



ADAPTATION FUND

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Adaptation Fund Board  
Ethics and Finance Committee  
Ninth Meeting  
Bonn, Germany, 26-27 June 2012

Agenda Item 8 e)

**CER MONETIZATION – PROPOSED AMENDMENTS TO  
MONETIZATION PROGRAM GUIDELINES TO PERMIT DIRECT  
CERS SALES TO GOVERNMENTS**

**Adaptation Fund – Direct CER sales to Governments:  
Issues for Consideration by the Adaptation Fund Board and Required Amendments to the CER  
Monetization Guidelines**

**Prepared by the World Bank as Interim Trustee for the Adaptation Fund  
June 2012**

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## **I. Background**

1. At its meeting in March 2012 (AFB17), the Adaptation Fund Board (the “Board”) requested the World Bank as interim trustee (the “trustee”) to:

*“present a concrete proposal for direct CER sales to governments, including the preparation of a standard legal agreement, options for price maximization, and propose the appropriate amendments to the guidelines, taking into account the principle of transparency”*

2. This paper responds to the Board’s request, outlining some issues for consideration by the Board, and presenting amendments to the CER Monetization Guidelines (the “Guidelines”) that would be required to enable the sale of Adaptation Fund CERs directly to sovereign governments, for consideration and approval by the Board. A draft form of the standard legal agreement that the trustee could use for this purpose is also attached, for the Board’s information.

3. As established in Decision 1/CMP.3, Adaptation Fund CERs are to be sold to: i) ensure predictable revenue flow for the Adaptation Fund, ii) optimize revenue while limiting financial risks, and iii) be transparent and monetize the proceeds in the most cost effective manner.<sup>1</sup> The sale of CERs is also to be administered under the instructions, direction and guidance of the Board, consistent with its responsibility to supervise and manage the monetization of CERs.<sup>2</sup> The Board approved the Guidelines for this purpose at its fourth meeting, in December 2008. The Guidelines permit CER sales by two distinct methods: i) on carbon exchanges, at prices prevailing in the market, to any buyer eligible to trade on such exchanges (including by way of an auction); and ii) through larger Over-the-Counter (OTC) transactions, executed often to multiple buyers, at minimum prices agreed in advance through brokers and dealers (typically large, publically traded financial institutions).

4. The following sections outline some issues for consideration by the Board, and recommended criteria for direct sales to governments if such sales are to be contemplated by the Board, and executed by the trustee.

## **II. Issues Related to Direct Sales to Governments**

### **A. General Criteria and Principles**

5. Governments are currently eligible to purchase Adaptation Fund CERs using either of the two sales methods presently in use, however direct sales to governments were not explicitly included in the Guidelines, as this was not considered the most cost-effective way to monetize CERs, while simultaneously adhering to requirements of predictability of resources, revenue optimization, and transparency. In the current CER market environment, however, where the supply of CERs has outpaced demand, sales to national governments could potentially provide an opportunity to diversify the pool of potential buyers and, if undertaken

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<sup>1</sup> FCCC/KP/CMP/2007/9/Add.1, para 28

<sup>2</sup> FCCC/KP/CMP/2008/11/Add.2, para 25

under certain conditions, could achieve cost-effectiveness and other objectives. At a time when the supply of CERs is increasing and traditional demand among compliance buyers has declined, sales to governments could be employed as an alternative method of monetizing CERs. This method may also be beneficial when exchange markets are thin or illiquid, and therefore unable to absorb the volume of sales that may be required by the Adaptation Fund to ensure predictable revenue flow.

6. Direct sales to governments should be undertaken only if there is a clear net benefit to the Adaptation Fund, when compared with the established methods of selling, through exchanges or via OTC transactions. It is recommended that the benefit to be identified should be: i) a price premium, net of transactions costs, when compared with alternative approaches, and/or ii) a higher volume of sales than would otherwise be possible through exchanges or OTCs. The trustee has explored whether governments may be motivated to pay a premium for Adaptation Fund CERs; it should be noted that CER buyers, including government representatives, are generally required to purchase CERs at prevailing market prices. The achievement of a price premium over the spot market price should therefore be considered only as a secondary objective for direct CER sales to governments. Nevertheless, governments may be prepared to purchase industrial gas and large hydro-derived CERs directly, that may otherwise be more difficult to sell in large volumes at prevailing market prices. The principal benefit is therefore expected to be an ability to monetize a higher volume of CERs than would otherwise be possible using the current established methods.

#### ***B. Inclusiveness and Diversification***

7. Consistent with the objective of inclusiveness, CERs should be available for purchase by any interested government. Nevertheless, the Board may wish to consider the implications of sales to governments in the event that such sales are not widely diversified across countries, and whether a large volume of CER sales to a limited number of governments would be acceptable to the Adaptation Fund. To date, the trustee has received unsolicited indications of interest from two countries; widespread demand from governments is not expected for the foreseeable future; and it is possible that there may be demand for such direct sales from only a limited number of countries.<sup>3</sup>

8. The Board may also wish to consider whether it would be acceptable for CER sales to governments to constitute a significant portion of future Adaptation Fund CER sales, or whether it is desired to strike an appropriate balance between sales through the carbon markets, and sales directly to governments. A cap on the volume of CERs to be sold to governments, or a cap on the volume of CERs to be sold to any one government or country could be established. This could, however, have the effect of reducing the flexibility to achieve the CMP-defined objectives for the monetization program (i.e. ensure predictable revenue flow, optimize revenue while limiting financial risks, and monetize in the most cost effective manner). It could also inhibit flexibility to sell CERs in the event market conditions do not permit large volume

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<sup>3</sup> Declared intended use of Kyoto assets amounts to roughly 443 million tonnes from 2008 to 2012, mainly from Spain, Italy, the Netherlands and Austria (*World Bank: State and Trends of the Carbon Market, 2012, p. 67*).

sales on exchanges or via OTC transactions, or if additional revenue for projects and programs was required by the Adaptation Fund.

9. Recognizing that this is a decision for the Board, no limits to purchases by governments or by individual countries would apply to Adaptation Fund CER sales by the trustee, unless otherwise instructed by the Board.

### **C. Cost-effectiveness**

10. Direct sales to governments must first meet the test of cost-effectiveness. When compared with regular sales on exchanges, the transaction costs associated with direct sales to governments could be high, as sales to governments would require the negotiation and execution of a legal agreement for the transaction, incurring legal and other costs both to the Adaptation Fund (through the trustee administrative budget), as well as to the buyer. Costs for external legal counsel would also be incurred by the trustee (estimated at between USD 7,000 to USD 10,000 per agreement). Such a transaction may also require an analysis of any tax, procurement, regulatory and other issues related to CER sales that would be settled in the buyer's legal jurisdiction. Because this could render the cost of smaller transactions prohibitive, the trustee recommends that any direct sales to governments should only be undertaken if the buyer agrees to purchase a minimum number of CERs, thus rendering the costs of the sale at least comparable to alternative sales methods. It is recommended that a minimum sale amount of 500,000 CERs apply to direct sales to governments, subject to review and adjustment by the trustee based on prevailing CER market prices and observed transaction costs over time.

11. The option of a price premium to cover transactions costs, on a full cost recovery basis, was also considered. This option is not recommended, however, as costs may not be fully visible until the transaction is complete, introducing uncertainty for both buyer and seller. It may also introduce distortions in the market price for CERs.

### **D. Transparency**

12. To meet the requirement for transparency, sales to national governments should be disclosed publicly. It is proposed that the ability to sell Adaptation Fund CERs directly to governments be communicated in advance of any sales (through the Board's record of decisions). The results of any sales, including amounts and average prices would be reported by the trustee in the quarterly financial reports to the Board; such reports are available to the public on both the Adaptation Fund website and the trustee's website ([www.worldbank.org/fiftrustee](http://www.worldbank.org/fiftrustee)).

13. When the trustee and a government agree to a transaction, it is proposed that the government have the option to issue a press release, if it so desires. It is recommended, however, that details of the agreement – volume, method of trading, etc. – not be

communicated until after the sale. It is not expected that such public disclosure would have any negative implications for the Adaptation Fund or the overall CER monetization program.

### **III. Options for Price maximization**

14. CERs are generally sold at market prices. The trustee's experience with OTCs and the CER auction in 2011 has demonstrated that buyers have not been willing to pay a premium over the market price for the privilege of buying Adaptation Fund CERs. As noted above, initial consultations with governments and brokers have revealed that governments are generally constrained by policy or other means to purchase at market prices. It may nevertheless be possible to achieve slightly higher prices, by offering a 'basket' of CERs derived from hydro, industrial gas, and so-called Green CERs. Such an approach may result in slightly higher prices achieved for some types of CERs (for instance, those derived from large hydros) if they are included in such a 'basket'.

