

# The Adaptation Fund

AFB/B.5/Inf.4  
March 5, 2009

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## **ADAPTATION FUND BOARD**

Fourth Meeting  
Bonn, 15 to 17 December 2008

### **REPORT OF THE FOURTH MEETING OF THE ADAPTATION FUND BOARD**

#### **INTRODUCTION**

1. The fourth meeting of the Board of the Adaptation Fund of the Kyoto Protocol was held at the “Langer Eugen” UN Campus in Bonn from December 15 to December 17, 2008. The meeting was convened pursuant to Decision 1/CMP.3 adopted at the third Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP).
2. The full list of the members and alternates, nominated by their respective groups and elected by the CMP pursuant to Decision 1/CMP.3, and present at the meeting, is attached as Annex I to the present report.
3. The meeting was also attended by Ms. Monique Barbut, Head of the Adaptation Fund Board Secretariat as well as the newly appointed Fund manager Ms. Marcia Levaggi from Argentina. A list of all participants, including observers present at the meeting, can be found on the Adaptation Fund website at <http://www.adaptation-fund.org/documents.html>.
4. The meeting was broadcast live through a link on the websites of the Adaptation Fund and the United Nations Convention to Combat Desertification (UNCCD). The UNCCD secretariat had also graciously provided logistical and administrative support for the hosting of the meeting.

#### **AGENDA ITEM 1: OPENING OF THE MEETING**

5. The meeting was opened at 9.35 a.m. on Monday, 15 December 2008, by the Chair, Mr. Richard Muyungi (United Republic of Tanzania, Least-Developed Countries), who welcomed the participants to Bonn and thanked the members and alternates of the Board for their hard work since the first meeting of the Board. Their work had been greatly appreciated by the Parties to the Kyoto Protocol at Poznan in Poland. He also thanked those members and alternates of the Board that had attended the fourth CMP, and he said that they had done an excellent job working as a group.

**AGENDA ITEM 2: ORGANIZATIONAL MATTERS**

*Adoption of the Agenda*

6. The Board considered the provisional agenda contained in document AFB/B.4/1, and an agenda item pertaining to the Chair of the Adaptation Fund Board for 2009 was added to the agenda of the meeting. The Board adopted the agenda contained in Annex II to the present report. Mr. Yvan Biot, (United Kingdom of Great Britain and Northern Ireland, Annex I Parties) was also invited to make a presentation on elements for the possible fiduciary standards for implementing entities, based on a paper circulated to the Board.

7. All present members and alternates of the Board individually declared that they had no conflict of interest with regard to any item on the agenda.

*Organization of Work*

8. The Board also agreed that agenda item 7 would be taken up after consideration of agenda item 5 (b).

**AGENDA ITEM 3: ORAL REPORT OF THE CHAIR ON INTERSESSIONAL ACTIVITIES AND ON THE OUTCOMES OF THE CONFERENCE OF THE PARTIES SERVING AS THE MEETING OF THE PARTNERS TO THE KYOTO PROTOCOL**

9. The Chair reported on the activities undertaken in the intersessional period, including the revision of the budget and his consultations with the United Nations Environment Programme (UNEP) on its contribution to the Fund. He also reported on the outcomes and activities undertaken at the fourth CMP that took place in Poznan, Poland from 1 to 12 December, 2008. He very much appreciated the side event and the question and answer session of the Board there, which were welcomed and well attended by the participants of the CMP. Several members also expressed their thanks to the Chair, and the Secretariat, as well as their appreciation for the side event and the question and answer session that had taken place in Poznan.

10. The Chair further reported on two critical issues discussed in Poznan, the first being legal issues related to the Adaptation Fund and the second, how to ensure for the Parties to have direct access to the Adaptation Fund. In that regard, the CMP decided that the Adaptation Fund Board be conferred with legal capacity, which would entail legal responsibility for the Board.

11. Following a request for clarification made by a member, the Chair listed the members and alternates that had resigned and had been replaced. There remained two further replacements to be made before the fifth meeting of the Board.

12. Several members expressed their wish for further discussion of the issue of the oath to be taken by the members of the Board. After a short discussion, the Chair proposed to take up the issue under the agenda item 'Other Matters'.

13. Following a request made by a member, the Chair said that he would send a letter of appreciation on behalf of the Board to the Government of Poland which had hosted the fourth CMP.

**AGENDA ITEM 4: REPORT ON THE ACTIVITIES OF THE SECRETARIAT**

14. The representative of the Secretariat drew the Board's attention to document AFB/B.4/2, which contained a report on the activities undertaken by the Secretariat since the third meeting of the Board. An offer for the position of Senior Adaptation Officer had been made to Ms. Marcia Levaggi, Head of the Technical and Economic Cooperation Section of the Embassy of Argentina in South Africa, who, among her other responsibilities, had served as the co-chair of the contact group on the Adaptation Fund during the 24<sup>th</sup> session of the Subsidiary Bodies of the United Nations Framework Convention on Climate Change (UNFCCC). She would probably take up that post in February 2009.

15. Following a discussion, the Board took note of the report on the activities of the Secretariat.

**AGENDA ITEM 5: ISSUES REMAINING FROM THE SECOND MEETING OF THE BOARD***Role and Responsibilities of the Adaptation Fund Trustee*

16. The invited Trustee introduced the document outlining the draft role and responsibilities of the Adaptation Fund Trustee (AFB/B.4/3), which had previously been considered at the second and third meetings of the Board as documents AFB/B.2/10 and AFB/B.3/3 respectively, and which had been revised to reflect the discussions that had taken place at those meetings. The invited Trustee briefly reviewed the principal functions of the Trustee, as contained in document AFB/B.4/3. She then introduced the changes, in particular to paragraphs 18 and 19, that had been made to the document by the Trustee in light of Decision 1/CMP.4.

17. A clarification was requested with respect to paragraphs 20, 24 and 25 of the document regarding the limited nature of the fiduciary responsibilities of the Trustee, as well as the reasons why the Trustee would not enter directly into agreements with eligible Parties or executing entities. The invited Trustee explained that it would not have an operational role with respect to Adaptation Fund programs and that its responsibilities would be CER monetization, establishing and managing the Trust Fund, financial management, investment management, tracking commitments made by the Adaptation Fund Board, transferring funds on written instructions of the Board and reporting on financial status and activities. The Trustee would have no responsibility for the ultimate use of funds.

18. At the request of the Board, the invited Trustee then circulated a version of document AFB/B.4/3 that indicated the changes that had been made to document AFB/B.3/3. Decision 1/CMP.4 was also distributed to the Board as an information document.

19. Following the discussion, the Board decided to adopt Role and Responsibilities of the Adaptation Fund Trustee, as revised, and as contained in Annex III to the present report.

**(Decision B.4/1)**

*Provisional Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund*

20. The representative of the Secretariat drew the Board's attention to document AFB/B.4/4, which contained draft provisional operational policies and guidelines for Parties to access resources from the Adaptation Fund. That document was a revised version of a document that had previously been circulated at the third Board meeting as document AFB/B.3/8.

21. The Chair reminded the Board that the document had to be updated to reflect the decisions taken by the fourth CMP. He also reminded the members that the Board had committed itself to adopting operational policies and guidelines for Parties to access resources from the Adaptation Fund at the present meeting.

22. Several members observed that some sections of the document had been superseded by the deliberations that had taken place at the fourth CMP, and that it was important to ensure that the document reflected the strategic priorities, policies and guidelines of the Adaptation Fund. With respect to eligibility criteria, a number of members expressed the view that it was important not to try to define what was meant by developing countries. A number of members also suggested different formulations for countries that were particularly vulnerable to climate change, while other members suggested that it was important to maintain an open definition of country eligibility. While all developing countries were in fact eligible for funding, in the early stages of the operation of the Fund it might not be possible to fund all project activities. It was therefore necessary to distinguish between eligibility for funding and techniques for the prioritization of funding. The mechanism for the approval of projects had to be both broad and equitable in scope while at the same time ensuring that urgent projects were funded as a matter of priority.

23. Mr. Enele Sopoaga, (Tuvalu, Small Island Developing States) wished it recorded that funding caps had been brought up in the context of the discussion of a special funding window for Small Island Developing States. He said that any allocation of resources had to take into account the impact of climate change and he observed that Small Island Developing States would have to bear the full brunt of that impact.

24. A number of techniques were suggested, such as the establishment of upper limits for funding projects, or caps, and the creation of special funding windows. There was support from several members for the suggestion that least developed countries and small island developing states and African countries be prioritised during the first funding period. Members were divided on the timeliness of those suggestions: some members noted that while all developing countries were vulnerable to the effects of climate change, the limited resources of the Fund, at least in its initial stages, might require the Adaptation Fund Board to opt for a less than ideal solution at the present meeting. However, the operational policies and guidelines could be modified when more funds became available. There was broad consensus among members that there should be three project/programme cycles, and caps should be applied to ensure the equitable use of funds so that countries with low capacity do not miss out. The three cycles discussed, but not yet agreed, were: small and community based projects; regular projects with a larger cap; and programmes.

