taxes on the interest and profits that a charitable organization earns each year on its passive investments. Therefore, even though the DCNA is a Netherlands Antilles foundation, it is not limited in its choice of assets managers to those located in the Netherlands Antilles, but could also select one in the Netherlands, the U.S., or other places such as London.

Place of incorporation

From a legal point of view, it also makes no difference whether the Trust Fund is incorporated in the Netherlands Antilles, the Netherlands or the U.S., since none of these three countries imposes any burdensome restrictions or requirements. However, both the Netherlands and the Netherlands Antilles have set rather low maximum limits (EUR 4.000) on how much of a tax deduction an individual or a corporation is entitled to claim for making charitable donations, whereas the U.S. does not set any maximum limits. The Netherlands and the Netherlands Antilles also impose a tax on charitable donations above a certain amount to be paid by the beneficiary, whereas there is no such tax in the US. For these reasons, it may be more advantageous for an individual and a corporation that wishes to donate relatively large amounts of money to the Trust

Fund to make a donation to the U.S. “Friends of the DCNA”, which can then transfer the donation to the DCNA.

Accountability

DCNA should hire a well-reputed international accounting firm to annually conduct an independent outside financial audit of the Trust Fund. The Trust Fund’s Operational Manual should set forth detailed procedures for all financial transactions, including requiring multiple signatures and even written approval by the Board in the case of withdrawals, transfers and contracts involving more than certain specified amounts of money. All donors should receive detailed annual financial and technical reports on the activities financed by the Trust Fund.

2 Introduction

The Trust Fund process

The establishment of a Trust Fund was first proposed in 1998 as a mechanism for providing predictable, long-term funding to cover the basic operating costs of the Netherlands Antilles' nature reserves. In that same year, the Dutch Parliament requested the Dutch Government to support a study of the feasibility of establishing such a Trust Fund. In early 2003, the Antillean government agency VSO/MINA commissioned such a feasibility study, on which work was started in January 2004. From a mere study of the feasibility of establishing a Trust Fund, this has evolved into a broader analysis and exploration of how the parks could be made financially sustainable, with emphasis on the potential and role of a Trust Fund.

Conclusions on feasibility

In the first of a series of three reports, the consultants[1] concluded that sustainable funding of nature parks can be achieved, considering the complementary potential of a series of financial strategies and a new political, institutional and social momentum which has become noticeable. This momentum is leading to growing political support by both the Dutch and the Antillean governments for the sustainable financing process. *The overall conclusion of the feasibility study is that establishing a nature parks Trust Fund is a feasible way of providing sustainable funding of nature parks in the Netherlands Antilles, if combined with several parallel and complementary funding mechanisms.*

This report

The present report B describes the design of the Trust Fund. Report A of the study examined: (1) a rapid economic valuation of nature and nature parks; (2) the Netherlands Antillean policy and socio-economic context from a conservation finance perspective; (3) donor potential; (4) financial strategies and scenarios for the nature parks. Report C presents communication and fundraising strategies to support the process towards financial sustainability for the protected areas of the Netherlands Antilles.

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[1] A consortium of AIDEnvironment (lead partner, based in Amsterdam, the Netherlands), EcoVision (based on Curaçao) and Mr Barry Spergel, a conservation trust fund specialist from the U.S.

3 A Trust Fund within the DCNA

One institution or two separately

One of the most fundamental issues to be decided when designing a protected areas trust fund is whether it should be set up as a separate new institution, or housed inside of an existing one. In most countries, it makes more sense to set up a trust fund as a separate new institution, because the purposes of a trust fund are either much broader or much narrower than the purposes of existing government environmental agencies or non-governmental conservation organizations. Another reason is that a trust fund is intended to serve as a model for collaboration between government and civil society in countries where the government has traditionally controlled everything in a top-down manner. But DCNA's purposes and objectives are very similar to the Trust Fund's, and the Netherlands Antilles already has a well-established pattern of collaboration between government and NGOs in the management of protected areas.

Rather than being set up as an independent charitable foundation, as had been proposed earlier, the Trust Fund should therefore be established under the legal and institutional umbrella of the DCNA. Table 1 summarises the Pros and Cons of setting up a single institution.

Responding to the CONs

In general, a key element in addressing the disadvantages (CONs) is to always comvey clear and consistent messages that anticipate to these concerns, in all external communication. Other solutions are to include specific provisions in the Bylaws on voting procedures or decision making competence of the Board vs special Committees.

The first "CON" argument from the table is based on too narrow a conception of what trust funds are and of what DCNA does. The GEF Evaluation Report on Conservation Trust Funds (GEF, 1998) states that they "are more than just financing mechanisms", and "have made impressive accomplishments in the areas of ...enabling the participation of civil society institutions in resource conservation...and increasing public awareness of conservation issues".

Table 1
PROs and CONs of establishing the Trust Fund under the umbrella of the DCNA

PROs	CONs
DCNA has a the type of **'mixed Board' composed of NGOs, government, private sector, and international donors** which is recommended for conservation trust funds by the GEF, USAID, WWF, TNC and CI.	**Conflict of interest:** the fact that grant beneficiaries (i.e., park management agencies) are members of the same Board which decides on grants to those agencies may seem at first like a conflict of interest.
DCNA's **general purposes include** the Trust Fund's **more restricted purpose** (i.e., sustainable funding of the recurrent management costs of protected areas). Combining DCNA and the Trust Fund will **avoid potential fundraising competition and potential confusion** between the two in the minds of donors that could result from having two separate organizations with almost the same goals.	**Similarity in purpose may confuse.** Although donors are likely to be confused if DCNA and the Trust Fund are legally separate entities with purposes that are similar, donors might also be confused if the two are combined, since DCNA may sound like a networking and mutual support NGO, whereas the Trust Fund may sound like a donor financing mechanism.
Making the Trust Fund part of DCNA will substantially **reduce administrative costs and complexity**, since the Trust Fund will not need to have its own separate Board of Directors, staff, office space, bank accounts, outside auditors etc.	**Broader use of funds**; donors may be against the use of funds they have given for the narrower purpose of the Trust Fund, to support DCNA's other broader purposes or all of its core operating costs rather than just a pro rata portion of those costs which are attributable to supporting the operating costs of the agreed nature parks.
There will be **no need to wait until a target minimum capital** is raised -which could take several years- before the Trust Fund can be operational since the DCNA will soon be fully operational with an office and full-time staff.	

No conflict of interest

Any possible misconception that having the park management organizationsrepresented on the DCNA's Board would amount to a conflict of interest because they would simply be making grants to themselves can be refuted by showing that:

- they represent less than half of the proposed 13 voting members of DCNA's Board of Directors, which means that by themselves they would only have power to "block" rather than to "make" grant awards.

- according to the Articles of Incorporation of the DCNA, none of the members of the Board who are nominated by the park management agencies shall have a right to vote on any matters directly relating to the award and allocation of grants to the agency which nominated them.
- a predetermined "distribution key" specified in the Bylaws will be used for the allocation of non-earmarked grants, instead of ad hoc annual decisions.
- even if the five park management organizations did collectively "control" the Board, it is unclear how any particular one of them could thereby gain an unfair advantage or share for themselves, since the other four could oppose any such attempt which would disadvantage them.

