

Forest Carbon Partnership Facility (FCPF)

Working Group (WG) on the Methodological and Pricing Approach for the Carbon Fund of the FCPF

Summary of the third WG conference call on March 1, 2012

Chair:

Duncan Marsh (The Nature Conservancy)

Participants:

José Carlos Fernandez (Mexico); Resham Dangi (Nepal); John Goedschalk (Suriname); Peter Horne (Australia); Anja Bursche (Norway/Germany); Jeff Fiedler (The Nature Conservancy); Nicholas Soikan Meitiaki (Indigenous Peoples); Andrew Hedges (Private Sector); Joshua Lichtenstein, Chris Meyer, Joanna Durbin, Mark Roberts; Suzanne Bretkopf (Civil Society Organizations); Benoît Bosquet, Ken Andrasko, Marco van der Linden, Manelle Ait Sahlia, Peter Saile and Rajesh Koirala (FMT).

All background documents for this call are available at:

<http://www.forestcarbonpartnership.org/fcp/node/472>

Discussion Summary:

A. Chairing arrangements of the WG

The WG participants endorsed the selection of Duncan Marsh to chair the conference call.

Regarding the arrangements for the face-to-face meeting in Paraguay, it was proposed to have two co-chairs; one co-chair would be selected from the financial contributors and one from the REDD Country Participants. This proposal was accepted by the WG.

It was noted that up to five civil society individuals from Civil Society Organizations (CSOs) listened in on the last WG call and/or this call but were not identified. WG members and the FMT discussed whether it was appropriate to have multiple CSO representatives on the WG calls, and noted that Germany and Norway currently split a seat on the WG, and that the original intent was to keep the numbers in the WG low to allow in-depth discussion. The CSO representative requested the possibility to have several CSO colleagues be present in Paraguay to observe the WG meeting. No conclusion was reached on either point.

Follow-up:

- Members are invited to discuss the selection of the co-chairs among themselves and inform the FMT of their decision by **March 9, 2012**.
- Members are invited to provide feedback to the FMT, by **March 9, 2012**, on the possibility to have multiple CSO representatives be present in Paraguay to observe the meeting.

B. WG Process and Products

Discussion:

The FMT requested the WG members to provide feedback on the WG process to date and how the final product should be prepared for the PC meeting in June.

On the WG process to date, members expressed general satisfaction with the process and the quality of the Background Notes, which help bring the WG members on the same page relative to the discussion topics. It was however noted by a member that the Background Notes mainly draw on existing information and that it would be good to bring in more new information and expertise. This new information could be based on experiences in existing standards and initiatives.

On the preparation of the final product of the WG, members requested the FMT to prepare a first draft of the final product for discussion during the meeting in Paraguay, based on the Background Notes and the summaries of the previous conference calls. This draft should contain draft definitions of the proposed principles for the methodological framework and draft guidance for the pricing approach. In addition it should reflect the WG discussions to date, in particular the rationale followed by the WG in arriving at its recommendations. The draft principles and guidance should be relatively concise and where diverging opinions have been expressed in the WG, the draft should provide different options.

Follow-up:

- All WG Members are invited to provide written feedback to the FMT on the principles for the methodological framework and guidance on pricing. Feedback can include, but is not limited to, choice of principles, the topics that should be included in the guidance on pricing, and suggested text for the definitions of both the principles and the guidance. Feedback should be provided to the FMT by **Monday March 12, 2012** (members are encouraged to provide their comments earlier).
- The FMT will prepare a first draft of the final product and circulate this to members by **March 16, 2012**.

C. Use of non-carbon values in existing carbon funds managed by the World Bank

Discussion:

In the context of the discussion on non-carbon values, some members expressed concerns about the summary of the second call of the WG, which suggested that a Technical Advisory Panel (TAP) would be appointed by the Carbon Fund in order to:

- Synthesize the different approaches developed to date to assess and price the non-carbon values associated with REDD+ activities; and
- Help identify options for consideration by the Carbon Fund on how to build an assessment framework for non-carbon values that would also be reflected in the price.

The concerns included a lack of clarity as to whom the TAP would be reporting to, and a concern that the TAP would be pre-empting recommendations by the WG and decisions by the PC on the accounting of non-carbon values.

The FMT clarified that any TAP would officially be established by the Carbon Fund or the FMT, but that the TAP output could feed into the discussion of the WG if it is produced in time to meet the WG's needs. The output of the TAP could help the WG to prepare a recommendation on how non-carbon

values could be considered in principles for the methodological framework and if and how this should be reflected in the price. WG members asked that the CF Participants review and approve the TOR of any TAP established on behalf of the CF.

The FMT briefly presented Background Note #4 which provides examples of Non-Carbon Values as Price Determinants in the World Bank's Carbon Finance Business. It was noted by members that the approach used by the Community Development Carbon Fund (CDCF) might not be applicable for the FCPF Carbon Fund because of the difference in scale. The larger scale of the Programs in the Carbon Fund would significantly complicate both the development of Community Benefit Plans and the monitoring of their implementation.

Some members also stressed the multiple functions and benefits that forests provide and the importance of recognizing these benefits in the methodological framework.

