Forest Carbon Partnership Facility

5a. Update on developing guidelines on modalities and procedures for ER Program buffers

Thirteenth meeting of the Carbon Fund (CF13)

Brussels, Belgium

October 13-16, 2015

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ER Program buffer guidelines: background

The Methodological Framework of the Carbon Fund foresees the potential use of buffers for:

- Uncertainty
  - Criterion 9 requires that uncertainty of the Emission Reductions (ERs) be quantified
  - Criterion 22 requires that a number of ERs (proportional to the estimated uncertainty) be set aside in a buffer reserve
- Reversals
  - Criterion 19 requires that the ER Program account for Reversals from ERs that have been transferred to the Carbon Fund during the Term of the ERPA
  - To do this, one option is that ERs from the ER Program are deposited in an ER Program-specific buffer, managed by the Carbon Fund (ER Program CF Buffer), based on a Reversal risk assessment

ER Program buffer guidelines: background (cont')

- Transfer of Title
  - Criterion 36 requires that the ER Program Entity demonstrate its authority to enter into an ERPA and its ability to transfer Title to ERs to the Carbon Fund
  - Footnote 15 adds that if Title to ERs becomes contested after the transfer of ERs to the Carbon Fund has occurred, the ERPA should provide for appropriate remedies, including the potential use of a buffer reserve

ER Program buffer guidelines: process so far

- At PC18, the PC adopted the FCPF General Conditions Applicable to Emission Reductions Payment Agreements (Resolution PC/18/2014/2).
- These General Conditions refer to Buffer Guidelines that will lay out the guidelines and the risk assessment tools for the buffers identified in the Methodological Framework.
- As part of the above Resolution, the PC further requested the Carbon Fund to establish a Review Group, which will review and provide feedback to the FMT throughout the preparation of the draft Buffer Guidelines.
- A consultant was hired to develop a first draft of the Buffer Guidelines.
- Three web-based meetings were held to discuss the first draft of the Buffer Guidelines and provide guidance to the consultant and the FMT

ER Program buffer guidelines: process so far (cont')

- Web-based Review Group meetings and one face-to-face Review Group meeting (in Bonn (September 3-4)) were held to discuss the first draft of the Buffer Guidelines and provide guidance to the consultant and the FMT
- The draft Buffer Guidelines were revised several times to take into account the guidance received from Review Group members during these meetings.
- The final draft version of the Buffer Guidelines was endorsed by the Review Group on October 8 with some caveats.
- The final version of the Buffer Guidelines is to be adopted by the Carbon Fund.

Members of the review group

Member
Chile (LAC)
Costa Rica (LAC)
DRC (Africa)
Nepal (Asia)
Canada
EC
Germany
Norway
UK
US
IP observer
NCSO observer
SCSO observer
Private sector observer

Main concepts in the draft guidelines

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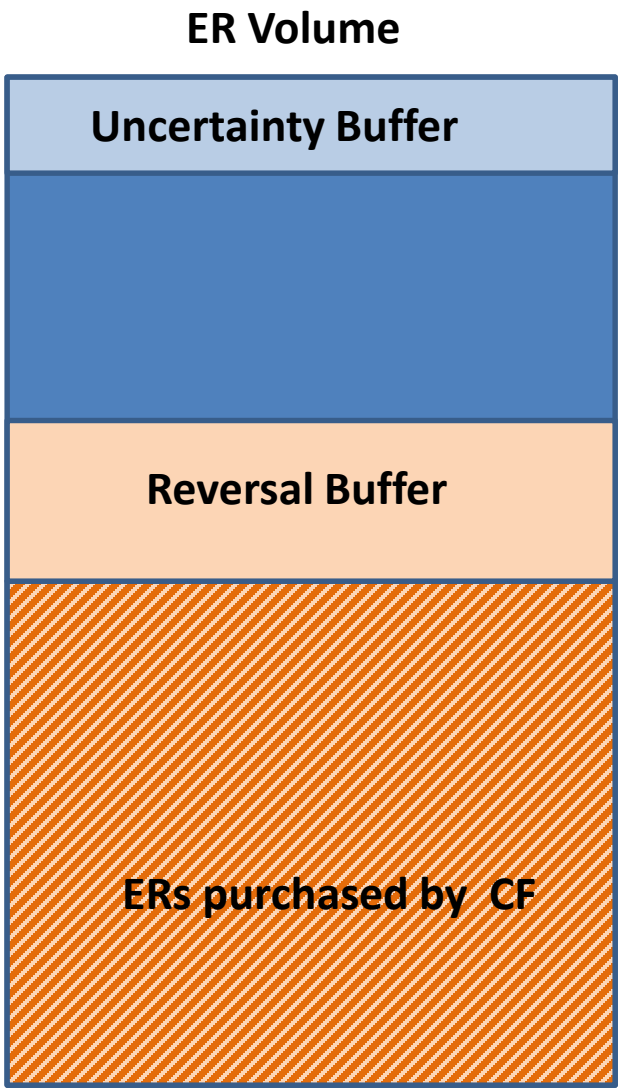
Use of buffer to manage Title to ER Risk