Any remaining donor concerns about having beneficiaries represented on the Board can be dealt with by simply including provisions in individual donor's grant agreements and/or in a specially added new section of DCNA's Bylaws that specifically sets forth the rules and restrictions governing the PA Trust Fund account within DCNA.

Narrow spending criteria

DCNA will not be able to use the Trust Fund's assets for any broader purposes than directly supporting the operational costs of the selected protected areas on each island, plus a stipulated amount to cover DCNA's own overhead, unless the Trust Fund generates more income than is required for its core purpose.

Domestic control over parks

Any potential concerns about ceding too much control over the parks to international donors by letting them have a role in deciding how to allocate grants from the Trust Fund (whether or not the Trust Fund and DCNA are combined) can be overcome by pointing out that neither the Trust Fund nor the DCNA has any legal powers of its own to manage or regulate protected areas.

4 Structure and Governance

Core endowment and sub-accounts

Although the simplest situation would be for the DCNA to just have a single unrestricted "core endowment fund" to cover the gaps in funding the operating costs of one marine and one terrestrial protected area on each island, in fact some donors may only be willing to contribute capital to an endowment or sinking fund that is restricted for one particular island or park, or for one particular type of conservation activity. Establishing different sub-accounts for many different purposes could add to the administrative complexity of disbursing and monitoring grants, but this would still be manageable so long as there are only a relatively small number of sub-accounts. On the other hand, the nature parks may not be able to forego any funding opportunities by refusing to accomodate a donor's wish to have a separate subaccount.

The proposed Trust Fund will, therefore, consist of:

- a *"core" endowment fund* to help finance the operating costs of selected nature parks on all islands.
- *separate subaccounts earmarked for restricted purposes,* to allow donors to earmark their contributions, provided that those purposes are also authorized by the general terms of the relevant Articles of Incorporation. Examples of restricted sub-accounts are a "Sea Turtle Trust Fund" or an "Environmental Education Trust Fund".

The term "Trust Fund"

In the case of the Trust Fund now being proposed, the term "Trust Fund" refers to the totality of endowments and sub-accounts which are established within the DCNA. None of these different funds would be a separate legal entity apart from the DCNA, or have its own separate Articles of Incorporation, or its own separate Board of Directors, unless determined otherwise in a particular grant agreement with a donor. These sub-accounts themselves could either be endowments, sinking funds or revolving funds.

Articles of Incorporation

In general, the "Articles of Incorporation" of any conservation trust fund should contain detailed provisions containing the elements listed in the following text box. In fact, all of these topics have already been addressed in the DCNA's Articles of Incorporation, and will be further elaborated in the DCNA's Bylaws. It is therefore unnecessary to have a different set of

Articles of Incorporation and Bylaws specifically for the Trust Fund.

Contents of Articles of Incorporation of conservation trust funds

- P*urposes* for which the trust fund or foundation is being established.
- Conditions of *eligibility to receive grants*, in terms of the general kinds of activities and kinds of beneficiaries that are eligible.
- Composition of the *Board of Directors*; the Board's powers; the procedures for appointing and replacing Board members; Board members' responsibilities, their term of office; and their remuneration (if any); the required frequency of Board meetings; the number of Board members whose presence is required in order to constitute a quorum; and the number of Board members whose vote is required in order to approve of any proposed action.
- Appointment and responsibilities of an *Executive Director and other staff* of the trust fund.
- Rules requiring *disclosure of any potential conflicts of interest* by the trust fund's board members or staff, and requiring the trust fund's Board members to *abstain from voting* on any proposed grants or contracts involving their own organizations.
- Establishment and functions of any *special committees* of the Board (such as a Finance Committee), and any outside advisory committees (such as a "Council of Patrons" or a Scientific Advisory Committee).
- Anticipated *sources of revenue* for the trust fund (described by general category rather than by naming specific donors).
- Provisions that make it possible to establish an endowment, and other kinds of separate *sub-accounts* for particular purposes.
- Provisions requiring an annual outside audit, and publication of an annual financial report.
- Conditions and procedures for *dissolution* of the trust fund and disposal of its assets, if that should ever be necessary.

Operational manual

The day-to-day rules and guidelines for administering the Trust Fund will be set forth in the DCNA's "Operational Manual". The Operational Manual will be adopted by DCNA's Board, and will be for the use of DCNA's Executive Director and other staff in carrying out their job responsibilities. The administration of the Trust Fund will constitute only one part of those job responsibilities.

One of the purposes of the Operational Manual will be to gather in one place all of the various restrictions, rules, terms and conditions for the different sub-accounts and the core endowment. The Operational Manual should set forth detailed procedures for all financial transactions, including requiring multiple signatures and even written approval by the Board in the case of withdrawals, transfers and contracts involving more than certain specified amounts of money. The Operational Manual (but not the Bylaws or the Articles of Incorporation) will therefore need to be partially updated whenever a new sub-account is established.

Grant agreements

The actual establishment of any Trust Fund is something that the DCNA's Board can accomplish at any time by passing a resolution. What will give relative permanence to the core endowment or separate sub-accounts are the Grant Agreements that will be signed between the DCNA and donors.

Common elements in grant agreements

- Reference to DCNA Articles of Incorporation and Bylaws, specifying any additional or deviating provisions.
- Additional governance structure applying specifically to the grant (e.g., a Finance, Advisory and/or Technical Committee, with or without representation of the donor) and its relation to the DCNA Board.
- Any specific voting rules, veto rights or approval authority the donor may have.
- Specific provisions concerning the eligibility of activities or cost items, including distribution keys for the allocation of revenues.
- Specific provisions concerning bank accounts and asset management.
- Procedure regarding the original grant in case of dissolution of the DCNA, or in case of use of funds for purposes that are not consistent with the terms of the Grant Agreement (e.g., right to a return of funds).
- Investment arrangements and guidelines that specifically apply to the grant.
- Additional detailed reporting obligations (annual workplan, annual progress report).
- Specific provisions concerning transparency (e.g., information access), and accountability (e.g., external evaluations).
- Specific provisions concerning dissolution of the fund or account.

DCNA Board of Directors

The Trust Fund as a whole, and each particular sub-account, will be managed by the DCNA's Board of Directors, in accordance with the DCNA's Articles of Incorporation and unless a Grant Agreement between the DCNA and a particular donor determines otherwise; this could be the case when a donor wants a separate decision-making body for its grant or sub-account, with or without representation of the donor. Its relation to the DCNA Board should then be clearly specified, as well as any specific voting rules, veto rights or approval authority which the donor and the DCNA may agree.

