

## Forest Carbon Partnership Facility (FCPF)

### Carbon Fund Process: Note on the timing of World Bank preparation process, and Options for Decisions by Carbon Fund Participants to Proceed to Negotiating an Emission Reductions Payment Agreement (ERPA)

May, 2016

*This FMT Note is intended to facilitate decisions by the Carbon Fund Participants at the fourteenth meeting of the Carbon Fund in June 2016 (CF14) with regard to i) whether to proceed to negotiating an ERPA for the proposed ER Programs for Costa Rica and the Democratic Republic of Congo and ii) the extent of progress in World Bank due diligence required prior to a decision to proceed to negotiating an ERPA.*

#### 1. Introduction

Paragraph 15 of the latest Process Guidelines for the Carbon Fund (dated April 14, 2015 and available at <http://www.forestcarbonpartnership.org/sites/fcp/files/2015/April/CF12%202c.%20TAP%20option%20%20CF%20Process%20guidelines%20-%20clean.pdf>) state the following:

“The REDD Country Participant or its authorized entity presents its ER Program Document at a Carbon Fund Meeting. Based on the information available to date, which **may** include the FCPF Participants Committee’s endorsement of the country’s Readiness Package, the final ER Program Document, the TAP assessment of the final ER Program Document, **the World Bank’s due diligence**, and technical, financial and legal information (e.g., business model, progress made in assigning a national authority with the responsibility to approve ER Programs by issuing final Letters of Approval (LoAs), etc.), the CFPs of the respective Tranche(s) decide whether to proceed to negotiating an ERPA for the proposed ER Program.” (Highlights are not in the original document)

Slides 5 to 8 of the presentation at CF12 on the Carbon Fund process (available at <https://www.forestcarbonpartnership.org/sites/fcp/files/2015/April/CF12%202c%20%20%20ER-PD%20assessment%20process%20and%20TAP%20ToR%20-%20presentation%20rev1.pdf>) indicate that much of the World Bank’s due diligence would be completed by the time the final ER Program Document (ER-PD) is submitted to the Carbon Fund Meeting. To be more specific, the presentation indicates that the World Bank Decision Review and Appraisal would be completed prior to the Carbon Fund Meeting at which the ER Program Document is considered.

This note considers the process as outlined in the presentation above and recommends that the World Bank’s Country Director (CD) should have the discretion whether to complete the Decision Review and Appraisal prior or subsequent to the relevant Carbon Fund Meeting.

## 2. Background

There are 5 stages of the World Bank's normal project (or program) cycle which would lead to ERPA signing, as summarized below:

Identification  
Preparation  
Appraisal  
Negotiations  
Approval

During **Identification** the initial program concept is agreed. This entails creation of a Program Concept Note (PCN) and completion of the **Concept Review**. This stage comprises an initial assessment of the program to determine whether the World Bank should support it and identifies potential risks and safeguard issues, including identifying the potential environmental and social safeguards policies that could be triggered. At the Concept Review meeting, World Bank management, including the CD, approves proceeding with program preparation. This approval represents an initial authorization by the World Bank of its official engagement to explore the program concept presented at the meeting. The Concept Review will also present a timetable for program preparation and appraisal. The documentation available at this stage are a Program Concept Note (PCN), and a joint Program Information Document (PID) which discloses basic information about the operation to the general public, and Integrated Safeguards Data Sheet (ISDS), which: (a) identifies possible environmental and social safeguards policies triggered by the program, and (b) defines a schedule for preparation of safeguards plans or instruments. The joint PID and ISDS is made public after the Concept Review so these documents will normally be available at the time of the decision of the Carbon Fund Meeting to proceed to ERPA negotiation. However, the Concept Review meetings for Costa Rica and DRC are scheduled only shortly prior to the upcoming Carbon Fund Meeting so it is possible that the joint PID and ISDS will not have been approved by the time of the Carbon Fund Meeting. The PCN is not a public document.

