Forest Carbon Partnership Facility (FCPF)

Decision on Extension of the Term of the Carbon Fund of the FCPF beyond 2020

April, 2015

This FMT Note is intended to facilitate a decision by the Carbon Fund Participants at the twelfth meeting of the Carbon Fund in April 2015 (CF12) to extend the term of the Carbon Fund beyond December 31, 2020.

1. The Current Term

Under the Charter of the FCPF both the Readiness Fund and the Carbon Fund are scheduled to terminate on December 31, 2020 (Section 22.1). The term of the Carbon Fund can be extended by unanimous consent of the Carbon Fund Participants (CFPs) (Section 23.2 (b)). The term of the Readiness Fund can be extended by unanimous consent of the REDD Country Participants and the Donor Participants (section 23.2 (a)). This is provided, in both cases, that the Trustee will continue to serve as trustee of the respective fund and that the Board of Directors of the World Bank expressly agrees to such an extension.

2. Implications of the Current Term and Possible Extension of the Carbon Fund

11 ER Program Idea Notes (ER-PINs) have been selected into the pipeline of the Carbon Fund, the latest in October 2014. They are Chile, Costa Rica, Democratic Republic of Congo, Ghana, Guatemala, Indonesia (provisional), Mexico, Nepal, Peru, Republic of Congo and Vietnam. Following the presentation of nine Early Program Ideas at the Carbon Fund meeting in April 2015 (CF12), several ER-PINs are expected to be presented at CF13 in the autumn of 2015, making a possible total pipeline of 20 or more programs.

Most of these 11 countries in the pipeline have entered into or are currently in the process of entering into Letters of Intent (LoIs). Before any negotiations on a potential future Emission Reductions Payment Agreement (ERPA) can start, such countries need to first develop their ER Program, present a corresponding ER Program Document (ER-PD) to the Carbon Fund and have their ER-PD selected by CFPs into the Carbon Fund program portfolio. In addition, under the Readiness Fund process and prior to a formal ER-PD submission to the Carbon Fund for its decision, these countries are required to prepare their Readiness Package and have such Readiness Package endorsed by the Participants Committee (PC).

The indications are that the first Readiness Packages will be submitted to the PC for endorsement in autumn 2015, with others following in FY16. First ER-PD submissions to the Carbon Fund for its decision are expected to follow in FY16. In addition, under the Methodological Framework advanced drafts of the Benefit Sharing Plan, the Reversal Management Mechanism and the Safeguards Plans will be required prior to ERPA signature.

The LoIs include an Exclusivity Period of up to 24 months during which the countries have to develop an ER-PD, have the PC endorse their Readiness Package, have CFPs select their ER-PDs into the Carbon Fund's program portfolio and negotiate an ERPA. Regarding ERPA negotiations, the LoI provides for a minimum ERPA Negotiation Period of 10 months. If the original Exclusivity Period is not sufficient to allow for such a minimum ERPA Negotiation Period, the Exclusivity Period would be automatically extended accordingly.

The pipeline of the Carbon Fund is currently being built under the assumption that the Carbon Fund terminates on December 31, 2020. This has a number of implications:

i) estimated ER potentials are currently based on a 2016-2020 ER generation period;
ii) depending on the verification process that is developed, the effective ERPA period may end in late 2019 or early 2020, to allow time for verification, transfer and payments by December 31, 2020;
iii) estimated ERPA terms and ER generation periods are short and may become even shorter in case of delays in ER Program preparation;
iv) short ER generation periods and ERPA terms result in lower ER volumes that can be generated under each ER Program and sold to the Carbon Fund and may lead to an under-commitment of available Carbon Fund resources;
v) to fill the pipeline of the Carbon Fund it has been necessary to select more ER-PINs with smaller volumes than originally anticipated; this over-programming can lead to unrealistic REDD country expectations;
vi) multiple verification events are difficult during a short ERPA term which may reduce confidence in ER volume estimates.

An ERPA term ends at the earlier of either the date of final transfer and payment for ERs or a stated final termination date as specified in the ERPA. It is normal practice under World Bank Carbon Funds for the final ERPA Reporting Period (during which ERs are generated) to end a year prior to that stated final termination date to allow for final verification, transfer and payment. Assuming a relatively optimistic ERPA signing date for the current pipeline of say December 2016 and a total of five years of ERPA Reporting Periods, the ERPA term would end in December 2022. For any additional programs selected into the pipeline in October/November 2015, the ERPA term is not likely to end until December 2023. The joint statement at the UN Climate Summit in September 2014 by Germany, Norway and the UK to fund up to 20 large scale REDD+ emission reductions programs, for programs proposed by 2016, could possibly mean later inclusions in the pipeline, although this is not yet clear.