Board composition

The composition of DCNA's Board of Directors is set forth in Article 6 of DCNA's recently registered Articles of Incorporation. The Board consists of up to thirteen voting members. The legally designated park management organizations of Curacao, Bonaire, St. Maarten, Saba and St. Eustatius are each entitled to nominate one voting member of the Board, and Aruba will also be entitled to nominate one voting member if it joins the DCNA. These voting members must then appoint a minimum of five (or, if Aruba joins the DCNA, a minimum of six) and a maximum of eight additional voting members to the Board as follows:

- Up to two members can be nominated by and from the Nature Forum, preferably one from the Windward and one from the Leeward Islands, provided that they are not an officer or board member of one of the organizations which are already represented on the Board;
- Up to three members can be representatives of international nature conservation organizations which provide significant support to DCNA;
- Up to three members can be individuals selected because of their significant financial expertise and experience in financial management, who have held senior-level positions in public or private sector organizations in the Netherlands Antilles.

Some attributes of successful Trust Fund Boards

- Members are of high integrity and respected within their communities.
- Diversity of membership is a key factor in establishing effective specialized committees.
- Active participation and leadership of prominent business people who bring a private-sector management perspective.
- Members serve with a primary commitment to the fund itself and not to the sectors they represent.

Non-voting government member

In order to ensure equitable representation of all of the islands and to provide continuing links with other conservation and environmental activities within the Antilles, the Environmental Department of the Antillean Ministry of

Public Health shall appoint one non-voting member of the Board to participate in all Board discussions and to give advice.

Articles 7 through 14 of the DCNA's Articles of Incorporation specify further details about the Board's manner of appointment, the convening and conduct of Board meetings, voting rules and procedures, the Board's powers and responsibilities, the election of Officers and of the Executive and Finance Committees, the hiring of an Executive Director and staff, and rules on disclosing and avoiding conflicts of interest by Board members and staff of the DCNA. No special changes need to be made to those Articles in order to enable the DCNA's Board of Directors to also serve, in effect, as the management board of the Trust Fund.

Council of Patrons

In order to give the Trust Fund the highest possible profile among potential donors, well-known and influential people could be invited to join a Trust Fund "Council of Patrons" or become Trust Fund "Honorary Board Members". In this capacity, they would have no right to vote (or even necessarily to participate) in meetings of the DCNA's Board of Directors; the Board would continue to be the sole body with decision-making powers over how the Trust Fund is invested or its investment income is spent. From time to time these Honorary Board Members or members of the Council of Patrons could be invited by the DCNA Board to give advice, but their primary mission would be to publicly (and privately) appeal to national and international political and business leaders to give political or financial support to the Trust Fund. The African Parks Foundation and the Peace Parks Foundation provide examples of successful honorary councils.

Finance Committee

The Board shall elect a Finance Committee which shall include the Treasurer and the board members selected for their financial expertise and experience in financial management. This Committee shall oversee and review all matters related to financial asset management including investment strategy and oversight and management of any third parties involved in the financial asset management of the Foundation. The Finance Committee shall also oversee the grant giving activities of the Foundation including ensuring that eligibility criteria are met and that rules and responsibilities of grantees are adhered to. Finally, the calculation of "bare minimum" and "basic budget requirements" for each protected area should be approved by the Finance Committee (see chapter 6).

Transparency and Reporting

The DCNA's Articles of Incorporation, Bylaws, annual budget and work plan, and summaries of all board meetings and board decisions relating to the Trust Fund, should be made publicly available and regularly updated on an internet website maintained by the DCNA. In addition, DCNA's annual reports should present the Trust Fund's financial balance sheet and a description of all projects and activities which the Trust Fund has supported over the course of the year, using verifiable monitoring indicators. All donors should receive detailed annual financial and technical reports on the activities financed by the Trust Fund. The following text box contains general guidelines on reporting and accountability.

U.S. National Charities Information Bureau Standards on Reporting and Accountability

Annual Reporting: An annual report should be available on request and should include:

a) an explicit narrative description of the organization's major activities, presented in the same categories and covering the same fiscal period as the audited financial statements.
b) a list of board members.
c) audited financial statements or, at a minimum, a comprehensive financial summary that 1) identifies all revenues in significant categories, 2) reports expenses in the same program, management/general, and fund-raising categories as in the audited financial statements, and 3) reports ending net assets.

Accountability: An organization should supply on request complete financial statements which:

a) are prepared in conformity with generally accepted accounting principles (GAAP), accompanied by a report of an independent certified public accountant, and reviewed by the board.
b) fully disclose economic resources and obligations, including transactions with related parties and affiliated organizations, significant events affecting finances, and significant categories of income and expense; and should also supply.
c) a statement of functional allocation of expenses, in addition to such statements required by generally accepted accounting principles to be included among the financial statements.

Budget: The organization should prepare a detailed annual budget consistent with the major classifications in the audited financial statements, and approved by the board.

Outside Auditing

The DCNA should hire a well-reputed international accounting firm to annually conduct an independent outside financial audit of all investment and disbursement of funds from the Trust Fund's core endowment and each of the separate sub-accounts. The audit should certify that the income of the Trust Fund and any sub-accounts are used in accordance with their objectives, budgets, guidelines and procedures. In addition, those audits should be published within 6 months after the end of each fiscal year. Such a deadline is necessary because otherwise audits can drag on for a year or more, by which time it may be much harder to take any necessary actions.

5 Capitalization

Minimum Fund size

A 1998 GEF evaluation concluded that in most countries, it is probably not worthwhile to set up a conservation trust fund with an endowment of less than US $5 million, because in that case too high a percentage of the trust fund's annual income from investments will have to be used to pay administrative expenses and asset management fees (GEF, 1998). Donors would be willing to contribute to a fund or a project which spends not more than 10% to 20% of its total budget on administrative costs. This has usually been the average administrative expense ratio or "cap" for conservation trust funds.

Less than minimum size

On the other hand, it would still be reasonable to set up a conservation trust fund whose core endowment has a capital of less than US$ 5 million, if the Trust Fund is also financed by separate accounts which are sinking funds or revolving funds. This is because even though the annual asset management costs and other administrative costs of a sinking fund may be roughly the same amount as those of an endowment, this amount will represent a relatively much smaller percentage of a sinking fund's annual grants budget than of an endowment's annual grants budget.

It would also still be worthwhile to establish a core endowment of less than US$5 million if:

- it is likely that there will be substantial future donations that will raise the endowment above $5 million.
- a donor agrees to pay for all or most of the trust fund's administrative costs during its first few years.
- the endowment can be accommodated under some less expensive alternative administrative structure, such as in the case of the DCNA.

Comparing Fund types

Endowment Funds offer the best long-term perspective and are, by their very nature, the most sustainable but they require large capital sizes to bridge relatively small financial gaps. The disadvantage of Sinking Funds is that they provide only a medium-term solution to financing the management costs of protected areas, and as soon as they are used up, additional funding sources again need to be found. The advantage is that their size can be much smaller than an Endowment Fund. On the other hand, Revolving Funds financed by a continuous in-flow of entry fees, dive fees, cruise ship passenger fees, or other types of tourism-related fees or taxes could provide a long-term solution if they are earmarked for the Trust Fund, although such fees or taxes may be politically difficult to establish since they may be initially opposed by the tourism industry. Which type of fund is preferable will depend on the relative importance of addressing medium-term versus long-term financial needs, and whether or not establishing some form of revolving fund is politically feasibile.