15. Sales should be spread over time, to contribute to the objective of achieving the average market price, and reduce the risk of exposure to market fluctuations. A cluster of large direct sales to governments at a point in time could work against this objective. It is proposed that at the start of each month the trustee and the interested government purchaser would agree to an amount for the coming time period. For example, it could be agreed that, throughout the time period, a minimum of 50,000 and maximum of 200,000 CERs could be sold per day.

16. For transparency, the agreed price for the CERs would be based on a neutral benchmark and any negotiated price premium would be expressed as a percentage of that benchmark. It is recommended that the prevailing spot exchange (BlueNext) average of the bid/ask prices at a set time be used. This would be established as follows:

- At a given time, on predetermined days, the trustee and a representative from the government would agree to transact a specified number of CERs.
- The agreed price would be the midpoint of the highest bid price and lowest ask price prevailing in the market at the time (for instance, if the highest bid price is 3.90, and the lowest ask price is 4.00, the trustee and the government would agree to average of the two, or 3.95).
- The Adaptation Fund would benefit from this pricing arrangement by receiving a slight premium over the bid price prevailing in the market at the time (in this example, a trade of 100,000 CERs would yield a benefit of USD 2,500).

17. Settlement would be performed in the same way as it is presently undertaken through OTC trades with dealers:

- Trade Date – Price and Volume are agreed.

- Trade Date + 1 day – government wires cash to the trustee’s Adaptation Fund Account. As soon as funds are received, the trustee sends request to CDM to transfer CERs to the government’s registry.
- Trade Date + 2 or 3 days – government receives CERs.

18. A second option to settle trades would be through an exchange (e.g. BlueNext). This option would require the buyer to join the carbon exchange and settle the CER purchase on the exchange. The direct costs associated with this are expected to be minimal, the buyer would assume all costs associated with such membership and other requirements, and the cost to the Adaptation Fund would be limited. For instance, transaction costs applicable on BlueNext are EUR40 per trade and EUR 0.01 per ton (incurred by both and seller and buyer). Such settlement would occur as follows:

- Trade date – Price and Volume are agreed to. Information on trade is entered into the exchange's on-line system by the trustee. Once the purchasing government agrees to the transaction, the CERs are transferred to government’s registry and cash is transferred to the World Bank Adaptation Fund account.

19. An advantage of using an exchange would be that since the trustee is ‘facing’ the exchange, there is no need for a formal legal agreement with the purchaser. As outlined above, a potential disadvantage would be that the government would be required to become a limited member of the exchange, which may, depending on the country circumstances, be administratively burdensome and require lengthy internal processes.

#### **IV. Conclusions**

20. The introduction of direct sales to governments could yield benefits to the Adaptation Fund, but may also bring with them other issues, as outlined above. If so requested by the Board, the trustee would proceed to undertake direct sales to governments, consistent with the principles and criteria described herein. No limits or maxima would apply to sales either to governments as a whole, or to specific governments or countries, unless the Board otherwise instructs the trustee.

21. Amendments to the CER Monetization Guidelines would be required to permit direct sales to governments; such amendments are contained in Annex 2. Additional, editorial amendments are also presented for the purpose of updating and removing outdated sections of the Guidelines.

22. A draft form of standard legal agreement that the trustee could use for direct sales to governments is attached as Annex 1, for information.

**Annex 1: Model Agreement for CER sales to Governments**

**DRAFT SUBJECT TO FURTHER REVIEW AND CHANGES BY ENGLISH LAW  
COUNSEL**

**INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, AS  
INTERIM TRUSTEE FOR THE ADAPTATION FUND**

**And**

**[ENTITY NAME]**

**Dated \_\_\_\_\_**

**EMISSION ALLOWANCES SPOT TRADE MASTER AGREEMENT**



**This Emission Allowances Spot Trade Master Agreement** is dated [●] **between:**

- (1) **International Bank for Reconstruction and Development** an international organisation acting as trustee for the Adaptation Fund, with its principal office at 1818 H Street N.W., Washington D.C. 20433 (“**ITAF**”); and
- (2) [**Purchaser name**] a [*insert nature of party*] existing under the laws of [●] whose [registered/principal/operational office is at [●] (the “**Receiving Party**”),

(each, a “**Party**”, and together, the “**Parties**”).

In consideration of the mutual undertakings in this Emissions Allowances Spot Trade Master Agreement (“**Agreement**”) and for other good and valuable consideration, the receipt and sufficiency of which the Parties acknowledge, the Parties agree as follows:

## **1 General Obligations, Representations and Warranties**

**1.1** Each Party represents and warrants to the other Party that:

- 1.1.1 it has the power and authority to enter into and perform its obligations under this Agreement and, by entering into this Agreement, it will not breach the terms of any contract with any third party or be in violation of any law or statute applicable to it;
- 1.1.2 it is not relying upon any representations of the other Party other than those expressly set out in this Agreement and it has entered into this Agreement after a full opportunity to review its terms and conditions, has a full understanding of those terms and conditions and of their risks, and is capable of assuming those risks;
- 1.1.3 the other Party is not acting as a fiduciary or an advisor for it, nor has the other Party given to it any advice, representation, assurance or guarantee as to the expected performance, benefit or result of this Agreement;
- 1.1.4 it shall, if ITAF, cause delivery to the Receiving Party of the Allowances free and clear of all liens, security interests, claims and encumbrances or any interest in or to them by any person;
- 1.1.5 if applicable, it has at all times: (i) maintained in full force and effect all Required Authorisations; and (ii) fully complied with the Relevant Scheme Rules to the extent necessary to permit the Transfer contemplated by this Agreement;
- 1.1.6 it has negotiated, entered into and executed this Agreement as principal (and not as agent or in any other capacity, fiduciary or otherwise), except in the case of ITAF, which has negotiated, entered into and executed this Agreement as trustee of the Adaptation Fund;
- 1.1.7 it is not insolvent nor, as far as it is aware, are there any insolvency proceedings pending or being contemplated by or threatened against it; and
- 1.1.8 its obligations under this Agreement constitute legal, valid and binding obligations, enforceable in accordance with its respective terms by an appropriate legal remedy, subject to applicable laws of bankruptcy, insolvency, fraudulent transfer, reorganisation, moratorium or similar laws of general applicability relating to or affecting the enforcement of creditors’ rights.

- 1.2 All Transactions are entered into in reliance on the fact that this Agreement (including, for the avoidance of doubt, all of its Schedules), all Daily Confirmations and all Transactions form a single agreement between the Parties and the Parties acknowledge and agree that they would not otherwise enter into any Transactions and, for the avoidance of doubt, any reference to “Agreement” includes any Daily Confirmations.

## 2 Trading Mandate

- 2.1 ITAF may at any time notify the Receiving Party of a trading mandate (“**Trading Mandate**”) specifying the time period where the offer contained in such mandate is open for acceptance (the “**Mandate Period**”) and the maximum volume of Allowances available for purchase pursuant to the Trading Mandate (the “**Maximum Volume**”).
- 2.2 ITAF shall on each Trading Day of the Mandate Period, or until the Maximum Volume is sold, notify the Receiving Party of the Offer Price for that Trading Day and the maximum volume of Allowances available for purchase on that Trading Day (the “**Daily Trading Cap**”) in a notice (the “**Daily Trading Notice**”) The Offer Price and Daily Trading Cap shall be applicable only for that one Trading Day on which such notification is made. The Daily Trading Notice shall be substantially in the form attached at Schedule 1 to this Agreement. A failure by ITAF to notify the Receiving Party of the Offer Price or Daily Trading Cap shall not be a breach of this Agreement.
- 2.3 The terms of the Daily Trading Notice shall be confirmed by ITAF to the Receiving Party by telephone on a recorded line by no later than 9 a.m. London Time on the relevant Trading Day.
- 2.4 The Daily Trading Notice shall also be sent by ITAF to the Receiving Party by email to [enter email address] by no later than 9 a.m. London Time on the same Trading Day.

## 3 Acceptance

- 3.1 The Receiving Party shall be entitled to accept the offer contained in the Trading Mandate for any amount up to the Maximum Volume at any time within the Mandate Period at the Offer Price applicable on that Trading Day provided that such acceptance shall only be effective to the extent that it is for an amount that is a multiple of 10,000 Allowances and that it does not exceed the Daily Trading Cap.
- 3.2 Upon acceptance pursuant to clause 3.1 the Receiving Party shall confirm such acceptance to ITAF by telephone on a recorded line by no later than 7 p.m. London Time on the relevant Trading Day, specifying the Purchase Quantity and the Purchase Price (being the Offer Price multiplied by the Purchase Quantity).
- 3.3 Following the confirmation telephone call from the Receiving Party pursuant to clause 3.2, ITAF shall complete the Daily Confirmation and Invoice, confirming the trade information specified in Clause 3.2. Such Daily Confirmation and Invoice shall be substantially in the form attached at Schedule 2 to this Agreement. ITAF shall send a copy of the Daily Confirmation and Invoice to the Receiving Party by email to [enter email address] or by SWIFT message by no later than 9 a.m. London Time on the next Trading Day.
- 3.4 For the avoidance of doubt, failure by ITAF to send a Daily Confirmation does not:

- 3.4.1 affect the validity or enforceability of any relevant Transaction; or
- 3.4.2 constitute a material breach of this Agreement.

