

# CLIMATE INVESTMENT FUNDS

CTF/TFC.11/12

April 8, 2013

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Meeting of the CTF Trust Fund Committee

Washington D.C.

May 2-3, 2013

Agenda 13

**CIF FINANCING AND CARBON MARKETS**

## PROPOSED DECISION

The CTF Trust Fund Committee reviewed document CTF/TFC.11/12, *CIF Financing and Carbon Markets*, along with document CTF/TFC.10/9, *Interactions between CIF Financing and Carbon Markets*, and welcomes the analysis showing that while there are interactions between the CTF and the carbon markets, the small portion of carbon market financing as a percentage of total co-financing in CTF-funded projects does not artificially promote carbon finance operations or distort the market. The analysis shows further that CTF projects are operating in sectors and locations that are able to attract commercial finance but that are not business-as-usual CDM operations.

As a follow-up to the study, the Trust Fund Committee requests the MDBs to:

- a) provide information, for public sector projects, at the time of submission to the Trust Fund Committee for CTF funding approval, as to whether carbon finance will be sought; and for private sector programs, such information should be provided when sub-projects are circulated to the Trust Fund Committee for information after they have reached financial closure; and
- b) explain, if carbon finance is sought by the CTF projects/sub-projects, whether net carbon emission benefits associated with the CTF investment will be realized, and indicate the ownership of the carbon asset.

The Trust Fund Committee requests the CIF Administrative Unit, working in collaboration with the MDB Committee, to:

- a) provide relevant information in the annual CTF monitoring reports, for projects/sub-projects that intend to seek carbon finance or have received carbon credits; and
- b) develop proposals and guidelines for review by the joint meeting of the CTF and SCF Committees for the use of results-based payment instruments in the CTF and other CIF programs, and explore the feasibility of providing for retirement of carbon credits when appropriate.

The Trust Fund Committee further requests an amendment to the last sentence of paragraph 28 of the CTF Investment Criteria to read: “The key decision criterion is whether carbon finance is an insufficient incentive to deploy the low carbon technology at scale in the recipient country *and whether net carbon emission benefits associated with the CTF investment will be realized*” (italicized text added).

## **I. INTRODUCTION**

1. In October 2012, the CIF Administrative Unit, in collaboration with the carbon finance experts from the MDBs, prepared a paper on *Interactions between CIF Financing and Carbon Markets* (CTF/TFC.10/9) and presented it to the CTF Trust Fund Committee (see Annex I). Although the paper was not discussed at the last Trust Fund Committee meeting, comments were provided subsequent to the meeting (Annex II). This document intends to provide an update on the status of interactions between the CIF (focusing on the CTF) and the carbon market based on project-level information collected from the MDBs since December 2012. The Trust Fund Committee is invited to review this information along with the paper presented to the Trust Fund Committee last October.

## **II. STATUS OF CIF-CARBON MARKET INTERACTIONS**

2. In the paper presented to the Trust Fund Committee in October 2012, one of the key findings was that the expected carbon finance sought through the CTF was expected to be approximately USD 1 billion. This finding was based on a desk review of the endorsed CTF investment plans, and five investment plans made references to seeking carbon finance through 12 projects.

3. Subsequent to the last Trust Fund Committee meeting, the CIF Administrative Unit interviewed the MDBs, including task teams of each of the projects identified in the five investment plans, to better understand the context of carbon finance co-financing in the projects and the current status of carbon finance involvement in these projects. It was found that none of the projects mentioned in the previous paper received carbon credits or expects to have a reasonable chance of receiving carbon credits, especially given the current carbon market conditions. It was suggested that the reference to carbon finance in the investment plans was mostly aspirational, without necessarily being backed up by concrete plans; nor did those projects expect carbon finance to directly co-finance CTF projects. Furthermore, high transaction costs to prepare carbon finance projects and uncertainty associated with the future of the carbon markets have put a damper for the host countries and MDBs to consider seeking carbon finance.

4. Another finding from discussions with the MDBs was that although none of the CTF projects that mentioned carbon finance in the endorsed investment plans has materialized, some other CTF projects (none mentioned in the previous paper) have sought carbon finance through the Clean Development Mechanism (CDM) (see Table 1). Among these four projects, one project (Indonesia Geothermal Development Project) is linked with two CDM projects (on two different sites). One is already registered as a CDM project, and the other is under validation by CDM. Of the other three projects, two were registered as CDM projects in Mexico prior to the creation of the CTF, and one project in the Philippines is under validation by CDM. In total, these projects expect to generate 12.5 million Certified Emissions Reductions (CERs).