Target Capital for the NA

As indicated in Volume A of this report, the Consultants estimate that a **target size of NAF 42 million** (equivalent to approximately EUR 18,9 million or US$ 25 million) is required to capitalize the Trust Fund core endowment up to a level that the 'basic' financial requirements for managing the average park can be met.[2] This estimate is based on data provided by the park managers (NAF 5 million of 'basic' requirements), by the Consultants' analysis of the unmet annual financial needs (NAF 1,4 million) and a calculation of how much capital would need to be invested in order to generate this amount of annual income. The estimate of NAF 42 million assumes a certain rate of return and size of an annual contribution to the DCNA by the Dutch Postcode Lottery. Changing these assumptions could change the target size of the endowment to as little as NAF 6,5 or as much as NAF 69 million (see also Part A).

Assumptions

The assumptions on which these calculations are based are the following:

- The long-term average (gross) rate of return on investment of the core endowment will be around 6 % per year[3], i.e., a

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[2] This calculation assumes that the share of each island in the revenues of the Trust Fund is determined by its specific annual deficit and not by a distribution key. In reality, the park management organizations agreed that islands will receive shares proportionate to their standardized basic requirements. This means that –with the Trust Fund at its target level- some islands will be somewhat above and others below their basic requirement level.

[3] A recent study (NACUBO, 2003) of 723 U.S. university endowments (worth a total of $230 billion) found that the median annual rates of return on their investments (calculated as of June 30, 2003, shortly after a 2-year period of sharp declines in U.S. and global stock markets) were:

- 2.9% for the previous 1-year period;
- -2.5% for the preceding 5-year period; and
- 8.5% for the preceding 10-year period.

NAF 42 million endowment will generate investment income of approximately NAF 2,52 million per year.

- In order to offset for an estimated long-term annual inflation rate of 1,8% and thereby maintain the same "real" value of the endowment's capital, an amount equal to 1,8% of capital (NAF 765.000 / year) will be subtracted from each year's investment income and reinvested back into the capital.
- The asset managers of the core endowment fund will charge a fee equal to around 0,5% per year of the endowment's capital.
- Administrative costs of NAF 145.000, equivalent to around 9,4% of the Trust Fund's total annual budget (i.e., gross returns minus asset management costs and reinvestment for inflation).

Sub-accounts

The above calculations will have to be modified if the Trust Fund consists not only of the core endowment but also of various restricted sub-accounts which themselves could either be endowments, sinking funds or revolving funds. In the final analysis, it is very difficult to say what the "target size" of the core endowment should be, because it all depends on exactly how much donors contribute to the various restricted sub-accounts, and within what period of time each sub-account which is a sinking fund must be completely spent.

Fundraising takes years

The amount of time that it is likely to take to raise even the minimum capital of $5 million for a Trust Fund core endowment may be several years, based on the examples of large successful conservation trust funds like the $90 million Mexican Nature Conservation Fund, the $36 million Bhutan Trust Fund for Environmental Conservation, the $70 million Amazon Region Protected Areas Initiative (ARPA), and even the coordinated international campaign to raise money to address the issues of the HIV-AIDS epidemic (UNAIDS). Some international donors may wait to make a contribution until other donors contribute first or agree to match their

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The US Department of Labor's regulations for calculating pension funds' liabilities to workers are based on the assumption that pension funds will earn an average annual rate of return on their investments of 7.5%. The average annual long-term investment returns of the S&P 500 Index and the Dow Jones Industrial Average have been more than 10% over the last 10-year period, and over the last 50-year period. Increasing the proportion of fixed-income bonds (versus stocks) in a portfolio of investments will result in more stable and more predictable, but lower, rates of return.

proposed contribution, or may give only modest amounts initially (e.g., $500.000) and then wait to see how well the Trust Fund succeeds in its first two to three years of operation before making larger contributions.

6 Grant-making criteria

DCNA's role

Conservation trust funds are not implementing agencies, nor are they directly involved in actual protected area management. Instead, their primary role is to make grants to implementing agencies, including governmental and non-governmental organizations that do have responsibility for managing protected areas. All this is also true of the DCNA; all that it does is to make promotion and raise funds for those areas, to provide technical assistance to conservation organizations, and to facilitate networking and exchange of information between all key stakeholders. DCNA Board members cannot vote on grants to their own organizations.

The establishment of the DCNA and of the Trust Fund does not affect the roles, responsibilities and internal structure of the protected area management agencies in the Netherlands Antilles, or the relationship of those management agencies to island governments. However, if the DCNA (or more specifically, the Trust Fund that will be established within the DCNA) provides a large portion of the annual budget for a protected area on a particular island, then the DCNA could indirectly exert an influence over the management of that protected area if it decides to hold up transferring funds to the protected area until certain conditions are satisfied (e.g., relating to financial accountability).

Grant-making criteria

There are at least three possible criteria or formulas that DCNA's Board could conceivably use for allocating grants from the Trust Fund:

- Awarding equal shares of the of the core endowment's annual investment income to each island.
- Proportionate shares: awarding each island a different fixed percentage of the total, based on factors such as:
  - financial requirement levels or other administrative criteria.
  - the relative size of their protected areas.
  - the relative size of their protected area management agencies' budgets and staff.
  - biodiversity factors, etc.
- Allocating grants to each island's protected areas in successive 'rounds' of disbursements according to

predetermined formulas for each round, based on combining principles of *equality* (equal amounts) and *solidarity* (islands with larger gaps between available income and basic requirements get a larger share than islands with smaller gaps). The justification for introducing solidarity here is that the considerable differences between islands in their ability to raise revenues from other sources is to some extent due to circumstances beyond their control (such as differences in tourism potential, or political leadership that may be more or less supportive of conserving the environment). Applying this principle of solidarity would mean that an island which is struggling to satisfy even its 'bare minimum' requirements (such as Statia) receives a much larger share of the Trust Fund revenues than an island whose protected area management agency may already surpass its 'basic' budget requirement level thanks to other revenue sources (such as Bonaire). [4]

Pros and Cons

The consultants feel that the third alternative is in some ways best, because it is based on an objective assessment of the relative unmet financial "needs" of each island's protected areas in a given year. On the other hand, the protected area management agencies of the five islands felt that this third option might be too complicated to determine each year and to administer, and might also be a disincentive for islands to also try to fundraise on their own. Therefore, they prefer the second option, and agreed that the Trust Fund's grants should be allocated based on the following fixed percentages:

- St. Maarten receives 11,3%
- Saba and Statia each receive 17,3%
- Bonaire and Curacao each receive 21,4%
- DCNA receives 11,3% to cover its expenses.

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[4] An example is to start with a first round of e.g. NAF 50.000 to each island by way of incentive, a second round with amounts that enable all islands to reach 100% or a fixed higher % of their 'bare minimum' level (in other words, those islands at or above this level won't receive anything in this round), and a third round (assuming that the total revenue amount allows for another round) divided in equal shares again. Other incentives could be built in as well, e.g. rewarding islands where the local government is making a bigger effort in supporting park management by allocating a budget line or by implementing user fees.