#### **4 Allowance Transfers**

- 4.1 Following receipt of the relevant Purchase Price in full (subject to Clause 7.3), ITAF shall Transfer (or procure the Transfer of) the relevant Purchase Quantity by no later than the Delivery Date as set out in the relevant Daily Confirmation and Invoice, or two Banking Days following receipt of payment whichever is the later, from ITAF's Account to the Receiving Party's Account as detailed below:

ITAF's Account:                      Account Identifier: 1004  
   Account Name: Share of Adaptation Proceeds  
   Participant: Adaptation Fund Board  
   Party: AF

Receiving Party's Account:        [insert detail]

- 4.2 The Transfer shall be considered to be completed and irreversible when the final notification in the total sequence of message and/or notification exchanges in respect of the Transfer has been received by the CITL and the ITL and the relevant Purchase Quantity of Allowances has been credited to the Receiving Party's Account in accordance with the Relevant Registries Regulation, whereupon risk of loss related to the Allowances, or any portion thereof, shall transfer from ITAF to the Receiving Party.
- 4.3 As soon as practicably possible after Transfer, ITAF shall confirm in writing to the Receiving Party that it has effected the Transfer.
- 4.4 The Parties agree to co-operate with each other in relation to the Transfer and to do such things as are necessary in accordance with, and as required by, the Relevant Scheme in order to Transfer the Allowances to the Receiving Party's Account by the relevant Delivery Date.

#### **5 Price, Taxes and Payment**

- 5.1 All amounts referred to in this Agreement are exclusive of any applicable VAT chargeable on the supply or supplies for which such amounts form the whole or part of the consideration for VAT purposes. The VAT treatment of the Transfer shall be determined pursuant to the VAT law of the jurisdiction where the supply or supplies are deemed to take place for VAT purposes, provided that the Parties hereto acknowledge that ITAF is immune from the payment or collection of any tax pursuant to the Articles of Agreement of the International Bank for Reconstruction and Development. Each Party shall, to the extent permitted by law, provide the other with any additional valid VAT invoices as required for the purposes of this Agreement and, to the extent required by law, shall correctly account for any VAT properly due in its jurisdiction.

Subject to obligations relating to VAT, each Party shall cause all royalties, taxes, duties, levies and other sums (including, without limitation, any stamp duty, other documentary taxes, climate change levy or other environmental tax or levy) ("**Other Taxes**") legally payable by that Party or otherwise arising in connection with this Agreement to be paid.

- 5.2** If either Party defaults in the performance of any payment obligation under this Agreement, then without prejudice to the other Party's other rights or remedies, the late-paying Party shall be liable to pay interest (before as well as after judgment) on the overdue amount to the other Party at a daily rate equal to the EUR-EONIA-OIS-COMPOUND rate plus 3 per cent for the period from and including the original due date for payment to but excluding the date on which the other Party receives payment of the overdue amount together with all interest that has accrued (the "**Interest Period**"). If such rate ceases temporarily or permanently to be published then the Party owed money may substitute a rate that it considers in good faith to be equivalent to that rate published by a European clearing bank. Any interest pursuant to this Clause 5.2 shall be calculated on the basis of daily compounding and the actual number of days elapsed.
- 5.3** Except as otherwise expressly provided in this Agreement, each Party shall be responsible for its own costs incurred in performing its obligations under this Agreement.

## **6 Force Majeure and Suspension Event**

### **6.1 Force Majeure**

Upon the occurrence of a Force Majeure, either Party may notify the other Party in writing of the commencement of the Force Majeure. Where the notification is from the Party affected by the Force Majeure (the "**FM Affected Party**"), to the extent available to such Party and to the extent it is reasonably practicable to do so, it should also provide to the other Party (the "**Non FM Affected Party**") details of the Force Majeure and a non-binding estimate of the extent and the expected duration of its inability to perform its obligations due to the Force Majeure.

The obligations of both Parties under this Agreement will be suspended for the duration of the Force Majeure. During the continuation of the Force Majeure, the FM Affected Party shall use all reasonable endeavours (which, for the avoidance of doubt, shall not involve the FM Affected Party incurring any costs (excluding immaterial incidental expenses)) to overcome the Force Majeure. Upon the Force Majeure being overcome or it ceasing to subsist, both Parties shall, as soon as reasonably practicable thereafter, resume full performance of their obligations under this Agreement (including, for the avoidance of doubt, any suspended obligations).

Where a Force Majeure continues for a period of nine Banking Days, either Party may, by written notice to the other Party, terminate this Agreement. Upon such termination, it will be deemed that the Parties have no further delivery or payment obligations under this Agreement provided that ITAF shall refund to the Receiving Party any Purchase Price paid in respect of any Allowances not delivered.

- 6.2** Where an event or circumstance that would otherwise constitute or give rise to a Default also constitutes a Force Majeure, it is to be treated as Force Majeure and not as a Default.

## **7 Default and Consequences**

- 7.1** Subject to Clause 6, a Party shall be in default (the "**Defaulting Party**"):

**7.1.1** if it fails to comply with any of its obligations under this Agreement (other than due to a Force Majeure or an obligation referred to in Clauses 7.1.2, 7.1.3 or 7.2,) and that failure is not remedied within five Banking Days of the other Party's giving notice of that failure;

**7.1.2** if it fails to make payment when due under this Agreement, and that failure is not remedied on or before the third Banking Day after the other Party's giving notice of that failure;

**7.1.3** if it breaches any of the warranties set out in Clause 1; or

**7.1.4** if it:

- (i) is dissolved (other than pursuant to a consolidation, amalgamation or merger);
- (ii) becomes insolvent or is unable to pay its debts generally as they fall due, fails generally to pay, or admits in writing its inability generally to pay, its debts as they become due;
- (iii) makes a general assignment, arrangement, composition or other arrangement with or for the benefit of its creditors;
- (iv) institutes or has instituted against it a proceeding seeking a judgment of insolvency or bankruptcy or any other relief under any bankruptcy or insolvency law or other similar law affecting creditors' rights, or a petition is presented for its winding-up or liquidation, and in the case of any such proceeding or petition instituted or presented against it, that proceeding or petition (a) results in a judgment of insolvency or bankruptcy or the entry of an order for relief or the making of an order for its winding-up or liquidation or (b) is not withdrawn, dismissed, discharged, stayed or restrained in each case within thirty days of the institution or presentation of that proceeding or petition;
- (v) has a resolution passed for its winding-up, official management or liquidation (other than pursuant to a consolidation, amalgamation or merger);
- (vi) seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all its assets;
- (vii) has a secured party take possession of all or substantially all its assets or has a distress, execution, attachment, sequestration or other legal process levied, enforced, or sued on or against all or substantially all its assets and that secured party maintains possession, or that process is not withdrawn, dismissed, discharged, stayed or restrained, in each case within 15 days of that event;
- (viii) causes or is subject to any event with respect to it that, under the applicable laws of any jurisdiction, has an analogous effect to any of the events specified in subparagraph (i) to (vii) of this Clause 7.1.4; or
- (ix) takes any action in furtherance, or indicating its consent to, approval of, or acquiescence in, any of the acts referred to in this Clause 7.1.4.

**7.2** If, on the relevant Delivery Date, ITAF procures delivery to the Receiving Party of no Allowances or fewer Allowances than the relevant Purchase Quantity, ITAF shall refund within 10 Banking Days to the Receiving Party an amount equal to the Default Quantity multiplied by the relevant Offer Price.

**7.3** If, on the relevant Payment Date, the Receiving Party pays ITAF any amount less than the relevant Purchase Price as set out in the relevant Daily Confirmation and Invoice (except where

such failure is caused by ITAF's non-performance or a Force Majeure) and that failure is not remedied on or before the third Banking Day after the other Party's giving notice of that failure, ITAF shall deliver to the Receiving Party only those Allowances that have been fully paid for as part of the Purchase Price received and shall not, for the avoidance of doubt, deliver to the Receiving Party the Shortfall Quantity.