In order to provide REDD Countries adequate planning horizons for ER Program development, at CF11 in October 2014 most CFPs agreed on the importance of a decision on the extension of the Carbon Fund at this Carbon Fund meeting (CF12).

ER-PD development is expected to take time and the current timeframe for ER Program implementation is challenging. The timeframe outlined above allows for no delays in implementation of the Program itself and thus generation of ERs, verification, delays over safeguards or ER title issues etc. The experience of the World Bank in managing 14 Carbon Funds over a period of 14 years is that delays are common, almost inevitable, especially in the more innovative funds like the FCPF, and that longer fund terms provide greater flexibility for buyers and sellers.

To allow for slippage in the implementation of these existing large programs and to provide greater flexibility for fund management in terms of delivery, the FMT recommends that CFPs agree to extend the term of the Carbon Fund to December 2025.

If there are delays, assuming the Carbon Fund term is extended beyond 2020, the ERPA terms could be more easily extended to take into account the delays, if agreed by CFPs. For the CFPs, a portfolio with potentially longer ERPA terms and ER generation periods reduces delivery risk. Extending the term of the Carbon Fund will also allow for clarity on a future REDD+ mechanism and future sources of funding for REDD countries. There would also be greater lessons learned regarding reversals, buffers, benefit sharing mechanisms and safeguards management in this longer timeframe.

ERPAs can initially be signed for 6-year terms (with a total of 5 years of Reporting Periods plus a year for final payment). If all goes well and the contracted ER amounts are generated, transferred and paid for as anticipated and contracted for, the ERPAs will terminate on time. If this happens across the Carbon Fund program portfolio then the Carbon Fund can be terminated early (assuming an extension to 2025 has been approved).

Given the delays experienced in other innovative Carbon Funds managed by the World Bank, and the technical, financial and political challenges in rolling-out such large-scale programs, it could be necessary to take a further decision at a later date to extend the term of the Carbon Fund beyond 2025, especially if the pipeline is opened beyond the autumn of 2015. Further extension of the Carbon Fund term at a later date will require the same unanimous consent of all the CFPs required at this time and could be more complicated at that time, with a lot of unknowns.

One risk of an extension of the term of the Carbon Fund is that REDD countries reduce their efforts to move quickly through the REDD process. One way to encourage progress would be to impose interim deadlines for reaching certain milestones in the ER Program business process. Such deadlines could be the trigger to drop a program from the pipeline or to change focus and prioritize other programs.

On the other hand, an extension of the Carbon Fund could have the opposite effect, encouraging programs to progress more quickly because they can see larger potential benefits if longer ERPA terms were available for early movers; indeed an extension and a guaranteed 5-year ERPA term, or longer, could provide the necessary incentives to increase the current level of effort and investment in the process. Including options in ERPAs, and an early indication of the real possibility of options, could also act as an incentive for earlier implementation. Given the up-front investment by REDD countries into the process, often with little in the way of guarantees, REDD countries would likely welcome these possibilities.

3. Estimated Costs

In terms of costs, if the Carbon Fund is extended, but not the Readiness Fund, administration costs are estimated at approximately $0.6 million per year. If both funds are extended the Shared Costs that would be charged to the Carbon Fund are estimated at approximately $0.6 million per year, so total costs would amount to approximately $1.2 million for each year of extension.

The approximate costs associated with the development and supervision of each additional ER Program from early ideas right through to the end of an ERPA term (after full delivery of all ERs) are currently estimated at around $1.7 million.