25. After a first round of discussions, the Chair undertook to provide a revised text that reflected the comments made during the discussion and to present it to the Board for its consideration at a subsequent session of the Meeting. He said that the discussion had revealed a number of important considerations, among which was the need to reflect on the number of

projects required, as well as how small those projects ought to be. Small scale and community-based projects could also be submitted by Governments, as part of a package, directly to the Board. It was also important to address the issue of vulnerability in broad way so as not to overlook some vulnerable groups. He undertook, when revising the document, to ensure that it was consistent with the strategic priorities, policies and guidelines of the Adaptation Fund as well as with all relevant decisions of the CMP.

26. Mr. Anton Hilber, (Switzerland, Western European and Others Group) also circulated a conference room paper on the proposed operational policies and guidelines of the Adaptation Fund. He asked that the specific proposals contained in the non-paper be taken into consideration in future revisions of the texts currently presented under agenda items 4 and 6, which he proposed should be merged.

27. At a subsequent session of the meeting, the Board considered a revised version of the draft provisional operational policies and guidelines for Parties to access resources from the Adaptation Fund, (AFB/B.4/4/Rev.1).

28. During the initial round of discussion of the revised text, it was observed that the section on operational principles had been taken from Strategic Priorities, Policies and Guidelines which had been approved by the Board at its third meeting and had been adopted by the fourth CMP in paragraph 6 of Decision 1/CMP.4. No change was therefore required to that text, although the Board requested that footnotes be added to cross-reference that decision. The members also thanked Mr. Hilber for his conference room paper, which had proved a useful input to the discussion. The Chair said that it was important to note in the introductory section of the text that the guidelines were expected to evolve, and that it was important that the Board reserve its right to amend them as necessary.

29. Following a subsequent discussion on funding windows and the activities to be financed by the Adaptation Fund Board, it was agreed to merge the revised text with the text on the operationalization of access to the Adaptation Fund, which had been discussed under agenda item 6. The Secretariat, with the approval of the Chair, was requested to circulate the merged text to the members and alternates of the Board by 15 January 2009.

#### *Establishing Board Committees*

30. The Representative of the Secretariat introduced document AFB/B.4/5, which contained the draft terms of reference for committees of the Board that had been presented to the Board at its third meeting as document AFB/B.3.12, and which had originally been submitted to the Board as a Chair's text at its second meeting.

31. After a discussion on the issue, the Board reached a general understanding on the need to establish committees. However, the Board could not agree on the number and specification of the committees. The Board agreed it should avoid creating unnecessary bureaucracy and costs. The Board agreed that the Chair, with the support of the Secretariat, would prepare an updated proposal for consideration by the Board at its fifth meeting, which would reflect the discussion at the present meeting, including the preference of many members that had been expressed for two

rather than four committees taking into account the precedent of the subcommittees of the Multilateral Fund Executive Committee of the Montreal Protocol.

#### **AGENDA ITEM 6: OPERATIONALIZATION OF ACCESS TO THE FUND**

32. The Representative of the Secretariat introduced document AFB/B.4/6, which contained elements of a feasibility study to assess a proposal to endow the Adaptation Fund with legal status and criteria for guidelines for accreditation by the Board of implementing entities. She said that the decision by the fourth CMP that the Adaptation Fund Board should be conferred with legal capacity had diminished the immediate need for such a feasibility study. She also said that at its third meeting the Board had recognized that the process of conferring legal capacity might take some time and therefore the Board had also considered an alternative approach which would provide fiduciary risk management oversight through legal entities established, or existing, at the national level in order to enable direct access to resources by Parties. To further that process, the Board had decided to develop criteria and guidelines for the accreditation by the Board of such legal entities, and Annex II of the document provided an example of the GEF minimum fiduciary standards as an example of such a standard.

33. The Chair then invited Mr. Yvan Biot to present a paper on the elaboration of fiduciary standards for implementing entities that he had submitted to the Board, together with Mr. Julien Rencki (France, Annex I Parties), for its consideration. In his presentation, Mr. Biot said that he had commissioned the paper to examine how best to facilitate direct access and to clarify the nature of international fiduciary standards. However, given the Secretariat's report on the Operationalization of access to the Adaptation Fund, the commissioned paper had focused on ascertaining the required competencies of national entities, as well as the different options for accessing funds from the Board by the mechanism of direct access. The paper had provided an illustrative governance structure and had recommended consideration of a number of essential functions for the operational management of the Fund, as well as the creation of an expert advisory group to provide recommendations and guidance on such issues as accreditation and project evaluation. Four options had been suggested for accessing funds from the Adaptation Fund: delegating all implementing functions to national implementing agencies; supporting national implementing agencies with an Adaptation Fund resource facility; using an international implementing entity; and direct access by national executing entities to the Adaptation Fund with assistance from an Adaptation Fund resource facility. Mr Biot concluded that the core issue related to direct access is how the Adaptation Fund Board manages its fiduciary risk. Maintaining high fiduciary standards is a requirement of 5/CMP.2 and is also necessary if the Adaptation Fund is to achieve its desired results. There may be a need to identify the extent to which the Adaptation Fund needs to assist eligible Parties to access funds in line with international fiduciary standards.

34. The members thanked Mr. Biot for his presentation and stressed that fiduciary oversight was an important part of the Board's functions. However, the Board also considered that although the feasibility study to endow the Adaptation Fund with legal status was no longer necessary, a possible design study on the operationalization of direct access by Parties to the resources of the Fund might be useful.

35. Following the discussion, the Secretariat was asked to prepare a revised version of document AFB/B.4/6, that incorporated the findings contained in the paper presented by Mr. Biot, as well as taking into consideration the views expressed by the members of the Board.

36. At a subsequent session of the meeting it was suggested that the revised document being prepared by the Secretariat be merged with document AFB/B.4/4/Rev.1 which had been discussed under agenda item 5, *Provisional Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund*.

37. The Board agreed to merge the two texts and requested the Secretariat to distribute the merged text to the members and alternate members of the Board by 5 January 2008 (see paragraph 28, above, of the present report).

38. The Board also decided to create a working group, chaired by Mr. Julien Rencki, (France, Annex I Parties), and composed of Mr. Yvan Biot, (United Kingdom of Great Britain and Northern Ireland, Annex I Parties), Mr. Farrukh Iqbal Khan, (Pakistan, (Non-Annex I Parties), Mr. Jerzy Janota Bzowski, (Poland, Eastern Europe), Ms. Emily Ojoo-Massawa, (Kenya, Africa) and Mr. Luis Paz Castro, (Cuba, Latin America and the Caribbean) to accelerate the conclusion of fiduciary standards, including the consideration of the possible ways and means on how to implement those standards, through a specific study or any other mechanism with a view to making a presentation on this issue at the next meeting.

**(Decision B.4/2)**

**AGENDA ITEM 7: MONETIZATION PROGRAM**

39. The Chair drew the Board's attention to the documents on the CER Monetization Program Guidelines (AFB/B.4/7) and on the CER Inaugural Sale Plan (AFB/B.4/8) and asked the invited Trustee to present the details regarding those issues.

40. After the presentation of the invited Trustee, there was a first round of comments made by members. Following a number of requests for clarifications on the monetization program as well as the inaugural sale plan, the invited Trustee undertook to provide further information to the Board at the subsequent session of the Meeting.

41. At a subsequent session the representative of the invited Trustee said that it was not possible to foresee the future direction of the price for CERs. The CER price was currently and primarily driven by the price for European Union Emission Allowances (EUAs). Although the spread between CERs and EUAs was narrowing, the falling price of EUAs had pushed the price of CERs down. Market analysts considered that the decrease in the price of the EUA had resulted from: (i) the fall in oil and gas prices, (ii) the current global slowdown, and (iii) the recent uncertainties in the development of the European Union Emissions Trading Scheme. The invited Trustee also explained the reasons for the proposed limited use of futures contracts. First, as liquid futures contracts settle annually each December, the Adaptation Fund as seller would have to wait a whole calendar year before receiving cash from the proceeds of the year's sales. Second, there was a risk associated with the margin calls which might result from the change in

the price of CERs. The representative of the invited Trustee gave an illustration which demonstrated the numerical size of such risks. He also explained that the purpose of holding a reserve of CERs was to ensure that there would be ongoing sales of CERs in the event that the issuance of new CERs was temporarily interrupted. The Board then discussed the pros and cons of a large-sized inaugural transaction, conceived as a large initial offering of CERs. A large-sized transaction would help establish the presence of the Adaptation Fund and raise public awareness of its activities.

