Annex 12

OPTIONS FOR THE OPERATIONALISATION OF A LOAN SCHEME TO COVER THE COST OF CDM PROJECT DEVELOPMENT TO COUNTRIES WITH LESS THAN 10 PROJECTS

(Version 01.1~~2~~)[*]

I. Introduction

1. This background document was prepared by the secretariat to facilitate the consideration of the Executive Board of the CDM (hereinafter referred to as the Board) on the regional distribution agenda item that will look at possible options to operationalize a loan scheme to countries with less than 10 registered CDM project activities. The Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP), at its fifth session, requested the Board to recommend guidelines and modalities for operationalizing a loan scheme for consideration at its sixth session (CMP 6).

2. At its fifth session (CMP 5, Copenhagen, 2009), the CMP:

   (a) Requested the Board to "allocate financial resources from the interest accrued on the principal of the Trust Fund for the Clean Development Mechanism, as well as any voluntary contributions from donors, in order to provide loans to support the following activities in countries with fewer than 10 registered clean development mechanism project activities:

      (i) *To cover the costs of the development of project design documents*;

      (ii) *To cover the costs of validation and the first verification for these project activities"*;

   (b) Decided that these "*loans are to be repaid starting from the first issuance of certified emission reductions"*; and

   (c) Requested "*the Executive Board to recommend guidelines and modalities for operationalizing the activities outlined above for consideration by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol at its sixth session*" (hereafter the 2/CMP. 5 decision).

3. Based on the 2/CMP. 5 decision, the secretariat contracted a consultant with relevant financial background and experience to explore and consult with relevant programmes in the secretariat and external organizations and banking institutions that have experience in loan schemes for similar purposes.

4. The mandated work to develop modalities and guidelines of operationalizing a loan scheme is to be carried out in two phases:

   (a) Phase 1: February - May 2010: to explore and assess the possible options for a loan scheme and recommend the best viable option for consideration and decision by the Board.

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[*] This version has been issued to correct version number and corrections to errors in figures and references in paragraphs 25, 26 (b), 26 (c) and 54 (b).

(b) Phase 2: June - September 2010: Following Board's consideration and decision on the best option, work would proceed as mandated by the CMP to develop draft guidelines and modalities for operationalizing the loan scheme including a system for accounting and monitoring. The output of phase II and the Board's deliberations on this agenda item will lead to preparation of draft recommendations for consideration at CMP 6.

5. The findings of the phase 1 were presented to the Board at its fifty-fourth meeting (28 May 2010) as annex 10 to the annotated agenda of the meeting, entitled **"Possible options for a loan scheme to cover the costs of CDM project development in countries with less than 10 projects"**. At this meeting, the Board "*requested the secretariat to work further on developing modalities and procedures for the operationalization of such a loan scheme based on a management model that has more outsourced functions and with minimum involvement of the secretariat for consideration by the Board at its next meeting*" (paragraph 84 of the EB 54 report).

6. This annex accordingly revisits the proposal made to the aforementioned annex 10 with regard to proposed loan management model, with a view to increasing the degree of outsourcing of the scheme management to institutions outside the UNFCCC secretariat. It also addresses some comments made during the Board meeting. One of such comments was to consult with designated national authorities (DNAs) on the loan scheme. The questionnaire sent to DNAs is attached as appendix II to this document. However, not enough responses had been received in time for incorporation in this document. The results will be presented orally to the Board at its fifty-fifth meeting. This document does not repeat the information and analysis provided in the previous report, in particular in sections 2-5 and 8. The updated list of potentially eligible countries is presented in appendix I to this document.

7. In light of the discussion at the fifty-fourth meeting of the Board, it can be useful to restate what should be the guiding principles in designing a loan scheme:

(a) Simple, and quick decision-making;

(b) Minimize the cost of administering the scheme;

(c) Select projects with a high probability of success in terms of ability to attract finance for project implementation, economic viability, and CDM registration, in order to minimize losses, and maximize emission reductions per dollar of scarce public resources;

(d) Mitigate conflicts of interest, given the Board and the UNFCCC secretariat's role in the regulation the CDM carbon market.

8. Unavoidably, some of these principles are difficult to reconcile, which poses dilemmas, for example between financial viability and CDM additionality, or between the requirements for a lean and speedy decision-making process and that of ensuring that high quality project activities will be selected. These dilemmas are surmountable. As regards the first example, additionality should not be too difficult to demonstrate in these countries given the small numbers of CDM project activities registered (about one on average per country); as regards the second example, the aim will be to minimize the amount of detailed analysis ("due diligence" in the banking jargon) after a project idea note (PIN) has been received from a loan applicant (see section 6).

II. Executive summary and recommendations to the Board

9. Following the discussion by the Board at its fifty-fourth meeting on the aforementioned annex 10 outlining possible options for the structuring of the loan scheme, the present annex presents new options which all have in common to increase the degree of outsourcing, as requested by the Board.

