UNITED
NATIONS

EP

UNEP/OzL.Pro.WG.1/30/3

United Nations
Environment
Programme

Distr.: General
23 April 2010

Original: English

Open-ended Working Group of the Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer
Thirtieth meeting
Geneva, 15–18 June 2010
Item 4(a) of the provisional agenda*

Report of the Executive Committee of the Multilateral Fund for the Implementation of the Montreal Protocol on a special facility under the Multilateral Fund (decision XXI/2)

Note by the Secretariat

1. In response to decision XXI/2, which requested the Executive Committee to continue its deliberations on the possible development of a special facility to expedite the collection and expenditure of funds for the achievement of supplemental benefits, and to report on these deliberations, including possible options for such a facility as appropriate, to the Working Group at its thirtieth meeting, the Executive Committee has submitted as an annex to the present document the excerpt from the report of the 59th Meeting of the Executive Committee on the further concept paper for a special funding facility for additional income from loans and other sources.

2. The document is reproduced as submitted to the Ozone Secretariat and no editing has been made to it.

* UNEP/OzL.Pro.WG.1/30/1.

EXCERPT FROM REPORT OF THE 59TH MEETING OF THE EXECUTIVE COMMITTEE (UNEP/OzL.Pro/ExCom/59/59)

Agenda item 12: Further Concept paper for a special funding facility for additional income from loans and other sources (decision 58/37)

240. The representative of the Secretariat, introducing document UNEP/OzL.Pro/ExCom/59/54, said that it addressed questions raised at the 58th Meeting in decision 58/37 with respect to a special funding facility. It defined the facility as a potential source of funding to maximize environmental benefits and as a store for funds that might accrue to the Fund from credits for energy efficiency and climate benefits. It included a discussion on the added value of using the facility rather than the Fund to finance climate benefits. The Treasurer had made a detailed assessment of the extent to which the treasury function could accommodate carbon credits and had concluded that UNEP as Treasurer would probably have to encash any credits upon receipt. It was pointed out that UNEP had, however, been innovative in accommodating the requests of the Meeting of the Parties for special treatment of contributions through the fixed-exchange-rate mechanism and promissory notes. The document contained an annex prepared by UNDP on the role of carbon markets as a financing source for the facility. The Executive Committee was being asked to consider any further action with respect to the facility and the requests of the implementing agencies for resource mobilization. The Secretariat's presentation was followed by those of implementing agencies and by Sweden on a proposed informal text.

241. The objective of the concept presented by the representative of the World Bank's Treasury was to make more funds available earlier (scale up funding) to maximize ozone and climate benefits through donor and market mechanisms and carbon financing. He suggested that scaling up funding could serve to meet the objectives of decision XIX/6 of the Nineteenth Meeting of the Parties to achieve climate benefits. He said that scaled up funding could bring significant benefits for the global environment through reduction of CO_2, the use of more energy-efficient techniques, avoidance of the leakage of large volumes of ODS with high-GWP and reduction of ODS banks. He explained that such funds for projects could also be fully absorbed by those demands and, cited specifically their use with respect to HPMPs.

242. The representative of the Bank showed several graphs illustrating the benefits of financial engineering for a greater global impact on the environment. For example, acceleration of projects over five years would result in the elimination of around 30,000 ODP tonnes.

243. A number of alternative mechanisms had been explored for the use of financial instruments for a greater global environmental impact. The first alternative was to scale up donors' contributions in the short and medium terms. The second consisted of the use of bonds to accelerate donor funding, secured by legally binding commitments of donors over a longer period. The third alternative consisted of the second alternative with the addition of the use of financial engineering (loans through the World Bank) to translate carbon credits for immediate use since such carbon assets were normally only available as cash when the enabling projects were completed.

244. In the ensuing discussion, Members raised a number of specific questions on the mechanism that had been presented. In reply to a question concerning the rate of inflation that had been used to estimate the loss of dollar value between the present and 30 years hence, the representative of the World Bank Treasury said that the main additional benefits would derive not from dollar inflation but from eliminating the sources of leakage of emission of GWP gases sooner rather than later.

245. A comment was made that the Bank's model might have fewer global environmental benefits than predicted because some new equipment would have to be replaced. The representative of the World Bank replied that the model had assumed that the life expectancy of such equipment was 10 to 15 years. As the model covered 10-20 years, the amount of new equipment to be replaced would be limited and the energy efficiency gain had been estimated to be 30 per cent.

246. The commitment by donors to make future contributions would be discounted to the present and a financial agent would issue bonds to private investors based on the legally binding commitments of donors. The interest paid to investors was already taken into account in the model and the transaction costs of the financial agent would have to be absorbed by future contributions.

