Forest Carbon Partnership Facility (FCPF)

Considerations Regarding Possible Extension of the Term of Funds of the FCPF beyond 2020

September 25, 2014

At the tenth meeting of the Carbon Fund in June 2014 (CF10) the CFPs agreed on the importance of discussing the long-term future of the FCPF Carbon Fund and its role as a pilot mechanism for results-based payments for REDD+ in one of the next Carbon Fund meetings. In this context, CFPs also agreed to discuss at the next Carbon Fund meeting (CF11) the Carbon Fund's current termination date of December 31, 2020, with consideration of the implications on the length of ER Program implementation. ***This FMT note is intended to facilitate this discussion.***

1. The Current Term

Under the Charter of the FCPF both the Readiness Fund and the Carbon Fund are scheduled to terminate on December 31, 2020 (Section 22.1). The term of the Carbon Fund can be extended by unanimous consent of the Carbon Fund Participants (CFPs) (Section 23.2 (b)). The term of the Readiness Fund can be extended by unanimous consent of the REDD Country Participants and the Donor Participants (section 23.2 (a)). This is provided, in both cases, that the Trustee will continue to serve as trustee of the respective fund and that the Board of Directors of the World Bank expressly agrees to such an extension.

2. Implications of the Current Term and Possible Extension

a) Carbon Fund

As of the time of writing, eight ER Program Idea Notes (ER-PINs) have been selected into the pipeline of the Carbon Fund (Chile, Costa Rica, Democratic Republic of Congo, Ghana, Mexico, Nepal, Republic of Congo and Vietnam), most of them in April and June 2014. Three more ER-PINs are being presented at CF11 (Guatemala, Peru and Indonesia), making a possible total pipeline of 11 ER-PINs.

Many of these countries have entered into or are currently in the process of entering into Letters of Intent (LoIs). Before any negotiations on a potential future Emission Reductions Payment Agreement (ERPA) can start, such countries need to first develop their ER Program, present a corresponding ER Program Document (ER-PD) to the Carbon Fund and have their ER-PD selected by CFPs into the Carbon Fund program portfolio. In addition, under the Readiness Fund process and prior to a formal ER-PD submission to the Carbon Fund for its decision, these countries are required to prepare their Readiness Package and have such Readiness Package endorsed by the Participants Committee (PC).

The indications are that the first Readiness Packages will be submitted to the PC for endorsement in the final quarter of FY15[1], with others following in FY16. First ER-PD submissions to the Carbon Fund for its decision are expected to follow in FY16. In addition, under the Methodological Framework advanced drafts of the Benefit Sharing Plan, the Reversal Management Mechanism and the Safeguards Plans will be required prior to ERPA signature.

The LoIs include an Exclusivity Period of up to 24 months during which the countries have to develop an ER-PD, have the PC endorse their Readiness Package, have CFPs select their ER-PDs into the Carbon Fund's program portfolio and negotiate an ERPA. Regarding ERPA negotiations, the LoI provides for a minimum ERPA Negotiation Period of 10 months. If the original Exclusivity Period is not sufficient to allow for such a minimum ERPA Negotiation Period, the Exclusivity Period would be automatically extended accordingly.

The pipeline of the Carbon Fund is currently being built under the assumption that the Carbon Fund terminates by the end of 2020. This has a number of implications:

i) estimated ER potentials are currently based on a 2016-2020 ER generation period;
ii) depending on the verification process that is developed, the effective ERPA period may end in late 2019 or early 2020, to allow time for verification, transfer and payments by December 31, 2020;
iii) estimated ERPA terms and ER generation period are short and may become even shorter in case of delays in ER Program preparation;
iv) short ER generation periods and ERPA terms result in lower ER volumes that can be generated under each ER Program and sold to the Carbon Fund and may lead to an under-commitment of available Carbon Fund resources;
v) to fill the pipeline of the Carbon Fund it has been necessary to select more ER-PINs with smaller volumes than originally anticipated; this over-programming can lead to unrealistic REDD country expectations; further, the windows for accepting new ER-PINs for pipeline consideration needed to be closed at CF11;
vi) multiple verification events are difficult during a short ERPA term which may reduce confidence in ER volume estimates.

An ERPA term ends at the earlier of either the date of final transfer and payment for ERs or a stated final termination date as specified in the ERPA. It is normal practice under World Bank Carbon Funds for the final ERPA Reporting Period (during which ERs are generated) to end a year prior to that stated final termination date to allow for final verification, transfer and payment. Assuming a relatively optimistic ERPA signing date for the current pipeline of say December 2016 and a total of five years of ERPA Reporting Periods, the ERPA term would end in December 2022. This timeframe allows for no delays in implementation of the Program itself and thus generation of ERs, verification, delays over safeguards or ER title issues etc. The experience of the World Bank in managing 14 Carbon Funds over a period of 14 years is that delays are common, almost inevitable, and that longer fund terms provide greater flexibility.

ERPAs can initially be signed for 6-year terms (with a total of 5 years of Reporting Periods plus a year for final payment). If all goes well and the contracted ER amounts are generated,

[1] FY is a fiscal year of the World Bank, running from July 1 to June 30, with FY15 ending June 30, 2015.

transferred and paid for as anticipated and contracted for, the ERPAs will terminate on time. If this happens across the Carbon Fund program portfolio then, assuming the Carbon Fund term has been extended beyond 2020, the Carbon Fund can be terminated early.