- The Review Group questioned the need to have a buffer to mitigate the risk that Title to ER might be challenged after the transfer occurred. They felt that proper program design (through conformity with the Methodological Framework) and ERPA terms/remedies may reduce such risk to acceptable levels.
- During the web-based Review Group meetings, the FMT presented how in the absence of a buffer, the ERPA General Conditions manage Title to ER Risk.
- Based on these discussions, the Review Group recommended not to have a buffer to manage Title to ER Risk

Basis for calculation of the buffers



- Subtract the reported and verified emissions and removals from the Reference Level to calculate Total ERs.
- Set aside a number of ERs from the Total ERs in the Uncertainty Buffer to reflect the level of uncertainty associated with the estimation of ERs (calculated as a percentage of Total ER)
- Carbon Fund will purchase percentage of the Total ERs as Contract ERs and Additional ERs
- Set-aside a number of ERs from the Total ERs in the Reversal Buffer (calculated as percentage of ERs purchased by CF)

Reversal buffer

- To calculate the quantity of ERs to be allocated to the Reversal Buffer, the guidelines contain a Reversal Risk assessment tool
- Reversal Risk assessment tool identifies a default set-aside of 10% and, in addition, 4 risk categories:

A. Lack of broad and sustained stakeholder support

B. Lack of institutional capacities and/or ineffective vertical/cross sectoral coordination

C. Lack of long term effectiveness in addressing underlying drivers

D. Exposure and vulnerability to natural disturbances

Reversal buffer (cont')

- For each risk category, the risk is assessed as 'high', 'medium' or 'low'
- Tool gives examples of risk indicators but not supposed to be complete list

Risk Factors	Example of Risk Indicators
A. Lack of broad and sustained stakeholder support	• **Are stakeholders aware of, and/or have positive experience with FGRM, benefit sharing plans etc. or similar instruments in other contexts?**
B. Lack of institutional capacities and/or ineffective vertical/cross sectoral coordination	• **Is there a track record of key institutions in implementing programs and policies?**
C. Lack of long term effectiveness in addressing underlying drivers	• **Are there experience in decoupling deforestation and degradation from economic activities?**
D. Exposure and vulnerability to natural disturbances	• **Is the Accounting Area prone to fire, storms, droughts, etc?** • **Are there capacities for preventing natural disturbances or mitigating their impacts?**

Reversal buffer (cont')

- Each risk category has a default risk percentage
- Depending on the risk assessment (high/medium/low) the default risk is discounted
- Example

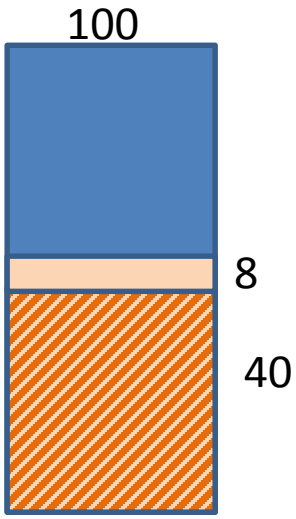
Risk Category	Default risk	Risk rating	Discount	Resulting risk assigned
C. Lack of long term effectiveness in addressing underlying drivers	5%	High	0%	5%
		Medium	2%	3%
		Low	5%	0%

Reversal buffer (cont')

- Total set-aside percentage is calculated as sum of default risk + risk assigned for each category
- Resulting range is 10-40% as indicated in the FCPF Methodological Framework
- Not specified in the Buffer guidelines but expectation that:
  - ER Programs will asses their risk in the ER-PD
  - TAP will review this assessment

Reversal Buffer (cont')