42. Following a discussion of the different points that had been raised by members, the Chair said that there appeared to be agreement that the invited Trustee should organize a significant initial sale of CERs. He then closed the session of the Board for further discussion.

43. During the closed session of the Board, the Board decided to approve the CER Inaugural Sale Plan of the invited Trustee, on the understanding that the invited Trustee would have the latitude to decide on the size and timing of the inaugural transaction, within the limits discussed during the closed session, and to approve the CER Monetization Program Guidelines contained in Annex IV to the present report.

**(Decision B.4/3)**

**AGENDA ITEM 9: WORK PLAN FOR THE BOARD AND BUDGETS FOR THE BOARD, SECRETARIAT, AND TRUSTEE FOR CALENDAR YEAR 2009**

44. The representative of the Secretariat introduced the elements for a 2009 Work Plan and Budget for the Board and Secretariat for the period 1 January to 31 March 2009 (AFB/B.4/9/Rev.1), as well as a paper that contained the revised budgets for the Board and Secretariat for the same period. The elements of the work plan contained both expected outcomes for the present meeting as well as the suggested work plan for the Board for 2009. In order to help finance its current activities, US \$700,000 had been borrowed from the Least-Developed Countries Fund (LDCF). That amount, together with approximately US \$100,000 in savings from amounts previously budgeted for expected expenditures, meant that the Adaptation Fund Board and Secretariat had sufficient money in hand to fund the present meeting, as well as to support the proposed activities until 31 March 2009. However, the DKK 3,000,000 contribution being received from the Government of Denmark had to be used to help repay the loan from the LDCF. The representative of the Secretariat thanked the Government of Denmark for its contribution.

45. Further discussion under this agenda item was held in closed session.

46. Following the discussion, the Board heard a presentation from the legal advisor of the UNFCCC secretariat who explained that organizations had different policies for deciding when to hold closed deliberations. Some held open meetings on their budgets, while others partially closed those meetings. In that case, the discussion of expenditures was usually open, while planning sessions were partially open, and the sessions were generally closed whenever staffing needs or the purchase of equipment were being discussed.



47. The Chair thanked the legal advisor of the UNFCCC for her presentation and it was agreed that as there appeared to be no common policy on when to close such sessions, the session of the Board would be closed upon the request of a member or alternate of the Board.
48. After discussions on the budget; the Board requested the Chair with the help of the Secretariat, taking into account the discussions on this item, to revise the budget for the Board and the Secretariat and to circulate it and the elements for a 2009 work Plan for the Adaptation Fund Board for intersessional decision.
49. The Board decided to adopt the budget estimates for Trustee Services for the Adaptation Fund for the period 1 July 2008 to 30 June 2009, as contained in Annex V to the present report.

**(Decision B.4/4)**

#### **AGENDA ITEM 9: CHAIR OF THE ADAPTATION FUND FOR 2009**

50. During the closed session held under the previous agenda item the Board also discussed the issue of the incoming Chair and Vice-Chair of the Adaptation Fund. Following a discussion, the Board decided to endorse the nominations by both developed and developing countries as follows:
- (a) Mr. Jan Cedergren (Sweden, Western European and Others Group), nominated by the United Kingdom on behalf of the Annex 1 parties, will be Chair of the Adaptation Fund Board;
  - (b) Mr. Farrukh Iqbal Khan (Pakistan, Non-Annex I Parties), nominated by Ghana on behalf non the Annex 1 Parties, will be the Vice-Chair of the Adaptation Fund Board
51. On the exact rotation of the Chairmanship and Vice-Chairmanship between Annex I and Non-Annex 1 Parties, the Board decided that the handover to the new leadership will be done at the first day of the fifth Board Meeting in March 2009, which completes the annual rotation of the group. The Board agreed that in the intersessional period between the fourth and the fifth Meeting, the actual Chair retains his final decisive powers on matters of the Board, but will consult closely with the incoming Chair and Vice-Chair to keep them in the loop and to allow a smooth transition to new leadership.
52. After the resignation of the current Vice-Chair, Mr. Naoya Tsukamoto (Japan, Annex I Parties) the Board Nominated Mr. Julien Rencki (France, Annex I Parties) to be the Vice-Chair of the Adaptation Fund Board for the remaining term of the current leadership.

**(Decision B.4/5)**

#### **AGENDA ITEM 10: OTHER MATTERS**

*Legal Capacity of the Adaptation Fund Board: Operationalization of paragraph 11 of Decision 1/CMP.4.*

53. The Board took up consideration of the legal capacity of the Adaptation Fund Board during its discussion of the role and responsibilities of the Adaptation Fund Trustee under Agenda Item 5.

54. One member asked for a clarification on the legal capacity of the Board and the legal advisor of the secretariat of the UNFCCC was asked to explain paragraph 11 of decision /CMP.4.

55. The Chief Legal Advisor of the UNFCCC secretariat explained that paragraph 11 of decision -/CMP.4 provided that the Adaptation Fund Board be conferred with such legal capacity as necessary for the discharge of its functions with regard to direct access by eligible Parties and implementing and executing entities. It followed from that decision that such legal capacity would have to be recognized in some domestic jurisdiction and that a Party to the Protocol would need to take the necessary legal measures for that to occur. He also said that it was also likely that a headquarters agreement with the host country would also be required, and that such an agreement might also contain provisions on privileges and immunities for the Adaptation Fund Board, its members, alternates members and officers. He gave as examples: the headquarters agreements by the Government of Germany for the UNFCCC secretariat, and by the Government of Canada for the Multilateral Fund for the Implementation of the Montreal Protocol.

56. One member then suggested that the Government of Germany be approached by the Chair to provide such a host country agreement. Other members asked whether the Board should invite a Party to undertake the role of host country or whether all Parties should be informed of the decision and invited to submit expressions interest to host the Adaptation Fund Board. It was also pointed out that any provision for the granting of legal capacity to the Board would require modifications to the Board's Rules of Procedure.

57. It was also suggested that the Chair of the Subsidiary Body for Scientific and Technological Advice be invited to address the Board at its fifth meeting on the subject of the lessons learned from the "Nairobi Work Programme" on impacts, vulnerability and adaptation to climate change. Following the discussion, the Board agreed to continue considering the issue of the legal capacity of the Adaptation Fund Board under 'Other Matters'.

58. The Chair said that it was important to move quickly to operationalize the legal capacity of the Board. He suggested that a small group of members and alternates of the Board work with the UNFCCC secretariat intersessionally to explore the possible criteria and guidelines, including the implication of possible transaction costs, a party to the Kyoto Protocol to host and confer legal capacity to the Adaptation Fund Board.

59. The Board decided to set up an Ad Hoc working group chaired by Mr. Richard Muyungi, (United Republic of Tanzania, Least-Developed Countries), and consisting of Mr. Jan Cedregren, (Sweden, Western European and Others Group), Mr. Luis Santos (Uruguay, Latin America and Caribbean), Mr. Mohammed Al-Maslamani (Qatar, Asia) and Mr. Amjad Abdulla (Maldives, Small Island Developing States) to work on the operationalization of the legal

capacity of the Adaptation Fund Board, and to report back to the Adaptation Fund Board on the progress on this urgent issue at its fifth meeting. Because of the urgency of this issue and the need to include some members with experience in this area the Board, also decided to bring Mr. Anton Hilber, (Switzerland, Western European and Others Group) in this group, so that he could share his experience since Switzerland is hosting a number of similar Funds.

**(Decision B.4/6)**

60. On the process of requesting a Kyoto Protocol Party to host and confer legal capacity to the Board, the Board instructed the Chair to consult the legal section of the UNFCCC on the exact language to use while writing such a request letter based on its experience and the examples of similar requests made before.

**AGENDA ITEM 11: DATE AND VENUE OF THE FIFTH MEETING OF THE ADAPTATION FUND BOARD**

61. As there was not adequate time to discuss the best dates for the fifth meeting of the Board, the Board instructed the Chair to set dates intersessionally and to inform the Members and Alternate, accordingly.

**AGENDA ITEM 12: ADOPTION OF THE REPORT AND CLOSURE OF THE MEETING**

62. A draft report was provided to the Board for comments. Because of time constraints, the report could not be adopted. The Board instructed the Chair to complete the Report and circulate it to Members and Alternates by 15 January for intersessional decision. The Chair requested the Secretariat to complete the draft Report by 5 January and send it to him for completion and circulation to Members and Alternates for comments and approval by the set date.

63. The Chair also undertook to send a letter to the invited Trustee which confirmed that the Roles and Responsibilities of the Adaptation Fund Trustee, CER Monetization Program Guidelines and Inaugural Sale Plan, and the budget estimates for Trustee Services for the Adaptation Fund for the period 1 July 2008 to 30 June 2009, had been adopted by the Adaptation Fund Board at the present meeting.

