# Forest Carbon Partnership Facility (FCPF)

# Carbon Fund

## Methodological Framework

January 7, 2019

## Background on the Methodological Framework:

During the eighth meeting of the Carbon Fund (CF8), the Carbon Fund Participants ('CFPs') decided to adopt the FCPF Carbon Fund Methodological Framework dated December 20, 2013 ('Methodological Framework').

As part of the Resolution CFM/8/2013/1 that adopted the Methodological Framework, CFPs also agreed to review the adopted Methodological Framework, after one year from the adoption of the Resolution or any other time period as may be agreed to by CFPs, to consider any relevant lessons learned from the application of the Methodological Framework to the ER Programs, and any relevant new guidance from UNFCCC negotiations on REDD+. If necessary, CFPs may consider modifying the relevant criteria and/or indicators of the Methodological Framework after this review, or at any later time as relevant. However, while the Carbon Fund encourages ER Programs to consider meeting such refinements on a voluntary basis, it will not require ER Programs, once an ERPA is signed, to meet new or revised criteria and indicators that may be subsequently approved by CFPs.

## Background of issues

As authorized by CFPs, the FCPF Facility Management Team ('FMT') has applied to be an emissions unit programme under the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) of the International Civil Aviation Organization (ICAO). The main purpose for applying to CORSIA is to create potential market demand for ERs that are generated by the ER Programs ('FCPF ERs') but are not transferred to and paid for by the Carbon Fund. In addition, having CORSIA allow for the use of FCPF ERs in its carbon offsetting scheme may enable Tranche A participants to sell their FCPF ERs to CORSIA-regulated airline companies.

ICAO has established a Technical Advisory Body (TAB) which will make recommendations to the Council on eligible emissions units for use by CORSIA. The Council is scheduled to meet from 2 March to 20 March 2020, with the Committee phase from 20 January to 7 February 2020. The Facility Management Team have been advised by the TAB that they will make recommendations to the Council in early January.

In order to provide their recommendations to the Council, the TAB have raised a number of questions regarding FCPF with the Facility Management Team both in writing and verbally. These questions have highlighted a few areas where the FCPF may not meet the eligible units criteria. Some major weaknesses have been rectified, for example by the agreement of the Verification Guidelines and by the setting up of a Centralized Transaction Registry. Other issues remain but the significance that the TAB attaches to these is not clear. These questions have also highlighted challenges for FCPF ERs to be used in other carbon markets. One of the key issues identified pertains to the non-permanence risk of FCPF ERs and the potential use of national reversal management mechanisms during the ERPA term and beyond.

Although most of the Emission Reductions generated by the 18 ER programs will be transferred to the Carbon Fund, Monte Carlo simulations presented during CF19 show that the total ER volume generated would be 208 million ERs on average ranging from 303 to 103 million ERs, meaning that around 32 million ERs and up to 127 million ERs could be available to third-party buyers. This is a significant volume that could be affected by the challenges mentioned above.

In order for the FMT to continue with the CORSIA application process, improve the acceptability of FCPF ERs by carbon markets, and provide other potential buyers with confidence that FCPF ER-related non-permanence risks are manageable, the FMT is proposing revisions to the Methodological Framework and to the FCPF ER Program Buffer Guidelines ('Buffer Guidelines') for decision at this 21st Carbon Fund meeting ('CF21').

## Issues for discussion and decision

The issues for discussion that require a decision at CF21 are the following:

1. Reversal management mechanism:
    a. Use of other reversal management mechanism besides the CF Buffer **during the FCPF Carbon Fund ERPA term**
    b. Continuation of the reversal management mechanism **after the FCPF Carbon Fund ERPA term**;
2. Application of CF Buffer to all FCPF ERs generated under an ER Program during the ERPA term, not limited to FCPF ERs transferred to and paid for by the Carbon Fund (as Contract ERs and Additional ERs).

## Issue 1: Reversal management mechanism

### *Issue 1 a: Use of other reversal management mechanism besides the CF Buffer during the FCPF Carbon Fund ERPA term*

The Methodological Framework requires in its Criterion 19, Indicator 19.1 to select a reversal management mechanism during the ERPA term with a choice between two different options: Option 1, a mechanism that is substantially equivalent to the CF Buffer; and Option 2, the CF Buffer. Out of the 18 ER Programs in the Carbon Fund portfolio, only one (DRC) has selected Option 1.

As part of the CORSIA evaluation, the TAB has indicated that the lack of definition of 'substantially equivalent' could represent a risk regarding the permanence of issued FCPF ERs.

### *Issue 1 b: Continuation of the reversal management mechanism after the ERPA term*

The Methodological Framework was designed with an expectation of one ERPA term of approximately 5 years and subsequent closure of the Carbon Fund. As part of Criterion 20, Indicator 20.1, the Methodological Framework therefore requires ER Programs to put in place a robust reversal management mechanism or another specified approach that addresses the risk of Reversals beyond the ERPA term ('Post-ERPA Reversal Management Mechanism'). Since the requirement is to have this in place at the latest 1 year before the end of the ERPA term, none of the 18 ER Programs in the portfolio have yet proposed such Post-ERPA Reversal Management Mechanism.

As part of the CORSIA evaluation, the TAB has indicated that this lack of definition of what a robust reversal management mechanism and any other alternative approach to address reversals could represent a risk regarding the permanence of FCPF ERs.