'Excess' amounts

If any funds remain after disbursements have reached certain agreed ceilings (i.e., if the Trust Fund has much greater income than now anticipated), this 'excess' amount could either be: (1) reinvested to increase the size of the Trust Fund's capital, or (2) disbursed in the form of grants to support other conservation activities that may be eligible for funding under the DCNA's Articles of Incorporation.

7 Place of incorporation

Three options

Possible locations for legally establishing (i.e., registering and incorporating) the Trust Fund which were considered by the Consultants are the Netherlands Antilles, the Netherlands, and the U.S. All three of these jurisdictions have well-established laws and regulations governing non-profit foundations and trust funds, which allow charitable organizations (including foundations and trust funds) to have almost any type of governance structure. In all three jurisdictions, it makes essentially no difference for tax or other legal purposes, whether the charitable organization is established as a “trust fund” or as a “foundation”.

None of these three jurisdictions imposes any burdensome legal requirements or restrictions on trust funds and foundations with respect to:

- the minimum or maximum number of directors on their governing boards;
- the citizenship of members of their board of directors;
- the country where their board meetings must be held;
- voting requirements; powers, duties and qualifications of the organization’s board members and officers;
- the need to obtain government approvals for decisions by the board (other than for the organization’s dissolution and liquidation);
- restrictions on the permissible objectives and activities of charitable organizations (except for certain restrictions on political and commercial activities of non-profit organizations);
- the permissible sources of funds for the organization;
- the ability to transfer the organization’s funds into or out of the country;
- maintaining the organization’s accounts in foreign currencies;
- the types of investments of the organization’s endowment which are permissible or impermissible (other than the general requirement that such investments must be “prudent”).

Tax considerations

There is one important difference between the three locations, however, in their tax treatment of charitable donations. In the Netherlands, a non-profit charitable foundation has to pay a gift tax of 11% (as opposed to the regular 42% which applies to individuals) on any gift received above a threshold level of around EUR 4.000 (see table 2). A similar gift tax in the Netherlands Antilles is expected to take effect soon. However, such tax considerations do not apply to bilateral donors, or to donors that are non-profit foundations or NGOs, since such organizations pay no income taxes anyway.

Table 2

Comparison of tax regimes in three countries

Tax advantage	US	Netherlands Antilles	Netherlands
Donations by individuals to conservation organizations are tax-deductible	YES, provided charity has 501(c)(3) status	YES, provided the organization is a resident of the N.A.(art. 16, par. 1, f Income Tax)	YES, but only between certain limits (also to a charity legally established in NA)
Donations by business companies to conservation organizations are tax-deductible[5]	YES, provided charity has 501(c)(3) status	YES, but only up to certain limits and provided the organization is a resident of the N.A (Art. 7, Profit Tax)	YES, but only between certain limits
Gift tax is levied on grants, to be paid by the charity, including grants to the charity's trust fund, endowment or other capital reserve[6]	NO, provided charity has 501(c)(3) status	YES, a tax will soon be imposed that is similar to the Dutch tax on charitable contributions	YES, but for charities lower tax rate of 11% applies to gifts above a threshold level
Interest or investment returns generated by investing the charity's trust fund, endowment or other capital reserve are tax-exempt	YES, provided charity has 501(c)(3) status	YES Art. 1, Profit Tax	YES

[5] In the US, charitable contributions by corporations can be deducted for purposes of calculating the corporate income tax (i.e., profits tax), which is levied at the national level and also usually at the state and local levels. Charitable contributions are not deductible against other kinds of taxes paid by corporations, such as real estate taxes, social security taxes for employees, unemployment insurance taxes, etc.

[6] A charity's endowment fund or capital reserve is not a legally separate entity, but is just a part of the charity. If a legally separate trust fund were established, it would itself be registered as a tax-exempt charitable entity, and would simply transfer its earned income (i.e., make non-taxable grants) to the "parent" charity.

"Friends of..." organizations

If the Trust Fund is legally established within the DCNA, and if the DCNA, wishes to raise funds and accept contributions directly from individual U.S. citizens or from U.S. "private foundations" , then in order to receive a U.S. tax deduction for such contributions, it will be necessary to establish a separate U.S. charitable organization that transfers such contributions to the DCNA for the Trust Fund. A U.S. charitable organization that is established primarily to channel U.S. contributions to a non-U.S. charitable organization is generally referred to by U.S. tax authorities as a "Friends of…"organization (e.g., "The U.S. Friends of Dutch Caribbean Nature Parks"). This "U.S. Friends" organization will need to have its own separate board of directors, articles of incorporation and by-laws. Setting up such an organization could cost several thousand dollars in lawyers' or accountants' fees. The US "Friends of…" organization will need to hold an annual board meeting and submit annual tax forms to the U.S. Internal Revenue Service. Dutch tax law has similar provisions.

Place of Incorporation

The DCNA will be legally established as a charitable foundation under the laws of the Netherlands Antilles. It was selected from among the five islands to be the legal domicile of the DCNA in order to create a greater sense of 'ownership' and involvement by the people from the three windward islands of St. Maarten, Saba and Statia, who often feel that they are too distant from the main center of national government and commerce in the relatively bigger and much more populous island of Curacao.

Sense of local ownership

Even before the idea of establishing the Trust Fund within the DCNA was discussed, the Consultants had concluded that the Trust Fund should probably be established in the Netherlands Antilles, in order to maximize a sense of "local ownership". This is particularly true since the trust fund is being created in order to financially support certain types of local land management that will have a direct or indirect impact on other local stakeholders, e.g., on people who might otherwise wish to develop or exploit the protected areas and their resources.

Even if it might be more advantageous from a tax perspective to legally incorporate the Trust Fund in the Netherlands or in the U.S., this might cause certain people to think that their country's publicly-owned protected areas are being somehow "controlled" by a distant, foreign entity, even if 90% or 100% of that legal entity's board members are citizens of the Netherlands Antilles. This kind of potential misunderstanding might be deliberately encouraged by unscrupulous politicians or business people who wish to "develop" or otherwise weaken the conservation management of the protected areas.

Location of investments

The issue of choosing the location in which to legally establish a trust fund is quite distinct from the issue of where to invest the money that is contributed to the Trust Fund by donors. A trust fund or foundation that is legally established in the Netherlands Antilles could decide to hire a bank or other asset manager in the U.S., the Netherlands, or anywhere else, and instruct the asset manager to invest the trust fund's endowment in various different parts of the world.

8 Administration and staffing

Executive management

The DCNA's Executive Director and the DCNA's financial officer (whenever one is hired) should prepare and submit to the DCNA's Board:

- Regular financial reports and technical reports to the Board on all grants made by the DCNA using the resources of the Trust Fund. These reports should be based on monitoring and evaluation of all such grants, which should be carried out either by the DCNA's Executive Director, other DCNA staff, or outside consultants hired specifically for this purpose.
- An annual work plan and budget for the coming year, including a list of proposed grants and allocations from the core endowment and the separate sub-accounts, which the Board should carefully review and discuss at its annual meeting, and then either approve or modify.
- A strategy for fund raising for the Trust Fund over the coming years.