64. The Chair expressed his thanks to Mr. Naoya Tsukamoto who was to resign his position as Vice-Chair of the Adaptation Fund Board at the end of the present meeting. He also thanked Mr. Enele Sopoaga, Tuvalu, Small Island Developing States, who was also completing his one year term, for his dedication and hard work during his term. The Chair also thanked the UNCCD Secretariat for its logistical support in hosting the meeting, and the UNFCCC Secretariat, particularly for its legal advice, as well as the invited Trustee.

65. Following the customary exchange of courtesies, the Chair declared the meeting closed at 7.00 p.m. on Wednesday, 17 December 2008.

**MEMBERS AND ALTERNATES PRESENT AT THE FOURTH MEETING**

<b>MEMBERS</b>		
<b>Name</b>	<b>Country</b>	<b>Constituency</b>
Mr. Cheikh Ndiaye Sylla	Senegal	Africa
Ms. Merlyn Van Voore	South Africa	Africa
Mr. Mahendra Siregar	Indonesia	Asia
Mr. Mohammed Al-Maslamani	Qatar	Asia
Ms. Ermira Fida	Albania	Eastern Europe
Mr. Jerzy Janota Bzowski	Poland	Eastern Europe
Mr. Jeffery Spooner	Jamaica	Latin America and the Caribbean
Mr. Luis Santos	Uruguay	Latin America and the Caribbean
Mr. Anton Hilber	Switzerland	Western European and Others Group
Mr. Jan Cedergren	Sweden	Western European and Others Group
Mr. Enele Sopoaga	Tuvalu	Small Island Developing States
Mr. Richard Muyungi	United Republic of Tanzania	Least-Developed Countries
Mr. Julien Rencki	France	Annex I Parties
Mr. Naoya Tsukamoto	Japan	Annex I Parties
Mr. Farrukh Iqbal Khan	Pakistan	Non-Annex I Parties

<b>ALTERNATES</b>		
<b>Name</b>	<b>Country</b>	<b>Constituency</b>
Mr. Elsayed Sabry Mansour	Egypt	Africa
Ms. Emily Ojoo-Massawa	Kenya	Africa
Mr. Damdin Davgadorj	Mongolia	Asia
Ms. Tatyana Ososkova	Uzbekistan	Asia
Ms. Dinara Gershinkova	Russian Federation	Eastern Europe;
Ms. Iryna Trofimova	Ukraine	Eastern Europe
Mr. Luis Paz Castro	Cuba	Latin America and the Caribbean
Mr. Markku Kanninen	Finland	Western European and Others Group
Mr. Hans Olav Ibrekk	Norway	Western European and Others Group
Mr. Amjad Abdulla	Maldives	Small Island Developing States
Ms. Vanessa Alvarez-Franco	Spain	Annex I Parties
Mr. Yvan Biot	United Kingdom of Great Britain and Northern Ireland	Annex I Parties
Mr. William Kojo Agyemang-Bonsu	Ghana	Non-Annex I Parties
Mr. Bruno Sekoli	Lesotho	Non-Annex I Parties

**ADOPTED AGENDA OF THE FOURTH MEETING**

1. Opening of the Meeting
2. Organizational Matters
  - (a) Adoption of the Agenda
  - (b) Organization of Work
3. Oral Report of the Chair on Intersessional Activities and on the Outcomes of the Conference of the Parties Serving as the Meeting of the Parties to the Kyoto Protocol
4. Report on the Activities of the Secretariat
5. Issues remaining from the First Meeting of the Board
  - (a) Role and Responsibilities of the Adaptation Fund Trustee
  - (b) Provisional Operational Policies and Guidelines for Parties to Access Resources from the Adaptation Fund
  - (c) Establishing Board Committees
6. Operationalization of Access to the Fund
7. Monetization Program
8. Work Plan for the Board and Budgets for the Board, Secretariat, and Trustee for Calendar Year 2009
9. Chair of the Adaptation Fund Board for 2009
10. Other Matters,
11. Date and Venue of the Fifth Meeting of the Adaptation Fund Board
12. Adoption of the Report and Closure of the Meeting

## **DRAFT ROLE AND RESPONSIBILITIES OF THE ADAPTATION FUND TRUSTEE**

### **I. BACKGROUND**

1. The Conference of the Parties to the United Nations Framework Convention on Climate Change (the Convention) decided in its decision 10/CP.7 that an adaptation fund (the Adaptation Fund) shall be established to finance concrete adaptation projects and programmes in developing country Parties that are Parties to the Kyoto Protocol to the Convention (the Kyoto Protocol), as well as activities identified in paragraph 8 of decision 5/CP.7. The decision was further endorsed by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) through its decision 28/CMP.1. In decision 1/CMP.3, the CMP decided that the Adaptation Fund shall finance concrete adaptation projects and programmes that are country driven and are based on the needs, views and priorities of eligible Parties, and that the Adaptation Fund Board shall be established as the operating entity of the Adaptation Fund.

2. In its decision 1/CMP.3, the CMP invited the International Bank for Reconstruction and Development (the World Bank) to serve as the trustee for the Adaptation Fund (the World Bank in such capacity, the Trustee) on an interim basis, and requested the Adaptation Fund Board to present the necessary legal arrangements to be concluded between the CMP and the Trustee for adoption by the CMP at its fourth session.

3. Decision 1/CMP.3 provides that the Trustee shall have the fiduciary responsibility and the administrative competence to manage the Adaptation Fund, and shall comply with principles and modalities for operations stipulated in relevant decisions of the CMP. It further provides that the Trustee shall be accountable to the Adaptation Fund Board for the performance of its fiduciary responsibilities and in particular for the monetization of certified emission reductions (CERs) in accordance with guidance provided by the Adaptation Fund Board.

4. In response to decision 1/CMP.3, the legal arrangement between the CMP and the Trustee will be concluded by way of decision by the CMP and the World Bank approving and accepting the terms and conditions of services provided by the World Bank as the Trustee (the Terms and Conditions). The terms set forth herein will be subject to acceptance by the Executive Directors of the World Bank of the invitation to serve as the Trustee, on the basis of the Terms and Conditions. The Trustee will commence provision of its services upon effectiveness of the Terms and Conditions.

### **II. TRUSTEE FUNCTIONS FOR THE ADAPTATION FUND**

5. The Trustee will provide its services to the Adaptation Fund in accordance with the Terms and Conditions. In the event of any inconsistency between the Terms and Conditions and this document, the Terms and Conditions will prevail to the extent of the inconsistency.

6. The Trustee will establish a trust fund for the Adaptation Fund (the Trust Fund) to hold in trust the funds, assets and receipts which constitute the Trust Fund, on behalf of the Adaptation Fund. For the avoidance of doubt, no CERs will be held in the Trust Fund.

7. The Trustee will perform two core functions for the Adaptation Fund: (A) monetization of CERs for the Adaptation Fund, and (B) trust fund management, including financial management of the resources of the Trust Fund; investment management;

and accounting and financial reporting.

8. The Trustee will perform its functions consistent with its Articles of Agreement, by-laws, policies and procedures, and be accountable to the Adaptation Fund Board for performance of its functions.

#### **A. Monetization of CERs**

9. The Trustee will administer the monetization of the CERs collected as the share of proceeds and forwarded to the Adaptation Fund under the instructions, direction and guidance of the Adaptation Fund Board consistent with its responsibility to supervise and manage the Adaptation Fund and for the monetization of the CERs, pursuant to the Terms and Conditions. Monetization of CERs is the transformation of the CERs into cash. The Trustee will undertake the monetization of CERs in accordance with paragraph 28 of decision 1/CMP 3. The monetization program is to be undertaken to (a) ensure predictable revenue flow for the Adaptation Fund; (b) optimize revenue for the Adaptation Fund while limiting financial risks; (c) be transparent and monetize the share of the proceeds in the most cost-effective manner, utilizing appropriate expertise for this task. These objectives will provide the basis for all work undertaken by the Trustee in connection with the monetization of CERs.

10. The Adaptation Fund Board will approve guidelines on monetization of CERs, based on proposals submitted by the Trustee. The guidelines will be consistent with the monetization objectives, taking into account changing market conditions and constraints, and may be amended from time to time as necessary. The Trustee will implement the CER monetization program in accordance with the guidelines.

11. Upon monetization of CERs, the Trustee will receive and hold the net proceeds of CER sales in the Trust Fund.

12. The Trustee will report to the Adaptation Fund Board on CER sales annually or as specified in the approved guidelines for monetization. The report will include summary and transaction information, such as price and volume information relating to CERs sold, the amount of CERs held in the account for the Adaptation Fund and any other relevant information.

13. With respect to engagement by the World Bank in any of the types of activities described in the Terms and Conditions, for its own account or for the account of clients other than the Adaptation Fund, the World Bank will put in place measures designed to avoid or mitigate conflicts of interest arising from its functions under the Terms and Conditions relating to the sale of CERs for the Adaptation Fund.

