



ADAPTATION FUND

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**CER MONETIZATION: ADDITIONAL OPTIONS
AND RECOMMENDED AMENDMENTS TO THE GUIDELINES**

(PREPARED BY THE TRUSTEE)

Background

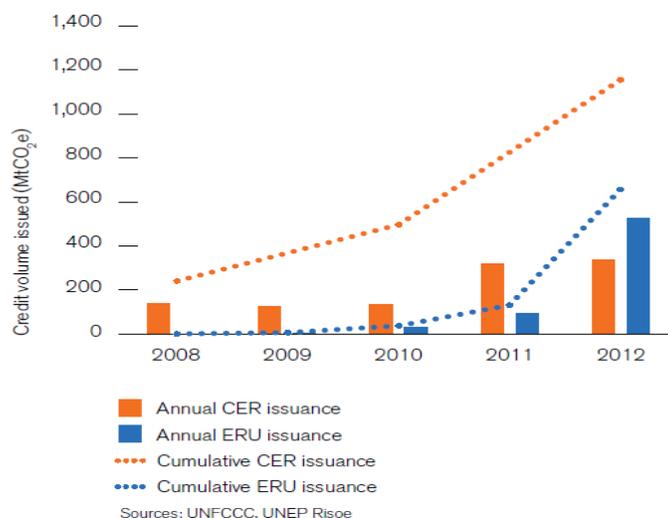
1 The Adaptation Fund Board has requested the World Bank, in its capacity as interim trustee for the Adaptation Fund (AF), to review the current AF Board Guidelines for the Monetization of CERs (“Guidelines”) and, in the context of current CER market conditions and low prevailing CER prices, present options for alternative approaches to CER monetization.

2 The purpose of this note is to present possible options the Board may wish to consider, and the amendments to the current Guidelines that would be required.

CER market outlook

3 The CER price has dropped significantly since 2011 - from over EUR 12 per ton, to EUR 0.35 per ton in early 2013. The price obtainable for CERs derived from industrial gas projects dropped to less than 10 Euro cents as their expiry date (May 2013) approached. The principal drivers of the drop in price have been record CER issuance up to the end of 2012 (*Figure 1 below*), and the collapse in the demand for CERs due to the economic slowdown in Europe.

Figure 1: CERs and ERUs issuance (2008-2012)



4 In May 2013, the World Bank published the report: *Mapping Carbon Pricing Initiatives*¹ which provides analysis on the supply and demand outlook for international credits, and developments in the European Union and other regional exchange trading schemes (ETSs). The report replaces the State and Trends of the Carbon Market series, issued by the Bank in previous years, and recognizes that current market conditions invalidate any attempt to undertake a quantitative, transaction-based analysis of the international carbon market; the report therefore focused on the emergence of regional initiatives. The report estimates that the CER market remains over-supplied by over 300 million tons and concludes that “Without a

¹ The report is available in its entirety at www.carbonfinance.org

major change in the supply/demand imbalance, no significant price recovery can be expected in the near future” (*Box 1 below*).

Box 1: Supply and demand outlook for international credits (2013 – 2020) (from Mapping Carbon Pricing Initiatives)

Analysts predict the overall demand for international credits for 2013–2020 to be around 1,600 MtCO_{2e}. The EU ETS and Effort Sharing Decision are the main sources of demand, with an estimated demand of less than 1,400 MtCO_{2e}. The potential demand from other schemes is about 250 MtCO_{2e}.

Estimates of supply of Certified Emission Reductions (CERs) and Emission Reduction Units (ERUs) (other potential international credits not included) are higher than 1,900 MtCO_{2e} for 2013–2020. This is still considerably lower than what was estimated last year (around 2,700 MtCO_{2e}) despite an increasing number of projects in the pipeline. The forecast was reviewed to reflect the market conditions, with projects stopping issuance due to low prices. These estimates are uncertain since it will take time to see the full effect of price decrease on supply and there is a large potential for resurgence in supply if the issue of demand is addressed.

Both supply and demand figures for international credits are influenced by developments at the national, regional, and sub-national levels (e.g., development of new schemes that accept CERs and ERUs, new market based approaches under the UNFCCC, and new bilateral agreements) and at the international level (e.g., outcome of international negotiations). It can nevertheless be concluded that in the current situation the supply of CERs and ERUs is likely to outweigh the global demand for international credits for 2013–2020.