**Table 1: CTF Projects Involving Carbon Finance**

Country	Project title	TFC approval date	MDB	Sector	CTF funding (USD million)	Expected emissions reduction (MtCO <sub>2</sub> e)	CDM status	Amount of CERs (Million)
Indonesia	Geothermal Development	Dec-10	IBRD	Public	125.0	33.0	CDM projects are on two different sites. One is registered in May 2012, and the other is under validation.	4.9
Mexico	Renewable Energy Program-Eurus Wind Power project	Nov-09	IDB	Private	30.0	12.0	Registered in January 2007	6.0
Mexico	La Ventosa project	May-09	IFC	Private	15.6		Registered in December 2007	1.5
Philippines	Market Transformation through Introduction of Energy-Efficient Electric Vehicles Project	Oct-12	ADB	Public	105.0	2.7	Under validation	0.1
Total					275.6	47.7		12.5

### III. PUBLIC FUNDING AND ODA

5. According to the Marrakesh Accords, “public funding for clean development mechanism projects from Parties in Annex I is not to result in the diversion of official development assistance and is to be separate from and not counted towards the financial obligations of Parties included in Annex I.”<sup>1</sup> The Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), in its interpretation on ODA eligibility under the CDM, states that “the CDM Board, at the time of considering a CDM project that includes ODA financing, would seek an affirmation (project by project) from the donor that public financing does not result in the diversion of ODA.”<sup>2</sup>

6. Among the projects listed in Table 1, three CDM projects have provided statements with respect to public funding and ODA. See Table 2. One project (registered in May 2012) states that the project does not involve any public funding from Parties included in Annex I to the UNFCCC, and the other two projects (under validation) acknowledge the involvement of the CTF but affirm that there is no diversion of ODA funds from Annex I Parties to the UNFCCC.

**Table 2: Statements on Public Funding of CDM Projects Involving the CTF**

Project Title	Statements with respect to Public Funding
Indonesia: Project Ulubela – PT. Pertamina Geothermal Energy (registered in May 2012)	The project does not involve any public funding from Parties included in Annex I of the UNFCCC.
Indonesia: Project Lahendong – PT. Pertamina Geothermal Energy	The proposed project activity along with other geothermal projects (Ulubelu Units 3&4) under PT Pertamina Geothermal Energy has applied for a total financing of USD 300 million from the World Bank (via International Bank for Reconstruction

<sup>1</sup> Conference of the Parties to the United Nations Framework Convention on Climate Change, Decision 17/CP.7, Modalities and procedures for a clean development mechanism, as defined in Article 12 of the Kyoto Protocol, 2001.

<sup>2</sup> “ODA Eligibility Issues for Expenditures under the Clean Development Mechanism (CDM)”, DAC/Chair(2004)4/Final.

(in the process of registration)	and Development (IBRD) and Clean Technology Fund (CTF) for the Geothermal Clean Energy Investment Projects. This financing was approved by the World on 26/07/2011. The project activity does not involve any public funding or Official Development Assistance (ODA) from Annex I countries of UNFCCC. The loan from the World Bank does not result in diversity of ODA and hence is not a part of the financial obligations of the Parties included in Annex I.
Philippines: Market Transformation through Introduction of Energy-Efficient Electric Vehicles Project (under validation)	The Quezon E-Trike project is part of a larger project by the ADB called the “Republic of the Philippines: Market Transformation through Introduction of Energy Efficient Electric Tricycles Project”. As of February 20, 2012, the Project is estimated to cost \$500 million. ADB will provide \$300 million from its ordinary capital resources, with a 15-year term, including a grace period of 5 years, an interest rate determined in accordance with ADB’s London Interbank Offered Rate (LIBOR)-based lending facility, and a commitment charge of 0.15% per annum, and such other terms and conditions set forth in the draft loan and project agreements. The Clean Technology Fund (CTF) will co-finance the Project with a grant of \$1 million and a loan of \$100 million. There is no diversion of ODA funds from Annex I countries.

#### IV. SUMMARY AND CONCLUSION

7. Although a number of CTF investment plans intended to seek carbon finance revenue up to USD 1 billion, a closer look at the recent developments at the project level suggests that seeking carbon finance by CTF projects has been more aspirational than what reality has borne out. None of the projects identified in those investment plans has received carbon credits or expects a reasonable chance of securing carbon credits. Nonetheless, four other CTF projects (or five CDM projects, as two of the CDM projects falls under the same CTF project), which were not identified in the previous paper, are found to have involved carbon finance. Two were registered as CDM projects before the creation of the CTF, another one was registered in May 2012, and two more are under validation. The total amount of CERs is about 12.5 million, which is around 26 percent of the expected GHG emissions reduction from those projects or about 2 percent of emissions reduction from the approved CTF projects. This is driven largely by the current market conditions of the CDM, however.

8. With respect to public funding and ODA, among the five CDM projects involving CTF, one design document states that there is no involvement of public funding from Annex I Parties to the UNFCCC, and two other design documents mention the involvement of the CTF but affirm that there is no diversion of ODA from Annex I Parties.

9. The Trust Fund Committee is invited to consider the information provided in this update along with the analysis provided in the previous paper (CTF/TFC.10/9).

10. Moving forward, it is proposed that:
- a) Public sector projects should indicate whether carbon finance will be sought at the time of submission to the Trust Fund Committee for CTF funding approval. For private sector programs, such information should be provided when sub-projects are circulated to the Trust Fund Committee for information after they have reached financial closure.
  - b) If carbon finance is sought, the projects/sub-projects should explain whether net carbon emission benefits associated with the CTF investment will be realized and indicate the ownership of the carbon asset.
  - c) For projects/sub-projects that intend to seek carbon finance or have received carbon credits, relevant information should be provided in the annual monitoring reports.