#### **B. Trust Fund Management**

14. In the management of Trust Fund resources, the following services will be provided by the Trustee:

- i) Financial management: management of the inflow of receipts from the sale of CERs; administration of contributions from donors, if any; recording of Adaptation Fund Board approvals of allocations; recording of commitments and cash transfers; management of reflows and currency conversions; management of cash flow; management of financial risk, including currency and interest rate risk management, as appropriate; and provision of financial and operational controls over the resources held in the Trust Fund.



- ii) Investment management: investment of funds; periodic review of the risk profile and asset composition of investment benchmarks; and allocation of investment income to the Trust Fund on a monthly basis.
- iii) Accounting and financial reporting: maintenance of accounting records and financial data; provision of periodic financial reports; preparation of annual, audited financial statements; coordination of external audit of the Trust Fund, and review of the consistency of specified financial data provided to the Trustee.

### III. OPERATING PROCEDURES FOR TRUST FUND MANAGEMENT

15. **Investment Management:** In accordance with the policies and procedures of the World Bank, the Trustee shall hold the funds, assets and receipts that constitute the Trust Fund separate and apart from the funds of the World Bank. The Trustee shall establish and maintain separate records and accounts to identify the resources of the Trust Fund, the commitments financed out of the Trust Fund, and the receipts and transfers of funds in the Trust Fund.

16. The Trustee shall invest the funds held in the Trust Fund, pending transfer of funds, in accordance with the Trustee's policies and procedures for the investment of trust funds administered by the World Bank, including commingling of the resources of the Trust Fund for administrative and investment purposes with other trust fund assets maintained by the World Bank. The commingling of Trust Fund resources for administrative and investment purposes should not affect the amount of resources from proceeds of CER monetization available in the Trust Fund for transfer of funds for Adaptation Fund operations, activities, projects and programs. The Trustee shall credit all income from such investment to the Trust Fund to be used for the same purposes as other funds held in the Trust Fund. No warranty is given by the Trustee as to the performance or profitability of the investment of the funds held in the Trust Fund.

17. **Allocation, Commitment and Transfer of Funds:** Subject to the availability of resources held in the Trust Fund, the Trustee will record commitments and make transfers of funds from the Trust Fund, in the manner agreed between the Adaptation Fund Board and the Trustee. Such commitments and transfers will be made only at, and in accordance with, written direction provided to the Trustee by the Adaptation Fund Board or other person designated in writing by the Adaptation Fund Board for this purpose.

18. In case of the transfer of funds to implementing entities identified *ex ante* by the Adaptation Fund Board as meeting the criteria adopted by the Adaptation Fund Board, the Trustee will, with approval of the Adaptation Fund Board, which may be based on standard forms, enter into agreements with the implementing entities, setting out the manner and procedures applicable for commitment and transfer of funds from the Trustee. Implementing entities will bear the responsibility for the use of Trust Fund funds transferred or for activities carried out therewith. It is understood that implementing entities will be responsible for, among others: conducting the necessary technical, environmental, social and financial due diligence in project preparation; entering into grant and other financing agreements with recipients; supervising, monitoring, and reporting on implementation of project activities and use of funds; and ensuring that AF-funded activities are carried out in a sound manner consistent with CMP and AF Board decisions.

19. In case of the commitment and transfer of funds directly to eligible Parties or to executing entities that meet the relevant criteria set by the Adaptation Fund Board, the Adaptation Fund Board will establish the necessary administrative capacity to carry out the

above listed tasks under paragraph 18, either on its own or through other legal entities contracted by it, and enter into financing agreements with the relevant eligible Parties and/or executing entities. To implement the commitments and transfers of funds from the Trustee, the Trustee will enter into a framework agreement with the Adaptation Fund Board, setting out the manner and procedures, according to which the Trustee will receive direction from the Adaptation Fund Board, record commitments and make transfer of funds to the relevant eligible Parties or to executing entities at the direction of the Adaptation Fund Board.

20. The Trustee will not enter directly into any agreements with an eligible Party or executing entity. Upon transfer of funds, the Trustee will have no responsibility for the use of Trust Fund funds transferred or for activities carried out therewith (as further described in paragraph 24 below).

21. **Contributions:** If requested by the Adaptation Fund Board, the Trustee may accept, in the manner and on terms mutually agreed between the Adaptation Fund Board and the Trustee, monetary contributions from donors to support the operations of the Adaptation Fund, including the financing of concrete adaptation projects and programmes. Under the guidance of the Adaptation Fund Board, the Trustee will enter into a trust fund administration agreement with each donor setting out the terms and conditions applicable to the administration and management of the contributions.

22. The Adaptation Fund Board Secretariat will ensure that the Trustee receives all information necessary in order to carry out its responsibilities.

23. **Trustee Costs and Expenses:** Costs and expenses incurred by the Trustee in connection with the performance of its functions, including CER monetization and trust fund management, will be reimbursed on a full cost-recovery basis from the assets held for the Adaptation Fund, consistent with the World Bank's policy to recover its full costs in the provision of trustee and administrative services. For this purpose, the Trustee will annually submit to the Adaptation Fund Board a proposal for mutual agreement for the services and activities to be provided by the Trustee and estimated fees, costs and expenses to carry out such services and activities for the initial and/or upcoming year, as applicable. Upon approval by the Adaptation Fund Board of such proposal, the Trustee will transfer from the Adaptation Fund resources the estimated amount to its own account; provided, however, that the amount transferred to cover the fees, costs and expenses will be subject to end-of-year adjustment to reflect actual costs and expenses incurred.

#### **IV. LIMITED FIDUCIARY RESPONSIBILITIES OF THE TRUSTEE**

24. In its role as trustee for the Adaptation Fund, the Trustee's responsibility will be limited to the management of the funds held in the Trust Fund, sales of CERs, financial management and sound investment of funds, recording commitments and making cash transfers of these funds, and the provision of regular reports and maintenance of accounting records and financial data, in accordance with the Terms and Conditions. In fulfilling its responsibility, the Trustee will rely on decision, instructions, directions or guidance provided to the Trustee in writing by the Adaptation Fund Board or such other person designated in writing by the Adaptation Fund Board, pursuant to the Terms and Conditions. The Trustee will not supervise, track, report on, or verify activities of implementing or executing entities or any other recipients of Adaptation Fund resources, nor will it supervise the use of funds by such entities. Accordingly, the Trustee will have no responsibility for the use of resources once they are transferred by the Trustee.

25. Under the Terms and Conditions, the Trustee will be indemnified, out of the assets held for the Adaptation Fund, including the Trust Fund resources, for any liabilities, claims,

losses, costs and expenses incurred by the Trustee in connection with or arising out of its activities as the Trustee, including sales of CERs. Such indemnification will not include any liabilities, claims, losses, costs or expenses incurred by the Trustee as a direct result of its own gross negligence or willful misconduct.

## **CER MONETIZATION PROGRAM GUIDELINES**

### **I. SCOPE**

1. These guidelines will apply to monetization of certified emission reductions (CERs) engaged by the International Bank for Reconstruction and Development (the World Bank) as trustee for the AF (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. The guidelines will come into effect upon effectiveness of the Terms and Conditions.

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

2. Through the CER Monetization Program, the Trustee will convert the AF's CERs into cash to fund adaptation projects. 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.

#### ***ENSURE PREDICTABLE REVENUE FLOW***

4. Following approval of the legal arrangement (the Terms and Conditions) between the CMP and the Trustee by the fourth session of the CMP and the World Bank Executive Directors, the CER Monetization Program would begin as soon as practicable. CER Monetization should begin 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) To ensure the predictability of funds, the AF Board decided to start the CER Monetization Program only after the settlement infrastructure for carbon markets is in place and CER markets are sufficiently developed.
- ii) 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.
- iii) The Trustee would 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.

***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 would carry out CER monetization through an ongoing program of spot sales in highly liquid markets. This would 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. At present, however, highly liquid and large spot markets have not yet developed. Therefore, the Trustee may have to supplement spot sales with the use of futures contracts and occasional OTC sales.

7. **Risk mitigation:** Carbon markets are still at an early stage in their development and pose risks regarding pricing, liquidity, clearing and settlement. The guidelines will address the management of these risks. Market risk arising from future movements of CER prices will be managed by spreading transactions over time to smooth price fluctuations. Settlement risk coming 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.

***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 would ideally consist of 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.).

### ***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, as discussed at the September AF Board meeting, are based on a three-tiered approach consisting of:

- Ongoing mechanistic sales conducted on liquid carbon exchanges;
- OTC sales through dealers in the case of high CER inventory; and
- Request for guidance from the AF Board under exceptional market circumstances.

15. The guidelines may be amended or supplemented with the written approval of the Trustee and the AF Board.

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.

### ***START OF MONETIZATION***

17. In decision AFB/B.3/1/L.1 at its third meeting, the AF Board decided that the monetization program should commence as early as practicable, in principle within the first quarter of 2009.