10. In particular three variants for increased outsourcing are outlined. The new possible role of the UNFCCC secretariat, for the most part confined to oversight of the Partner Institution(s) to whom administration of the scheme would be entrusted, is also described, as well as the key areas for necessary interaction between the UNFCCC secretariat and the Partner Institution(s).

11. This new annex contains a further elaboration of the eligibility criteria on the one hand, and loan terms and conditions on the other.

12. The Board is requested to:

(a) Indicate which variant of the outsourced management model it endorses;

(b) Indicate whether it agrees with the proposed eligibility criteria and loan terms and conditions;

(c) Indicate whether it agrees to charging an upfront fee to borrowers, and the maximum amount of this fee;

(d) Provide any other guidance to the UNFCCC secretariat as may be necessary to further develop the modalities and procedures of a loan scheme within the timeline set by the Parties at CMP 5.

III. Management mode

Four functions to be performed

13. A loan scheme as contemplated requires four key functions to be performed.

14. Project origination (F1), including the following tasks:

(a) Market the facility (dedicated website, conferences, etc.)

(b) Collect and acknowledge receipt of application forms.

(c) Screening of projects

(i) Check whether all requested supporting documentation (e.g. PIN, etc.) is attached;

(ii) Perform CDM eligibility analysis (likely emission reduction volume, additionality, etc.)

(iii) Check compliance with host country requirements, if any at this stage

(iv) Seek clarifications, ask for additional information, perform site visits if need be to check reality of projects, and identity of project proponents

(d) Enter eligible projects into a dedicated project database.

15. Project appraisal (F2), including the following tasks:

(a) Perform a detailed analysis* of eligible projects

(i) Financial viability and bankability of project, including site visits if need be.

(ii) Additional CDM analysis, including site visits, if need be.

(b) Take a decision on whether to extend a loan based on the detailed analysis.

16. Fund flows (F3), including the following tasks:

(a) Sign the loan agreement.

(b) Disburse funds, in up to [three] installments (see section 5).

(c) Collect repayment upon first (and subsequent if appropriate) issuance of CERs.

(d) Distribute issued CERs once the loan has been repaid.

17. Loan administration (F4), including the following tasks:

(a) Monitor project progress, and events triggering loan disbursement, cancellation, write-off, acceleration (see section 5), etc. till repayment;

(b) Inform the disbursing entity about whether any of the above milestones or events has occurred;

(c) Monitor compliance with loan covenants (e.g. regarding fraud, corruption, etc., see section 5), if any;

(d) Troubleshooting and, if need be, litigation.

The original proposal: summary of the "hybrid" model recommended to the Board at its fifty-fourth meeting.

18. The UNFCCC secretariat's recommendation to the Board at its fifty-fourth meeting was for a "hybrid" model in which:

(a) The secretariat would work with UN agencies and Regional Development Banks† in project origination and project appraisal.

(b) The UNFCCC secretariat would act as secretariat to an Evaluation Committee, which would decide on project eligibility and whether to extend a loan, would sign the loans, and would disburse the funds.

(c) A small, dedicated, unit would be established within the UNFCCC secretariat with no reporting lines to the Board to mitigate potential conflicts of interest (between the UNFCCC as lender and regulator of the CDM market). A small team of qualified staff (two full-time equivalents) would need to be created for that purpose.

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* "Due diligence" is the banking term.

† This does not exclude cooperation with other development financial institutions.

19. This proposal was not endorsed by the Board at its fifty-fourth meeting, as a number of Board members requested a higher degree of outsourcing in the management of the scheme. The remainder of this report presents options involving a higher degree of outsourcing to third parties outside of the UNFCCC secretariat.

The new proposal: three variants proposing increased outsourcing.

20. A higher degree of outsourcing could be achieved by three variants:

(a) Variant 1: *increased outsourcing within the "hybrid model"*. In this variant, one or several third parties (Partner Institutions) would perform functions 1 (loan origination), 2 (loan appraisal), and 4 (loan administration). The UNFCCC secretariat would confine its role to function F3, i.e. signing the loans, disbursing the funds to the borrowers, and releasing the issued CERs once the loan has been repaid (or repaid in accordance with the agreed repayment schedule, see section 5). In this variant, the UNFCCC secretariat would not be involved in approving a loan, and generally would have no interface with the project owner, other than being the signatory of the loan agreement, and no involvement in the process and decision to extend a loan. The rationale for keeping F3 with the UNFCCC secretariat is two-fold: (a) oversight: –the loans are signed by and accounted in the books of the very institution that collects and manages the funds deposited in the Trust Fund of the CDM; there is no need to transfer funds to an outside party; and (b) loan security: –the UNFCCC secretariat can withhold the issued CERs pending loan repayment; this would be the only "security interest"[‡] if the borrower fails to repay the loan and one that the UNFCCC secretariat alone can exercise; if the lender were a third party, that link would be weakened.