**7.4** In the event of a default falling within Clause 7.1, the Party not in default (the "**Non-defaulting Party**") shall have the right to immediately terminate this Agreement and any Transactions entered into between the Parties upon written notice to the Defaulting Party. The Non-defaulting Party shall calculate the Event of Default Loss and shall notify the Defaulting Party of such amount, including detailed support for the calculation of such amount. If the Event of Default Loss is:

**7.4.1** a positive number, the Defaulting Party shall pay this amount to the Non-defaulting Party within three Banking Days of invoice or notification of the Event of Default Loss, which amount shall bear interest in accordance with Clause 5.2; or

**7.4.2** a negative number, the Non-defaulting Party shall pay an amount equal to the absolute value of the Event of Default Loss to the Defaulting Party within thirty Banking Days of the invoice or notification of the Event of Default Loss.

**7.5** The amounts set out in Clause 7.4 are the Parties' reasonable pre-estimate of the losses that would flow from the events of default contemplated by the Parties. No other amounts (except for interest for late payment pursuant to Clause 5.2) shall be payable by either Party in respect of a default.

**7.6** The Non-defaulting Party shall have the right to set-off any amounts owing pursuant to the provisions of Clause 7.4 against any Other Amounts Owing. This right of set-off shall be without prejudice to any other right of set-off, counterclaim, combination of accounts, lien, charge or other right to which any Party is at any time otherwise entitled (whether by operation of law, contract or otherwise). If an amount is unascertained, the Non-defaulting Party may reasonably estimate the amount to be set off (subject to the Non-defaulting Party accounting to the Defaulting Party when the obligation is ascertained), and the Parties shall make any adjustment payment required within three Banking Days of the amount becoming ascertained.

**7.7** If ITAF fails to make a Transfer to the Receiving Party's Account on or before the Delivery Date for any reason (except where such failure is caused by the Receiving Party's non-performance or a Force Majeure) and that failure is not remedied within one Banking Day of the other Party's giving notice of that failure (in either case, the "Final Delivery Date") ITAF shall pay to the Receiving Party the Receiving Party's Replacement Cost within three Banking Days following receipt of invoice or notification from the Receiving Party. Upon the Receiving Party's receipt of the Receiving Party's Replacement Cost, ITAF's obligation to Transfer the Default Quantity to the Receiving Party's Account by the relevant Delivery Date, and the corresponding payment obligation of the Receiving Party, shall both be fully discharged and the other and future obligations of the Parties in respect of the Transaction shall remain in full force and effect.

## **8 Limitation on Liability**

**8.1** This Agreement sets forth the full extent of the Parties' obligations and liabilities arising out of or in connection with this Agreement, and there are no conditions, warranties, representations or terms,

express or implied, that are binding on the Parties except as specifically stated in this Agreement. Any condition, warranty, representation or other term which might otherwise be implied into or incorporated in this Agreement, whether by statute, common law or otherwise, is hereby expressly excluded.

- 8.2** Save as expressly provided otherwise in this Agreement, and in particular in Clause 8.3 of this Agreement, neither Party shall be liable under or in connection with this Agreement for any loss of income, loss of profits or loss of contracts, or for any indirect or consequential loss or damage of any kind, in each case howsoever arising and whether caused by tort (including negligence), breach of contract or otherwise.
- 8.3** Nothing in this Agreement shall exclude or in any way limit either Party's liability for fraud, or for death or personal injury caused by its negligence.
- 8.4** The liability of ITAF under this Agreement shall not exceed the net value from time to time of the Adaptation Fund. The Receiving Party shall have no recourse to assets belonging to ITAF personally or held by it in any capacity other than as the trustee of the Adaptation Fund.

## **9 Confidentiality**

Neither Party may make any public disclosure, communication or announcement about the contents of this Agreement or of any of the other information of which it has become aware in connection with this Agreement except: with the prior written consent of the other Party; to the extent required by applicable law or a competent court or other competent authority; to the professional advisers of each Party, provided that each Party ensures that the matters disclosed are kept confidential; or in respect of information which is lawfully in the public domain.

## **10 Miscellaneous**

- 10.1** This Agreement and any non-contractual obligations arising out of or in connection with it shall be governed by the laws of England and Wales.
- 10.2** Any notice under this Agreement:
- 10.2.1** must be in writing; and
- 10.2.2** must be addressed as shown below, or as otherwise notified by a Party to the other Party from time to time.

ITAF Address:

The World Bank  
MSN MC7-706  
1818 H Street N.W.  
Washington, D.C. 20433  
Fax no: 202-477-8355  
E-mail: rhunt@worldbank.org  
Attention: Robert Hunt

Receiving Party [insert detail]

The Parties submit to the non-exclusive jurisdiction of the courts of England and Wales to resolve any disputes that arise between them relating to this Agreement.

- 10.3** Any notice or other written communication to be given or made in respect of the Agreement by one Party to the other is to be given or made in writing by e-mail or by facsimile transmission to the other at the address or contact number that the other Party gives to the notifying Party from time to time or, if no address or contact number has been so given, at the other Party's registered office. A written notice is deemed to have been received: (a) if delivered by hand, on the Banking Day of delivery or on the first Banking Day after the date of delivery if delivered on a day other than a Banking Day; (b) if sent by registered mail, on the second Banking Day after the date of posting or, if sent from one country to another, on the fifth Banking Day after the date of posting; (c) if sent by facsimile transmission and a valid transmission report confirming good receipt is generated, on the day of transmission if transmitted before 11:00 a.m. Central European Time on a Banking Day or otherwise on the first Banking Day after transmission; or (d) if sent by e-mail, on the day of receipt, if received before 11:00 a.m. Central European Time on a Banking Day or otherwise on the first Banking Day after receipt provided that the provisions of this Clause 10.2 do not apply to Clauses 3.1 to 3.4 (inclusive) or to Clauses 3.6 or 3.7 of this Agreement.
- 10.4** Neither Party may assign or transfer all or part of this Agreement without the prior written consent of the other Party.
- 10.5** The failure of either Party to enforce or to exercise at any time or for any period of time any term of or any right pursuant to this Agreement does not constitute, and shall not be construed as, a waiver of such term or right and shall in no way affect that Party's right later to enforce or to exercise it.
- 10.6** If any term of this Agreement is found to be illegal, invalid or unenforceable under any applicable law, such term shall, insofar as it is severable from the remaining terms, be deemed omitted from this Agreement and shall in no way affect the legality, validity or enforceability of the remaining terms.
- 10.7** The Agreement constitutes the entire agreement and understanding of the Parties with respect to its subject matter and supersedes and extinguishes any representations previously given or made with respect to its subject matter other than those given or made in the Agreement, but nothing in this Clause 10.6 limits or excludes any liability for fraud in relation to those representations.
- 10.8** Clauses 7, 8, 9 and 10 shall remain in full force and effect notwithstanding such expiry or termination.
- 10.9** The relationship of the Parties is that of independent contractors dealing on an arm's length basis. Except as otherwise stated in this Agreement, nothing in this Agreement shall constitute the Parties as partners, joint venturers, fiduciaries or co-owners, or constitute either Party as the agent, employee or representative of the other, or empower either Party to act for, bind or otherwise create or assume any obligation on behalf of the other, and neither Party shall hold itself out as having authority to do the same.
- 10.10** No alteration to or variation of this Agreement shall take effect unless and until the same is in writing and signed on behalf of each of the Parties by a duly authorised representative.



- 10.11** No third party shall have any right under the Contracts (Rights of Third Parties) Act 1999 (UK) to enforce any terms of this Agreement.
- 10.12** The Parties intend that they shall be legally bound by the terms of this Agreement from the moment they agree to the commercial terms set forth in Clauses 2 and 3 (whether orally or otherwise) on the relevant Trading Day. Each Party hereby acknowledges to the other Party and consents that such other Party may, from time to time, and without further notice, electronically record telephone conversations between the Parties' respective trading, marketing and other relevant business personnel of the Parties in connection with this Agreement or other commercial matters between the Parties. The time of dealing will be confirmed by the Receiving Party upon written request.
- 10.13** Notwithstanding the date of signing and delivery of this Agreement, its effective date is the date first written above.
- 10.14** This Agreement may be signed and delivered in counterparts with the same effect as if both Parties had signed and delivered the same copy, and when each Party has signed and delivered a counterpart, all counterparts together constitute one Agreement.
- 10.15** The Parties acknowledge and agree that no provision of this Agreement or of the rules of any arbitral board or organisation, nor the submission to arbitration by ITAF, in any way constitutes or implies a waiver, termination or modification by ITAF of any privilege, immunity or exception of ITAF granted in international conventions or applicable law.