18. At its third meeting the AF Board also decided that the Trustee would start the CER Monetization Program once the settlement infrastructure for carbon markets is in place, with the connection made between the International Transaction Log (ITL) and the Community International Transaction Log (CITL), and subject to the legal arrangements between the CMP and the Trustee being adopted by the CMP (Report of the third meeting of the AF Board). See Annex 1 for background on ITL and CITL.

19. Prior to starting the CER Monetization Program, the Trustee will verify the effectiveness, reliability and performance (time for delivery, likelihood of fails etc.) of the ITL-CITL connection, which was announced on October 16, 2008 by the European Commission. Upon the Trustee being satisfied with the functioning of the CITL-ITL system, the transactions associated with the CER Monetization Program can start.

20. At its December 2008 meeting, the CMP will decide whether or not to approve the legal arrangements between the CMP and the Trustee. If the CMP approves the legal arrangements and they are accepted by the World Bank, and the Trustee is satisfied with the functioning of the ITL-CITL infrastructure, the Trustee will execute the first transactions under the CER Monetization Program which could start as early as January 2009. The Trustee will prepare a first public sale as a large-sized OTC inaugural transaction, as decided by the AF Board at its third Meeting (Decision D/AFB.B.3/5).

21. The Trustee will suspend spot sale transactions under the CER Monetization Program if the connection between the KM and EU ETS becomes impaired. If the CITL-ITL based settlement 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.

#### ***ONGOING MECHANISTIC SALES CONDUCTED ON LIQUID CARBON-EXCHANGES***

22. The Trustee would follow a mechanistic approach for CER sales executed on exchanges and would 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:

- i) Maximize, to the extent possible, the volume of CER spot sales conducted on exchanges over the initial period of the CER Monetization Program (2009-2012).
  - ii) 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.
  - iii) 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 over 2008-2012, with the goal being to spread transactions evenly throughout the upcoming quarter.
- b) The Trustee will maintain a minimum inventory in the CER account corresponding to approximately two months of CER inflows. Two months of CERs represents a little more than 1m tons, based on an initial estimate of 32m tons CERs to be received by the AF until 2012, given that there are 4m tons at the end of 2008, and that CERs are issued on a regular basis (i.e. between 6 – 7m tons per year). The purpose of the inventory is to enable the Trustee to maintain a continual selling program in the event of a temporary slowdown or disruption of CER issuances.
  - c) 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.
  - d) 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.
  - e) The Trustee will conduct trades on an anonymous basis.
  - f) 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) As carbon markets have grown in volume, several exchanges have been established for emissions trading. As of end October 2008, the largest are the European Climate Exchange (ECX), the BlueNext environmental exchange, the New York Mercantile Exchange Green (NYMEX Green) and the Nordic Power Exchange (Nord Pool). The Trustee has performed

an initial selection according to the following criteria: nature and number of contracts, liquidity (number, volume, frequency and size of transactions), market share, nature and quality of settlement and clearing services made available to participants (with an imperative requirement for delivery-versus-payment (DVP) settlement), number and nature of entities participating, and ownership status (the support of a well-established, large and reputable exchange or financial group being a plus). The Trustee has performed a study and found that ECX and BlueNext were ahead of the others at the time of the initial selection process (September-December 2008): ECX was the leading exchange but only offered futures contracts; BlueNext, sponsored by the NYSE-Euronext, was second to ECX overall, was offering a spot CER contract and had a leading position in the spot market.

- b) The Trustee proposes to use BlueNext and ECX initially for the portion of the CER Monetization Program that is to be implemented in the form of mechanistic ongoing sales on liquid exchanges. The Trustee will initially use ECX for futures trades and BlueNext for spot trades. 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. A summary presentation of the selected exchanges is given in *Annex II*.

### ***OTC SALES***

23. The Trustee will conduct OTC sales in the manner described below.
24. **Criteria justifying an OTC transaction:** OTC transactions will be considered whenever one of the following situations occurs:
- i) To address an over-accumulation in the AF CER account due to the slow pace of sales on exchanges as compared to the proceeds of the 2% tax on the new flow of CERs issued. As holding CERs has a cost in the terms of lost revenues from the investment income of cash proceeds, over-accumulation would occur when the volume CERs are significantly above the minimum inventory level and above the volume of sales that can be executed on exchanges over the coming two quarters.
  - ii) To sell CERs which are not eligible under the EU ETS (for example CERs generated by large hydro projects). Such CERs are either not of interest for Europe-based buyers (the main participants on the European carbon exchanges) or not accepted for trading in the European based exchanges. For such CERs, and until liquid exchanges for the trading of such CERs develop outside of Europe, the Trustee will execute OTC sales to reach out to the population of interested buyers, after careful separation of the AF CERs between the EU ETS eligible and the non-eligible

- iii) To accelerate the availability of cash in response to the need for new project financing expressed by the AF.
- iv) To accelerate the availability of cash for administrative costs associated with the management of the AF Trust Fund.
- v) To attract the attention and communicate about the action and the operations of the AF towards carbon market participants, entities connected with the UNFCCC, the Kyoto Protocol and the Bali Roadmap, and the wider public.

25. **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.

26. 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.

27. The Trustee will ensure that the settlement processes applicable to OTC transactions are DVP processes to limit **counterparty** credit risk for the AF.

#### ***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. Pending a decision by the AF Board, the Trustee may take such actions as it deems necessary or appropriate with respect to continuing or suspending the CER Monetization Program including taking actions that may conflict with the guidelines if the

Trustee believes that compliance with the guidelines pending a decision by the AF Board could result in material detriment to the value of the AF's assets.

### ***SETTLEMENT***

30. **Settlement of a CER transaction:** The Trustee will settle trades relying on a bank to perform settlement functions (the "Settlement Agent") and the exchange's infrastructure as follows:

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

31. **Selection of a Settlement Agent:** The Trustee will conduct the selection of the Settlement Agent 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.

32. **Role of the Settlement Agent:** The Trustee will request that the Settlement Agent take charge of the following responsibilities and will monitor their performance in executing these tasks:

- i) Participate in all the clearing and settlement functions once the trade is performed by the Trustee.
- ii) Liaise between the Trustee and the carbon exchanges on which the trades are executed.
- iii) Offer an on-line trading platform, if possible, which allows the Trustee to directly link and trade on the selected CER exchanges.
- iv) The Trustee will instruct the Settlement Agent to hold a provisional stock of CERs in preparation of transaction settlements, in the Settlement Agent's account in the registry used for settlement (AF's subaccount with the Settlement Agent).

The Trustee will require the Settlement Agent to maintain a stock that will not exceed two weeks of transactions on the exchanges.

- v) Acting as a representative of the Trustee, instructs transfer of CERs from the CDM registry, to the Settlement Agent account with the registry used for settlement AF's subaccount with the Settlement Agent, and then to the clearing house used for the settlement.
- vi) Working with the exchanges, distinguish between eligible and non-eligible CERs.
- vii) Execute currency exchange, after cash proceeds are received.
- viii) Manage margin requirements in connection with future trades.

### *SUMMARY OF DISCUSSION*

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

## **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, and 3) OTC sales.
- 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 three categories: 1) spot sales on exchanges, 2) futures sales on exchanges, and OTC sales.
- 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 or sold OTC;
- 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.

## ATTACHMENT 1: BACKGROUND ON CARBON FINANCE

### A. The Kyoto Mechanisms

1. Certain signatories to the KP (the so-called Annex I countries: 38 industrialized countries and 11 countries with economies in transition) agreed to reduce their GHG emissions by 5.2% below their 1990 levels by the end of the first commitment period (2008-2012).
2. The Kyoto Protocol (KP) offers three market-based mechanisms that will assist Annex I countries (developed countries and economies in transition) to supplement their national efforts to meet the targets of the Kyoto Protocol. These mechanisms exploit the opportunities arising from the differences in the cost of reducing greenhouse gas emissions in different regions and the fact that the impact on and benefit to the atmosphere is the same.
3. The three mechanisms are the Clean Development Mechanism (CDM), the Joint Implementation (JI), and the Emission Trading. The CDM allows developed countries and transition countries to sponsor projects that reduce greenhouse gas emissions in developing countries in return for Certified Emission Reductions (CERs) that they can use against their own KP greenhouse gas reduction targets. The JI allows developed countries and transition countries implementing project activities that reduce emissions in other developed or transition countries in return for Emission Reductions Units (ERUs). The emission trading scheme allows developed countries and transition countries to trade among themselves some of their Assigned Amount Units (AAUs), acquired CERs, ERUs, and Removal Units (RMUs).