(b) Variant 2: *full outsourcing with participation of the UNFCCC secretariat in decision-making*. In this variant all four functions would be entrusted to a third party (or parties.), which would sign the loans, account them on its own books, disburse the funds, etc.

The UNFCCC secretariat would have decision rights within an Evaluation Committee, which would review projects and decide to extend a loan. This could range from a single right to vote to veto rights. Variants 1 and 2 could be combined. The rationale of this option is to give the UNFCCC secretariat a say in loan decisions. In this variant one designated UNFCCC secretariat staff (with an alternate) would review reports prepared by the Partner Institution(s) for the Evaluation Committee, would make comments if any, and take part in the decision whether to endorse or reject the proposal.

(c) Variant 3: *full outsourcing, with no involvement whatsoever of the UNFCCC secretariat in the decision to extend a loan*. In this variant the Partner Institution would perform all four functions subject to oversight by the UNFCCC secretariat as described below.

21. The role of the UNFCCC secretariat in these variants is discussed below.

[‡] A security interest is a property interest created by agreement or by operation of law over assets to secure the performance of an obligation, usually the payment of a debt. It gives the beneficiary of the security interest certain preferential rights in the disposition of secured assets. Such rights vary according to the type of security interest, but in most cases, a holder of the security interest is entitled to seize, and usually sell, the property to discharge the debt that the security interest secures. Source: Wikipedia

Requirements for Partner Institutions

22. Depending on which variant above is selected, the Partner Institution(s) to whom management of the loan scheme will be outsourced will need to satisfy a number of requirements:

(a) Expertise in performing three (v1) or all (v2, v3) four functions.

(b) Track record in managing similar loan schemes in developing countries, where project participants often need significant assistance in preparing projects etc, not just concessional funds to alleviate the cost of CDM project development.

(c) Charging a reasonable cost for its services.

23. The Partner Institution may be one institution of or grouping (consortium) of institutions, from the public and/or the private sector. It is recommended that one Partner Institution (which itself could sub-contract other organizations) be selected to minimize the duration and complexity of the selection process, and facilitate oversight by the UNFCCC secretariat.

Partner Institution selection process

24. It is recommended that the UNFCCC secretariat engage the Partner Institution through a competitive bidding process, even though it may not be obliged to, for example if another UN agency is candidate to run the loan scheme[§].

Partner Institution remuneration

25. As a rough indication, the total administrative cost of running the scheme should not exceed 20% of the amount of funds available for lending. Assuming conservatively a volume of resources of $8mln ($3mln + 5 x $1mln) available to the loan scheme over the next five years, the total administrative cost should not exceed ~~$800,000, or $160,000~~ **$1.6 mln or 320,000** p.a. on average. Informal consultations indicate that the range of such costs would be 20-40 %.

Legal issues

26. Given the Board decision to outsource management of the loan scheme to the extent possible, the relevant legal issues identified and responses are:

(a) Whether the share of proceeds (in the CDM Trust Fund) may be used for the loan-scheme?
Paragraph 8 of Article 12 of the Kyoto Protocol (KP) provides that the CMP "ensure that a share of the proceeds from certified project activities is used to cover administrative expenses as well as to assist developing country Parties ….to meet the costs of adaptation." The KP thus defines how the share of proceeds is to be utilized. In view of such an explicit provision, it is not clear whether the proceeds could be legally used for the purposes of the type of loan scheme contemplated. Parties may need to clarify their understanding of paragraph 8 of Article 12.

[§] Financial Regulations and Rules, dated 9 May 2003, ST/SGB/2003/7, Rule 105.17.

With respect to whether interest income can be considered distinct from the share of proceeds, the answer appears to be no. Regulation 4.18 states that income derived from investments shall be credited as provided in the rules relating to the each fund or account. Rule 104.15 states that income [derived] from General Fund investments shall be taken into account as miscellaneous income. Regulation 4.19 states that income derived from investments of the Working Capital Fund shall be credited as miscellaneous income [working capital fund may be regarded the same as the operating reserve, which in case of CDM is the current USD 45 million. Thus interest on this portion of the investments is treated as miscellaneous income]. This means that after being credited, interest is considered income of the trust fund without distinction. This also implies that reference to "interest income" for purpose of loans is intended to cap the risk exposure but not in itself of consequence to the financial base of the Trust Fund. Furthermore, at the end of the financial period, all surplus income is taken into reserves, and here again, there is no distinction of the source of the particular type of income.

(b) Whether the secretariat has the mandate to oversee management of such a loan scheme?

Article 14 of the Protocol and Article 8.2(f) of the Convention clearly specify that the secretariat functions shall be (inter alia)... to enter...into such administrative and contractual arrangements as may be required for the effective discharge of its functions. In addition, 8.2~~3~~(g) states "...and such other functions as may be determined by the COP". Thus, the secretariat would require a clear mandate from the CMP to oversee management of such a loan scheme but, once given such a mandate, it may enter into administrative and contractual arrangements as required for the effective discharge of its mandate.