It is worth noting that at the time of writing the Methodological Framework in 2013 there was an unclear idea of what the mechanisms post-2020 could be (the then expected end date of the Carbon Fund) so it was left open intentionally, expecting that markets and ER Program entities would propose different mechanisms. At the time of this note the use of buffers as a reversal management mechanism to manage non-permanence risk is the only operational mechanism used by the major Standards issuing forestry ERs, i.e. California, VCS, Gold Standard, CAR.

The ER Program Buffer Guidelines provide detailed procedures on the cancellation of Buffer ERs at the end of the ERPA term, but they do not include any requirement regarding the Post-ERPA Reversal Management Mechanism other than it being ‘robust’.

This lack of clarity on how the non-permanence risk of FCPF ERs will continue to be managed after the ERPA term generates uncertainty to buyers that might be interested in acquiring FCPF ERs during or beyond the ERPA term, therefore impacting a REDD Country’s ability to identify potential buyers other than the Carbon Fund.

### *Proposed actions*

The following modifications to the Methodological Framework and the Buffer Guidelines are proposed:

| Issue | Section of the MF or BG | Description |
|---|---|---|
| Requirements for Reversal Management Mechanism during ERPA term | MF – Indicator 19.1 | To eliminate Option 1 and require all ER Programs use the CF Buffer during the ERPA term. This is de-facto the option selected by all ER Programs that have not yet signed an ERPA so this should not cause any disruption. |
| Requirements for Post-ERPA Reversal Management Mechanism | MF – Indicator 20.1 | To require ER Programs to have in place a robust Post-ERPA Reversal Management Mechanism that is equivalent to the CF Buffer.<br><br>The definition of what is equivalent is provided in the Buffer Guidelines (see below). |
| | MF – Indicator 20.2 | To avoid reference to the Options of Indicator 19.1 and keep the cancellation of credits as a measure in case no Post-ERPA Reversal Management Mechanism in accordance with Indicator 20.1 is established. |
| | BG – Section 11 | To make the Buffer Guidelines consistent with the above changes to the Methodological Framework. |
| | | The Post-ERPA Reversal Management Mechanism is considered equivalent to the CF buffer if all the following conditions are met:<br><br>1) It is a buffer;<br>2) It covers the reversals of the units generated under the FCPF during the ERPA term;<br>3) It allows the transfer of the Buffer ERs from the CF Buffer;<br>4) The actual reversal risk set-aside percentage determined by the Post-ERPA Reversal Management Mechanism is equal to or higher than the actual reversal risk set-aside percentage of the CF Buffer[1] |

[1] The actual Reversal Risk Set-Aside Percentage under both RMM will be determined in the reporting period before the latest one year before the end of ERPA term, and will be verified by Independent Reviewer at verification. This will be used by the FMT to determine if they are equivalent.

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| | | 5) It has in place a periodical monitoring and a third-party verification mechanism to confirm if there have been reversals and makes monitoring and verification reports publicly available;<br>6) The Post-ERPA Reversal Management Mechanism is operational and able to address identified reversals;<br>7) It is acceptable to relevant carbon markets or other schemes in cases where the ER Program wishes to meet those requirements[2]. |

If other alternative Post-ERPA Reversal Management Mechanisms become viable in the relevant timeframe (ie prior to the 1 year before the end of an ERPA), the Methodological Framework and Buffer Guidelines could be revised later to include other specific options (for example insurance or host country guarantees) with their own conditions or criteria.

## Issue 2: Application of CF Buffer to all FCPF ERs

### *Background*

The Methodological Framework and the Buffer Guidelines (Section 4.6, 6.2, 6.3 and 9.4) require that Buffer ERs for reversal risk be calculated as a percentage from the amount of FCPF ERs transferred to and paid for by the Carbon Fund, namely Contract ERs and Additional ERs. This means that the Buffer Guidelines currently do not provide for the need to set aside Buffer ERs for reversal risk for FCPF ERs other than Contract ERs and Additional ERs. This would make FCPF ERs sourced from these ER Programs (other than Contract ERs and Additional ERs) not acceptable to third-party buyers and carbon markets as their reversal risk is not managed by the CF Buffer and, thereby, they are not fully compliant with the FCPF requirements. Moreover, there is a risk that FCPF ERs originating from ER Programs are issued as 'FCPF credits' without being covered under the CF Buffer, and, thereby, not being compliant with the FCPF requirements of the Methodological Framework. This would constitute a reputational risk for the FCPF Carbon Fund and for the World Bank.

### *Proposed actions*

The FMT proposes to revise the Buffer Guidelines and the Methodological Framework by replacing the terms "Contract and Additional ERs" by "Emission Reductions".

Carbon Fund Participants should note that requiring the application of the Buffer Guidelines to all Emission Reductions will require that the Buffer Guidelines contain the necessary provisions to enable its application to Emission Reductions not transferred to the Carbon Fund. For instance, terms such as ERPA term, ERPA start date, and Trustee will need to be rationalized, and specific requirements contained in the ERPA General Conditions (e.g. procedures in the case of reversals or force majeure events) will need to be incorporated into the Buffer Guidelines and the Process Guidelines. These other issues will be presented at CF21 for information purposes and the FMT proposes to seek a decision in a future Carbon Fund meeting or virtually, as agreed.



[2] E.g. the 'Carbon Offsetting and Reduction Scheme for International Aviation' (CORSIA) developed by the International Civil Aviation Organization (ICAO).