

Forest Carbon Partnership Facility (FCPF)

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

1st conference call (January 11, 2012)

Background Note #1

1. Recap of the objectives of the Carbon Fund, and characteristics of potential ER Programs

The Carbon Fund's strategic objective is to pilot performance-based payment systems for Emission Reductions (ERs) generated from REDD+ activities, with a view to ensuring equitable benefit sharing and promoting future large-scale positive incentives for REDD+. To meet this objective, the Carbon Fund intends to support about five ER Programs to be undertaken by FCPF REDD Country Participants that have achieved, or made considerable progress towards, REDD+ Readiness.

As part of the design phase of the Carbon Fund, an Issues Note was agreed which highlights technical aspects of the Carbon Fund and amplifies or clarifies the original Information Memorandum of the FCPF that was discussed in the design phase of the FCPF in 2007-2008. This Issues Note lists, among other things, the following characteristics for the selection of ER Programs into the portfolio of the Carbon Fund:

1. Be submitted by the governments or government-approved entities of countries that are FCPF REDD Country Participants, i.e., countries that were selected into the Readiness Mechanism of the FCPF;
2. Be based on performance, i.e., payments for ERs relative to an agreed reference emission level (REL) and/or forest reference level (FRL);
3. Generate high-quality and sustainable ERs (including environmental and social benefits, and minimization of the risk of non-permanence);
4. Be consistent with emerging compliance standards under the UNFCCC and other regimes, as applicable;
5. Be based on transparent stakeholder consultations;
6. Use clear and transparent benefit-sharing mechanisms with broad community support. Adequate governance and financial management arrangements for a transparent benefit sharing will need to be in place prior to the effectiveness of the ERPA; and

7. Generate learning value by testing and demonstrating different approaches that are proposed by REDD+ countries, and learn from them in order to inform the international community on their feasibility.

For sub-national ER Programs, these should also:

8. Be undertaken at a significant scale, e.g., at the level of an administrative jurisdiction within a country or at the national level, in line with the proposed national REDD+ management framework;
9. Be consistent with the (emerging) national REDD+ strategy and recognized as such by the appropriate national authority;
10. Demonstrate capacity to measure and report on ERs. The system should be consistent with the (emerging) national REDD+ MRV system;
11. Be consistent with the national REL/FRL, or with the national approach establishing the REL/FRL;
12. Be integrated in a national institutional framework that will manage and coordinate sub-national programs; and
13. Provide for an assessment of and measures to minimize the risk of displacement of emissions (leakage), reversals (non-permanence) and other relevant risks.

2. Basis for establishment of the Working Group

In order to assist the Carbon Fund's strategic objective and help to ensure that Emission Reduction Programs in the portfolio of the Carbon Fund meet the characteristics listed in section 1 above, the Charter establishing the FCPF anticipates that:

1. The Participants Committee (PC) shall adopt policy guidance on pricing methodologies for Emission Reductions Payment Agreements (Section 11.1(f)); and
2. The PC shall, on the basis of the recommendations from the Facility Management Team (FMT), provide guiding principles on the key methodological framework on REDD (Section 11.1(i)).

To initiate these activities, the FMT started some early thinking on pricing methodologies and a methodological framework for the Carbon Fund. These were discussed with the Carbon Fund Participants and presented to the PC during its 10th meeting in Berlin (refer to <http://www.forestcarbonpartnership.org/fcp/node/324>, agenda item 6 of the PC for the presentations and background documents). Consequently, the Participants Committee of the FCPF adopted a resolution, requesting the FMT to establish a Working Group on the methodological and pricing approach for the Carbon Fund of the FCPF.

3. Scope of the Working Group

According to Terms of Reference as approved by the PC at the Berlin meeting (attached), the scope of the Working Group is to make recommendations to the PC on both broad, overarching guiding principles for the key methodological framework and policy guidance on pricing methodologies.

