

**RE: Call for public inputs on the draft revised
"Guidelines on the assessment of investment analysis"**

Dear Members of the CDM Executive Board,

We are grateful to the Executive Board for launching a call for inputs from stakeholders on the draft "Guidelines on the assessment of investment analysis" and would like to submit our comment. We are also thankful to the Methodologies Panel for developing the Guideline and appreciate the amount of time and effort that must be devoted to refine the Guideline.

We believe it is basically a positive move to incorporate and combine the draft "Tool to calculate the weighted average cost of capital (WACC)" into the draft Guideline, and eliminate uncertainties and ambiguities by setting a default value of return of equity. MUMSS would like to make the following comments and suggestions for further improvement.

1. The meaning of "parameters that are standard in the market"

- ✓ We understand that a benchmark based on parameters that are standard in the market does not necessarily have to be WACC, but paragraphs 15 to 17 seem to assume that WACC would be used. Thus, it would be easier for the reader if it were clarified that this guideline is applied if WACC is used as the benchmark based on parameters that are standard in the market.
- ✓ It would give more clarity to the reader if the Guideline stated that "market" means both the financial market and the industry sector of the CDM project proponent.

2. Compulsory use of the default values (Paragraph 15)

Paragraph 15 states that "If the benchmark is based on parameters that are standard in the market, the values provided in Appendix A *shall* be used". We believe the project participants should also have a choice of calculating the return on equity from financial market data, industry data or other publicly available sources that could be validated by DOEs. Project developers should be allowed to enjoy some flexibility so that a realistic return of equity could be calculated, if such data is available.

3. The default values are too low (Appendix A)

We believe the default figures provided for return on equity are too low. As could be seen from the table below, in most of the cases, the average benchmark value of registered projects is higher than the default return on equity of the draft Guideline.

It can be assumed that the benchmark used in registered projects is in most cases a weighted average of equity and debt costs. It is generally recognised that debt cost is lower than the expected return on equity. So, the equity portion of a benchmark is likely to be higher than the benchmark. However, the default

values given for return on equity are in most cases lower than the average benchmark used in registered projects. We therefore feel that the default return on equity is over conservative and request it to be higher to appropriately represent the expected return on equity in host countries.

Host country ¹	Average value of benchmark of registered projects ²	No. of samples	Default return on equity of the draft Guideline		
			Group 1	Group 2	Group 3
Brazil	17.06%	32	11.75%	12.75%	11.25%
India	13.79%	195	11.75%	12.75%	11.25%
Indonesia	14.49%	12	12.5%	13.5%	12%
Malaysia	11.31%	34	10.9%	11.9%	10.4%
Mexico	12.0%	14	11.2%	12.2%	10.7%
Thailand	11.39%	16	11.2%	12.2%	10.7%
Vietnam	12.15%	19	12.75%	13.75%	12.25%

Note:

1. Host countries with more than 10 sample cases were selected. China has more than 10 sample cases, but it is excluded in the above table as government set benchmark is used in most cases.
2. The figures are compiled from “IGES CDM Investment Analysis Database” (25 Nov. 2010) <http://www.iges.or.jp/en/cdm/report.html>

We would like to add that there is the concern of the default values becoming the de facto upper limit of benchmark in the actual application of the Guideline. This is not appropriate in the case of a project-based mechanism like the CDM, where some projects will have a very different risk-profile to others, particularly those that are pioneering a new technology or new area of business. This would also fly in the face of previous EB guidance that barriers, should, as far as possible be reflected in quantitative terms as part of a financial analysis. If the EB’s default values become compulsory, then project developers will no longer be able to justify the use of higher benchmark values for more risky or challenging projects.

4. Calculating the default values (Appendix A)

- ✓ Explanation of the following is needed, especially for the benefit of project participants in host countries:
 - a) reason for using US risk free rate and US equity risk premium
 - b) how the adjustment factors of the three industry groups were determined
- ✓ We request more clarity on the frequency of updating the default values.

5. Calculating the cost of debt (Paragraph 16)

In reality, documented evidence on “cost of debt financing of comparable projects” is almost never available, because credit policies are usually undisclosed and financial institutions usually do not have

information on average lending rate or risk premium for each industry sector. As a result, project participants in many cases have to use the commercial lending rates, ie the prime lending rates, which are excessively low to be used as cost of debt for project proponents needing CDM finance. Therefore values that reflect the risk for cost of debt should be provided.

6. Editorial matter (Paragraph 13)

It may be easier for the reader if “internal company benchmark” is used instead of “company-specific benchmark”.

Thank you for your consideration.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Hajime Watanabe', is written over a horizontal line.

Hajime Watanabe

Chairman, Clean Energy Finance Committee

Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.