## **11 Definitions**

In this Agreement:

**"Account"** means any digital record of a Party or person in any relevant Registry that will be used to record the issue (if applicable), holding, transfer, acquisition, surrender, cancellation, and replacement of Allowances;

**"Adaptation Fund"** means: means the fund containing the Adaptation Fund CERs and cash as administered by ITAF and established pursuant to Article 12 paragraph 8 of the Kyoto Protocol, Decisions 3 and 28 of the first session, Decision 5 of the second session and Decision 1 of the third session of the Conference of the Parties serving as a Meeting of the Parties to the Kyoto Protocol (Decisions 3/CMP.1, 28/CMP.1, 5/CMP.2 and 1/CMP.3);

**"Adaptation Fund CERs"** means the quantity of CERs generated by a particular project deducted by the CDM Registry administrator upon each issuance for the purposes of assisting to meet the costs of adaptation for developing countries vulnerable to the adverse impacts of climate change in accordance with paragraph 8, Article 12 of the Kyoto Protocol;

**"Allowance"** means any one or more of an EU Allowance, a Certified Emission Reduction and an Emission Reduction Unit as more fully specified in Clause 2.1;

**"Annex 1 Country"** means one of the countries listed, from time to time, in Annex 1 of the UNFCCC and also in Annex B of the Kyoto Protocol that has ratified, accepted, acceded or approved the Kyoto Protocol;

**“Banking Day”** means any day (other than a Saturday or Sunday) in which commercial banks are open for general business in Washington D.C. and the jurisdiction where the Receiving Party has its registered office;

**“CDM”** or “Clean Development Mechanism” means the Clean Development Mechanism referred to in Article 12 of the Kyoto Protocol;

**“CDM Registry”** means the intergovernmental registry administered by the UNFCCC Secretariat established to issue CERs and to hold accounts for Allowances;

**“Certified Emission Reduction”** or **“CER”** means a unit issued pursuant to Article 12 of the Kyoto Protocol and decision 3/CMP.1 of the COP/MOP, as amended from time to time, which may be used for compliance purposes in accordance with Article 11a(3)(a) and (b) of the Directive, as amended from time to time;

**“CITL”** or **“Community Independent Transaction Log”** has the meaning given to the **“independent transaction log”** in Article 20(1) of the Directive;

**“Commitment Period Reserve”** means the commitment period reserve that each Annex 1 Country is required to maintain in its Registry in accordance with paragraphs 6 to 10 of decision 11/CMP.1 of the COP/MOP, as amended from time to time;

**“Compliance Period Traded Allowance”** means an Allowance that ITAF agrees to Transfer to the Receiving Party and the Receiving Party agrees to accept from ITAF under this Agreement;

**“COP/MOP”** means the Conference of the Parties to the UNFCCC serving as the meeting of the Parties to the Kyoto Protocol. For the avoidance of doubt, a reference to “Parties” in this definition only is a reference to the Parties to the UNFCCC and the Parties to the Kyoto Protocol and not a reference to the Parties of this Agreement;

**“Daily Confirmation and Invoice”** means the notice specifying the number of Allowances that the Receiving Party has opted to purchase from ITAF at the relevant Purchase Price in respect of the relevant Trading Day;

**“Daily Trading Cap”** has the meaning set out in Clause 2.2;

**“Daily Trading Notice”** has the meaning given to it in Clause 2.2;

**“Delivery Date”** means the date on which ITAF is due to deliver the relevant Purchase Quantity to the Receiving Party, being no later than two Banking Days following the relevant Payment Date, as specified in the relevant Daily Confirmation and Invoice;

**“Default”** means any of the circumstances described in Clause 7.1;

**“Default Quantity”** means, in respect of the relevant Delivery Date, the quantity equal to the positive difference between (a) the relevant Purchase Quantity and (b) the quantity of Allowances delivered on the relevant Delivery Date in accordance with the terms of this Agreement;

**“Directive”** means Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emissions allowance trading within the Community and amending Council Directive 96/61/EC, as amended by Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004, and as may be amended from time to time;

**“Eligibility Criteria”** means the criteria for emissions trading pursuant to Article 17 of the Kyoto Protocol which are required to be satisfied in order that Allowances to be Transferred in respect of this Agreement can be Transferred or accepted on a cross border basis in accordance with this Agreement;

**“Emission Reduction Unit”** or **“ERU”** means a unit issued pursuant to Article 6 of the Kyoto Protocol and decision 10/CMP.1 of the COP/MOP, as amended from time to time, which may be used for compliance purposes in accordance with Article 11a(3)(a) and (b) of the Directive (as amended from time to time);

**“EU”** means the European Union, as it exists from time to time;

**“EU Allowance”** means an “allowance” as defined in the Directive;

**“Euro”** means the lawful currency of the Member States that have adopted the single currency of the European Union;

**“EUR-EONIA-OIS-COMPOUND”** means a reference rate equal to the overnight rate as calculated by the European Central Bank and appearing on Reuters Screen EONIA Page in respect of each day in the Interest Period;

**“EU Registries Regulation”** means the EU Commission Regulation adopted in order to establish a standardised and secured system of registries pursuant to Article 19(3) of Directive 2003/87/EC and Article 6(1) of Decision 280/2004/EC, as amended by EU Commission Regulation (EC) No. 916/2007, and as may be amended from time to time;

**“EU Registry”** means the registry established by a Member State or non Member State pursuant to the Directive in order to ensure the accurate accounting of the issue, holding, transfer, acquisition, surrender, cancellation, and replacement of Allowances;

**“Event of Default Loss”** means an amount that the Non-defaulting Party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with the termination of the Agreement and any Transactions entered into between the Parties pursuant to Clause 7.4, any loss of bargain, cost of funding (based on the actual costs of the Non-defaulting Party, whether or not greater than market costs) or, at the election of the Non-defaulting Party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or re-establishing any related trading position (or any gain resulting from any of them). It includes losses and costs (or gains) in respect of any payment required to have been made and not made or non-compliance with Clause 5 or 6 on or before the termination date. It does not include the Non-defaulting Party’s legal fees or out-of-pocket expenses. The Non-defaulting Party may (but need not) determine its Event of Default Loss by reference to quotations of average relevant rates or prices from two or more leading brokers in the Allowances trading market who are independent of the Parties;

**“FM Affected Party”** has the meaning given to it in Clause 6.1;

**“Executive Board”** means the executive board of the Clean Development Mechanism that is referred to in Article 12(4) of the Kyoto Protocol and established pursuant to decision 3/CMP.1 of the COP/MOP;

**“Force Majeure”** means the occurrence of any event or circumstance beyond the reasonable control of the FM Affected Party, including a Suspension Event, that could not, after using all

reasonable efforts (which shall not involve the FM Affected Party incurring any costs (excluding immaterial, incidental expenses)), be overcome and which renders the FM Affected Party unable to either (i) where the FM Affected Party is ITAF, deliver the relevant Purchase Quantity from ITAF's Account (ii) where the FM Affected Party is the Receiving Party, accept the relevant Purchase Quantity into the Receiving Party's Account, in accordance with the Scheme. The inability of a Party to perform a relevant delivery or acceptance obligation as a result of there being insufficient Allowances in ITAF's Account (whether caused by the low or non-allocation of Allowances from a Member State or non-Member State or the failure of ITAF to procure sufficient Allowances to meet its delivery obligations) shall not constitute a Force Majeure; provided, however, that this is not an exhaustive list of events which will not constitute a Force Majeure and is provided for the avoidance of doubt only;

**"ITL"** or **"International Transaction Log"** means the 'UNFCCC independent transaction log' as defined in Article 2(w) of the EU Registries Regulation;

**"ITL-Registry Operation"** means the establishment of and continuing functioning of the link between the ITL, CITL and the Relevant Registry. In addition, where this Agreement concerns CERs as set out under Clause 2.1, "ITL-Registry Operation" shall also include the establishment of and continuing of functioning of the link between the CDM Registry and the ITL;

**"Kyoto Protocol"** means the protocol to the UNFCCC adopted at the third conference of the parties to the UNFCCC in Kyoto, Japan, on 11 December 1997, as may be amended from time to time;

**"Mandate Period"** means [5] Trading Days starting on [x date] and ending on [x date], inclusive;

**"Maximum Volume"** has the meaning given to it in Clause 2.1;

**"Member State"** means any one of the signatories to the treaties establishing the European Union from time to time;

**"Non-defaulting Party"** means the Party that is not the Defaulting Party;

**"Non-EU Registry"** means a registry established by a sovereign state pursuant to the Article 7, paragraph 4 of the Kyoto Protocol and Decision 19/CP.7 of the COP/MOP in order to ensure the accurate accounting of the issue, holding, transfer, acquisition, surrender, cancellation, and replacement of, amongst other things, CERs and ERUs;