¹⁹ *Source: estimates from Thomson Reuters Point Carbon in Table 13 of Kossoy, A. and Guigon, P., State and trends of the carbon market 2012, World Bank, May 2012.*

5 At the end of May 2013, there were 10.3 million Adaptation Fund CERs available to be monetized. These CERs are associated with the first commitment period (CP1), and will therefore no longer be accepted by the European Union ETS after early 2015. These CERs should therefore be monetized by this time (March 2015).

6 There is also uncertainty with respect to how Adaptation Fund CERs from CP1 would be carried over to the second commitment period (CP2) in 2015. If CP1 CERs can be carried over after ‘true-up’ period in 2015, they could benefit from demand from other regional ETSs. National and regional initiatives, however do not readily present opportunities for monetizing AF CERs, as the use of CERs is not envisioned under these schemes, at least in the period leading up to 2015 (e.g. China presently is not planning for CDM CERs to be accepted into their national ETS).

7 Markets are also expected to remain over-supplied up to 2015 and possibly beyond, and there are no clear signals as to when the markets may improve. Many traditional carbon market participants, facing challenging conditions, are exiting the market, or starting to focus on new emission schemes and market mechanisms in developing countries.

8 The Adaptation Fund Share of Proceeds will also be receiving CP2 CERs, which have longer shelf life under the EU ETS, and are valid until 2020. However it remains uncertain what the demand in EU ETS will be for CDM CERs after 2015. Tables 1 and 2 below provide a summary of CER demand and supply in the EU ETS and in other regions (source: *Mapping Carbon Pricing Initiatives*):

Table 1: Potential Demand for International Credits (2013-2020)

Country or group of countries	Assumption	Potential demand 2013–2020 (MtCO ₂ e)
Australia	After linking with the EU ETS: 12.5% of Australia's compliance obligation allowed to be met through international credits	Around 90 ²⁰
EU-27, Iceland, Lichtenstein, Norway and Switzerland	Demand for international credits between 2008 and 2020: around 2,400 MtCO ₂ e, ²¹ of which about 1,060 MtCO ₂ e were used until 2012 for compliance. ²² Other credits were already secured – but not yet used – by EU ETS installations, or are in the hands of governments and intermediaries	Less than 1,400
Japan	Japan has declined to sign up for CP2 and will therefore not be allowed to buy secondary Kyoto credits. No estimates provided due to uncertainties around potential demand for offsets under the Joint Crediting Mechanism (JCM) / Bilateral Offset Credit Mechanism (BOCM) and for Kyoto credits from companies under Japanese voluntary scheme, and around the GHG reduction target that is currently under review	Low
New Zealand	Only demand for CP1 Kyoto credits. Range is calculated by the New Zealand government and depends on whether carry-over is allowed in 2015 ²³	Around 70
North America	Only California, demand limited to Reducing Emissions from Deforestation and Forest Degradation (REDD) credits ²⁴	Around 80
Total		Around 1,600

Table 2: Potential supply of CERs and ERUs (2013-2020)

	Potential supply 2013–2020 (MtCO ₂ e)
CERs, EU ETS eligible	1,690
CERs, others	223
ERUs, EU ETS eligible	7
Total	1,920

Source: Thomson Reuters Point Carbon, *Carbon Market Monitor*, April 10, 2013.

(Notes for Tables 1 and 2 - from *Mapping Carbon Pricing Initiatives*)

²⁰ Calculation provided by the World Bank.

²¹ Around 1,700 MtCO₂e including aviation for the EU ETS and around 700 MtCO₂e for the Effort Sharing Decision.

²² Source: Thomson Reuters Point Carbon, *Carbon Market Analyst*, 2 May 2013.

²³ Source: Government of New Zealand, *Consultation on domestic carry-over provisions*, February 2013, <http://climatechange.govt.nz/consultation/ets/proposed-options-for-carry-over-units-ets-2013.pdf>.

²⁴ Own calculation according to the California Cap-and-Trade Regulations allowing 2% in REDD credits in the first and second compliance period, and 4% in the third compliance period

Additional CER Sales Possibilities for the Adaptation Fund

9 **Governments:** In 2012, the Adaptation Fund introduced the possibility for sovereign governments to purchase AF CERs, through agreements directly with the Trustee. To meet conditions of cost-effectiveness, a minimum purchase of 500,000 CERs is presently required. In addition, the AF Board required that such purchases be limited to CERs derived from industrial gas projects, and that the applicable prices be at a premium to those prevailing on exchanges. There was, however, no demand for such purchases under these conditions and, in any event, the AF no longer has industrial gas derived CERs available for purchase². Preliminary indications from at least one government suggest, however, that if purchase of other (non-industrial gas derived) CERs were permitted, and the condition of a price premium was removed, then demand for Adaptation Fund CERs from governments may emerge. The minimum purchase amount was established for cost-effectiveness considerations. If, however, governments agree to accept the trustee's standard purchase agreement, it may be possible to execute cost-effective sales at a lower threshold, determined on a case-by-case basis by the trustee.

