Proceedings of the Round Table: Options to promote market based mechanisms

Organised by KfW and Nordic Environment Finance Corporation (NEFCO)

Dated 7 May 2013

at KfW Liaison Office to the EU, Square de Meeûs 37, 1000 Brussels 4

Agenda

12.00 – 12:20	Design elements of market approaches	Andrew Prag (OECD)
12.20 – 12.40	Examples for performance based approaches	Florian Sekinger (KfW) & Ash Sharma (NEFCO)
12.40 – 13:00	EU-Commission: Post-Doha views on how to proceeded in regard to market based approaches	Erika Hasznos (DG Climate)
13.00 – 13.45	Moderated Dialogue Session: Expectations and options to promote market based approaches	Moderator & participants
13.45 – 14.00	Conclusions and potential next steps	Moderator & participants

Moderation and workshop summary by Moritz von Unger of Atlas Environmental Law Advisory

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Objective

The following is a debrief note from the roundtable on ‘Options to Promote Market-Based Instruments’ organized by KfW and NEFCO on 7 May 2013 in Brussels, Belgium. The event brought together experts from the European Union (EU), EU Member States and international finance institutions for an informal exchange of views on the subject of international climate finance and the use of market-based instruments and results based finance (RBF). The roundtable was the first in a series of meetings with a follow-up meeting tentatively set for autumn 2013 in Stockholm, Sweden. The initiating meeting aimed at setting the scene and identifying themes, or work clusters, for further discussion. While Chatham House Rules1 applied to the event, presenters agreed to the circulation of their presentations under their name.

The event is the first activity of the KfW-NEFCO Initiative on Market Based Mechanisms.

Background

As financial institutions with an international climate finance portfolio, KfW (Germany) and NEFCO (Nordic countries) wish to contribute to an increased momentum for market based mechanisms through focused exchange and coordination among potential first movers from the finance sector, the EU, its Member States, and other interested stakeholders.

KfW and NEFCO have long been involved—in cooperation with the German Government, the EU and the Nordic Governments, respectively—in developing performance-based approaches to international climate finance interventions. Recent activities include the strategic focus of piloting new climate finance models and, while international standard setting is lagging behind, of keeping the door open for future market mechanisms.

The EU Commission as well as European Governments have underlined that market-based approaches shall be an important element within expanded global mitigation activities. This has also resulted in detailed inputs to the negotiation process by the European Union (c.f. the inputs on the New Market Mechanism and the Framework for Various Approaches).

The regulatory challenges regarding the regulatory design, governance aspects, funding/demand and the place and role of the private sector are likely to persist for some time, and the latest UNFCCC session in Doha (COP 18) has produced little guidance, if any. Yet, while the gap in ambition among developed countries to combat climate change and to support developing countries with their mitigation action is widening, policy makers worldwide are increasingly looking for formats and models of climate intervention that would allow for (bottom-up) pilots and trials to add experience, to feed into international negotiations, and to increase the momentum for market-based approaches.

Results based finance (RBF)—making payments for measurable, pre-agreed actions that have been achieved and verified—has received wide consensus from both developed and developing countries, and it is enshrined in the constitutional act of the Green Climate Fund. It allows for incentivizing low carbon investments by reducing risks and providing transparent and predictable

[1] http://www.chathamhouse.org/about-us/chathamhouserule.

funding, which also increases the ability of investors to leverage debt. EU Governments have embraced the concept and are increasingly applying it in their climate finance portfolios.

Against this backdrop, the roundtable organizers wish to take stock together with their colleagues and to share their views on how to proceed on market-based approaches in an organized, complementary, and perhaps integrated manner.

The event was moderated by Moritz von Unger of Atlas Environmental Law Advisory.