### B. Clean Development Mechanism

4. The CDM offers developed countries an alternative to reducing their own emissions. It allows them to purchase CERs. These CERs are generated by projects located in developing nations which provide emission reductions that are additional to what would otherwise have occurred. One CER equals 1 ton CO<sub>2</sub>e.
5. A project must follow specific steps to produce CERs. The CDM Executive Board will validate the compliance of the project with certain requirements and will formally accept it as a CDM project. The acceptance by the CDM means that emission reductions (ERs) generated by the project may be used by countries to meet their KP targets. The CDM Executive Board will verify ex-post the amount of CO<sub>2</sub>e reductions generated over a period of time by the project activity and will issue and certify these ERs (CERs).
6. The holding, transfer and acquisition of CERs and the other Kyoto Units is tracked and recorded through a system including three components. Each Annex I country maintains a national registry which contains accounts for holding the country's Kyoto Units as well as those held by any legal entity authorized by the country. Transfer and acquisitions of CERs between entities take place through these national registries. An International Transaction Log (ITL) verifies transactions as they are proposed, including their issuance, transfer and acquisition between registries. The CDM registry contains CER accounts for the developing countries participating in the CDM and for the AF.

7. Upon being instructed by the CDM Executive Board to issue CERs, the CDM registry administrator issues specified quantity of CERs. The CDM registry forwards two percent of the CERs issued to the AF account and forwards the remaining CERs to the registry accounts of countries and project participants involved, in accordance with their request.

### **C. European Emissions Trading Scheme (EU ETS)**

8. The trading of carbon assets has considerably developed in the last couple of years especially in Europe with the establishment of the EU ETS. The EU ETS was established to help the European countries to meet their individual commitments under the Kyoto Protocol. The EU ETS is in its second phase from 2008-2012 and is expected to reduce emissions 8% below the 1990 level.

9. Under this scheme, entities must hold emission permits (allowances - EUA) in order to be able to emit CO<sub>2</sub>e. Each country establishes a National Allocation Plan (NAP) that sets the nominal emission reductions that will be achieved during a period and creates the allowances that could be traded to help the entities to meet their targets. The NAPs are approved by the European Commission. In addition, the EU ETS allows the use of CERs to help the European countries to meet their emission targets. All CERs except those from nuclear facilities and land use, land-use change and forestry activities may be accepted. However, each NAP specifies a maximum amount of CERs (and ERUs) that may be used for compliance purposes by operators in the EU ETS. The EUA represents 1 ton of CO<sub>2</sub>e and is fungible across European countries.

10. Each EU country has a registry used to record the holding and transfer of all issued EUAs. These registries have accounts for each entity that wish to participate in trading. The registries are linked through a Community Independent Transaction Log (CITL) that records all the transfers of allowances between parties. The CITL needs to be linked with the ITL in order to transfer the CERs issued by the CDM into the EU ETS.



**ATTACHMENT II: CARBON EXCHANGES**

1. ECX is owned by Climate Exchange Plc, which also owns the Chicago Climate Exchange (CCX). The parent company was founded in 2002 with the establishment of the CCX. The ECX was launched two years later in 2004 and began trading in EUA futures in 2005. Trading in CER futures began in 2008. ECX currently does not do any trading on the spot market, although it has not ruled out the possibility sometime in the future. ECX has 93 members and is located in London.
  
2. BlueNext was incorporated in December of 2007 as a joint venture between the NYSE-Euronext and Caisse des Dépôts. In addition to being the only major carbon exchange trading in the EUA and CER spot markets, it also has recently begun trading in the futures markets for both assets. BlueNext has 82 members and is based in Paris.

**ATTACHMENT III: GLOSSARY**

**Adaptation Fund Trust Fund:** Trust fund for the AF established by the Trustee. Cash proceeds from monetization of CERs, investment income and any contributions to the AF Trust Fund will be held in the AF Trust Fund prior to disbursement on AF Board-approved Programs and projects.

**Annex I Countries/Parties:** Parties include the industrialized countries that were members of the Organization for Economic Co-operation and Development (OECD) in 1992, plus countries with economies in transition (the EIT Parties), including the Russian Federation, Baltic States, and several Central and Eastern European States.

**Annex B Countries/Parties:** Countries included in Annex B to the Kyoto Protocol that have agreed to a target for their greenhouse gas emissions.

**Assigned Amount Unit (AAU):** Assigned Amount Units are the quantity of greenhouse gases that an Annex I country can release in accordance with the Kyoto Protocol, during the first commitment period of that protocol (2008-12).

**Cap-and-trade system:** A system under which a government or international body sets a cap on the amount of emissions a polluter can emit and issues allowances accordingly. Polluters are required to hold allowances which represent the right to emit a fixed amount of emissions. Polluters that exceed their fixed amount can buy allowances in the market. Polluters that fall below their fixed amount can sell their allowances.

**Carbon dioxide equivalent (CO<sub>2</sub>e):** The universal unit of measurement used to indicate the global warming potential of each of the six greenhouse gases. Carbon dioxide – a naturally occurring gas that is a byproduct of burning fossil fuels and biomass, land-use changes, and other industrial processes – is the reference gas against which the other greenhouse gases are measured.

**CDM Registry:** Electronic database managed by the UNFCCC secretariat, serving as the CDM registry administrator, into which CERs are issued from CDM projects and from which CERs are distributed to national registries.

**Certified Emission Reduction (CER):** A certified emission reduction is a carbon credit worth 1 metric ton of avoided or reduced carbon dioxide equivalent under the rules of the KP. CERs are issued by the CDM Executive Board and recorded in the CDM registry.

**Clean Development Mechanism (CDM):** The mechanism, defined in Article 12 of the Kyoto Protocol, permits countries with an emission-reduction or emission-limitation commitment (Annex B Party) to implement emission-reduction projects in developing countries. These projects earn CERs that can be counted towards meeting Kyoto targets.

**Community Independent Transaction Log (CITL):** The CITL records the issuance, transfer, cancellation, retirement and banking of allowances that take place in the national registries of EU Member States.

**Delivery Versus Payment (DVP):** Delivery of a security or a commodity contingent upon receiving payment in cash. This is the norm for settling securities on major international exchanges in order to reduce the risk in the settlement of the transaction.

**Emissions Reduction Purchase Agreement (ERPA):** Agreement which governs the purchase and sale of emission reductions under the Kyoto Protocol.

**Emission Reduction Unit (ERU):** A unit of emission reductions issued pursuant to Joint Implementation. This unit is equal to one metric ton of carbon dioxide equivalent and is usable against a country's Kyoto targets.

**Emissions Trading:** Emissions trading, defined in Article 17 of the Kyoto Protocol, allows countries to sell emissions in excess to their emissions targets to countries that are over their targets. Emissions trading is one of the three KM.

**EU Emission Allowance (EUA):** EUAs are the allowances in use under the EU ETS. An EUA unit is equal to one metric ton of carbon dioxide equivalent.

**European Union Emissions Trading Scheme (EU ETS):** The EU ETS is the European Union's emission trading mechanism. It was launched on January 1, 2005 as part of EU climate policy towards its Kyoto commitment and beyond. In its first phase from 2005 to 2007, the EU ETS regulated CO<sub>2</sub> emissions from energy intensive installations representing some 40 percent of EU emissions. Those emissions were capped at 6,600 million CO<sub>2</sub> over the 2005-2007 period. Following this pilot phase, extending from 2008 to 2012, an average annual cap at 5.8% below 2005 verified emissions was set. To meet their compliance requirements, installations may use EUAs, CERs and ERUs (the latter for Phase II only). Further information may be found at <http://ec.europa.eu/environment/climat/emission.htm>

**Forward Contract:** A forward contract is a non-standardized contractual agreement traded over the counter, to buy or sell a particular financial instrument or commodity at a certain date in the future, at a specified price.

**Futures Contract:** A futures contract is a standardized contractual agreement, traded on a futures exchange, to buy or sell a particular financial instrument or commodity at a certain date in the future, at a specified price. A futures contract has lower risk than a forward contract because it is (i) marked to market on a daily basis and (ii) the settlement failure risk is borne by an exchange.

**International Transaction Log (ITL):** The ITL links together the national registries and the CDM registry and is in charge of verifying the validity of transactions (issuance, transfer and acquisition between registries, cancellation, expiration and replacement, retirement and carry-over). It is connected to the CDM registry and Japan's, New Zealand's, the Russian

Federation's, and Switzerland's national registries. Connections to other national registries are currently being implemented.

**CITL-ITL Connection:** CITL and ITL are the transaction logs that check if transactions between registries fulfill the requirements of the KM and the EU ETS respectively. Currently ITL and CITL are disconnected impeding the transfer of CERs issued under the CDM to national registries in the European Union. The connection, originally scheduled for 2007, was completed on October 16, 2008.

**Joint Implementation (JI):** The mechanisms, defined in Article 6 of the Kyoto Protocol, allows Annex B Parties to earn ERUs from an emission-reduction or emission removal project in another Annex B Party that can be counted towards meeting its Kyoto target.

