



ADAPTATION FUND

AFB/EFC.8/8
14 February 2012

Adaptation Fund Board
Ethics and Finance Committee
Eighth Meeting
Bonn, 14 March 2012

Agenda Item 10 c)

ADDITIONAL INFORMATION FROM THE TRUSTEE ON CER MARKETS AND MONETIZATION

**Trustee Responses to Questions from AF Board Members on CER markets
and CER monetization**

Q1: Should a floor price be set – where the Trustee will stop selling CERs?

A1: The trustee would not recommend setting a firm floor price because: 1) There is little guidance as to what such a price should be. The Adaptation Fund project and program pipeline remains uncertain and therefore provides little guidance on the minimum resources required from CER monetization (the only guidance from the CMP, reflected in the CER Monetization Guidelines, is to "optimize" revenue); 2) There is no certainty with respect to future CER prices. If CER prices did not increase after breaching an established floor price, or kept falling (even gradually), the Adaptation Fund would risk being out of the market at a time when it may have been beneficial for regular sales to have continued, even as prices declined.

Q2: What is the expected pace of sales through 2012? Please provide a report from the Trustee as to the type of CERs held in inventory.

A2: The amount of CERs in inventory at end-January is approximately 7 million tons. Based on UNEP projections, an additional 6.1 million tons will be allocated to the Adaptation Fund through year-end 2012. Of the total 13.1 million, approximately 4.5 million are "Green" CERs, which will be eligible for compliance through 2015 and, therefore would not necessarily need to be sold in 2012, unless the AF required liquidity for projects and programs. It is expected that the remaining 8.6 million CERs would be sold over the remaining 200 (approx.) trading days remaining to end December 2012. This would imply an average rate of 40,000 CER tons sold per day. The traditional pace of daily sales has been 10,000 CER tons a day on the BlueNext exchange, with additional large OTC sales transacted as needed and when market conditions permit.

The table below shows current holdings as of end-January, 2012. In addition, estimates of future Adaptation Fund allocations, based on UNEP estimates and historical breakdowns, are shown in the column "New CERs*".

Table 1: as at January 31, 2012

Type of CER	Inventory	New CERs*	Total
Industrial Gas	3,211,436	4,007,427	7,218,863
Green	2,646,608	1,849,582	4,496,190
Large Hydro	1,116,683	308,264	1,424,947
Total	6,974,727	6,165,273	13,140,000
* Based on following historical percentages:			
Industrial Gas	65%		
Green	30%		
Large Hydro	5%		

Q3: Is it possible to consider resuming daily sales on a lower volume (e.g. 50% of present levels than before) and what would the implications be both for the fund and from a general market perspective? Will the Trustee sell only HFC and N2O related CERs in 2012, or will other CERs be sold?

A3: Industrial Gas CERs will no longer be compliant in the EU after May 1, 2013 (and status of Large Hydro CERs post-2012 has not been determined). These CERs constitute a projected 65% of the AF inventory in 2012 and the trustee believes it is prudent to sell both of these types of CERs in 2012, before the deadlines. In light of this, and increased CER issuance by the CDM, the pace of sales should increase relative to the 2009-2011 average, not decrease.

Q4: Please clarify if the decision regarding CER sales is the responsibility of the AFB members or the Trustee?

A4: In accordance with CMP Decisions and The Terms and Conditions of Services of the Trustee, the Adaptation Fund (AF) Board is the party responsible for the monetization of CERs and for providing instructions, directions and guidance to the Trustee to undertake such monetization. The Trustee is accountable to the AF Board for performing its fiduciary responsibilities, including the monetization of CERs, but always under the instructions, direction and guidance of the AF Board. Based on its responsibility for providing guidance, the Adaptation Fund Board adopted the Monetization Guidelines (the Guidelines) to be followed by the Trustee to implement the CER monetization program at its fourth meeting (Decision B. 4/3). Further detail is provided in Annex 1, attached.

Q5: Please comment on press articles forwarded by Board Members.