During **Preparation** the government prepares the program with the World Bank's advice and support. During this stage the environmental and social impacts are assessed and mitigation measures are prepared (e.g. safeguards plans). An Appraisal Package, consisting of a Carbon Finance Assessment Memorandum (CFAM) or equivalent and an appraisal stage PID and ISDS are prepared for a **Decision Review meeting**. The ER-PD would be used as a basis for completion of the CFAM or equivalent. The CFAM or equivalent provides a comprehensive description of the program's rationale, components, financing, and implementation plan. It presents the technical assessment by the World Bank's Task Team of the program's suitability, its compliance with relevant World Bank policies, and critical risks and related mitigation measures. The Decision Review meeting authorizes the World Bank to proceed with appraisal (and negotiations in principle, if appropriate). The appraisal stage PID and ISDS are publicly disclosed. Draft safeguard documents would also normally be disclosed prior to appraisal.

During **Appraisal** the government and the World Bank review the adequacy of the program preparation, including a review of all aspects of the program relating to economic, technical, environmental, social,

institutional, and fiduciary aspects. On completion of appraisal the Task Team prepares a package of legal documents and confirms that appraisal has been conducted in accordance with the Decision Review meeting.

During the **Negotiations** stage, the government and the Bank negotiate draft legal agreements. In the case of the FCPF Carbon Fund, this is the stage where the ERPA terms are negotiated. Signing of the ERPA is the equivalent of the **Approval** and the beginning of **implementation**.

For normal World Bank projects, concept stage to completion of Appraisal usually takes 6-12 months. However, these ER Programs are complex and the first large-scale ER programs being developed so the time from concept stage to completion of Appraisal is likely to be longer than a normal Bank project. Although the Costa Rica and DRC programs are more developed than projects/programs normally are at concept stage, these two programs will have only completed the Concept Review meetings shortly prior to the Carbon Fund Meeting. For these programs World Bank due diligence has been ongoing during the program development. A planned timetable for each program preparation and appraisal should be available after the Concept Review.

For future programs it is envisaged that at the time of the relevant Carbon Fund Meeting the Concept Review Meeting will have been completed, at a minimum. Whilst it is likely that a Decision Review meeting (which provides authorization to proceed with appraisal) will not be completed prior to relevant Carbon Fund Meetings, it is envisaged that for future programs much of the due diligence work will be completed and that Decision Review meetings can follow shortly after the decision by Carbon Fund Participants to proceed to negotiating an ERPA.

### 3. Implications of the Different Models

If the process as outlined in the presentation from CF12 (available at <https://www.forestcarbonpartnership.org/sites/fcp/files/2015/April/CF12%202c%20%20%20ER-PD%20assessment%20process%20and%20TAP%20ToR%20-%20presentation%20rev1.pdf>) is followed, ie. the World Bank's Decision Review and Appraisal are completed prior to the relevant Carbon Fund Meeting, there is a risk to the World Bank and the country that the Carbon Fund Participants (CFPs) decide not to proceed with a program after a decision to commit from the World Bank and after completion of due diligence (including assessing safeguards plans and fully assessing and appraising the program), involving significant human and financial resources and commitment from both the World Bank and the country. A positive Decision Review meeting also makes expectations difficult to manage.

This situation could be avoided if the process outlined in the presentation is revised so that the World Bank is required to have only completed the Concept Review prior to the relevant Carbon Fund Meeting. Further due diligence could be completed prior to the relevant Carbon Fund Meeting (and is likely to be in future cases) and a Decision Review meeting could be planned for shortly after the decision by Carbon Fund Participants to proceed to negotiating an ERPA, but the extent of due diligence completed beyond the Concept Review meeting would be at the discretion of the Country Director.