(c) How should the secretariat address potential risks associated with overseeing the management of such a loan scheme (e.g., misappropriation/misuse of funds, recovering the funds if no project is ever submitted, etc?)

The secretariat would address potential risks associated with overseeing the management of such a loan scheme through adequate contractual arrangements with the entity to which management of the loan scheme is outsourced. The entity may be a UN agency or~~f~~ another international or intergovernmental organization. Rule 105.11 (a) of the UN financial rules and regulations specifically mentions the "Management and other support services may be provided to Governments, specialised agencies and other international and intergovernmental organisations or in support of activities financed from trust funds or special accounts on a reimbursable, reciprocal or other basis consistent with the policies, aims and activities of the UN with the approval of the Executive Secretary (USG-Management)." The selection of the entity to which the management of the funds is outsourced must go through normal procurement procedures unless it is a UN agency.

Oversight by the UNFCCC secretariat

27. The relation between UNFCCC secretariat and the Partner Institution(s) will be governed by a contract, which will set out the objectives and roles entrusted to the Partner Institution, the terms of its remuneration, the targets, etc. As regards oversight of the Partner Institution it will contain provisions in particular on the five following aspects:

(a) Transfer of funds to the Partner Institution(s). The UNFCCC secretariat will transfer funds upon request of the Partner Institution based on a forecast of loan disbursements

and agreed annual budget for administrative (management) costs. Ideally there should be no more than one such transfer every year.

(b) Business Plan, Reporting, Budget and Financial Account. The Partner Institution would prepare and submit for review by the UNFCCC secretariat:

(i) An annual Business Plan, setting out the Partner Institution's approach, organization, resources, and suggestions for the loan scheme management. This Business Plan will need to be formally approved by the UNFCCC secretariat.

(ii) Quarterly reports covering the project pipeline (loan applications submitted, loan applications at due diligence stage) and project portfolio (loans signed, amounts disbursed, progress with milestones such as completion of PDDs, validation, cancellation, repayments, write-off.) The last calendar Quarterly report will include a review of past year performance and summary of key data (complementing the Annual Account as described below.)

(iii) An annual Budget providing forecasts of disbursements, reflows, administrative costs, etc. and amount requested for the annual transfer of funds (see above.) This Budget will need to be formally approved by the UNFCCC secretariat.

(iv) An annual Financial Statement providing information on amounts disbursed, cancelled, prepaid, written-off, accelerated, and administrative costs incurred[**].

(c) Procedures for loan application submission and processing, and templates (including that of the loan agreement) will be defined by the Partner Institution in line with the principles set out in this report, and subject to approval by the UNFCCC secretariat.

(d) Interim evaluation of the loan scheme, by an independent expert. This evaluation could take place at the end of the first year, so that adjustments can be made to the scheme as may be necessary.

(e) Right for the UNFCCC secretariat to terminate the contract in case of under-performance (e.g. fewer than x loans signed in a given period), or breach of contract (e.g. in case of misconduct).

Steering Committee

28. It is proposed that performance of the loan scheme will be reviewed by a Steering Committee that would convene at least once a year, or more frequently if at least two members of the Steering Committee so request. The Steering Committee would have the right to summon the Partner Institution, if there are concerns about the performance or issues that require such meeting. The membership of the steering committee would be determined once it is clear which variant of the outsourced management model will be in place.

IV. Tentative project eligibility criteria

29. The Partner Institution(s) will define project eligibility criteria in line with the principles set out below.

[**] In variant 1 the Budget and Financial Statement will not contain information on loan disbursements, reflows, as the UNFCCC secretariat would be signing and disbursing loans.

Countries

30. 129 countries have fewer than 10 registered CDM project activities, but only those having a functioning DNA would be eligible, currently [100].

31. There is a risk that the Partner Institution(s) be flooded with project proposals / loan applications given the very large number of countries concerned. It does not appear necessary, though, to set selection criteria pertaining to country characteristics, other than the security level in the country, as periodically monitored by the UN. The project-related eligibility criteria described below are strict enough as to obviate the need for additional country-related criteria.

Project and project proponents

32. Integrity of project owner and key project protagonists. Integrity is part and parcel of the due diligence process of international financial institutions, which use integrity check-lists and often conduct checks on some prospective clients if there is evidence or suspicion of past or current acts of money laundering, corruption, fraud or other criminal activities. For this loan scheme, only information in the public domain will be utilized, as project specific checks would be too expensive and time-consuming. However, subsequent disclosure of evidence of such act(s) would trigger the right to accelerate the loan, i.e. to call for immediate and total repayment of the loan.

33. Capacity of project owner to implement and operate the project (including with the support of third parties, e.g. wind turbine manufacturers under warranty and maintenance contract).

34. Commercially viable and available technology. The loan scheme will only support projects using proven and commercially viable technologies.