**"Offer Price"** means the minimum price at which ITAF shall sell its Allowances to the Receiving Party on the relevant Trading Day, as set out in the relevant Daily Trading Notice;

**"Other Amounts Owning"** means any or all amounts owing (whether or not matured, invoiced or due as primary obligor or surety) from the Receiving Party or ITAF (as the case may be) under any other agreements, confirmations or term sheets between them relating to the sale and purchase of Allowances;

**"Other Taxes"** has the meaning given to it in Clause 5.1;

**"Payment Date"** means the date on which payment of the relevant Purchase Price is due, being the first Banking Day immediately following the relevant Trading Day, as set out in the relevant Daily Confirmation and Invoice;

**“Purchase Price”** means the amount payable for the number of Allowances purchased on the relevant Trading Day, multiplied by the relevant Offer Price;

**“Purchase Quantity”** means the number of Allowances the Receiving Party has opted to Purchase at the relevant Offer Price, in respect of the relevant Trading Day, [subject to the confirmation of ITAF];

**“Receiving Party’s Replacement Cost”** means, in respect of a failure by ITAF to Transfer any number of Allowances with respect to the relevant Delivery Date pursuant to Clause 7.7:

- (a) the positive difference, if any, between (i) the price the Receiving Party, acting in a commercially reasonable manner, does or would pay in an arm’s length transaction concluded on the Final Delivery Date for an equivalent quantity of Compliance Period Traded Allowances to replace the Default Quantity, and (ii) the Purchase Price multiplied by the Default Quantity; plus
- (b) interest for the period from (and including) the relevant Delivery Date to (but excluding) the date of the written notice demanding such Receiving Party’s Replacement Cost calculated on the amount determined pursuant to paragraph (a) above at the rate specified in Clause 5.2; plus
- (c) the amount of such reasonable costs and expenses which the Receiving Party incurs in respect of the Default Quantity (including, without limitation, broker fees, commissions and legal fees.

**“Relevant Registries Regulations”** means the EU Registries Regulation or any other laws or regulations adopted by a sovereign state to establish a standardised and secured system of registries for the transfer of Allowances;

**“Relevant Registry”** means an EU Registry or a Non-EU Registry through which either Party is obliged to perform a Transfer or acceptance obligation under and in accordance with this Agreement;

**“Relevant Scheme”** means:

- (d) the scheme of transferring Allowances between either or both of (i) persons within the European Union and (ii) persons in third countries, in either case as recognised in accordance with, and subject to, the procedures set forth in the Directive established in, and as implemented by the national laws of, any Member State and certain non-Member States;
- (e) the scheme of transferring, amongst other things, CERs and ERUs, between and within Relevant Registries established under the Kyoto Protocol and the decisions of the COP/MOP; or
- (f) any other scheme of transferring Allowances between persons in the same country or different countries as recognised in accordance with procedures set forth in the laws of any sovereign state;

**“Relevant Scheme Rules”** means the rules and regulations of participation in, and operation of, a Relevant Scheme as applicable in the relevant sovereign state as amended from time to time;

**“Required Authorisations”** means all governmental and other licences, authorisations, permits, consents, contracts and other approvals (if any) that are required to enable a Party to fulfil any of its obligations under this Agreement;

**“Shortfall Quantity”** means, in respect of any Purchase Quantity as specified in the relevant Daily Confirmation and Invoice, the amount of Allowances not paid for by the Receiving Party on or before the relevant Payment Date;

**“Suspension Event”** means, on any date, a Party is unable to perform its Transfer or acceptance obligations under and in accordance with this Agreement through a Relevant Registry as a result of any of the following:

- (a) an absence of ITL-Registry Operation; or
- (b) the Member State or non-Member state in which the Relevant Registry is located has failed to achieve or maintain its Eligibility Criteria; or
- (c) in the case of ITAF only, the Member State or non-Member State in which the Relevant Registry is located has breached its Commitment Period Reserve;

**“Trading Day”** means any Banking Day during the Mandate Period;

**“Trading Mandate”** has the meaning given to it in Clause 2.1;

**“Transaction”** means an oral or written agreement between the Parties to undertake one or more transfers of Allowances subject to the terms of this Agreement;

**“Transfer”** means (whether used as a verb or a noun) the transfer of Allowances from one Account to another under and in accordance with and for the purposes of the Scheme such that the Receiving Party becomes the recognised, registered holder of the complete and unencumbered title to the Allowances, and **“Transferred”** and **“Transferring”** are to be construed accordingly. The term **“Transfer”**, as applied to ITAF, shall be construed to mean that either ITAF itself or a third party (under the direction of ITAF) will effect such Transfer, and **“Transferred”** and **“Transferring”**, as applied to ITAF, are to be construed accordingly;

**“UNFCCC”** means the United Nations Framework Convention on Climate Change adopted in New York on 9 May 1992; and

**“VAT”** means value added tax as levied by the Member States or non-Member States.

## **12 Interpretation**

The following interpretive provisions apply to this Agreement:

- 12.1** Reference to any legal instrument includes amendments, consolidations, re-enactments and replacements of it;
- 12.2** Any reference to a “Clause” or “schedule” is a reference to a Clause or schedule of this Agreement;
- 12.3** Words in the singular are to be interpreted as including the plural, and vice versa, to the extent the context permits or requires;
- 12.4** Any reference to “time” is deemed to be Central European Time unless otherwise specified;

**12.5** Unless otherwise specified, where a date specified in this Agreement to be a Delivery Date would otherwise fall on a day that is not a Banking Day, then such date will be deemed to be the next following day that is a Banking Day.

**In witness** whereof the Parties have duly executed and delivered this Agreement on the respective dates set out below with effect from the date set out on the first page of this document.

For and on behalf of  
**International Bank for Reconstruction and  
Development, as Trustee for the Adaptation  
Fund**

Authorised Signatory  
Name:  
Date:

For and on behalf of  
[Counterparty's full legal name]

Authorised Signatory  
Name:  
Date:



## Schedule 1

### Form of Daily Trading Notice

Daily Trading Notice	
Date:	[•]
Trading Day:	[•]
Mandate Period	[•] to [•]
Offer Price for the Trading Day:	€[•] per Allowance
Daily Trading Cap	[        ] Allowances

## Schedule 2

### Form of Daily Confirmation and Invoice

This Confirmation supplements, forms a part of, and is subject to the Emissions Allowances Spot Trader Master Agreement dated \_\_\_\_\_.

Daily Confirmation and Invoice	
Date:	[●]
Trading Day:	[●]
Mandate Period	[●] to [●]
Offer Price for the Trading Day:	€[●] per Allowance
Purchase Quantity for the Trading Day	[●] Allowances
Purchase Price (being the Offer Price x Purchase Quantity)	€[●]
Payment Date (being the first Banking Day following the Banking Day on which the Receiving Party receives the Daily Confirmation and Invoice)	[●]
Delivery Date (being the Payment Date +2)	[Payment Date +2]
ITAF's Bank Account Details	Account Name: [●] Account Number: [●] Swift Code: [●] IBAN Code: [●]
Receiving Party's Account	[insert detail]

For and on behalf of

**International Bank for Reconstruction and Development, as Trustee for the Adaptation Fund**

Authorized Signatory

Name:

Date:

## **Annex 2**

### **AMENDED AND RESTATED CER MONETIZATION PROGRAM GUIDELINES JUNE 2012**

#### **I. SCOPE**

1. These amended and restated Guidelines apply to monetization of certified emission reductions (CERs) by the International Bank for Reconstruction and Development (the World Bank) as trustee for the Adaptation Fund (the Trustee) for the Adaptation Fund (the AF) (the CER Monetization Program) pursuant to the terms and conditions (the Terms and Conditions) of services to be provided by the Trustee.

#### **II. OBJECTIVES OF THE CER MONETIZATION PROGRAM**

2. Through the CER Monetization Program, the Trustee will convert the AF's CERs into cash to support funding decisions by the AF Board. According to Decision 1/CMP.3, paragraph 28, the three objectives of the CER Monetization Program are to:

- Ensure predictable revenue flow for the AF;
- Optimize revenue for the AF while limiting financial risks; and
- Enhance transparency and monetize the share of the proceeds in the most cost-effective and inclusive manner, utilizing appropriate expertise.

3. The three Program objectives are discussed below.

##### **A. Ensure Predictable Revenue Flow**

4. CER Monetization is undertaken in advance of formal approvals of AF programs/projects by the AF Board. This will support the AF Board's decisions about calls for proposals and specific project/program commitments, and ensure cash will be available to fund the initial disbursements for AF programs/projects.

- i) The CER Monetization Program will help to ensure that project and program commitments authorized by the AF Board are made on the basis of liquid assets, consistent with best financial management practice.
- ii) The Trustee will provide the AF Board with information on funds in the AF Trust Fund available to be disbursed for program/project commitments. AF Board authorization of specific projects and programs would then be based on cash levels in the AF Trust Fund. This process will help insulate AF commitments from the uncertainties of the CER market.