Scope of work for guiding principles for the methodological framework

As discussed above, the Methodological Framework should address different characteristics listed in section 1. In particular, the framework should address:

1. carbon accounting;
2. programmatic characteristics, including inherent social and environmental benefits; and
3. additional social and environmental benefits beyond carbon.

At the time of early discussions on the methodological framework with the Carbon Fund Participants and in the PC, there was consensus that, in order to generate learning value and allow demonstrating different approaches, the methodological framework for the Carbon Fund is not expected to consist of detailed calculation methods or protocols. Rather the framework should provide the overarching guidance and act as a Standard that is designed to achieve a uniform approach in complying with the ER Program characteristics discussed above.

The ToR specifically requests the Working Group to recommend broad, overarching guiding principles for the methodological framework. In a standards-based approach, principles represent the fundamental statements about the desired outcome of a program, and are the 'intent' level of a standard which elaborate on the objectives and define the scope and desired outcome.

The principles would subsequently be translated by the Carbon Fund and the FMT into a set of standards, which are the 'content' level of a programmatic standard that set out the conditions that need to be met in order to deliver a principle. It can be possible to verify a standard directly, or it can be further elaborated through indicators (quantitative or qualitative parameters or measures, which can be achieved and verified in relation to a standard).

Scope of work for policy guidance on pricing methodologies

Determining a fair value for ERs under the FCPF Carbon Fund is difficult, given that there are few relevant precedents to draw from and the Fund is expected to generate learning value.

Similar to defining principles for the methodological framework, the WG is expected to prepare policy guidance that could discuss the desired outcomes of the pricing approach for the Carbon Fund, and provide overarching guidance on a valuation approach that could support these desired outcomes. In preparing the policy guidance, the Working Group could consider the possible outcomes that were part of the early discussions on the Proposed Valuation and Pricing Approach for the Carbon Fund. These outcomes include:

1. Entice both buyers and sellers to transact ERs from REDD+ and safeguard their respective interests and rights in a reasonable manner;
2. Propose transparent mechanisms that reflect the risk allocation between parties to the transaction, and allows risk and benefit sharing by sellers and buyers. In this context risks and

benefits mainly refer to the uncertainty on performance-based mechanisms, and the effect this might have on the possible future valuation of Emission Reductions;

3. Reflect the quality of ERs generated by each ER Program, including non-carbon values as appropriate; and
4. Leave room for adjustments later, to align with emerging guidelines under the UNFCCC and other regimes, as applicable, and as demand and supply for ERs from REDD+ activities evolve.

Interaction with and follow up by other bodies in the FCPF

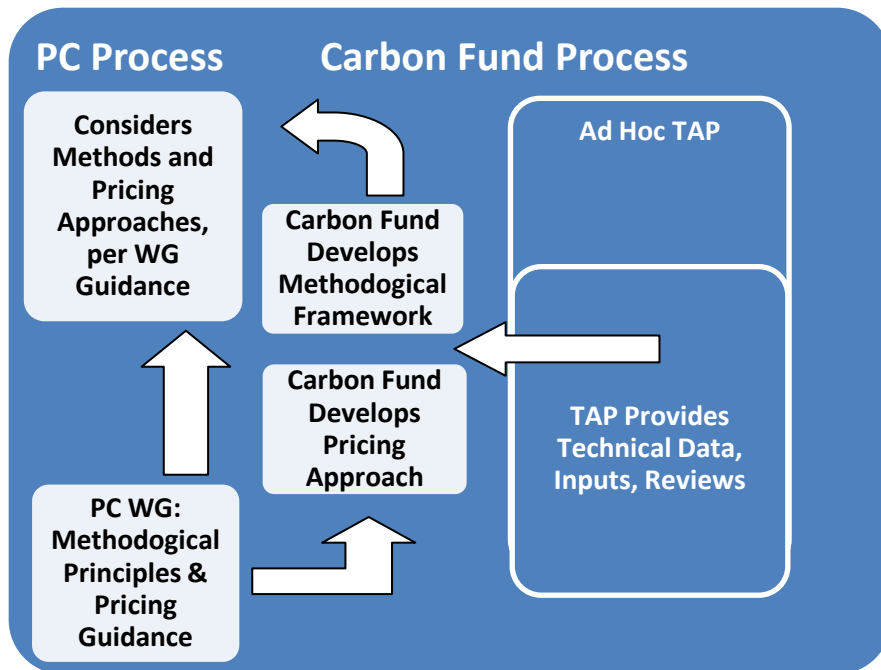
Based on the recommendations from the Working Group, the PC would conclude their mandate from the Charter as quoted above by adopting the policy guidance on pricing methodologies for Emission Reductions Payment Agreements and the guiding principles on the key methodological framework.