4. Possible Reasons for Delays

i) Program Development

Actual program development with complex technical and financial challenges, as well as achieving political agreement across a number of different government ministries and with local communities can be a lengthy process in itself.

ii) Readiness Package

Submission of a Readiness Package to the PC for endorsement prior to submitting the ER Program Document (ER-PD) to the CF entails a large effort, partly consisting of a multi-stakeholder self-assessment. It is expected that a country would have prepared a national REDD+ strategy, designed a Reference Emissions Level/Reference Level (REL/RL) and a Measurement, Reporting and Verification (MRV) system, prepared an Environmental and Social Management Framework (ESMF) and established a Feedback and Grievance Redress Mechanism (GRM) as well as be able to assess progress on all nine subcomponents and the 34 corresponding assessment criteria in the Readiness Package Assessment Framework. Delays in any of these processes, especially the multi-stakeholder self-assessment, are possible.

iii) Negotiating an ERPA

One factor determining speed of ERPA negotiation is the level of dissemination of knowledge regarding the program amongst different government ministries and lawyers. Legal negotiations, especially those with large financial implications, can be completed quickly or can lead to significant delays. Experience in other World Bank Carbon Funds, especially innovative funds with no compliance market, has shown that differences between buyer and seller over price, quantities, options (call or put) can take time to resolve. There is a potentially additional complicating factor, over and above other World Bank Carbon Funds, with the possible use of emission reductions for compliance with domestic commitments, which could take time to resolve.

iv) Program Implementation

The World Bank Carbon Funds (with almost 200 signed ERPAs) have had many experiences of delayed starts to implementation, ranging from a couple of months to several years, with projects/programs occasionally never moving into implementation. The right incentives need to be in place to ensure implementation on time. In addition, implementation can be temporarily or permanently halted for a variety of reasons, including political (e.g. coups, changes in government), conflict and security issues, and social safeguards issues.

v) Verification against Methodological Framework and ER-PD, including ER Title

The World Bank has much experience of verifications, especially against Clean Development Mechanism (CDM) methodologies, having experience of more than 350 verifications across a range of different projects. Although many go smoothly, particularly where verifications of the same project or similar project types have been carried out previously, some verifications can involve repeated site visits, requests for further data, corrections etc. It is likely that the early verifications in the FCPF Carbon Fund take time to finalize, since the whole process of MRV in REDD+ will be new to the programs themselves, the World Bank and the independent reviewers.

vi) Safeguards delays, grievance redress, Inspection Panel

There is also the possibility that safeguards issues can delay a program at any stage. In the design stage World Bank Safeguards Specialists may require additional safeguards prior to proceeding with implementation. Lack of adequate safeguards could also lead to lack of endorsement of a Readiness Package by the PC. Serious grievance redress issues or Inspection Panel requests can also delay implementation.

5. Staffing Capacity

There is no relation between these possible reasons for delays and FMT or World Bank Global Practice capacity. In fact, Senior Management within the World Bank have recently approved 7 new positions within the FMT, five of which are related specifically to Carbon Fund program development, to ensure the FMT has the staff capacity to deliver on the current pipeline of programs. Senior Management is also currently considering a 3-year strategic staffing plan covering both the FMT and the Environment and Natural Resources Global Practice which will ensure they have the staff capacity to deliver both on the current pipeline of programs and on a possible increased pipeline of programs.

6. Funding of the increased program

Current Situation

The CF has total commitments of approximately $450 million. Assuming 9 programs enter into the portfolio of the fund, total costs of the fund over its current lifetime (to December 2020) are estimated at $32 million, leaving around $420 million for purchase of emission reductions. If the current pipeline of 11 programs are all developed into programs, enter the portfolio of the CF and deliver emission reductions according to the ER-PINs, assuming a price of $5 per ton, the estimated capital requirement is between approximately $467 million and $701 million, depending on assumptions around the reversal buffer. If the reversal buffer is 40% across the portfolio, the estimated capital requirement is $467 million, if 25% $584 million, and if 10% $701 million. See table below.

Portfolio Simulation (Oct 2014)			
Reversal Buffer	40%	25%	10%
Aggregate ER Payments (11 ER programs)	$467m	$584m	$701m

There are many estimates and assumptions involved in producing these figures and in some cases program numbers are in a state of flux. However, this is the best information available at present.

Expanding the Pipeline

The joint statement from the governments of Germany, Norway and the United Kingdom at the UN Climate Summit indicated a willingness to fund through a range of funding mechanisms up to 20 new, results-based, large-scale, REDD+ emission reduction programmes proposed by 2016. These need to be credible, robust proposals. Since then these governments have indicated that they support an extension of the CF, including opening a second pipeline, so that there is no “gap” in funding performance-based emission reduction programmes until such point as the Green Climate Fund is operationalized.