247. In answer to a query regarding the procedure whereby the countries would access funds from the facility, the Bank advised that the documentation required for project proposals under the Multilateral Fund would not be affected. Moreover, the existing role of the Executive Committee would not be changed with respect to the approval of projects. In response to concerns about the risk of bonds

associated with guaranteed commitments, the representative of the Bank indicated that there would be no risk for Multilateral Fund resources, because the risk would be absorbed through the proposed mechanism. The mechanism had already been used previously, and the bonds would be triple A rated. A similar facility, the International Finance Facility for Immunization, had been used successfully resulting in more people being vaccinated earlier than would have been the case without the Facility, thus saving lives. In such facilities, the money was invested very securely and was used as liquid assets.

248. The representative of the World Bank Treasury, replying to one Member's question, said that it had experience and expertise in market volatility and envisaged a structure to mitigate the associated risks.

249. The representative of UNDP gave a short presentation on a facility to develop and establish compliance carbon markets as a source for financing ODS climate benefits, which was based on Annex I to document UNEP/OzL.Pro/ExCom/59/54, which it had prepared. He suggested that voluntary carbon markets (VCM) provided an opportunity for "learning by doing" over the short term in advance of compliance markets, however, the voluntary market was unlikely to absorb the significant supply of ODS credits. A medium-term option was the development of an ODS climate facility consisting of a donor-led fund and an accompanying oversight framework. Under that facility, the Montreal Protocol bodies would have a key role in the oversight framework, with the Ozone Secretariat acting as the registry. Components of the ODS climate facility were set out in Annex 1 to document UNEP/OzL.Pro/ExCom/59/54. UNDP suggested initially that its proposed climate facility would cover costs of a defined number of high quality, diverse demonstration projects funded on the basis of incremental costs with an accounting for carbon credits. In the long term, if the ODS climate facility was successful, the aim was to link ODS direct emissions to the compliance carbon markets, and to arrive at a situation where compliance carbon markets financed ODS climate benefit costs. Responding to a question raised, he said that high-quality, robust credit alone would not be sufficient to gain access to compliance markets, which might not be limited to those under the United Nations Framework Convention on Climate change (UNFCCC), but also include domestic and regional markets.

250. The representative of UNIDO said that his Organization had a specific mandate to link industry with energy and the environment. It had a branch dealing with climate change matters and another with chemical destruction, and was currently chairing the United Nations Energy Group. It was seeking to develop concepts and methods to identify and quantify the additional environmental benefits of HCFC phase-out and ODS destruction activities, and to identify sources of financing for additional climate benefits, as well as the most effective combination of different sources of financing. UNIDO was considering a variety of financial options to maximize the benefits of the ODS bank destruction projects and co-financing from UNIDO. Private sector involvement was also being sought through the producer responsibility programme, and the response so far had been positive. With regard to HCFC phase-out projects, he said that a combination of financial sources would be required to maximize the benefits for HPMP implementation. Efforts were also being made to develop a sector or national approach to address the needs of small and medium-sized enterprises (SMEs). The concepts and methodologies being developed by UNIDO in two pilot projects on HCFC phase-out and management and destruction of ODS banks would serve as a model for other projects. Lastly, he noted that UNIDO would be convening a conference on carbon financing in 2010 focusing on Montreal Protocol activities.

251. The representative of the World Bank introduced the main findings of the final draft of its study on financing the destruction of unwanted ODS through the voluntary carbon market (UNEP/OzL.Pro/ExCom/59/Inf.2). The study had been prepared under a contract with ICF International. The Bank had established a steering committee with representation from the Voluntary Carbon Standard (VCS), the Chicago Climate Exchange (CCX) and the Climate Action Reserve (CAR), permitting close interaction with those bodies and direct exposure to the rapid developments in the market for the inclusion of ODS as an offset project type.

252. The study had concluded that significant opportunity existed for ODS destruction projects under the VCM in a distinct time-frame but depended on a number of factors, including the attractiveness and value of an ODS offset, growth of the voluntary market, rates of ODS recovery and development of capacity in project monitoring and verification. The study had determined that ODS destruction credits were unlikely to flood the market or have a negative impact on compliance markets. It was expected that a global market platform would be created with the three standards that would enable carbon credits to be provided for ODS destruction by early 2010, including one standard allowing destruction to take place in Article 5 countries. Along with the methodologies currently available and protocols of CCX, which already offered ODS destruction as a project type, and CAR, there would be a number of options for financing ODS destruction offset projects.

253. The study found, however, that although the VCM could be one source of financing for ODS destruction and could complement global and local approaches to dealing with unwanted ODS, it was not a panacea. Some ODS would not be recovered by the VCM, and the cost compared to revenue might be prohibitive depending on the "effort" level to extract ODS, the project size and the price of credit per tonne of CO2 equivalent. Given those and other challenges, the study suggested possible roles that actors in the existing Montreal Protocol community could play towards an enabling framework, from Article 5 countries to the Ozone and Multilateral Fund Secretariats, the TEAP and the implementing agencies. The study also contained rules and procedures for the three standards mentioned above, a guide to developing ODS destruction offset projects, and steps for Article 5 countries to address such standards.

