Forest Carbon Partnership Facility (FCPF)

Proposal for introducing flexibility to FCPF ERPAs[1]

January 2025

This FMT note presents and analyses options to enhance flexibility in emission reductions payment agreements (ERPAs) to provide qualifying REDD+ countries additional pathways to monetize a portion of their FCPF-issued greenhouse gas (GHG) emission reductions (ERs) in carbon markets. ***Through this note the FMT is requesting FCPF Carbon Fund Participants (CFPs) to approve a change in the portfolio management strategy by considering country requests for additional ERPA flexibility as outlined in the note.***

Background

Several REDD+ countries with ER Programs under the FCPF Carbon Fund (CF) have reached out to the FMT expressing interest in accessing the carbon market to both increase the amount of finance mobilized for communities and to support the long-term sustainability of their ER Programs. REDD+ countries have delivered on their first reporting periods under their FCPF ERPAs and have had ERs issued to them. With the goal of achieving higher prices per ER unit than have been agreed for Contracted ERs, namely Contract ERs and Additional ERs, under the FCPF ERPAs, these countries have started exploring the access to carbon markets to monetize these credits and increase finance mobilization. This is especially true of REDD+ countries expected to generate ERs in excess of their Contracted ER volume (Excess ERs).

Considering REDD+ countries' interest in ER monetization through carbon markets, FMT shared an initial proposal in February 2024 ('Options for exploring excess ERs from ERPAs') followed by a presentation to CFPs and written response to CFP feedback on 6 March 2024. This proposal aimed to allow REDD+ countries that met a number of conditions, to 'release' a very low amount of ERs generated during a Reporting Period (i.e., 100,000 ERs) from the Contracted ER volume and treat them as Excess ERs, enabling them to pilot the monetization of these Excess ERs in carbon markets separately, apart from the FCPF ERPAs. This 'released' ER volume was not to change the overall Contracted ER volumes under FCPF ERPAs but intended to bring expected future Excess ERs forward to pilot the monetization in carbon markets. The initial proposal did not receive full CFP support due to concerns regarding benefit sharing and demand-side integrity requirements.

A new FMT note, discussed at CF28 (June 2024), expanded on the February 2024 proposal by: i) not limiting the amount of Contract ERs that would be 'released'; ii) including two mechanisms to enable the 'release' of ERs from Contracted ER volumes (Retained ERs or Floor Price approaches); iii) addressing concerns from CFPs regarding demand-side integrity (i.e., demand-side integrity good practices were encouraged to third-party buyers) and benefit sharing (i.e., countries are required to use the existing Benefit Sharing Plan (BSP) for any revenue generated from these 'released' (Excess) ERs). At CF28, CFPs were generally supportive of including flexibility in the FCPF ERPAs, but there were disagreements regarding the 'enforceability' of demand-side integrity requirements and good practices. During CF28, the FMT provided a 'middle-ground' proposal that would require countries to report how third-party buyers would meet demand-side integrity good practices, and that such requirement would be embedded in the (amended) ERPAs. This proposal did not receive full CFP support.

[1] While references are made to annexes, these annexes are excluded from publication to allow further discussion.

This further revised FMT Note addresses the identified issues by refining the FMT's 'middle-ground' proposal that was made at CF28. This FMT Note describes FMT's further improved 'middle-ground' proposal, provides the demand-side integrity good practices and includes a questionnaire that countries will need to require from third-party buyers. This revised FMT Note no longer includes the 'Floor Price' approach due to lack of experience in its implementation under ISFL and the 'Retained ERs' approach would achieve the same objectives.

Justification for additional ERPA flexibility

Host countries generating ERs with FCPF support have two objectives. First, to achieve climate impact through the reduction and removal of GHG emissions from deforestation and forest degradation. Second, to mobilize finance flows to those contributing to the generated and verified volumes of ERs and/or impacted by the ER Program, including indigenous peoples (IPs) and local communities (LCs). While the first of these objectives is achieved through the programmatic investments made, the impact and scope of achieving the second objective is directly linked to the finance mobilized from these programs through the monetization of these ERs through either results-based climate finance (RBCF) or sales to carbon markets. This financing flow to beneficiaries through the BSP is required by the FCPF Methodological Framework.

Introducing flexibility to current FCPF ERPAs by allowing 'released' (Excess) ERs to be paid for by third-party buyers at a higher price would allow REDD+ countries to mobilize additional climate finance to support the sustainability and expansion of their ER Programs, including the generation of non-carbon benefits. Currently, market projections for carbon credit prices vary, with estimates ranging from $6-15 per ER unit[2] for units without required corresponding adjustment. A significant premium is paid for carbon credits with required corresponding adjustment.