The FMT has written to REDD Countries in the FCPF encouraging them to prepare Early Ideas for the April CF meeting in Paris and submit ER-PINs for inclusion in the pipeline for the October/November 2015 CF meeting. The FMT currently estimates that around 10 ER-PINs could be submitted in the autumn.

7. Green Climate Fund (GCF)

The Green Climate Fund (GCF) was established at COP16 and officially launched in COP17. It is designated as the operating entity of the financial mechanism established under Article 11 of the UNFCCC. The Board, composed of an equal number of developed and developing country Parties, has full responsibility for funding decisions, and the World Bank serves as interim trustee. The GCF will finance activities that enhance action on adaptation and mitigation. A results-based approach will be an important criterion for allocating resources from the fund. Results-based financing approaches are likely to include, in particular for incentivizing mitigation actions, payment for verified results, where appropriate. In addition, in October 2014 the GCF Board adopted an “Initial Logic Model and Performance Measurement Framework for REDD+ Results-based Payments”.

The GCF has recently received total funding commitments of $10.2 billion in December 2014, including $3 billion from the USA, and over $1 billion from each of France, Germany, Japan and the UK.

There are a number of different options, and varying combinations thereof, for future operations of the FCPF Carbon Fund in relation to the GCF. None of these options, or combinations thereof, should lead the CFPs to a decision NOT to extend the FCPF Carbon Fund.

For the purposes of a decision on the extension of the Carbon Fund at this April 2015 Carbon Fund meeting the real question regarding the GCF is could it take over the proposed pilot programs of the FCPF Carbon Fund immediately post December 2020 effectively and efficiently or is it better that these pilot programs be completed by the FCPF by 2025, by which time a more-informed decision could be made by the GCF Board on the future model for a REDD+ results-based payment mechanism in the GCF. Until there are more details of how the GCF will be operational, the FMT prefers not to make assumptions of the working relationship between the GCF and FCPF at this point.

8. Unanimous Consent

As noted in section 1, an extension of the term of the Carbon Fund requires unanimous consent of the Carbon Fund Participants (CFPs). BP Technology Ventures (BP) do not support an extension of the

Carbon Fund beyond 2020 per se. However, they wish to support other CFPs and are willing to support a resolution extending the Carbon Fund provided they are allowed to exit the fund as if it were closing on December 31, 2020. The FMT have agreed a draft resolution with BP on this basis. Under this draft resolution BP would only be responsible for any ERPA payments for emission reductions delivered by that date. Since the date of deliveries of emission reductions can only be estimated, programs will need to be accepted into the portfolio assuming no funds are available from BP for ERPA payments. A commitment from others to novate BP's *unused* contribution could solve this issue and allow the fund to commit all of BP's funding through ERPAs.

9. Readiness Fund

At the Participants Assembly (PA) meeting in Arusha in October 2014 Participants had mixed views on the need to extend the Readiness Fund at this point in time. Considerations in favor of an extension related mostly to ensuring sufficient timelines for new REDD+ Countries to conclude readiness and reach the Readiness Package stage. Considerations for maintaining the current term until 2020 related to the fact that there is no immediate need for an extension and that the decision could be revisited at a later stage, when there is greater clarity on readiness progress as well as on the global context for REDD+. Readiness Packages need to be endorsed by the PC before countries can formally submit ER Programs to the Carbon Fund for the CFPs to decide whether to proceed to negotiating an ERPA for the proposed ER Program. Currently the Readiness fund terminates on December 31, 2020. If this termination date remains, Readiness Packages could not be endorsed by the PC after this date. If there is still demand for countries to enter the portfolio of the Carbon Fund after that termination date or if the PC wishes to endorse Readiness Packages for non-Carbon Fund countries after this date then it will be necessary to extend the Readiness Fund. At this time the FMT envisages all necessary Readiness Packages for inclusion in the Carbon Fund being endorsed prior to termination of the Readiness Fund so this should not impact on Carbon Fund pipeline. However, if the Carbon Fund continues beyond the Readiness Fund, the implications for broader governance and the governance options beyond 2020 will need to be considered. These governance issues can be considered at a later date.

10. Recommendation

Assuming the Carbon Fund continues with its current potential pipeline of 11 ER-PINs and with any additional programs selected into the pipeline at the autumn 2015 Carbon Fund meeting, the FMT recommends extending the term of the Carbon Fund to December 2025.

It is still intended that ERPA terms will be five years. If all ERPAs are completed before the new termination date of the fund, the fund can be terminated early.