10 **Institutional carbon market participants:** Presently, the Guidelines restrict the OTC transactions to dealer banks only. As noted above, due to the current market conditions, the number of active dealer banks in the CER market has been decreasing. Some non-bank institutions, including CER market brokers, fund managers, and other institutional purchasers may be interested to purchase AF CERs for both compliance and voluntary reasons. There may therefore be opportunities to sell to institutions directly, on the same terms as those applicable to sales to governments. Before entering into any such transactions, the Trustee

² A nominal number of such CERs were added to the Share of Proceeds immediately prior to the May 2013 deadline and remain in the Share of Proceeds since monetization of these CERs was not possible.

may be required to carry out due diligence with respect to the purchaser and may also require an analysis of any tax, regulatory and other issues related to CER sales to be settled in the buyer's jurisdiction. These issues would be assessed on a case-by-case basis by the trustee who, based on its sole determination, would reserve the right not to proceed with any transaction.

11 **Use of futures markets:** The Guidelines presently contemplate the sale of AF CERs on futures markets, albeit on a limited scale. The challenge in the current market environment relates to the requirement to post a substantial 'variation margin' (an amount required to be deposited with the buyer or intermediary to protect them from the possibility that one of the parties to the transaction will cancel it prior to the delivery date). The Trustee estimates that an amount of approximately USD 5 million would be required to be posted for this purpose³. In the current context, where the AF is operating at the 50% cap for Multilateral Implementing Entity project and programme approvals, and available new project and programme funding is approximately USD 100 million, this would constitute the encumbrance of a significant amount of AF trust fund resources, for what would likely be limited benefit. There may, however, be opportunities to sell CERs on the daily futures market (i.e. one day contract) without the requirement to post variation margin. To date this has not been possible as there has been very limited activity in this market; however the Trustee will continue to monitor and make use of daily futures where possible.

Recommendation

12 Notwithstanding current market conditions, the monetization of AF CERs should continue, at a modest pace (annual rate of approximately 5-7 million tons) with the objective of reducing the AF CER inventory well in advance of the March 2015 date discussed above. This serves to reduce market risk to the AF by seeking to avoid a build-up of CER inventory and mitigating the risks associated with a potential requirement to sell a large volume of CERs in the months leading up to March 2015. It is also recommended that the Guidelines be amended to expand opportunities for direct CER sales to governments and other institutions. A revised, marked up version of the Guidelines showing the recommended changes is attached.

13 Recommended decision:

- i) The monetization of AF CERs by the trustee should continue, at a modest pace, with the objective of reducing the CER inventory up to March 2015.
- ii) The conditions contained in Decision B.18/37, limiting direct sales to CERs derived from industrial gas projects and that such sales be executed only at a premium price, be removed.
- iii) The "Amended and Restated CER Monetization Guidelines" (June 2012) is amended as indicated in Annex 1 attached.

³ A 2 million CER open position (sales of 8 million tonnes per year / 4 quarterly contracts) x EUR 2 (assumed potential average price fluctuation during quarter) = EUR 4 million (approx. USD 5 million).

Annex 1

AMENDED AND RESTATED CER MONETIZATION PROGRAM GUIDELINES ~~JUNE 2012~~JULY 2013

I. SCOPE

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

II. OBJECTIVES OF THE CER MONETIZATION PROGRAM

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

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

3. The three Program objectives are discussed below.

Ensure Predictable Revenue Flow

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

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

Optimize Revenue and Limit Financial Risks

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

Enhance Transparency, Inclusiveness and Cost-Effectiveness

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

Six Criteria to Implement the Program Objectives

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

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

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

III. RULES GUIDING THE EXECUTION: THREE-TIERED APPROACH

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

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

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

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

A. Ongoing Mechanistic Sales Conducted on Liquid Carbon-Exchanges

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

- (i) Continuous execution of spot straight sales on liquid exchanges

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

maintain a presence in futures CER trading to diversify selling channels and maintain a continuous and seamless access to CER markets.