Managing administrative costs

Most conservation funds have had administrative costs in the 10% to 20% range. In general, the smaller the size of the endowment, the more difficult it has been to stay within administrative cost ceilings. Furthermore, trust funds with relatively straightforward criteria for the allocation of grants (e.g. to pay the recurrent costs of protected areas), or with a more narrowly defined range of eligible recipients/activities, will incur lower management costs than those conducting more open, competitive grants programs over a broader range of potential activities. Thus, developing a well-focused grant-making program is important as a means for managing costs as well as for maximizing conservation impact.

Start-up costs

Administrative costs generally constitute a much higher percentage of total revenues in the first year or two after a conservation trust fund is first established, because of "start-up costs" that include many one-time expenditures. Some international donor agencies that are prohibited by their own regulations from contributing to endowment funds may nevertheless be able to make institutional capacity-building grants that will support a conservation trust fund's first one to five years of administrative costs. Sometimes they may also pay for the trust fund's first one to five years of grant-making.

Ceiling on administrative costs

The DCNA's Articles of Incorporation impose a 20% ceiling on administrative and operating expenses of the Trust Fund, although the actual percentage (if the Trust Fund's core endowment reaches its target size) will only be around half that amount. This could refer to the following costs:

- a proportionate share of the salaries and benefits of all DCNA staff involved with working on the Trust Fund;
- Trust Fund-related domestic and international air travel for the Executive Director;
- a proportionate share of the costs of renting office space and of the purchase or lease of office equipment;
- telephone, fax, postage and publications expenses;
- the short-term hiring of outside consultants such as lawyers, accountants and information technology specialists for Trust Fund-related tasks.

Obviously these costs would vary depending on the number and complexity of sub-accounts and the size of the DCNA's staff. A more precise estimate of administrative costs could be done once certain basic parameters of the Trust Fund have been further determined. The Trust Fund can use DCNA's staff and office facilities, and each year the Finance Committee can consult with the DCNA's staff to determine what percentage of the DCNA's staff and overhead costs should be considered as the Trust Fund's administrative expenses.

Operations manual

The Trust Fund's day to day administration will be governed by its Operations Manual, which will set forth procedures for things such as calls for proposals, proposal review, and project selection; disbursement procedures; requirements for financial and technical reporting by grantees; procedures for supervision and monitoring. The Operational Manual should be made publicly available, in order to promote full transparency.

9 Asset management

Who manages the assets

The Trust Fund's capital should be invested by independent professional asset managers, rather than by the DCNA's Board or by a Trust Fund Finance Committee, which could lead to conflicts of interest. The role of the DCNA Board (and/or Finance Committee) with respect to investing the Trust Fund's assets is to:

(1) establish general investment policies and guidelines.
(2) appoint an asset manager whose responsibility is to implement these policies and guidelines.
(3) monitor the asset manager's performance in relation to agreed benchmarks and targets, and replace any asset manager that consistently fails to reach them.

The Board's and the Finance Committee's roles should never be to pick and choose individual stocks or other investments, since this could result in what might appear to be conflicts of interest (e.g., if a member of the Board or the Finance Committee recommends that the Trust Fund should invest in a company in which the member has a personal financial interest).

The criteria for choosing a financial institution to serve as the Trust Fund's asset manager are based on:

- skill and past performance relative to other asset managers.
- research capacity.
- ability to give customized service to the trust fund and its fees for providing such service.
- ability to invest globally (especially now that the US dollar is likely to continue to decrease in value over a long period because of US budget and trade deficits).

Location of asset manager

In no case should more than half of the Trust Fund's assets be invested in a single country, whether that be the Netherlands Antilles, the Netherlands, or the US. An asset manager that is based in any of those three countries is not thereby limited to only being able to invest in those countries, but can (and should) invest globally. From a legal and a tax perspective, it makes no difference whether the Trust Fund's assets are invested by an asset manager located in the U.S., in the Netherlands or in the Netherlands Antilles, since none of these countries impose any taxes on the interest and profits that a charitable organization earns each year on its passive investments. Therefore, even though the DCNA is a Netherlands Antilles foundation, it is not limited in its choice of assets managers to those located in the Netherlands Antilles, but could also select one in the Netherlands, the U.S., or other places such as London.

Asset manager performance

Overseeing the investment practices and performance of an asset manager (i.e., the financial institution or firm that has been hired to invest the trust fund's capital endowment) is a crucial responsibility of the Board members of a conservation trust fund. An asset manager's practices and performance have an immediate impact on the amount of money that will be available to carry out the trust fund's annual programs and activities, and also has a long-term impact on the size of the trust fund's capital. This can be even more important financially than the short-term investment returns.

Finance Committee oversight

Conservation Trust Fund Boards often decide to delegate a large part of their responsibility for overseeing and communicating with the asset manager to a Finance Committee, particularly if most of the other Board members lack expertise in managing investments. Such a Committee will be established by the Board of the DCNA. However, all decisions to hire or change asset managers, or to adopt or modify investment policies and guidelines, should be approved by the full Board, except in urgent cases, when only the Executive Committee's approval should be required. The DCNA Board should adopt all of these same principles in relation to the Trust Fund. All requests to the asset manager to withdraw money from the Trust Fund's accounts should require the signatures of both DCNA's Chairman of the Board and its Executive Director.

Fiduciary standards

When donors are deciding whether to contribute to a trust fund, they usually wish to know whether the trust fund's Board has satisfied international fiduciary standards in terms of the trust fund's investment guidelines, professional investment consulting services utilized, asset allocation and diversification practices and the methods used for the contracting, oversight and review of investment managers.

The American Law Institute redefined traditional "prudent investor rule" in 1992, in ways that allow trustees and directors to do a more efficient job of managing their investment responsibilities. The main rules are:

- Investments should be judged based on the total portfolio.

- No asset classes are flatly forbidden.
- Risk is to be managed, not avoided.
- Delegation is clearly authorized.

Asset management guidelines

These rules require a diversification of investment portfolios to achieve an optimal trade-off between risk and return. In case of the Netherlands Antilles Protected Areas Trust Fund, an asset manager should invest the assets in a highly diversified mix of categories based on "Modern Portfolio Theory". This usually involves investing in a variety of different mutual funds which are each the most consistently top-performing in their respective category (such as funds specializing in Japanese large company stocks, European government bonds, US real estate investment trusts, etc.). Annex 1 provides more details on guiding principles for asset management based on this approach.

Diversified management

In addition to combining different asset classes in a portfolio, another way of minimizing risk while maximizing returns in order to achieve long-term consistency of results, is to also select different asset managers for different classes of assets. By investing a trust fund's portfolio in a combination of different funds that are each managed by the top-rated fund managers for each different class of assets in the portfolio, it should be possible for the trust fund's portfolio to achieve higher and more consistent returns than if its portfolio is only managed by one or two investment managers.