Since these principles and the policy guidance would focus on the overall objectives and desired outcomes, the Carbon Fund will build on the guidance and the principles adopted by the PC, to develop a more detailed, technical and operational pricing methodology and methodological framework.

This detailed pricing methodology and methodological framework would then be presented to the PC by the Carbon Fund Participants for information and feedback. An ad hoc Technical Advisory Panel (TAP) of experts can be called upon to provide inputs on specific aspects, if required and requested by the Participants.

The whole process is summarized in Figure 1.

Figure 1: Proposed Relationship of PC Working Group to Carbon Fund Work



4. Proposed process and schedule

In accordance with the ToR, work will be conducted via: 1) conference calls and/or emails, 2) one face-to-face meeting organized by the FMT, tentatively in the margins of PC11 in March, 2012 and a presentation on the outcome of the Working Group to PC11, if feasible; 3) a presentation to PC12 in June, 2012 (if the WG's work is not completed by PC11).

The FMT proposes the following tentative schedule of activities for the Working Group:

| Date | Type of interaction | Subject |
|-------------------|---------------------|---|
| January 11, 2012 | Conference call | Review ToRs and agree on key issues for discussion and schedule of activities |
| February 9, 2012 | Conference call | Methodological framework: Discuss objectives and desired outcome regarding carbon accounting methods in the Carbon Fund Pricing: Discuss guidance on valuation methods for determining ER price |
| February 29, 2012 | Conference call | Methodological framework: Discuss objectives and desired outcome for ER Programs in the Carbon Fund when considering programmatic characteristics, including inherent social and environmental benefits; and additional social and environmental benefits beyond carbon. |

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| | | Pricing: Discuss guidance on consideration of differences in quality between Programs and the consequences for valuation of ERs |
| March 23, 2012 | Face-to-face meeting in Paraguay before the Carbon Fund meeting (tentatively being considered for March 24-25) and PC 11 (March 28-30). Dial-in for WG members unable to attend. | Discuss outstanding issues from the conference calls and plan for future sessions |
| April 18, 2012 (tbc) | Conference call | tbd |
| May 16, 2012 (tbc) | Conference call | tbd |
| June 26-28, 2012 | PC 12, adoption of the policy guidance on pricing methodologies for Emission Reductions Payment Agreements and the guiding principles on the key methodological framework | |

With the wide spread geographical location of the participants, timing of the conference calls will need to be discussed, especially given Canberra's involvement (+14 hours from Washington). Tentatively it is suggested to use one of the following time slots (e.g., Washington originates the calls at 6 a.m. or 7 a.m. Washington time). Calls are expected to last around 2 hours:

| Mexico City | Washington DC | Paramaribo | Berlin | Kathmandu | Canberra |
|--------------------|----------------------|-------------------|---------------|------------------|-----------------|
| 5.00 AM | 6.00 AM | 8.00 AM | 12.00 noon | 4.45 PM | 10.00 PM |
| 6.00 AM | 7.00 AM | 9.00 AM | 1.00 PM | 5.45 PM | 11.00 PM |