## **B. Optimize Revenue and Limit Financial Risks**

5. An essential objective of the CER Monetization Program is to obtain the market value for the AF's assets.
6. **Sales revenue optimization:** Ideally, the Trustee will carry out CER monetization through an ongoing program of spot sales in highly liquid markets. This will ensure fair and transparent pricing, reduce transaction costs associated with price discovery, and minimize costs and risks coming from insufficient liquidity or settlement processes. It is possible to trade spot on liquid exchanges, which represent the best approximation of an efficient market as long as the volume of sales is consistent with their capacity. The Trustee may supplement spot sales with the use of futures contracts and occasional OTC sales.
7. **Risk mitigation:** Market risk arising from future movements of CER prices will be managed by spreading transactions over time to smooth price fluctuations. Settlement risk from the potential default by buyers of CERs will be mitigated by the use of delivery-versus-payment settlement mechanisms, either when trading on exchanges or OTC through dealers.

## **C. Enhance Transparency, Inclusiveness and Cost-Effectiveness**

8. The CER Monetization Program should be designed so that the sales processes are transparent, inclusive, and cost-effective.
9. **Transparency and disclosure:** The CER Monetization Program guidelines will be made publicly available. The Trustee will record details of all transactions executed under the Program, either conducted on exchanges or OTC. While full transparency may be difficult to implement and potentially detrimental to best execution in some instances, given the public international nature of the AF and its role under the Kyoto Protocol, the highest level of transparency possible will apply to the implementation of the CER Monetization Program.
10. **Inclusiveness:** The guidelines should allow the broadest range of compliance buyers and participants in emissions trading to participate in the transactions executed under the CER Monetization Program, especially major CER buyers (governments and corporations with Kyoto or EU ETS commitments).
11. **Cost effectiveness:** The most cost-effective approach is trading spot on highly liquid and developed markets in which various transaction costs are minimized. Trading on exchanges represents the approach closest to trading on an efficient market. Nevertheless the Trustee will be responsible for minimizing implied costs (membership, margin calls for future trading, etc.). The direct cost of selling through dealers (payment of fees) will also have to be minimized and balanced against the benefits associated with

the sponsorship of the dealer community (broad outreach to investors, market information, etc.).

#### **D. Six Criteria to Implement the Program Objectives**

12. These three objectives are divided into six criteria which have been presented and discussed with the AF Board, and which the CER Monetization Program guidelines aim to satisfy. The six criteria are to:

- Optimize revenues;
- Minimize risks;
- Enhance transparency;
- Be inclusive;
- Be cost effective; and
- Make funding rapidly available.

13. These overall objectives and six related criteria establish the framework for how the CER Monetization Program is structured.

### **III. RULES GUIDING THE EXECUTION: THREE-TIERED APPROACH**

14. It may not be possible to achieve all these criteria at the same time, and in certain circumstances tradeoffs may have to be considered. To help address this, the CER Monetization Program guidelines outline an approach consisting of:

- Ongoing mechanistic sales conducted on liquid carbon exchanges (including auctions);
- Over-the-Counter (“OTC”) sales through dealers in the case of high CER inventory;
- Sales directly to governments; and
- Request for guidance from the AF Board under exceptional market circumstances.

15. The Guidelines may be amended or supplemented by decision of the AF Board, with the agreement of the Trustee.

16. See *Table 1* at the end of this Section for an illustration of how the three-tiered approach meets each of the Program’s objectives and corresponding criteria.

#### **A. Ongoing Mechanistic Sales Conducted on Liquid Carbon-Exchanges**

17. The Trustee will follow a mechanistic approach for CER sales executed on exchanges and will not try to time the market or make forecasts as to the direction of CER prices. The approach described below will be driven by the volume of incoming CERs, exchange liquidity and desired inventory levels.

- (i) Continuous execution of spot straight sales on liquid exchanges
- a) The Trustee will primarily conduct straight spot sales (meaning sales executed spot, according to the way trades are normally executed on the exchange, as opposed to a specific form of auction or any form of customized and out-of-the-ordinary transaction), whenever possible on every trading day on the selected exchange(s). The size and the number of transactions executed on a given day will be determined by the Trustee so as to:
- Maximize, to the extent possible, the volume of CER spot sales conducted on exchanges over the period of the CER Monetization Program.
  - Accommodate the liquidity on the exchange and not move or disrupt the market price. To determine the size and number of transactions, the Trustee will rely on indicators made public by exchanges such as the total number of trades per day and the average size of a transaction.
  - Spread the sales of CERs over time so as to average CER market prices. At the beginning of each quarter, the Trustee will determine the planned daily sales volume for such quarter based on the amount of CERs issued during the previous quarter and based on the volume of CERs expected to flow into the AF account, with the goal being to spread transactions evenly throughout the upcoming quarter.
- b) The Trustee will keep records of all transactions executed on the selected exchange(s). In particular, the record of daily number, volume and selling price of transactions will be kept as well as the corresponding data applicable to the exchange.
- c) The Trustee will monitor over time the effective presence and access to the selected exchange(s) of compliance buyers and investors, either directly or through brokers.
- d) The Trustee will conduct trades on an anonymous basis.
- e) The Trustee will mitigate settlement risk by using the delivery-versus-payment settlement facility provided by the exchange. The Trustee will interrupt trading whenever and as long as this facility is discontinued.

- (ii) Limited use of futures contracts
  - a) Although the Trustee will sell CERs on selected exchanges primarily through spot contracts, the Trustee may use futures to a limited extent. Specifically, the Trustee will sell CERs on exchanges using futures contracts only to: access through the futures contracts a liquidity which is manifestly lacking on the spot contracts in the selected exchange(s); and maintain a presence in futures CER trading to diversify selling channels and maintain a continuous and seamless access to CER markets.
- (iii) The Trustee will determine the maximum amount of sales through futures contracts based on their characteristics and associated costs and risks:
  - a) The Trustee will place a limit on selling CERs through futures contract derived from the costs and risks associated with “margin calls” or collateral requirements. Selling futures could entail the transferring of cash, known as “collateral”, or “margin”, to the exchange or the clearing house performing the settlement functions for the exchange. An initial margin deposit, which would be made in cash in the case of the AF, is required whenever a futures position is opened. With market movements, the margin is recalculated over time, resulting in margin adjustments or “margin calls” and the possible provision of additional collateral until the futures contract is closed. While all margin posted is returned at the expiration of the contract, a sharp increase in the price of CERs could entail suddenly raising large amounts of cash to post as collateral.
  - b) The Trustee will set the limit on future trades of CERs in the following way; determine the cumulative size of futures trades so as to cap to a reasonable amount the margin call, not to exceed €20 million, which would result from the strongest possible increase in the CER price. Cash used will be put aside in the Trust Fund cash account. The amount of CERs that should be delivered at expiration will be kept aside as well in the CDM registry account of the AF.
  - c) The Trustee will furthermore limit the trading on futures based on the AF’s objective of rapid availability of funds. Currently CER futures contracts only have liquidity for December expiration. Therefore, cash proceeds from the sales will not become available until the end of a given year. The Trustee will continuously assess the availability and liquidity of futures contracts with intermediate expiry dates (March, June and September for instance). In

determining the maximum amount of futures sales in a given year, the Trustee will incorporate the objective of keeping a cash inventory in the AF Trust Fund cash account commensurate with the expected disbursements of the AF throughout the year.

- (iv) Selection of exchanges based on their strength, reputation and liquidity
  - a) Several exchanges have been established for emissions trading; the largest are ICE/ECX, and the BlueNext environmental exchange. The Trustee will continue to monitor the evolution of the status and offering of the various exchanges in competition in carbon markets according to the criteria used for the initial selection, and will adapt accordingly its selection of exchanges in the future.

## **B. OTC Sales**

18. OTC transactions will be considered in the following situations:

- i) Over-accumulation in the AF CER account due to high rates of CER issuance by the CDM, temporary suspension of ongoing mechanistic sales, or other reasons.
- ii) Illiquid markets for certain types of CERs after careful separation of the AF CERs ('green' CERs, CERs generated by large hydros, industrial gas, etc.)
- iii) To attract potential price or volume advantages for 'green' CERs.
- iv) To accelerate the availability of cash in response to the need for new project financing expressed by the AF.
- v) To accelerate the availability of cash for administrative costs associated with the management of the AF Trust Fund.