Introducing such flexibility would also **increase the number of countries able to potentially access finance from carbon markets.** It is currently foreseen that six countries[3] generate ERs in excess of the Contracted ER volumes that could be monetized separately, while ERPA flexibility may expand this to an additional seven countries[4]. This increases the sustainability of ER Programs and reduces the perceived unfairness of certain countries being better able to access carbon markets at potentially higher prices than others. The FMT estimates that around 55 million ERs could potentially be made available to the carbon market by the end of 2028. While these 55 million ERs would result in payment of $275 million from the FCPF CF ($5/ER unit) as Contract ERs, **if monetized in carbon markets at $6-15 per ER unit, REDD+ countries could potentially significantly increase the amount of carbon finance mobilized, potentially tripling the amount of finance mobilized and to be shared through the benefit sharing process with ER Program stakeholders.**

The additional carbon finance would also likely to directly benefit IPs and LCs in REDD+ countries as this additional finance mobilized would flow to them (in cash or in kind) as beneficiaries under the BSP and thereby promote the expansion and sustainability of mitigation action on the ground.

Why this request now? Rightly or wrongly, the vintage of carbon credits plays a significant factor in their value in the carbon market. Currently, there is a decreased willingness among carbon market buyers to

[2] Based on projections by Trove Research, *Global Carbon Credit Price Scenarios to 2050*, August 2023. A revision in February 2024 presents a slightly narrower range of $6-14,80 per ton.
[3] Côte d'Ivoire, DR Congo, Guatemala, Indonesia, Madagascar, Viet Nam
[4] Costa Rica, Dominican Republic, Fiji, Ghana, Lao PDR, Nepal, Republic of Congo. Mozambique and Chile are excluded from consideration.

pay for credits that are 3+ years old and credits lose value over time, with discounts ranging between 21% and 62% depending on the year[5]. Therefore, countries that seek to mobilize carbon finance need to move expeditiously to seek buyers to avoid a loss in value, especially in the case of FCPF ER Programs since the vintages of their emission reductions are between 2018 and 2024. A delay in considering flexibility options would result in a delayed carbon market entry, resulting in potentially significant discounts to the value of ERs generated under FCPF ER Programs. Moreover, it is important to note that the price of $5/ton was defined a long time ago and does not consider changing circumstances. Not allowing countries to increase their options would be seen as a lack of adaptability of the FCPF CF to new circumstances.

ERPA flexibility mechanics

The overarching intent of introducing ERPA flexibility is to provide REDD+ countries an alternative pathway to monetize their ERs at a potentially higher price. The characteristics and mechanics are described in the table below.

ERPA Flexibility
Eligibility: - Eligible country must have: - Successfully gone through the first monitoring, reporting, verification, transfer, and payment process (See Annex B - *Error! Reference source not found.*), and;   - Demonstrated readiness for carbon market transactions (See Annex B - *Error! Reference source not found.*).   **Contract ER Volume and Retained ER Volume**:   - Eligible country is allowed to retain a certain ‘released’ volume of ERs generated during a Reporting Period as Excess ERs (Retained ER Volume) for the purpose of monetizing them separately in the carbon market.   - The amount of Retained ER Volume is proposed by the country and decided at the time of ERPA amendment.   - All remaining ERs during the relevant Reporting Period (beyond the Retained ER Volume) would be transferred to and be paid for by the FCPF CF as Contracted ERs (Contract ERs and/or Additional ERs).   - The total Contracted ER Volume would not be affected initially but may be reduced accordingly at a later stage.   - The country’s ERPA(s) would be amended as per the regular process.   **Put Option**: A Put Option provision is introduced to the FCPF ERPA(s) for the Retained ER Volume giving the country the right, but not the obligation, to sell all or part of the Retained ER Volume as Contract ERs to the FCPF at the price already agreed under the ERPAs in case the country is not successful in monetizing the Retained ER Volume separately in the carbon market.   **Benefit sharing**: The country is required by the (amended) ERPA(s) to adhere to the FCPF-approved BSP as it pertains to the sharing of proceeds from the sale of the Retained ER Volume (See Annex B - *Error! Reference source not found.*).   **Demand-side integrity**:   - The ERPA amendment(s) will include a commitment from the country that it supports high-integrity carbon markets and commit to act in good faith in its efforts to apply good practices on demand-side integrity when monetizing the Retained ER Volume (See Annex B - *Error! Reference source not found.)*. The FMT has developed a draft guidance note that provides information and materials on such good practices (See Annex C – *Draft Guidance Note on Demand-Side Integrity*).

[5] EDF, personal communication

- The country is required by the (amended) ERPA(s) to submit a filled-out Questionnaire regarding demand-side integrity practices (See Annex B - *Error! Reference source not found.*). Such Questionnaire will be used as a tool by countries to assess the integrity of potential 3rd party buyers. The country is required to take into account the information received through the Questionnaire in its final decision whether or not to proceed with the 3rd party sale. If the country decides to proceed with the 3rd party sale it shall explain to the FMT in writing how the 3rd party sale meets good practices on demand-side integrity.