Responsible investment

The investment portfolio should be invested directly with asset managers of socially or environmentally screened funds (i.e., Smith Barney's LCG, and the LGA S&P 500 Eco-index fund). Such funds only invest in the stocks or bonds of companies that are considered to have demonstrated a positive social or environmental record relative to other companies in the same industry.

Separate accounts

For accounting and record-keeping purposes, the DCNA should keep the Trust Fund's assets in distinct accounts –one for the core endowment and one for each sub-account- that are separate from the DCNA's other accounts, such as a bank account that is used for day-to-day expenditures, or an account that the DCNA uses for depositing grants that it receives from donors for short-term projects. This is because the whole purpose of establishing a trust fund is to provide relatively secure and reliable sources of long-term funding for protected areas.

Pooled investment

The asset manager should pool all of the Trust Fund's endowment and sinking fund capital, i.e. manage the assets in a single restricted account of the DCNA, unless Grant Agreements with particular donors require otherwise. The annual investment income should then be allocated between the core endowment and the different sub-accounts in proportion to their respective shares of the total capital being invested. In the case of sub-accounts which are sinking funds, the DCNA's Board would also draw down and disburse a portion of the capital remaining in that particular sub-account, in addition to allocating to each sub-account its respective share of the income earned by investing the entire pooled capital of the Trust Fund during that year. The restricted purposes for which a particular sub-account can be used would be set forth in a Grant Agreement between the DCNA and the donor, provided that these particular criteria are consistent with the DCNA's general purposes as set forth in its Articles of Incorporation.

10 Lessons learned from other Trust Funds in the Caribbean

The following section has been included in response to a request made by several participants at the Inception Workshop held on Curaçao in February 2004, and is largely based on several published studies.

10.1 Key factors in fund operations

Some key success factors for Trust Fund operations, rather than for their establishment, are presented here as identified in an evaluation by the GEF secretariat published in 1998 (GEF, 1998).

Factors important for successful Trust Fund operations

- Clear and measurable goals and objectives; a "learning organization" mentality and environment, flexibility to make adjustments in objectives or approach based on feedback and experience.
- A governance structure with appropriate checks and balances, conflcit of interest provisions and succession procedures. "Ownership" of the fund by its governing bodies, indicated by members' commitment of time, engagement in policy and building support of the fund with varied constituencies.
- Linkage between the trust fund and the leadership of a national biodiversity strategy or environmental action plan.
- Ability to attract dedicated competent staff, and a strong Executive Director. Harmonious and productive board-staff relationships.
- Basic technical capacity that permits the fund to become a respected and independent actor in the community.
- Constructive relationships with relevant government agencies and key existing non-governmental organizations (such as socio-economic development NGOs).
- Financial/administrative discipline, transparency and consistency.
- Mechanisms for continuing to involve a wide variety of stakeholders in the fund's programs and direction.
- Asset management competitively selected; diversified portfolio of investments; financial experts to provide regular reporting and comparison to benchmarks.

10.2 Mexico

Defining rules and roles

A recent study of the very successful Mexican Nature Conservation Fund (FMCN) concluded that “defining the roles and functions of each participating institution is the most frequent source of problems” [for conservation trust funds]. Given the fact that many, if not most, partnerships between organizations eventually fail due to lack of an organizational structure, considerable effort should be directed at defining the rules within partnerships.” One of the lessons to be learned from the experience of the Mexican fund is that it is better to work out these arrangements in advance.

Another recent case study of the FMCN quoted a personal communication from the Executive Director of the fund since its inception about things that, in looking back 10 years later, he would have done differently:

Lessons learned in the Mexican Trust Fund

A) Consider more carefully whether the benefits provided by asset managers outweigh the costs. The selection of FMCN's three asset managers took a large amount of time and money, and these managers were initially given discretionary power to decide on the best financial strategy for the fund, following the investment guidelines of the fund's major donors, such as USAID and the World Bank/GEF. In hindsight, FMCN’s Executive Director does not feel that the results garnered by the managers from 1996 to 2000, were worth their cost (a total of approximately US$250.000 – 300.000 per year). The fund has since altered its relationship with its asset managers so that they do not have the power to decide what and when to buy. They now make transactions only at the direction of the fund, which, in turn, is guided by its Board Finance Committee and its independent financial advisor, based in Mexico.

B) Make sure that the fund's income from its investment strategy covers the fixed costs of the fund. FMCN has just recently adjusted its portfolio so that the fixed income portion of investments provides the money necessary to cover the budgets of its conservation programs, which should not be subjected to short-term risk and potential shortfall. The variable income portion (15-20% in equities) produces resources over the long term to maintain the real value of the endowment.

C) Work from the beginning to raise non-earmarked endowment funds that are sufficient to cover the basic operative and administrative costs of the core staff of FMCN. In this way, accounting and cost-sharing between programs are easier and more money can be directed to field activities. Even though FMCN has been very successful in raising its endowment, all of the funds are earmarked for specific programs and there is not enough "general" money to cover overhead in an ample way that allows for a permanent capacity building process of the core staff.

D) Establish an internal communication strategy early on. When the staff of FMCN was only 4 -5 people, they did not feel that such a strategy was necessary. However, FMCN now has 24 employees and more than 10 donors and programs, so effective internal communication is vital. Something else that was not attended to from the start was the creation of a good staff evaluation and motivation mechanism (the lack thereof, however, has not hindered results due to the high level of staff commitment and capacity). Although it has taken more than a year to do so, the fund developed, through a participatory process, a system for performance evaluations (and concurrent bonuses) that was applied for the first time in December 2001.

E) Consider carefully the implications involved in how often the board of directors rotates. FMCN agreed, in response to requests by donors to ensure transparency and democratic transitions, that its board would change members every six years. However, in countries where there are not large numbers of qualified people to serve in such capacities, losing effective members takes its toll on the strategic capabilities of an organization. FMCN has made some adjustments to its Board Renewal Policy to work within these restrictions while still retaining the talent of its Board.

10.3 Belize

Revolving Trust Fund

Belize's Protected Area Conservation Trust (PACT) also provides certain lessons to be learned. The PACT was established by a special act of parliament, and is entirely financed by a US$3,75 "conservation fee" that all foreign tourists must pay (i.e., it is a revolving fund). The fee is collected at the airport from tourists who are departing Belize, and at ports from passengers arriving by cruise ship. The legislation establishing PACT stipulated that all of the revenues from these fees should go directly to the PACT rather than to the government treasury. PACT is legally independent of government, and its 7-member board of directors is composed of 3 representatives from different government ministries, and 4 non-governmental representatives, including one from the private-sector "Belize Tourism Industry Association". This has since been expanded to a 9-member Board that includes 4 members from Government and 5 members from outside of Government.