Follow-up:

- All WG Members, but in particular Soikan and Resham, are invited to provide ideas on the type of benefits that should be addressed in the Methodological Framework and how these could be monitored by **March 9, 2012**.

D. Policy guidance on pricing methodologies

Discussion:

Based on Background Note #6, the WG members discussed options for valuing Emission Reductions, specifically:

- Sources of valuation in the context of the Carbon Fund; and
- Pricing formulae for the Carbon Fund.

Sources of valuation in the context of the Carbon Fund

The WG discussed the different options for valuing ERs and their pros and cons, based on table 1 of the background note.

It was noted that option 4 (indexation) does not seem feasible for the Carbon Fund and can probably be dismissed.

Some members expressed concerns about the feasibility of auctions (option 5) at this stage although some other members wanted to keep this option open to inform option 1 (willingness to pay/receive) for a later stage or when other options don't lead to a clear price signal.

One member highlighted the role of implementation costs as a price determinant. Other members thought that implementation costs could be reflected in the design for the ER Program and its documentation and considered during ERPA negotiation. In that context, the FMT highlighted a manual on opportunity costs that has been developed by the FMT and the World Bank Institute that can inform the design of ER Programs (see <http://wbi.worldbank.org/wbi/learning-product/estimating-opportunity-costs-redd>).

Several members expressed a preference for option 1 (willingness to pay/sell) as the primary price discovery mechanism for the Carbon Fund. However it was stressed that this option is only feasible if

both parties in an ERPA negotiation have as much information as possible. Therefore option 2 (market surveys) and option 3 (transaction benchmarks) could be considered to inform this option, and potentially auctions as well (option 5). Option 4 was not considered feasible, and some members suggested it should accordingly be deleted.

A pricing formula for the Carbon Fund

The WG discussed the different options for establishing a price formula for ER Programs and their pros and cons, based on table 2 of the background note.

Members indicated that option 2 (purely floating prices) might not be appropriate in the context of the Partnership since this might be risky for both the Carbon Fund Participants and the REDD Country Participants.

Most members expressed a preference for either option 3 (Combination of fixed and floating price) and/or option 4 (Fixed pricing during the first years of the ERPA, and combination of fixed and variable thereafter), since either would create incentives for the Programs to improve and provide learning value. However it was noted that the lifetime of the ERPAs under the Carbon Fund (up to 2020) is relatively short. For that reason, some members would still like to consider option 1 (Purely fixed price) in order to keep the transactions relatively simple.

One member stressed the risk of fixed prices for early movers, especially if these prices are low. This is not only a risk for the entity implementing the program but also creates a 'reputational' risk if local communities feel they have received a bad deal. The design and pricing approach in the Carbon Fund pricing formula should therefore allow for learning and provide flexibility. In response, another member noted that there are existing pricing models that help to ensure a fair balance between buyers and sellers. Another member urged that protracted debate on a pricing approach should be avoided so as not to create a barrier to quick progress on ER Programs, and emphasized the value of learning in the Carbon Fund.

Follow-up:

- WG members are invited to provide further inputs on and examples of payment models that can ensure a fair balance between buyers and sellers and allow for flexibility by **March 9, 2012**.

D. Methodological Framework: Programmatic Elements

Some members expressed concern about Background Note #5 on ER Programmatic Elements for the Methodological Framework of the Carbon Fund of the FCPF, specifically on principle 3 in table 2. Here it was stressed that there should be a broad assessment of safeguards as identified in the UNFCCC texts, including those that go beyond the World Bank safeguards.

Members expressed the need to have social and environmental benefits be part of the design of ER Programs. In this regard members referred to existing frameworks like the REDD+ Social & Environmental Standards initiative and the possibility of adopting those for the Carbon Fund. However, concerns were also raised about the costs of monitoring/assessing these benefits and the role of financial incentives for REDD countries to help them make a balanced decision on how social and

environmental benefits would be integrated in the ER Program design. Others noted that addressing social and environmental benefits in ER Programs and in the Methodological Framework is the flip side of safeguards; and that consideration of co-benefits could be addressed through an ER Programmatic Element on this topic rather than through the pricing approach.

Further discussion on this topic was postponed because of time constraints and it was decided to have an additional conference call to discuss this topic.

D. Next steps

- ❖ The FMT prepared this summary report of the third call. It will also be posted on the FCPF web site under: <http://www.forestcarbonpartnership.org/fcp/node/472> on the Methodological and Pricing Approach for the Carbon Fund of the FCPF.
- ❖ To be able to continue the discussion on the ER Programmatic Elements in the Methodological Framework and prepare for the meeting in Paraguay, an additional conference call is scheduled for March 12, 2012. The FMT will check availability of the WG members for that date. The existing Background Notes would be used for this call and no new notes will be prepared.
- ❖ The FMT was tasked with drafting short-version carbon accounting and programmatic principles, and pricing guidance, for consideration by the WG as a way to move forward quickly.
- ❖ WG members were encouraged to contribute any draft text on principles, or ideas they sought to be reflected in them, by Monday, March 12 to the FMT to help inform its rough drafting of principles for circulation by March 16 for the WG's consideration.