19. **Execution of an OTC transaction:** The Trustee will determine the size and timing of the OTC trade based on ongoing consultation with dealer banks involved in carbon markets. The Trustee will select the dealers that will participate in the OTC sale based on an objective process, using the same general criteria that the Trustee uses when selecting dealers for its own capital market operations. In respect of a particular transaction, the Trustee will consult with dealers and seek their advice. The quality of the recommendations applicable to the specific transaction under consideration will be among the criteria the Trustee will use to select the dealers who will participate in the transaction.

20. When executing an OTC sale, the Trustee will verify the distribution of CERs to buyers achieved by the selected carbon dealer. The Trustee will ensure that the



distribution meets the requirement of the CER Monetization Program for inclusiveness of all interested CER buyers. This includes making sure that as many as possible compliance buyers and governments will be made aware of, and given the opportunity to participate in, the OTC sale. While the sale price achieved in an OTC sale may not be directly comparable to prices then prevailing on exchanges, notably because of its larger size making it non-tradable on any existing exchange, the Trustee will monitor the pricing based on a number of public price references.

21. The Trustee will ensure that the settlement processes applicable to OTC transactions are 'Delivery-Versus-Payment (DVP) processes to limit counterparty credit risk for the AF.

### **C. Direct Sales to Governments**

22. While CER sales on exchanges and via OTC transactions will be the principal methods for monetizing Adaptation Fund CERs, direct sales to governments will be considered in the following situations:

- i) Over-accumulation in the AF CER account due to high rates of CER issuance by the CDM, temporary suspension of ongoing mechanistic sales, or other reasons.
- ii) Illiquid markets for certain types of CERs, after careful separation of the AF CERs ('green' CERs, CERs generated by large hydros, industrial gas, etc.)
- iii) To accelerate the availability of cash in response to the need for new project financing or for administrative costs associated with the management of the AF Trust Fund.
- iv) Governments express an interest in purchasing CERs, subject to the criteria below.

23. **Execution of direct sales:** Direct sales to governments would be undertaken only if there is a net benefit to the Adaptation Fund when compared with the alternatives of selling through exchanges or OTC transactions. The benefit would be identified either as: i) a price premium, net of transactions costs, when compared with alternative approaches, and/or ii) a higher volume of sales than would otherwise be possible through exchanges or OTCs.

24. Direct sales to national governments must meet the CMP principle of cost-effectiveness. Under normal circumstances, transaction costs associated with such sales could be high, as sales to national governments would require the negotiation and execution of a legal agreement for the sale, incurring legal and other costs both to the Adaptation Fund (through the trustee administrative budget), as well as to the buyer. Such a sale may also require an analysis of any tax, regulatory and other issues related to CER sales to be settled in the buyer's jurisdiction.

25. Thus, direct sales to national governments would only be undertaken if the buyer agrees to purchase a minimum of 500,000 CERs, subject to review and adjustment by the trustee based on prevailing CER market prices, thereby rendering the costs of the sale comparable to alternative sales methods.

26. The Trustee will ensure that the settlement processes applicable to direct sales transactions are DVP processes to limit counterparty credit risk for the AF.

27. Sales to national governments would be disclosed publicly. The ability to sell Adaptation Fund CERs directly to governments would be communicated in advance of any sales. The results of any sales, including amounts and average prices would be reported by the trustee in the quarterly financial reports to the Board; such reports are publicly available on the Adaptation Fund website.

#### **D. Further Requests for AF Board Guidance**

28. If extraordinary events occur that make compliance with the guidelines impracticable or impossible, the Trustee will report to the AF Board and request further guidance from the AF Board. An extraordinary event would include any event that results in extreme movements in prices and/or liquidity of CERs or in carbon markets generally. Such an event could be brought on by global macro-economic conditions, events specific to the CER markets, or a significant governance or economic policy change in the Kyoto Protocol, the UNFCCC or the global institutional framework for climate change.

29. In such event, the Trustee will provide the AF Board with relevant information about the event and its impact on the market and will propose alternative courses of action for consideration by the AF Board. The Trustee will act only upon these AF-Board approved Guidelines, AF Board decisions adopted according to AF Board rules and procedures, or written instruction from the AF Board Authorized Designee<sup>1</sup>, in accordance with its Terms and Conditions.

30. The Trustee will suspend spot sale transactions under the CER Monetization Program if the CER market infrastructure becomes impaired. If the market infrastructure remains disrupted over an extended period, the Trustee will seek guidance from the AF Board. The Trustee will then present specific short-term funding options based on then-existing market conditions and limitations.

#### **E. Settlement**

31. **Settlement of a CER transaction:** The Trustee may settle trades directly, or rely on a bank to perform settlement functions (the “Settlement Agent”) as follows:

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<sup>1</sup> The Chair of the Adaptation Fund Board or authorized designee

- i) The Trustee will close a selling transaction with an eligible counterparty, either on an exchange or OTC. In the case of a spot transaction, on the settlement date, the trustee (or Settlement Agent) will then ensure that the CERs are delivered to the buyer while the payment in cash is received by the trustee for credit to the AF Trust Fund. The trustee will endeavor to use the DVP framework of an exchange, whereby confirmation of payment is received prior to delivery of the CERs. In case it is not possible on the exchange, the trustee will seek to settle outside the exchange on a DVP basis. Based on instructions from the trustee, the CERs sold will be transferred from the AF account in the CDM registry to the trustee's account in the registry used for settlement, and then to the clearing house. The buyer's cash payment will be transferred from the buyer's account to the clearing house, and then to the AF Trust Fund cash account. The cash proceeds from the monetization will then be held in the AF Trust Fund.

32. **Selection of a Settlement Agent:** If the Trustee uses a Settlement Agent the selection of the Settlement Agent will be in a transparent manner following the procurement guidelines of the World Bank. Only firms that have experience in carbon trading and a strong settlement department will be considered for the role of Settlement Agent.

## F. Summary

TABLE 1

	<b>Optimization of Revenues</b>	<b>Minimization of Risk</b>	<b>Transparency</b>	<b>Inclusiveness</b>	<b>Cost Effectiveness</b>	<b>Funding Availability</b>
<b>Start of Monetization</b>	After Connection	After Connection	After Connection	After Connection	After Connection	Before Connection
<b>Ongoing Straight Sales on exchanges</b>	Price efficiency in developed Market	Spot transactions, averaging of prices, DVP settlement	Liquidity and price transparency in large and developed exchanges	Large fraction of compliance buyers, either directly or through brokers trade on selected exchanges	Trading on exchange avoids dealer's fee. Cost of exchange membership	Spot transactions make funding immediately available
<b>OTC sales through dealers based on criteria</b>	Efficient distribution and price discovery by dealers. Pricing checked by Trustee	DVP settlement applies. Dealers provide information on market price evolution and best timing	The Trustee checks the pricing with public prices (exchanges or brokers). The Trustee has access to the order book of the dealer(s)	The dealer is requested to distribute broadly to all compliance buyers	Dealer's fee controlled by competitive selection process of dealer(s)	Immediate and large funding availability
<b>Direct Sales to Governments</b>	Price would be at minimum of the average bid-ask spread	DVP	All sales would be publicly disclosed in the trustee's financial status reports to the AF Board	Any government would be eligible to purchase CERs	Minimum purchase of CERs would be required to ensure at least comparable cost to other sales methods	Depends on the number of countries likely to avail of this option

#### **IV. REPORTING**

33. On a quarterly basis, the Trustee will provide the AF Board with a report on its activities undertaken under the CER Monetization Program.

34. The report will communicate the details of the trading activity in CER markets undertaken by the trustee on behalf of the AF. In such quarterly reports, the following information will be provided:

- Tonnage of CERs held by the AF CER account at the beginning and at the end of the period;
- Volume of new CERs tonnage entering the account of the AF in the CDM registry during the quarter; total volume of CERs having entered the AF CER account with the CDM registry since inception;
- Volume of sales of CERs executed during the quarter, and since the beginning of the calendar year; these volume of sales will be broken down into three categories: 1) spot sales on exchanges, 2) futures sales on exchanges, 3) OTC sales, and 4) sales to governments.
- Revenues in cash associated with the sales of CERs (in Euros and in US dollars) during the quarter, and since the beginning of the calendar year; these revenues will be broken down into four categories: 1) spot sales on exchanges, 2) futures sales on exchanges, OTC sales, and 4) sales to governments.
- Average sales price per ton sold (in Euros and in US dollars) during the quarter, and since the beginning of the year for CERs sold either spot or futures on exchanges, OTC, or to governments;
- For futures trades, the tonnage of CERs to be delivered at various maturities in the future (for instance the December maturity of the year under review) and the cash amount to be received (in Euros or in US dollars) at the expiration of the contracts. The report will indicate the value placed or received as collateral, the average at the beginning and at the end of the period.

35. In a highly volatile market, the Trustee will report on a more ad-hoc basis.