Meeting Summary

After welcome notes by KfW and NEFCO and the introduction of participants, the roundtable took off with a range of presentations. Andrew Prag (OECD) gave a presentation on design elements of market approaches, examining the emerging framework of various approaches (FVA) and the new market mechanism (NMM) before comparing the two concepts of allowance trading, on the one hand, and crediting, on the other. Mr Prag found that despite substantial differences in the governance structure (FVA targeting looser and bilaterally negotiated structures, the NMM to be built on a centralized institution, similar in parts to the Clean Development Mechanism (CDM)), both FVA and NMM will ultimately rely on a set of similar, if not uniform rules with a UNFCCC based body overseeing implementation and enforcement. Regarding trading vs. crediting, again Mr Prag noted more similarities than differences, especially if crediting occurs against the performance of a broader group of installations/operators. For all the details, Mr Prag concluded, the UNFCCC can only act as moderator and facilitator, while demand must come from domestic or multilateral cap-and-trade systems. Both at the international and at the domestic level, the Parties should be mindful of 15 years of CDM experience.

Ash Sharma (NEFCO) and Florian Sekinger (KfW) reported on early experiences with performance based approaches. NEFCO, with its post 2012 NEFCO Carbon Fund, has been at the forefront of international climate investment since the inception of the carbon markets and the experimenting with “early” Joint Implementation (JI). Venturing into new mechanisms, NEFCO has recently led a feasibility study into nationally appropriate mitigation actions (NAMAs) in Peru and in Vietnam, and it is currently preparing for a larger NAMA implementation in the solid waste sector in Peru. Mr. Sharma commented that NMMs could complement other sources of financing for NAMAs. Mr Sharma was a member of the Methane Finance Study Group, convened in late 20012 at the request of the G 8, which evaluated new approaches for financing projects to reduce methane emissions worldwide. He concluded that RBF was an area of some interest for donors, and could form an area of further work for the current initiative. While important groundwork in many areas of climate finance intervention is made, Mr Sharma notes, he increasingly witnesses ‘readiness fatigue’ (referring to the key climate finance concept of “country readiness” to engage in action) although he was pleased to note a number of implementation focussed initiatives including the German/UK collaboration on a NAMA Facility.

Florian Sekinger (KfW) delivered a status report of two recently started results and sector based finance pilot interventions the bank is leading on behalf of the European Commission in Indonesia and several Latin American countries. The interventions combine (1) preparations (including a sector transformation concept), (2) institutional set-up, (3) implementation, (4) measuring—reporting—verifying (MRV), and (5) payments linked to verified emission reductions (RBF). A major focus at this stage (phase (1): preparations) lies on responding to target country needs and priorities and to establish an emission reduction course that is broad, ambitious and has full in-country support. This said, relevant design features—among them the logic of payments (to whom?)—have not yet been settled for.

Mr Sekinger's presentation was followed by a lively discussion on the strategy, and the options, for any experience gained with market based pilot interventions to feed into the international (UNFCCC based) negotiation process. Participants identified the risk that the detachment of practical pilot interventions from the international rule-making process could potentially de-legitimize actions taken. The pilots in question, it was argued, are really domestic interventions, which would have to be modified on a case by case basis for international replicability.

Participants also noted that pilot interventions offer the opportunity to test—at a small scale and in a domestic, or bilateral, context—forms and models for climate finance interventions, without being held up by a frustratingly slow international process. In fact, bottom-up pilot interventions do not only explore technical options (which may not be the same for each country, but still replicable mutatis mutandis) but also the sort of political commitments (e.g. on the scope of a sector or the ambition of a baseline) that countries would resist to make at the international level (within the UNFCCC process). In this, such pilot campaigns may facilitate international cooperation and ultimately pave the way to a viable international agreement.

Ms Erika Hasznos (European Commission, DG Climate) gave the last presentation of this roundtable discussing the "non-multilateral" FVA and the centralized NMM. While emphasizing stark differences, Ms Hasznos agreed with Mr Prag that there are numerous key similarities, namely the way to define an economic sector (which would then present the scope for FVA or NMM interventions) as well as the challenge to prevent 'free-riding' within any country and sector. Linking the FVA or the NMM to NAMAs through crediting options should be possible as long as the result is mitigation action "beyond mere offsetting". It is paramount, Ms Hasznos noted, that the international carbon market infrastructure, which has been set up over the past decade, be not lost during these years of international regulatory limbo.