If the CFPs select the program after the World Bank has completed the Concept Review, there is little, if any, downside. All stakeholders, including the CFPs and Observers, know that the World Bank will carry out its due diligence to its own standards before negotiating an ERPA, including an assessment of environment and social impacts and preparation of mitigation measures (e.g. safeguard plans). If the risks of the program are too high the World Bank will not proceed, which is presumably something the CFPs would wish to rely on the World Bank for. In other words, the end result will be the same – the World Bank will complete its due diligence before proceeding to the Negotiations stage, including with respect to the World Bank’s social and environmental safeguards. The only difference is that the World Bank and the REDD Country work together from Concept Review to Appraisal/Negotiations secure in the knowledge that the CFPs have given the go-ahead to proceed to negotiating an ERPA. There will be some uncertainty around the time it will take to complete World Bank due diligence but a timetable for program preparation and appraisal should be agreed at the Concept Review.

If the CFPs decide not to proceed with a program, the World Bank can drop it before the Decision Review meeting and before raising expectations to unacceptable levels.

It is likely that CDs will authorize the World Bank Task Team to proceed beyond the Concept Review stage prior to the CFPs decision to proceed at a Carbon Fund Meeting, with the possibility of completing the Decision Review and Appraisal prior to the relevant Carbon Fund Meeting. However, this is not the case for Costa Rica and the Democratic Republic of Congo (DRC), which are submitting ER-PDs at CF14, although due diligence has been ongoing during the program development. Nor would it be a requirement going forward. At the time of the relevant Carbon Fund Meeting, only the Concept Review stage must be completed. However, the World Bank CD may decide to proceed beyond Concept Review stage prior to the CFPs decision at the relevant Carbon Fund Meeting to proceed to negotiating an ERPA.

In either model the CFPs will still be represented in ERPA negotiations and will still need to approve the ERPA term sheet, including commercial terms such as price, ERPA term, and numbers of contract and option Emission Reductions, as well as the final ERPA itself.

Key areas of outstanding due diligence work at the time of the Carbon Fund Meeting can be identified at the meeting. Also, key issues on which the program may fail due diligence should be known by that time and can be identified at the meeting.

#### **4. Options for Decisions by Carbon Fund Participants**

If CFPs agree with the FMT recommendation that a CFP decision to select a program into its portfolio and authorize ERPA negotiations for an ER Program should only be sought after completion of the Concept Review stage by the World Bank, the FMT outlines below four options for the decisions by CFPs:

- i. Decide to select an ER Program into its portfolio and proceed to negotiating an ERPA subject to completion of World Bank due diligence and final World Bank approval of the program, provided that ERPA negotiations shall not start before World Bank management has appraised the ER Program.

- ii. Decide to provisionally select an ER Program into its portfolio and proceed to negotiating an ERPA subject to: completion of World Bank due diligence and final World Bank approval of the program, provided that ERPA negotiations shall not start before World Bank management has appraised the ER Program (as in (i) above), and other requirements, such as a list of key issues to be addressed, have been fulfilled to the satisfaction of the World Bank.
- iii. Request the REDD Country to resubmit a revised ER-PD with specific revisions or attention to certain areas
- iv. Decide not to select an ER Program into its portfolio and, therefore, not to proceed to negotiating an ERPA and do not request the country to resubmit (i.e. rejection)

Option iv above should only be valid if the proposed ER Program is substantially different from the selected ER-PIN or the selection has portfolio management implications eg in relation to net emission reductions across the portfolio. Other issues, such as non-compliance with the Methodological Framework, could be addressed through options ii or iii above. Even without completion of World Bank due diligence by the time of the relevant Carbon Fund Meeting, the World Bank and the REDD Country are still relatively heavily invested in the program, which poses a reputational risk for both the World Bank and the CFPs.

### **Recommendation**

The FMT recommends that the World Bank only submits ER-PDs to the CFPs for selection after completion of the Concept Review stage of the World Bank's normal project (or program). The decision to proceed beyond Concept Review stage prior to the decision by CFPs to proceed to negotiating an ERPA would be at the discretion of the World Bank's CD.