A5: The information contained in the press articles forwarded by Board Members is consistent with what the trustee has reported to the Board to date, i.e. that an oversupply of both CERs and EUAs, combined with the fear that Europe will enter into a recession, continues to push carbon prices down. The downward movement that began in June, 2011 has yet to show signs of reversing or even stabilizing. The auctions by Greece and other countries are part of both issues - countries selling carbon credits to help their fiscal situation, and at the same time putting more supply on an over-supplied market. However, the upcoming auctions are for the most part not news and have been discounted, or "priced in", by the market. Private sector analysts' outlook for the carbon markets has become quite pessimistic for 2012, with some analysts predicting prices remaining at or below the current levels for an extended period. In addition, as previously reported by the trustee, the AF faces a deadline to sell the industrial gas CERs, ideally by year-end therefore, the Trustee's position remains that CER sales should resume along the lines agreed at the last Board meeting.

Q6: Will the price of CERs rise in April after new EU legislation on Civil Aviation?

A6: The new legislation could have a positive effect, but this is likely already reflected in current CER prices. It is unfortunately not possible to predict future CER prices.

Annex 1: Responsibility for the monetization of CERs

Please see excerpts of the relevant provisions in Decision 1/CMP.3 and Terms and Conditions below:

Decision 1/CMP.3

Functions of the Adaptation Fund Board

Paragraph 5. (k) To be responsible for the monetization of certified emission reductions issued by the Executive Board of the clean development mechanism and forwarded to the Adaptation Fund to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation, and to report annually to the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol on the monetization of certified emission reductions.

Trustee

Paragraph 22. Decides 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 in accordance with guidance provided by the Adaptation Fund Board.

Terms and Conditions of Services of the Trustee

II. A. Roles and Responsibilities of the Trustee

Paragraph 3. The CMP hereby (...) (2) imbues the Adaptation Fund Board with the capacity, power and authority to render decisions and provide instructions, directions and guidance to the Trustee hereunder and to cause to be effectuated the sale of certified emission reductions (CERs) collected as the share of proceeds for the Adaptation Fund pursuant to paragraphs 24, 25, 26, 27 and 28 below (...)

Paragraph 8. For the purpose of the monetization of CERs for the Adaptation Fund, the Trustee, in its capacity as agent of the CMP, is hereby authorized by the CMP to administer sales of CERs under the instructions, direction and guidance of the Adaptation Fund Board consistent with its responsibility for the monetization of CERs, pursuant to paragraphs 24, 25, 26, 27 and 28 below.

Paragraph 24. The CMP hereby authorizes the sale of CERs from the account established and maintained at the CDM registry for the Adaptation Fund to hold and transfer CERs collected as the share of proceeds to assist in meeting the costs of adaptation in accordance with Article 12, paragraph 8 of the Kyoto Protocol (the CDM Account) in the manner set forth hereunder.

Paragraph 25. The sale of CERs from the CDM Account shall be administered 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 CERs.

Paragraph 26. Pursuant to the authority provided under paragraph 3 above, the Adaptation Fund Board may cause to be entered into any and all contracts necessary for the sale of CERs from the CDM Account by granting to the Trustee any necessary power of attorney on behalf of the CMP, so that the Trustee may execute contracts of sale with the relevant third party CER purchasers and such other contracts necessary in connection with the sale or the facilitation of the sale of CERs, at the direction of the Adaptation Fund Board pursuant to paragraph 28 below.

Paragraph 27. Pursuant to the authority provided under paragraph 8 above, and in furtherance of paragraph 24, 25 and 26 above, the Trustee may, at the direction of the Adaptation Fund Board pursuant to paragraph 28 below: (1) cause the transfer of title to the CERs to the relevant third party purchasers upon receipt of payment in respect of the transfer; (2) enter into arrangements with the CDM Registry Administrator to effectuate such transfers of CERs; (3) engage with the relevant service providers for the purposes of execution, clearance, settlement and other logistic matters in connection with the sale or the facilitation of the sale of CERs; and (4) take other such actions as necessary to effectuate the sale of CERs for the benefit of the Adaptation Fund.

Paragraph 28. Sales of CERs and transfers of title in respect of such sales pursuant to paragraphs 24, 25, 26 and 27 above shall be effected by the Trustee only in accordance with the guidelines agreed in writing between the Trustee and the Adaptation Fund Board.