Compensating for Reversals Using the Reversal Buffer

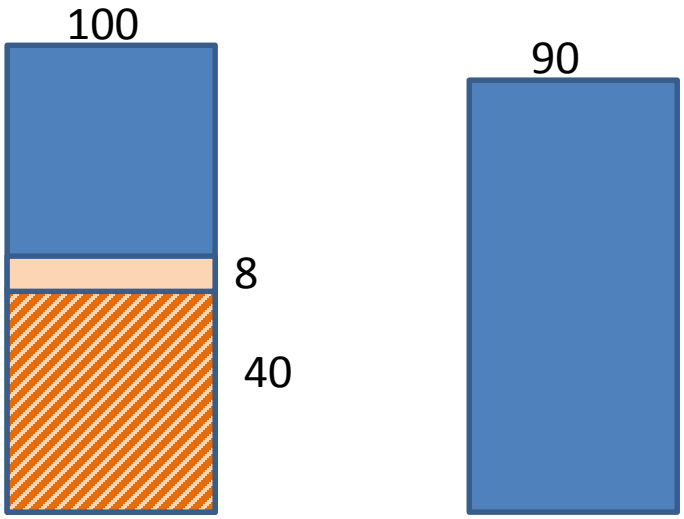


First monitoring period

- First monitoring period, amount available for purchase is 100
- Risk assessment of the program leads to a set-aside percentage of 20%
- Carbon Fund pays for 40 ER
- So 8 ERs go into the Reversal Buffer

Reversal Buffer (cont')

Compensating for Reversals Using the Reversal Buffer



First monitoring period

Cumulative over the first and second monitoring periods

- Second monitoring period, a Reversal has occurred and the cumulative emissions over the 2 periods is 90 → Reversal of 10
- CF paid for 40% of the ERs so the Reversal Buffer is used to compensate for 40% of the Reversal
- So 40% * 10 = 4 ERs are cancelled from the Buffer
- New Reversal Buffer: 8 – 4 = 4

Pooled Reversal Buffer for Force majeure events

- The Reversal Buffer is program specific as decided in the FCPF Methodological Framework
- However the draft Buffer Guidelines foresee that half of the Default Risk percentage of 10% (i.e. 5% of purchased Contract ERs and Additional ERs) should be deposited into a Pooled Reversal Buffer account
- If the amount of Buffer ERs in the Reversal Buffer account does not suffice to fully compensate for a Reversal, the Pooled Reversal Buffer can be used if:
  - Reversals involve a non-human induced Force Majeure Event (such as drought, flood, storm, pests etc);
  - Impacting at least 25% of the ER Program Accounting Area.

Uncertainty Buffer

- 'Uncertainty Buffer' has two objectives:
  - to create incentives for improving uncertainty associated with the estimation of ERs
  - manage the risk that the emission reductions were overestimates for prior reporting periods
- The contribution to the Uncertainty Buffer is determined by multiplying an appropriate "conservativeness factor" with the aggregate uncertainty of the estimate for Total ERs
- Appropriate "conservativeness factor" is already determined in the FCPF Methodological Framework

Uncertainty Buffer (cont')

- What happens to the Uncertainty Buffer if the Aggregate Uncertainty of Total ERs is Reduced?

- Draft Guidelines define 2 situations:

1. Aggregate Uncertainty of Total ERs for a prior reporting periods is reduced such that : (1) a lower conservativeness factor would apply to those periods; and (2) the result is a **lower estimate of Total ERs for the prior reporting periods**;

2. Aggregate Uncertainty of Total ERs for a prior reporting period is reduced such that: (1) a lower conservativeness factor would apply to those periods; and (2) the result is an **equal or higher estimate of Total ERs for the prior reporting periods**

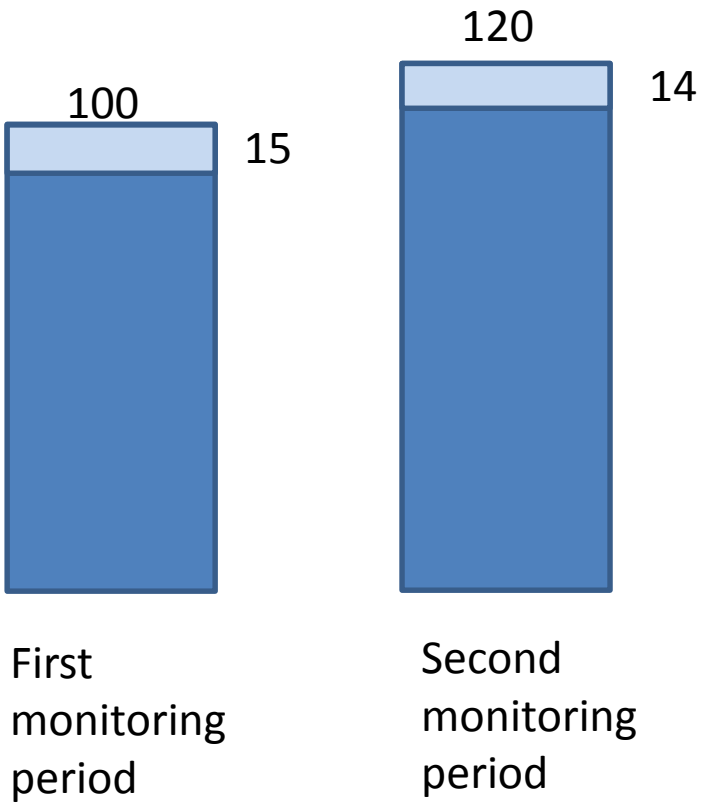
Uncertainty Buffer

- Example of calculations

- First monitoring period Total ERs is calculated as 100
- Aggregate uncertainty of the estimate for Total ERs leads to a conservativeness factor of 15%
- So 15 ERs go into the Uncertainty Buffer