**Kyoto Mechanisms (KM):** The three flexibility mechanisms that may be used by Annex I Parties to the Kyoto Protocol to fulfill their commitments through emissions trading (Art. 17). Those are the Joint Implementation (JI, Art. 6), Clean Development Mechanism (CDM, Art. 12) and trading of Assigned Amount Units (AAUs).

**Linking Directive EU-ETS:** The Linking Directive allows for the import of CDM emission reduction credits from activities located in developing countries and tapping mitigation potentials in the industry, in the waste management sector, in the mining sector, etc.

**Long-term CERs (ICERs) and Temporary CERs (tCERs):** Long-term CERs (ICERs) and temporary CERs (tCERs) are granted for projects that remove (sequester) carbon from the atmosphere and store it in vegetation and soil through afforestation and reforestation projects. These projects carry the risk of non-permanence, because the sequestered carbon could be released to atmosphere as a result of natural or human disturbances. Hence the credit is only issued and renewed for as long as the carbon is sequestered, and up to a maximum of 60 years. A ICER is issued (pursuant to Article 12 of the Kyoto Protocol) for an afforestation or reforestation CDM project activity, which expires at the end of the crediting period of the project activity for which it was issued (20 or 30 years). A tCER is issued (pursuant to Article 12 of the Kyoto Protocol) for an afforestation or reforestation CDM project activity, which expires at the end of the commitment period (5 years). Both tCERs and ICERs are subject to a 5-year verification cycle. The national registries have to include a tCER replacement account for each commitment period in order to replace them before expiry with other emission certificates (AAUs, CERs, ERUs, RMUs and/or tCERs).

**Monetization:** The term "monetization" follows the way it is used in CMP Decision 1/CMP.3. Monetization is a transaction that transforms CERs into cash.

**National Allocation Plan (NAP):** Documents, established by each Member State and reviewed by the European Commission, that specify the list of installations under the EU ETS and their absolute emissions caps, the amount of CERs and ERUs that may be used by these installations as well as other features such as the size of the new entrants reserve and the treatment of exiting installations or the process of allocation (free allocation or auctioning).

**Over-the-Counter (OTC):** OTC transactions refer to the trading of financial instruments directly between two parties. By contrast, exchange transactions refer to the trading of financial instruments through corporate entities such as stock or futures exchanges.

**Primary Market Transaction:** A primary market transaction is a transaction between the original owner (or issuer) of the carbon asset and a buyer.

**Secondary Market Transaction:** A secondary market transaction is transaction where the seller is not the original owner (or issuer) of the Carbon asset.

**Spot Transaction:** Purchase or sale of an underlying instrument at a specified price for immediate (normally not more than two days) delivery. By contrast, a forward transaction is the purchase or sale of an underlying instrument at a specified price for delivery on a fixed future date.

**BUDGET ESTIMATE FOR TRUSTEE SERVICES  
FOR THE ADAPTATION FUND  
FOR THE PERIOD JULY 1, 2008 – JUNE 30, 2009**

1. In its decision 1/CMP.3, the CMP invited the World Bank to serve as the Trustee for the Adaptation Fund on an interim basis, and requested the Adaptation Fund Board to present the necessary legal arrangements to be concluded between the CMP and the Trustee for adoption by the CMP at its fourth session.
2. The Trustee will perform two core functions for the Adaptation Fund: (a) monetization of CERs for the Adaptation Fund, and (b) trust fund management, including financial management of the resources of the Trust Fund; investment management; and accounting and financial reporting. The Trustee will perform its functions consistent with its Articles of Agreement, by-laws, policies and procedures. Decision 1/CMP.3 further provides that the Trustee shall be accountable to the Adaptation Fund Board for the performance of its fiduciary responsibilities and in particular for the monetization of certified emission reductions (CERs) in accordance with guidance provided by the Adaptation Fund Board.
3. The Invited Trustee hereby proposes to the Adaptation Fund Board a budget for the period July 1, 2008 – June 30, 2009 for services to be provided to the Adaptation Fund, for mutual agreement with the Adaptation Fund Board. As stipulated in the Legal Arrangements regarding the services to be provided by the Trustee to the Adaptation Fund, and in the Roles and Responsibilities of the Trustee, the Trustee is required to submit a budget estimate to the Adaptation Fund Board, for mutual agreement and approval by the Board. This estimate reflects the Trustee's best estimate of the fees, costs and expenses for the year, on a cost-recovery basis. It is subject to review and adjustment at the end of the period, based upon actual fees, costs and expenses incurred during the period July 1, 2008 – June 30, 2009.
4. Fees, costs and expenses incurred by the Trustee with respect to services provided and work undertaken up to June 30, 2008, estimated at \$377,000 will not be charged to the Adaptation Fund and constitute an in-kind contribution of the World Bank to the Adaptation Fund.
5. **The Adaptation Fund Board is hereby requested to agree to an estimated budget comprising US\$ 890,000 for Trustee services and US\$ 475,000 for CER Monetization services (for a total of US\$ 1,365,000) for the period July 1, 2008 to June 30, 2009.** This estimate does not include the costs and expenses referred to in paragraph 3 above and represents a downward revision from the estimate of US\$ 944,100 presented to the Adaptation Fund Board in June 2008. The June estimate did not include an estimate of CER monetization costs. The estimate presented herein is subject to adjustment at the end of the period to reflect full cost recovery as well as any realized savings.
6. The proposed budget reflects the following components:
  - i. ***CER Monetization (US\$ 475,000)***: The CER Monetization budget estimate is based on: cost measures of the resources, including staff costs, system

development changes, travel, and expenses deployed by the World Bank as Trustee of the AF to prepare and execute the CER Monetization Program. The budget estimate comprises three distinct and separate items:

- Costs for the preparation and execution of transactions
  - Settlement costs: The tasks associated with the settlement of transactions will be outsourced by the Trustee to a specialized provider, or “Settlement Agent”, recruited through a competitive selection process as per the rules applicable by the World Bank for its procurement. Estimates are based upon initial quotes received from service providers currently submitting proposals to the World Bank
  - exchange membership fees required to allow the Trustee to trade on the ECX and Bluenext exchanges. Estimates are based upon initial price conditions announced by ECX and Bluenext
- ii. **Financial management (US\$ 140,000):** This estimate assumes that sales of CERs begin in January 2009. The final cost will depend on the level and financing and the number of funding initiatives approved by the Adaptation Fund Board, and the complexity of operational procedures for recording allocations, commitments and making cash transfers.
- iii. **Investment management (US\$ 10,500):** Investment management fees are calculated based on a cost of 3.5 basis points against the average annual balance of the portfolio. The projected average portfolio size for the Adaptation Fund Trust Fund is estimated at \$60 million over the period January-July 2009.
- iv. **Relationship management (US\$ 198,600):** These costs include staff time related to participation in Adaptation Fund Board and related meetings; work in collaboration with the Adaptation Fund Board and the Secretariat to develop best practice operational policies relating to financial transactions; and development of robust and efficient reporting and transactional processes and procedures for the Trust Fund. These costs are normally higher in the early years of a trust fund when significant senior staff time is required to establish the trust fund and put in place its policy and transactional framework.
- v. **Accounting and reporting (US\$ 147,500):** The estimate is based on the assumption that an audited financial statement will be required for FY09; also included would be costs associated with establishing the accounting model to be used for the Adaptation Fund.
- vi. **Legal services (US\$ 170,400):** Costs include the legal work to establish the Adaptation Fund Trust Fund and legal advice related to establishment of the CER monetization program. Also included are costs of contractual services for outside legal counsel on the issues of providing legal personality to the Adaptation Fund and selling CERs under security trading regulations.
- vii. **External audit (US\$ 90,000):** This covers an external audit of the financial statements of the Trust Fund during FY09.

- viii. **Travel (US\$ 133,000):** Four staff to attend four Board meetings each; and four staff to attend the COP/MOP meeting in December 2008.

**Table 1: Budget Estimate for Services Provided by the Trustee  
1 July 2008 to 30 June 2009  
(USD)**

<b>Trustee Services</b>	<b>FY09 Budget (June 2008 Estimate)</b>	<b>FY09 Proposed Budget (Current Estimate)</b>
Financial Management	140,100	140,000
Investment Management	10,500	10,500
Relationship Management	274,200	198,600
Accounting and Reporting	147,500	147,500
Legal Services	157,800	170,400
External Audit	90,000	90,000
Travel	124,000	133,000
<b><u>Sub-Total*</u></b>	<b><u>944,100</u></b>	<b><u>890,000</u></b>
CER Monetization	n/a	475,000
<b><u>Total</u></b>		<b><u>1,365,000</u></b>

\* does not include costs amounting to US\$ 377,000 incurred by the Invited Trustee prior to June 2008, which will not be billed to the Adaptation Fund.