254. Replying to a question from the Chair, the representative of the World Bank explained that the assumption of a recovery and destruction rate of 10 per cent had been founded largely on data based on experience in the United States of America and represented the midpoint in a range that had been under consideration. Written comments from Members would be welcome over the next month so that ICF International could finalize the report by the end of 2009.

255. The representative of Sweden introduced a discussion paper entitled "Montreal Protocol Multilateral Fund special funding facility ('SFF')". He highlighted the fact that the facility was a time-limited instrument that was to give priority to projects related to pollution prevention and abatement of the threat to stratospheric ozone and mitigating climate threats. He described its administration, the modalities of its operation, its reporting requirements and other provisions. It was clarified that a more substantial discussion would be welcomed at the 60th Meeting of the Executive Committee.

256. One Member expressed broad support for the paper and said that it had well characterized the major features of a facility and an option to move forward, which would be of use to the Secretariat in its presentation of the issue to the Open-ended Working Group at its 30th meeting. The text should be made available to the Open-ended Working Group, together with an addendum containing the information outlined in the other presentations during the present Meeting. She said that the facility should have a clear scope; provide a means of accessing capital; could be initially capitalized by voluntary contributions from Parties and other sources; absorb risks in accessing climate markets; provide an opportunity to address environmental benefits beyond those required by Article 10 of the Protocol; and serve as a means of receiving a return on investment with some premium.

257. Another Member observed that the decision of the Meeting the Parties to consider a special funding facility suggested that the Committee could not on its own take a decision to create such a facility but instead required the Committee to discuss some options for its consideration. He said that it was difficult to understand how the elements of a facility would fit together on the basis of the mandate. The facility and climate impact indicators, which would provide information concerning climate benefits and the energy efficiency of equipment, were all being considered in isolation but they would have to be brought together in order to implement the mandate of decision XIX/6 paragraph 11(b). Otherwise, it was difficult to see what the facility would be doing compared with what the Multilateral Fund should be doing under decision XIX/6. He said that there had to be discussion under a single agenda item covering all aspects of the issue.

258. A Member urged caution and expressed the view that using the carbon market would fundamentally change the Fund's work. The area of application of the facility should be very clearly distinct from that of the Fund. The Fund had a clear mandate to provide stable and sufficient funding in respect of HCFC phase-out. Participation in unclear carbon markets would undoubtedly be undertaken at great risk, might even lead to negative results and impact negatively on the achievements of the Fund over the past 20 years. There might be too high a level of uncertainty to allow the Fund to become involved in the carbon market. The Fund should not evolve from a funding mechanism into a banking institution geared to profit. If national ozone units were to take the lead, his own country lacked both the capability and the resources for it. There had to be further detailed study of whether such a funding facility was needed, the level of expected benefits and possible risks, as well as the policy and legal issues.

259. Several Members, agreed with the two previous speakers on the dangers and risks and the need to bring together issues currently being considered in isolation and said that it would be wise to follow the request from the Meeting of the Parties to observe developments. Another agreed that the Fund should not steer away from its very specific objectives and tasks, and expressed concern about the funding facility scenarios.

260. Expressing serious anxiety regarding the scaling up of available funding, one Member said that highly volatile carbon markets were a hazardous place for the Multilateral Fund's resources. To his knowledge, the CCX had fluctuated between seven dollars and 50 cents since he started reviewing information on it. Great care should be taken not to send false signals to the markets. Discussion of the issue should continue. One Member said that her delegation had always expressed reservations concerning financial mechanisms under the Kyoto Protocol, and it would have to review the situation with respect to the Montreal Protocol very carefully.

261. Another stated that it was important to respond to the request of the Meeting of the Parties. The Executive Committee should provide input to the Open-ended Working Group, and should decide at an early stage in its 60th Meeting whether to establish a contact group to consider the agenda item, contributions to which should be submitted by delegations within one month of the end of the current Meeting. Information on climate indicators presented at the current Meeting should also be included in the paper to be presented to the 60th Meeting.

262. One Member said that, if it was decided to continue discussion of the topic at the 60th Meeting, the decision on ODS destruction should be borne in mind, while another suggested that the special funding facility was to be regarded as a mechanism for ODS destruction and/or for other purposes. With regard to the requests for resource mobilization from UNDP, UNIDO and the World Bank, it was proposed that they be carried over to the 60th Meeting.

263. Following the discussion, the Executive Committee decided to request the Secretariat to consolidate the material presented during the Meeting on the Special Funding Facility, with any additional contributions submitted by Members by the end of 2009, into a single agenda item addressing both the Facility as well as any issues related to decision XIX/6 paragraph 11(b) of the Nineteenth Meeting of the Parties for consideration at its 60th Meeting.

(Decision 59/48)