35. Financial viability. A project will likely not secure finance, and will not be viable if it does not generate enough revenue to cover all costs, including the cost of capital. Financial viability can be assessed by means of financial projections, and comparing the internal rate of return to the cost of capital or net present value, etc. Key parameters to review are investment costs relative to benchmarks, level of electricity or heat prices, existence of a power purchase agreement, operating costs, etc. The intention is not to develop sophisticated financial models, but to understand the key economic drivers and risks of a project and how revenues, costs and profitability are sensitive to changes in the value of these drivers (e.g. to a change in water flow, load factor, feed-in tariff, etc.)

36. Likelihood of securing project finance. This depends on the financial viability of the project but also on the availability of finance (senior and mezzanine debt, equity) on suitable terms in the project host country. Access to commercial finance is an issue in many of the potential beneficiary countries owing to factors such as investment climate, political risk, etc.

37. Likelihood of the project being completed and commissioned (permits, licenses, political violence risk, etc.). This is a function of the previous two factors, but also on whether the project owner can secure the necessary permits, land, etc.

38. Minimum CDM track record of either the project owner or its CDM advisor (e.g. the project proponent or their CDM advisor successfully validated at least one project of the same technology/methodology) and willingness (for the CDM advisor) to share in development risk by accepting that its remuneration–including from the loan–be tied to attainment of certain milestones, such as validation. To minimize losses, and attain a higher degree of success, it is essential that loans be only extended to project owners that have a certain track record in developing this type of project, or more likely have engaged advisors with the right credentials. This criterion in turn will make possible a lighter due diligence process and quicker decisions by the Partner Institution on whether to extend a loan.

39. Minimum emission reduction potential of [100] ktCO_2 over the crediting period[††]. A threshold of that order is justified if the loan is to be repaid in the first issuance year (see below section 5). At a spot market of $10 a CER 15,000 CERs would need to be issued to generate an amount sufficient to repay a loan of $150,000. This means a project would need to generate approximately 100,000 CERs on the basis of a 7-year crediting period. For a relatively low-risk project (in terms of creditworthiness, likelihood of securing construction finance, probability of CDM registration) that will generate substantial non-CDM revenues (e.g. corporate energy efficiency, fuel switch at an existing power plant or green-field renewable energy project, etc.) the threshold could be lower, as the lender can draw comfort from the existence of non-CDM revenue streams.

40. Need for the loan: It is recommended not to include a requirement that there be a "*demonstrated need*" for the loan, as this would run counter in many cases to the requirement that the project be bankable, e.g. if a project cannot raise $150,000 for CDM-related costs, how could it be expected that it can raise twenty or fifty times that amount in project finance? Between two projects of equal merit, risk, financial strength, and likelihood of progressing till registration, the Partner Institution should pick the one that needs that support most.

CDM process

41. Meeting CDM eligibility criteria. Another cornerstone of the project appraisal process is the assessment of the probability that the project can be registered. Key requirements in this regard are that the project be "additional", and has a credible baseline.

Eligible CDM transactions

42. Programmes of Activities (PoAs) would also be eligible to loans under the scheme. PoAs present great potential in developing countries, and would represent a good use of the loan scheme given the high upfront costs of developing PoAs.

Environmental and Social Safeguards

43. As per current CDM rules.

Eligible Costs

44. PDD (including methodology clarifications and revisions when needed).

45. Validation.

46. First verification.

[††] Too high a threshold might be too restrictive for a number of countries. A lower threshold would need to be compensated by a longer repayment schedule (see Section 7.)

47. It is also recommended to make the two following costs items eligible under the UNFCCC loan scheme, possibly in a later phase of the scheme in light of the results of the interim evaluation referred to above:

(a) New CDM methodology development (range: €100-200k)[‡‡].

(b) Other non-strictly CDM-related costs such as feasibility or environmental studies necessary to develop a project with significant GHG emission reduction potential and other sustainable development co-benefits.

V. Tentative loan terms and conditions

48. The Partner Institution(s) will apply the loan terms and conditions set out below. These may need to be refined in the loan agreement template that will be developed.

Obligor

49. The project owner

Loan terms

50. Tenor: The tenor (as in duration) of the loan will not be fixed *ex ante* but linked to first issuance of CERs. Repayment would normally be in the first issuance year, unless an exception is warranted. This would allow funds in the scheme to revolve faster, and thus enable the Partner Institution to extend more loans in a given period.

51. Interest rate: It is proposed no to charge any interest rate on these loans. Charging an interest would defeat the purpose of stimulating projects in countries where multiple barriers hinder CDM project development, and would complicate the operation of the scheme.

52. Fees:

(a) No arrangement, commitment or other fees are foreseen, again in view of the purpose of the scheme.

(b) Alternatively, the lender could charge a one-time fee (upfront fee), equal to e.g. 1% of the loan amount, with a minimum of $1,000. This would ensure that only serious applications are put forward.