- (iii) The Trustee will determine the maximum amount of sales through futures contracts based on their characteristics and associated costs and risks:
 - a) The Trustee will place a limit on selling CERs through futures contract derived from the costs and risks associated with “margin calls” or collateral requirements. Selling futures could entail the transferring of cash, known as “collateral”, or “margin”, to the exchange or the clearing house performing the settlement functions for the exchange. An initial margin deposit, which would be made in cash in the case of the AF, is required whenever a futures position is opened. With market movements, the margin is recalculated over time, resulting in margin adjustments or “margin calls” and the possible provision of additional collateral until the futures contract is closed. While all margin posted is returned at the expiration of the contract, a sharp increase in the price of CERs could entail suddenly raising large amounts of cash to post as collateral.
 - b) The Trustee will set the limit on future trades of CERs in the following way; determine the cumulative size of futures trades so as to cap to a reasonable amount the margin call, not to exceed €20 million, which would result from the strongest possible increase in the CER price. Cash used will be put aside in the Trust Fund cash account. The amount of CERs that should be delivered at expiration will be kept aside as well in the CDM registry account of the AF.
 - c) The Trustee will furthermore limit the trading on futures based on the AF’s objective of rapid availability of funds. Currently CER futures contracts only have liquidity for December expiration. Therefore, cash proceeds from the sales will not become available until the end of a given year. The Trustee will continuously assess the availability and liquidity of futures contracts with intermediate expiry dates (March, June and September for instance). In determining the maximum amount of futures sales in a given year, the Trustee will incorporate the objective of keeping a cash inventory in the AF Trust Fund cash account commensurate with the expected disbursements of the AF throughout the year.
- (iv) Selection of exchanges based on their strength, reputation and liquidity
 - a) Several exchanges have been established for emissions trading; the largest are ICE/ECX, and the BlueNext environmental exchange. The Trustee will continue to monitor the evolution of the status and offering of the various exchanges in competition in carbon markets according to the criteria used for the initial selection, and will adapt accordingly its selection of exchanges in the future.

B. OTC Sales

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

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

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

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

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

C. Direct Sales to Governments and Institutions

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

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

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

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

25. Thus, direct sales to national governments and institutions would only be undertaken if the buyer agrees to purchase a minimum of 500,000 CERs, subject to review and adjustment by the trustee based on prevailing CER market prices, thereby rendering the costs of the sale comparable to alternative sales methods. The trustee reserves the right not to proceed with any particular transaction.

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

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

D. Further Requests for AF Board Guidance

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

29. In such event, the Trustee will provide the AF Board with relevant information about the event and its impact on the market and will propose alternative courses of action for consideration by the AF Board. The Trustee will act only upon these AF-Board approved Guidelines, AF Board decisions adopted according to AF Board rules and procedures, or written instruction from the AF Board Authorized Designee⁴, in accordance with its Terms and Conditions.

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

E. Settlement

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

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

32. **Selection of a Settlement Agent:** If the Trustee uses a Settlement Agent the selection of the Settlement Agent will be in a transparent manner following the procurement guidelines of the

⁴ The Chair of the Adaptation Fund Board or authorized designee

World Bank. Only firms that have experience in carbon trading and a strong settlement department will be considered for the role of Settlement Agent.

F. Summary

TABLE 1

	Optimization of Revenues	Minimization of Risk	Transparency	Inclusiveness	Cost Effectiveness	Funding Availability
Start of Monetization	After Connection	After Connection	After Connection	After Connection	After Connection	Before Connection
Ongoing Straight Sales on exchanges	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 (<u>approx. 1 wk</u>)
OTC sales through dealers based on criteria	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
Direct Sales to Governments and Institutions	Price would be at minimum of the average bid-ask spread	DVP	All sales would be publicly disclosed in the trustee's financial status reports to the AF Board	Any government would be eligible to purchase CERs; <u>institutions may be subject to prior due diligence by the trustee</u>	Minimum purchase of CERs would be required to ensure at least comparable cost to other sales methods	Depends on the number of countries <u>and institutions</u> likely to avail of this option

IV. REPORTING

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

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

- Tonnage of CERs held by the AF CER account at the beginning and at the end of the period;
- Volume of new CERs tonnage entering the account of the AF in the CDM registry during the quarter; total volume of CERs having entered the AF CER account with the CDM registry since inception;

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

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