Uncertainty Buffer

- Example of calculations



- Second monitoring period Total ERs is calculated as 120
- But the program has improved its MRV system in such a way that the aggregate uncertainty of the estimate for Total ERs leads to a lower conservativeness factor of 12%
- So 14 (14.4) ERs go in the Uncertainty Buffer for the second monitoring period
- The guidelines then require that the results of the first monitoring period get re-assessed

Uncertainty Buffer – situation 1

2 scenarios

Scenario 1	Scenario 2
Total ERs: 90	Total ERs: 98
Buffer: 15 -10 = 5	Buffer: 15 -2 = 13
Recalculated Buffer: 12% * 90 = 10.8	Recalculated Buffer: 12% * 98 = 11.76

- Based on the improved MRV, the result from the first monitoring period is re-calculated and it turns out the re-calculated ERs are lower than the 100 previously calculated
- First step: the difference between the previously calculated ERs and the re-calculated Total ERs is taken from the Buffer ERs set-aside in the previous monitoring period(s) → 15 in this example
- Based on the improved accuracy, the buffer set-aside is also re-calculated based on the new conservativeness factor of 12%

Scenario 1:

- The guidelines specify that the 'liability' is restricted to the ERs deposited in the previous monitoring period(s)
- So in this case there is a 'shortage' but the program does not need to compensate from the second monitoring event
- New Buffer = the 5 ERs remaining from the first monitoring event + the 14.4 deposited from the second monitoring event

Uncertainty Buffer – situation 1 (cont')

2 scenarios

Scenario 1	Scenario 2
Total ERs: 90	Total ERs: 98
Buffer: 15 -10 = 5	Buffer: 15 -2 = 13
Recalculated Buffer: 12% * 90 = 10.8	Recalculated Buffer: 12% * 98 = 11.76

Scenario 2:

- In this case, what is released back to the program is the difference between the buffer ERs deposited in the previous monitoring period(s) and the recalculated buffer
- So in this case 13 – 11.76 = 1.24 ERs are released back to the program
- New Buffer = 11.76 + the 14.4 deposited from the second monitoring event

Uncertainty Buffer – situation 2

2 scenarios

Scenario 1	Scenario 2
Total ERs: 102	Total ERs: 130
Recalculated Buffer: 12% * 110 = 13.2	Recalculated Buffer: 12% * 130 = 15.6

- Based on the improved MRV, the result from the first monitoring period is re-calculated and it turns out the re-calculated ERs are higher than the 100 previously calculated
- Based on the improved accuracy, the buffer set-aside is also re-calculated based on the new conservativeness factor of 12%
- If the re-calculation is greater than the original allocation, then additional ERs should be allocated to the Uncertainty Buffer to make up the difference

Scenario 1:

- The re-calculated buffer is smaller so 15 – 13.2 = 1.8 is released back
- In addition, 102 – 100 = 2 new ERs are created

Uncertainty Buffer – situation 2

2 scenarios

Scenario 1	Scenario 2
Total ERs: 102	Total ERs: 130
Recalculated Buffer: 12% * 110 = 13.2	Recalculated Buffer: 12% * 130 = 15.6

Scenario 2:

- The re-calculated buffer is larger so 15.6 – 15.0 = 0.6 ERs need to be added to the buffer
- In addition, 130 – 100 – 0.6 = 29.4 new ERs are created

Uncertainty Buffer (cont')

- If the ER Program Entity does not wish to maintain an uncertainty buffer reserve beyond the end of the ERPA term, then the Buffer Manager should cancel the ERs in the Uncertainty Buffer account in the ER Transaction Registry prior to the end of the ERPA term.
- If the ER Program Entity wishes to continue maintaining a buffer reserve serving the same function as the Uncertainty Buffer beyond the end of the ERPA term, then the Buffer Manager should transfer ERs from the Uncertainty Buffer account in the ER Transaction Registry to an equivalent buffer account designated and controlled by the ER Program Entity or any other entity designated by the ER Program Entity prior to the end of the ERPA term

Next steps

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Next steps

- Carbon Fund Participants need to make final decision on approving the guidelines
- The guidelines were not available to the Carbon Fund Participants in accordance with standard practices, i.e., 2 weeks before the meeting
- Hence the FMT would like to request the CFPs to agree to a process for virtual adoption of the Guidelines through a resolution, in accordance with the rules of procedure

THANK YOU!

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