[‡‡] An outright grant could be justified warranted if the new methodology presents the attributes of a public good (i.e. is not tied to particular, proprietary technology that cannot be easily adapted to suit other technologies). A grant would be outside the scope of the envisaged loan scheme, but could be considered under a possible donor-funded scheme complementing the loan scheme.

53. Disbursement:

(a) Disbursement of the loans will be upon milestones, e.g. validation, registration. Payment should be tied to *success*, not simply to the production of e.g. a PDD. Most of the competent service providers in this market understand and accept that, and indeed most already operate on this basis. Staggered disbursement will also mitigate risks to the UNFCCC funds.

(b) Disbursement of the loans will be made directly to the service provider/CDM advisor/DOE, as the case may be. This is common practice for IFI loans. Payments to the project owner will only be made if the previous option is impractical.

54. Repayment:

(a) It is proposed that the project owner be given the option to repay the loan either in cash or by requesting the Partner Institution to monetize a number of issued CERs sufficient to extinguish, as it were, the amount owed. The Adaptation Fund is also funded through CER monetization, and there is now a body of experience on this mechanism[§§]. It would be a responsibility of the Partner Institution to make arrangements to that effect.

(b) To eliminate the market risk to the project owner/borrower of a declining CER price on the spot market, the UNFCCC secretariat could agree that it will absorb the loss if that price falls below the level prevailing at the time of entering into the loan agreement. E.g. if the spot CER price is $10, and was $12 at the time of loan signing, and if the loan amount is $120,000, the Partner Institution will sell 10,000 CERs ($120,000/$12) for a price of $100,000, hence a loss of $20,000.

(c) The loan will normally be repaid in one installment, in the first issuance year. Exceptionally the Partner Institution could agree to a two- or three- year repayment period. It should be stressed that any lengthening of the repayment period will reduce the volume of reflows and hence the ability of the scheme to “revolve” in order to finance more projects in a given time period.

55. Security:

(a) Loan security (as in collateral) would consist in “withholding” issued CERs. Currently the UNFCCC secretariat operates a mechanism whereby the issued CERs are placed in a pending account till all fees owed to it (the so-called “share of proceed” fees, SOF fees) have been settled. They can then be distributed to the project owner. This mechanism could be applied to loan repayment as well. Note that it would be difficult to extend this system (a lien on CERs) to third party lenders if the “full outsourcing” model were selected (hence the Variant 1 proposal, in which the UNFCCC secretariat would be signatory of the loans).

[§§] In accordance with decision 1/CMP.3, paragraph 5 (k), the Adaptation Fund Board is funded through the monetization of 2% of the CERs issued by the Board. Through the CER Monetization Program, the World Bank as trustee converts the Adaptation Fund’s CERs into cash. The CER monetization guidelines, as approved by the Adaptation Fund Board, provide for the World Bank as trustee to conduct ongoing sales on carbon exchanges as well as over-the-counter. As of May 2010, the trustee had sold 5,595,000 CERs, generating revenues of approximately $95.7mln for the Adaptation Fund.

(b) There would be no other security, collateral, or guarantee for the loans. First, because the 2/CMP 5 decision could be construed as suggesting that loan repayment is only due if and when there are issued CERs. Second, because taking security in respect of such small loans would be complex, time-consuming and costly (legal instruments needed to be drafted to take security over an asset).

(c) For projects that did not get registered but still went on to be commissioned and generate revenue (the case for CDM additionality would have been slim anyhow), repayment in cash would remain due. As the loan would be unsecured, legal action might be unavoidable to enforce repayment. It is anticipated that these cases would be few.

56. Loan amount: the cap would be the lesser of [90]% of eligible costs or $150,000. This provision will prevent inflated prices. Exceptions could be granted, e.g. if a new methodology is needed. The floor would be $[50,000].

57. Key covenants: the intention is to keep these to the minimum. Covenants are undertakings given by the borrower in the loan agreement. They can be positive (things the borrower should do, besides repaying the loan in due course) or negative (things the borrower should not do). Positive undertakings will include, inter alia, the obligation to report periodically to the lender in respect of key aspects of the project (see below). Negative undertakings will include, inter alia, standard clauses on fraud, corruption, and misconduct as can be found in IFI loan agreements.

58. Competition: The project owner would undertake in the loan agreement (and as condition for disbursement) to seek the most competitive offer from service providers and/or DOEs. In practice, this would mean getting at least three quotes on the basis of clear terms of reference.

59. Loan cancellation, acceleration, prepayment, write-off:

(a) Cancellation: a loan can be cancelled (by both parties) if the project is abandoned, or if the project owner does not need the funds any longer, or (by the lender only) if there is a breach of the loan agreement (e.g. misconduct, etc.)

(b) Acceleration: a loan can be accelerated (called immediately, by the lender) if there is a breach of the loan agreement (e.g. misconduct, etc.)