Use for projects

Government agencies and NGOs can apply for grants from PACT, but these grants can only be used for projects that support the conservation of Belize's protected areas (representing 48% of the country's total area). Some of Belize's protected areas are operated by NGOs (such as the Belize Audubon Society) under management contracts signed with government, which is very similar to the system in the Netherlands Antilles.

Strength and weakness

On the one hand, Belize deserves praise for being the first country to apply the "user pays" principle to ALL foreign tourists, by making them pay a fee for the conservation of the pristine natural environment (which is the main reason why tourists visit Belize), in contrast to merely making those tourists who visit a protected area pay an entry fee. On the other hand, PACT has not functioned as a mechanism for financing the recurrent costs of Belize's protected areas, because the legislation establishing PACT prohibits PACT from funding staff salaries or any other "core costs" of either government agencies or NGOs. PACT has therefore limited itself to awarding grants for one-time, non-recurrent activities, such as construction of trails and visitor centers, demarcation of protected area boundaries, and environmental education and awareness programs.

The original reason why the PACT legislation prohibited PACT from making any grants to cover the day-to-day operating costs of protected areas was in order to prevent PACT from simply becoming a replacement for already existing sources of government and private funding for protected areas, which would have resulted in a "zero sum game" for conservation. However, this limitation has made PACT's role in supporting conservation of the country's biodiversity rather marginal. Furthermore, PACT has let its administrative costs become much too high, consuming over 60% of its budget, because it has six full-time staff members and has purchased its own building to serve as its offices.

High administrative costs

The other major problem with the PACT is its extremely high administrative costs, which in fact are even larger than its total annual grants budget. This is mostly the result of having a very large permanent staff (13 people) in relation to the size of its annual budget (US $1 million). This is therefore something that should definitely be avoided by the proposed Dutch Caribbean Protected Areas Trust Fund.

10.4 Suriname

Asset management

Several other important lessons about the "best practices" for trust fund asset management can be learned from its experiences of the Suriname Conservation Foundation (SCF), which was established in 2001 with a capital of US $8 million that was contributed by the GEF and CI:

- a trust fund's board should solicit, evaluate and compare proposals from at least five asset management firms before selecting one through an open, transparent and well-documented process;
- a trust fund's board of directors needs to not only adopt asset management guidelines, but also needs to continually monitor and ensure that these are being consistently followed by the asset manager;
- a minimum of 3 to 5 five individuals---including members of a trust fund's Financial Committee, its Chairman of the Board, and its Executive Director---should receive monthly, quarterly and annual investment performance reports from the asset manager; they should carefully review these statements and be able to directly contact the asset manager in case of any questions;
- it is important to have a highly diversified portfolio of investments, and not allocate too large a percentage of the portfolio's assets to any particular asset class, to any particular currency or country, or to any particular fund manager.

11 Next Steps

The next steps that are required in order to operationalize the Trust Fund are:

1. Finalize DCNA's Articles of Incorporation and officially register DCNA as a Netherlands Antilles charitable foundation.

2. Hold meetings of the DCNA Board in order to:
   - conclude the selection process of Board members.
   - approve a set of Bylaws and an Operations Manual.
   - elect members of the Trust Fund Finance Committee.
   - hire an Executive Director.

3. Open a local bank account for the Trust Fund, and proceed to select an Asset Manager.

4. Start raising funds for the Trust Fund core or sub-accounts, in line with the proposed fundraising strategy (see Volume C) and sign specific grant agreements with each donor.

5. Prepare and approve a Workplan and Budget for the first year of the Trust Fund's operation.

6. Establish a "Friends of DCNA" organization at least in the U.S., in order to fundraise for the Trust Fund and enable U.S. donors in those countries to claim a tax deduction for their contributions.

References

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VOMIL/MINA, 2000. *Begroting en financieringsplan voor de beheerskosten van belangrijke natuurgebieden van de Nederlandse Antillen.* Willemstad, N.A.

www.pactbelize.org

www.conservationfinance.org
[Note: this particular website includes links to many general publications and case studies on conservation trust funds, many of which have been used as a basis for writing this study]

Annex 1 Guiding Principles for Asset Management

Modern Portfolio Theory ("MPT") is based on decades of research by economists into the relationship between risk and return. Its **basic guiding principle is "diversification"** --- not putting all of your eggs into one basket. Diversification of investment portfolios can best be achieved through asset allocation – the process of deciding what different classes of assets should be included in an investment portfolio, and what percentage of the portfolio should be allocated to each particular asset class. Asset classes are investments that share certain characteristics, such as large-capitalization stocks or long-term government bonds, or that are geographically focused on different markets, such as Japan or Latin America. **Different asset classes often move in different cycles and offset each other**, so that **combining them tends to reduce portfolio volatility**, which in turn tends to promote compound growth over time, leading to higher returns.

Even asset classes with lower returns and higher risk may improve portfolio performance, if their returns typically move in different directions or in different cycles compared to the returns generated by other asset classes that are included in the same portfolio. For example, stocks in emerging markets tend to follow very different cycles than stocks in large capitalization US growth stocks, and both of these tend to differ from the cycles of real estate investments, or the cycles of high-yield corporate bonds. By combining different asset classes, it is possible to create portfolios that deliver the best possible trade-off between risk and return for a particular investor.

This **requires complex mathematical calculations of expected asset performance**, based on an analysis of both past and predicted capital market trends. It **also requires knowing a particular investor's tolerance for risk and volatility, and the investor's hoped for rate of return over a specific period of time.** Investors who have a longer time horizon (for example, a younger individual investor who may not need to withdraw any money from his investment portfolio until some distant future event such as retirement) **may be willing to accept greater short-term risks and volatility in exchange for getting a larger return in the long run**. However, a conservation trust fund is more similar to an older individual investor who has to rely on the quarterly returns from his investment portfolio in order to pay his monthly rent and daily living expenses.

A trust fund's hoped for rate of return on investments, and its tolerance for risk and volatility should be defined in **asset management guidelines**, such as the following ones adopted by the Board of the Suriname Conservation Foundation:

1. "The primary investment objective of the Foundation is to attain **a total return** over the long term consisting of income and capital appreciation, net of investment expenses, **that is at least five percentage points greater than the rate of inflation** measured by the Consumer Price Index in the United States over a five-year period."

2. "The Investment Manager is expected to achieve these objectives within a range of portfolio **risk** that a prudent manager with professional skills in investment management would take in similar economic, financial, and market environments. As a general rule, the Board of Trustees is more concerned with the **consistency of the total return over an extended period of time** rather than the fluctuating returns that may occur over shorter interim periods."

Rather than hiring a single asset manager to invest all of the trust fund's assets, the best way to diversify risk and achieve the highest returns is to **hire a financial consulting firm that can evaluate and select the top-performing asset managers for each different class of assets, and then invest a percentage of the portfolio with each such asset manager.** For example, the top-rated managers of mutual funds that invest primarily in US real estate are not likely to be the same as the top-rated managers of mutual funds that invest primarily in high tech growth stocks or the top-rated managers of mutual funds that invest in European government bonds. The financial consulting firm should continually monitor each asset managers' performance, and replace those that have under-performed other managers of that particular asset class.