However, ER-PD development will take time and the current timeframe for ER Program implementation is challenging. If there are delays, assuming the Carbon Fund term is extended beyond 2020, the ERPA terms could be more easily extended, if desired by CFPs. If the term of the Carbon Fund ends prior to the desired ERPA extension date, then the term would need to be extended again. Further extension of the term at that point will require the same unanimous consent of all the CFPs required at this time and could be more complicated at that time, with a lot of unknowns. In addition, the Board of Directors of the World Bank, who would have to agree to such further extension, may not appreciate such multiple extension requests.

Allowing for only one year of slippage in the scenario outlined above would require extending the term of the Carbon Fund to December 2023. To allow for greater slippage and provide greater flexibility, the FMT recommends that CFPs consider extending the term of the Carbon Fund to at least December 2025.

Following the recent announcement by Germany, Norway and the UK to fund up to 20 large scale REDD+ emission reductions programs, if CFPs were considering adding to the current potential pipeline of 11 ER-PINs, through another Tranche of the Carbon Fund if necessary, assuming ER-PINs for any additional ER Programs were submitted to the CFPs by December 2016 (in line with the announcement), it would make sense to consider extending the term of the Carbon Fund by a further two years, to December 2027. If such an extension was agreed, ERPAs for the ER Programs in the current ER-PIN pipeline could still have ERPA terms ending no later than 2024.

For the CFPs, a portfolio with longer ERPA terms and ER generation periods reduces delivery risk. Extending the term of the Carbon Fund will also allow for clarity on a future REDD+ mechanism and future sources of funding for REDD countries. There would also be greater lessons learned regarding reversals, buffers, benefit sharing mechanisms and safeguards management in this longer timeframe.

One risk of an extension of the term of the Carbon Fund is that REDD countries reduce their efforts to move quickly through the REDD process. However, the opposite would be true if longer ERPA terms were available for early movers; indeed an extension and a guaranteed 5-year ERPA term, or longer, could provide the necessary incentives to increase the current level of effort and investment in the process. Including options in ERPAs could also act as an incentive for earlier implementation. Given the up-front investment by REDD countries into the process, often with little in the way of guarantees, REDD countries would likely welcome these possibilities.

In terms of costs, if the Carbon Fund is extended, but not the Readiness Fund, administration costs are estimated at approximately $0.5 million per year. If both funds are extended the Shared Costs that would be charged to the Carbon Fund are estimated at approximately $0.6 million per year, so total costs would amount to approximately $1.1 million for each year of extension.

The approximate costs associated with the development and supervision of each additional ER Program from early ideas right through to the end of an ERPA term (after full delivery of all ERs) are about $1.7 million.

b) Readiness Fund

There are currently 47 REDD countries participating in the Readiness Fund, all at very different stages of readiness, ranging from those developing ER Programs and MRV systems to those who have only recently submitted Readiness Preparation Proposals (R-PPs). There will continue to be considerable differences between such REDD countries in terms of progress; some intend to present Readiness Packages for endorsement by the PC by June 2015, others will take much longer, and still others may decide not to prepare the Readiness Package.

Assuming the intent is to enable as many of these REDD countries as possible that show a commitment to the readiness process to submit a Readiness Package for PC endorsement, and given the limited financial and technical resources available, there is also a case for considering an extension of the Readiness Fund. However, it is difficult at this time to be precise about the term of any possible extension of the Readiness Fund.

There is currently sufficient funding available to provide $3.8 million grants to all 44 active REDD countries plus an additional grant of $5 million to 18 countries. As countries progress through readiness, it will be possible to assess if there is a need for more financial resources.

If the Readiness Fund were to be extended, in order to ensure progress on readiness is maintained it will be necessary to continue to operate on a first-come, first-served basis, without guarantees of funding, and to impose deadlines which are respected.

There are cost implications if the Readiness Fund were to be extended but the costs are very dependent on the nature of the extension. The costs of Country Implementation Support (by the Delivery Partners) to all 44 active REDD countries have been included in the long-term financial plans, as have the additional support costs for the additional $5 million grants. However, the costs of continuing FMT support to REDD countries, and the Secretariat, administrative and legal costs necessary to maintain the Readiness Fund and hold meetings have not been factored in. Assuming continuing meetings, additional grant requests, endorsement of Readiness Packages etc, a very broad brush estimate of additional costs for continuing to run the Readiness Fund over and above the current long-term financial plan would be around $2 million per annum.

Given the desire to ensure progress on readiness is maintained and that there is no urgent pressing need to make the decision to extend the Readiness Fund now, it may be wiser to delay any extension of the term of the Readiness Fund until there is more clarity with regard to the overall progress in REDD country readiness. The subject of extension of the Readiness Fund will be raised for initial discussion by the PC/PA at the upcoming meeting in Arusha, Tanzania.

3. Conclusions

a) Carbon Fund

Assuming the Carbon Fund continues with its current potential pipeline of 11 ER-PINs, the FMT recommends that CFPs consider extending the term of the Carbon Fund to at least December 2025.

If CFPs were considering adding to the current potential pipeline of 11 ER-PINs, assuming ER-PINs for any additional ER Programs were submitted to the CFPs by December 2016, it would make sense to consider extending the term of the Carbon Fund by a further two years, to December 2027.

ERPA terms can be set well before the closing date of the CF.

b) Readiness Fund

The subject of extension of the Readiness Fund will be raised for initial discussion by the PC/PA at the upcoming meeting in Arusha, Tanzania.