(c) Prepayment: a loan can be prepaid (partly or fully reimbursed) by the project owner if it has no need of the funds and sufficient resources to reimburse the disbursed amount. This would be a most unlikely occurrence given the concessional nature of the proposed loan scheme.

(d) Write-off: a loan would be written-off (by the lender) if the project is abandoned, fails to get registered, or is discontinued as a result of e.g. bankruptcy.

60. Reporting: The borrower will report on a six-monthly basis to the lender on progress and development in respect of key project activities: permits and licenses, construction, validation, etc. The Partner Institution will develop a template for this report. These reports would not be sent to the UNFCCC secretariat but aggregated and summarized in the Partner Institution's own periodic reports to the UNFCCC secretariat.

VI. Loan application process

61. The selected Partner Institution(s) will be responsible for organizing the procedures for the submission and processing of loan applications, and producing the relevant templates[***], in accordance with the principles set out in the present document, and subject to approval by the UNFCCC secretariat (see above).

62. An Evaluation Committee will make decisions on the loan in one or two stages. If Variant 2 above is selected, a representative from the UNFCCC secretariat will participate in the committee meetings, with simple voting or veto right. The Partner Institution will act as secretariat to the Evaluation Committee and will draft minutes of the meeting. These minutes will be attached to the Quarterly reports to the UNFCCC secretariat (see above.)

63. The Partner Institution will appoint the Committee members (but for the UNFCCC secretariat representative in Variant 2) and the list of Committee members will be submitted to UNFCCC secretariat for approval. Committee members should collectively possess the following competencies: CDM expertise, emission reduction project development, project finance, legal. The Evaluation Committee would not need to meet physically.

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[***] In Variant 1 the UNFCCC secretariat would define its own template for the loan agreement.

Appendix I

Countries with 10 or fewer registered CDM activities (as of end June 2010)

Table 1: Countries with fewer than 10 registered CDM projects

	Number of countries with fewer than 10 registered projects	%	Number of countries with zero project	%	Number of registered projects	%
AFR	51	40%	36	45%	28	22%
LAC	25	19%	13	16%	36	28%
ASP	44	34%	27	34%	53	41%
EE	9	7%	4	5%	13	10%
TOTAL	129	100%	80	100%	130	100%

Source: UNFCCC secretariat

Key:

AFR: Africa

ASP: Asia and Pacific

EE: Eastern Europe

LAC: Latin America and Caribbean

Region	Countries with <10 or none registered CDM project	Number of projects	DNA
AFR	Algeria	0	Y
AFR	Angola	0	N
AFR	Benin	0	Y
AFR	Botswana	0	Y
AFR	Burkina Faso	0	Y
AFR	Burundi	0	N
AFR	Cameroon	1	Y
AFR	Cape Verde	0	Y
AFR	Central African Republic	0	N
AFR	Chad	0	N
AFR	Comoros	0	N

Region	Countries with <10 or none registered CDM project	Number of projects	DNA
AFR	Congo	0	N
AFR	Côte D'Ivoire	1	Y
AFR	Democratic Republic Of Congo	0	Y
AFR	Djibouti	0	Y
AFR	Egypt	5	Y
AFR	Equatorial Guinea	0	Y
AFR	Eritrea	0	Y
AFR	Ethiopia	1	Y
AFR	Gabon	0	Y
AFR	Gambia	0	Y
AFR	Ghana	0	Y
AFR	Guinea	0	Y
AFR	Guinea-Bissau	0	N
AFR	Kenya	2	Y
AFR	Lesotho	0	Y
AFR	Liberia	0	Y
AFR	Libyan Arab Jamahiriya	0	N
AFR	Madagascar	0	Y
AFR	Malawi	0	Y
AFR	Mali	1	Y
AFR	Mauritania	1	Y
AFR	Mauritius	0	Y
AFR	Morocco	5	Y
AFR	Mozambique	0	Y
AFR	Namibia	0	Y
AFR	Niger	0	Y
AFR	Nigeria	3	Y
AFR	Rwanda	1	Y

Region	Countries with <10 or none registered CDM project	Number of projects	DNA
AFR	Sao Tomé And Principe	0	N
AFR	Senegal	1	Y
AFR	Seychelles	0	N
AFR	Sierra Leone	0	Y
AFR	Sudan	0	Y
AFR	Swaziland	0	Y
AFR	Togo	0	Y
AFR	Tunisia	2	Y
AFR	Uganda	2	Y
AFR	United Republic Of Tanzania	1	Y
AFR	Zambia	1	Y
AFR	Zimbabwe	0	Y
ASP	Bahrain	0	Y
ASP	Bangladesh	2	Y
ASP	Brunei Darussalam	0	N
ASP	Bhutan	2	Y
ASP	Cambodia	4	Y
ASP	Cook Islands	0	N
ASP	Cyprus	6	Y
ASP	Democratic People's Republic Of Korea	0	Y
ASP	Fiji	1	Y
ASP	Iran (Islamic Republic Of)	1	Y
ASP	Iraq	0	N
ASP	Jordan	2	Y
ASP	Kazakhstan	0	N
ASP	Kiribati	0	N
ASP	Kuwait	0	Y
ASP	Kyrgyzstan	0	Y