Table 1: ERPA flexibility mechanics

ERPA flexibility process

If the ERPA Flexibility strategy were to be approved by CFPs, the process for program entities for embarking on this pathway would be as follows:

1. Program Entity requests FMT to be granted ERPA Flexibility.
2. Bank, as Trustee, and Program Entity agree on the Retained ER Volume and negotiate the ERPA amendment(s).
3. ERPA amendment(s) will include language as described in the 'ERPA Flexibility' box above. Such language will not only allow Program Entities to gain experience in applying demand-side integrity consideration in its FCPF ER monetization efforts but also creates contractual accountability for Program Entities to act in good faith when applying demand-side integrity good practices in its 3rd party buyer sale efforts and reporting back to the FMT.
4. FMT shares the proposed ERPA amendment(s) with CFPs for no-objection.
5. Upon no-objection, Bank and Program Entity sign the ERPA amendment(s).
6. Once the Program Entity has identified one or more buyers, through direct sale, auction, or other means, the Program Entity will use the Questionnaire as a tool to assess the integrity of potential 3rd party buyers. The Program Entity must consider the responses when deciding whether or not to proceed with the 3rd party sale, and report back to the FMT with the filled-out questionnaire for each 3rd party buyer and an explanation in writing how the 3rd party sale meets good practices on demand-side integrity.
7. Sold Retained ER Volume (FCPF ERs) is issued and cancelled in CATS, and then re-issued in a third-party registry for their final transaction. FCPF ERs that are issued for Article 6 purposes will include a Letter of Assurance and Authorization (LOAA) attached[6] and will be labelled as ITMOs[7]. Such label will be replicated by the third-party transaction registries. This labelling will mitigate buyers using non-ITMOs for compliance purposes.
8. Program Entity implements the FCPF-approved BSP with regard to the proceeds of the 3rd party sale and reports on this implementation to the Bank.
9. FMT periodically presents at FCPF CF meetings the results of the Questionnaires received from program entities (not disclosing publicly the name of the 3rd party buyer linked to each questionnaire), together with any justification that a Program Entity has given to the FMT in writing to sell to a specific buyer. This will serve to inform CFPs about program entities' efforts to

[6] Such letter of authorization will be in line with the template in Annex 1 of the FCPF Process Guidelines and will clarify, among others, (1) whether the authorization refers to an Art. 6.2 or 6.4 activity, and (2) the potential uses covered by the authorization. This will be required in the ERPA amendment(s).

[7] Should the UNFCCC review find any inconsistencies regarding the application of Corresponding Adjustments, the Program Entity commits through the amended ERPA to making best efforts to remedy such inconsistencies in a timely fashion.

apply demand-side integrity good practices and help generate experience and lessons learned in promoting high-integrity carbon markets.

10. Upon the conclusion of the Verification of the last Reporting Period, the Contract ER Volume may be revised to account for the delivery of the Retained ER Volume that has been used by the Program Entity.
11. The uncommitted funds resulting from such potential adjustment, may be used for paying for more Additional ERs (through the exercise of call options) from other ER Programs, or can be used for additional programming under other Bank-administered trust funds, such as SCALE.

Options for CFPs consideration

This note presents CFPs with a request to approve FMT's proposal to allow flexibility to be added to ERPAs with REDD+ countries. The pros and cons, along with an indication of BSP and demand-side integrity requirement implications, are presented in the table below.

Option & Description	Pros	Cons	BSP	Demand-side integrity
Option 1. Status quo (case-by-case requests) There would be no change in the portfolio management strategy. CFPs would consider requests for ERPA flexibility on a case-by-case basis (e.g., Costa Rica).	Lower demand for ERPA flexibility so: • Fewer disruptions • Guaranteed payment for delivery of verified ERs	More barriers to ERPA flexibility: • Fewer countries piloting carbon markets • Less additional finance mobilized • Impact on long-term sustainability of ER Programs	i) Contract ERs: BSP applies ii) Retained ERs: Country confirms use of BSP for revenues from monetization.	i) Contracted ERs: No issue for Contracted ERs ii) Retained ERs: CFP approval of buyer on a case-by-case basis
Option 2. ERPA Flexibility Change in the strategy to manage the FCPF CF portfolio. Change from maximizing portfolio delivery, to maximize climate finance mobilized by countries, while respecting environmental integrity.	• Fewer barriers for countries to mobilize additional climate finance mobilization for ER Programs and stakeholders: • More countries can pilot access to carbon markets early on. • FCPF CF can support country access to markets. • 'Exit strategy' for ER Programs beyond the FCPF CF • Newly uncommitted funds could be used to support additional ER Programs (See Annex B - **Error! Reference source not found.**)	• ERPA amendment could cause disruption in countries • Reputational risk linked to monetization of FCPF ERs in markets	BSP applies in all cases	PE publicly commits to high -integrity markets and to act in good faith in its efforts to follow good practices with regard to demand-side integrity Questionnaire required to be filled for every 3rd party buyer and used in country decision making

Table 2: Pros and Cons of ERPA Flexibility, along with impact on BSP and demand-side integrity

Request to CFPs

The FMT is requesting CFPs to:

1. Approve a change in the portfolio management strategy (Option 2 above) by considering country requests for additional ERPA flexibility as outlined in this FMT Note.

If CFPs do not agree to granting countries additional ERPA flexibility to maximize climate finance mobilization, the FMT will proceed with the Status Quo (Option 1 above) and focus on maximizing ERPA portfolio delivery while considering case-by-case requests.

Tranche Participants could reach divergent decisions, but this would be discouraged (See Annex B - **Error! Reference source not found.**).