Following the presentation, participants shared their experience with climate finance pilot actions. The German Government is currently developing a sectoral crediting approach for the cement sector in Tunisia, and the German Environment Agency is exploring carbon market options in Chile and South Africa, while also studying options for the continuation of JI in Germany and other countries with a 'capped environment'. The European Investment Bank (EIB) is involved in a Reduced Emissions from Deforestation and Forest Degradation (REDD+) funding scheme that addresses drivers of deforestation and leverages broader payments for REDD related ecosystem services. Norway sponsors a number of activities in the field of new mechanisms and sectoral approaches (including REDD+), among them the "Energy+ Initiative", which channels finance to three partner countries on the basis of emission reductions achieved (thus, RBF).

Participants felt that while the results of the interventions undertaken have so far been mostly positive, if not without difficulties, there is a risk of redundancies or duplication, and that climate finance initiatives are sometimes more competitive than complementary, which would also explain the noted host country 'readiness fatigue'.

One of the last subjects raised was finance and funding options for pilots. Participants discussed a number of potential strings of finance, including the option to (i) release ‘surrogate credits’ for emission reductions achieved (delivering countries would receive direct (e.g. EUAs from unused new entry reserves) or indirect (e.g. auction revenues) carbon credit assets), (ii) to open domestic cap-and-trade schemes for directly fungible credits (e.g. FVA or NMM credits sellable into the EU ETS or the Effort Sharing Decision scheme), (iii) to allow for FVA or NMM crediting against the new Kyoto targets, and (iv) to anticipate crediting under the new international climate change agreement to be negotiated by 2015 and to enter into force by 2020. Participants largely agreed that most of the options are for now unrealistic, all the more so since the EU ETS is experiencing a substantial over-supply with credits and extremely depressed carbon prices, which makes it unlikely that the European legislator would open the scheme for any more supply or that EU Member States would have large surrogate amounts to share with developing countries. Thus, for some time to come, available funds will exclusively come from public sources and will, in most cases, allow for little more than providing incentives for pilot actions. It is all the more important, participants found that funds are spent wisely and that RBF is one of the most promising ways forward.

Contemplating issues for further discussion (‘work clusters’), participants stated that they wished to

- enter into a number of EU / EU Member States case studies to better understand how to address questions with both a technical and directly political dimension, such as sector definition and baseline setting;
- discuss options for intensifying results based finance interventions, with a particular view on the potential role of international finance institutions; and
- explore options for better coordination and mainstreaming of actions in Europe and possibly beyond; the establishment of a web-based archive and the circulation of relevant information among roundtable participants were options raised thus far.

Participants agreed that they would use the roundtable to share key sources and other information and they expressed their wish to meet in this constellation again, perhaps with wider participation . Mr Sharma indicated that NEFCO and KfW are planning to convene a second event in Stockholm, Sweden (TBC), jointly with the Nordic Council of Ministers.

List of participants

Name	Organisation
Stefan Agne	EU-Commission
Matthias Börner	KfW
Stefanie Ewerbeck	KfW
Thomas Forth	BMU (German Ministry of Environment)
Cordula Glitzner	KfW
Erika Hasznos	EU-Commission
Kristin Lang	EIB (European Investment Bank)
Andrei Marcu	CEPS (Centre for European Policy Studies)
Andrew Prag	OECD
Martin Schröder	KfW
Florian Sekinger	KfW
Ash Sharma	NEFCO
Bente Støholen	Ministry of Environment, Norway
Moritz von Unger	Atlas Environmental Law Advisory
Frank Wolke	UBA (German Federal Environment Agency)