Region	Countries with <10 or none registered CDM project	Number of projects	DNA
ASP	Lao People's Democratic Republic	1	Y
ASP	Lebanon	0	Y
ASP	Marshall Islands	0	Y
ASP	Micronesia (Federated States Of_	0	N
ASP	Mongolia	3	Y
ASP	Myanmar	0	Y
ASP	Nauru	0	N
ASP	Nepal	2	Y
ASP	Niue	0	N
ASP	Oman	0	N
ASP	Pakistan	7	Y
ASP	Palau	0	N
ASP	Papua New Guinea	1	Y
ASP	Qatar	1	Y
ASP	Samoa	0	N
ASP	Saudi Arabia	0	Y
ASP	Singapore	1	Y
ASP	Solomon Islands	0	N
ASP	Sri Lanka	6	Y
ASP	Syrian Arab Republic	2	Y
ASP	Tajikistan	0	Y
ASP	Timor-Leste	0	N
ASP	Tonga	0	N
ASP	Turkmenistan	0	Y
ASP	Tuvalu	0	N
ASP	United Arab Emirates	4	Y
ASP	Uzbekistan	7	Y
ASP	Vanuatu	0	N

Region	Countries with <10 or none registered CDM project	Number of projects	DNA
ASP	Yemen	0	Y
EE	Albania	1	Y
EE	Armenia	5	Y
EE	Azerbaijan	0	Y
EE	Bosnia And Herzegovina	0	N
EE	Georgia	2	Y
EE	Montenegro	0	Y
EE	Republic Of Moldova	4	Y
EE	Serbia	0	Y
EE	The Former Yugoslav Republic Of Macedonia	1	Y
LAC	Antigua And Barbuda	0	Y
LAC	Bahamas	0	Y
LAC	Barbados	0	Y
LAC	Belize	0	Y
LAC	Bolivia	4	Y
LAC	Costa Rica	6	Y
LAC	Cuba	2	Y
LAC	Dominica	0	Y
LAC	Dominican Republic	2	Y
LAC	El Salvador	6	Y
LAC	Grenada	0	Y
LAC	Guyana	1	Y
LAC	Haiti	0	N
LAC	Jamaica	1	Y
LAC	Nicaragua	4	Y
LAC	Panama	6	Y
LAC	Paraguay	1	Y
LAC	Saint Kitts And Nevis	0	N

Region	Countries with <10 or none registered CDM project	Number of projects	DNA
LAC	Saint Lucia	0	Y
LAC	Saint Vincent And The Grenadines	0	N
LAC	Suriname	0	Y
LAC	Trinidad And Tobago	0	Y
LAC	Uruguay	3	Y
LAC	Venezuela	0	N

Source: UNFCCC secretariat

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Appendix II

Questionnaire sent to DNAs

Questionnaire on proposed loan scheme to finance CDM project development costs

I. Preamble

1. At its fifth session (Copenhagen, 2009), the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP 5) (a) requested the Executive Board to allocate financial resources from the interest accrued on the principal of the Trust Fund for the Clean Development Mechanism, as well as any voluntary contributions from donors, in order to provide loans to support the following activities in countries with fewer than 10 registered clean development mechanism project activities to cover the costs of the development of project design documents, validation and the first verification for these project activities; (b) decided that these loans are to be repaid starting from the first issuance of certified emission reductions; and (c) requested the Executive Board to recommend guidelines and modalities for operationalizing the activities outlined above for consideration by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol at its sixth session".

2. It is envisaged that loans would:

(a) cover such costs up to about $150,000

(b) would be interest-free and

(c) would only be repayable if CERs are issued.

(d) Funds available currently stand at ca 3 million, but could increase gradually, in line with the increase in the "share of proceeds" (CDM registration fees).

(e) The scheme would be revolving

3. The UNFCCC secretariat is seeking inputs from potential beneficiary countries on the design of the scheme, and would be grateful if you could respond to the following questions, in the table provided below, by **[2nd] July latest**,

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#	Question	Yes*	No*	Comments
1	Would a loan scheme facilitate the development of CDM projects in your country? In what way? If not, why not?			
2	Should loan eligibility be restricted to certain types of projects, methodologies, etc. given the limited amount of available funds? Which?			
3	Do you think DNAs should play a role in the loan scheme? Which, at what stage?			
4	Do you agree with the proposed loan terms (as set out above)? If not, what alternative terms would you recommend?			
5	Which institution would be best qualified and positioned to perform the functions of project selection and appraisal?			
6	Which recommendations would you make to ensure the success of the scheme?			

* please use the “Comments” column if a Yes or No is not appropriate.