Share of Proceeds to assist in meeting the costs of adaptation

I. Background

A. Mandates

1. Article 12, paragraph 8, of the Kyoto Protocol states that a “share of the proceeds” from project activities under the Clean development Mechanism (CDM) is to be used to “cover administrative expenses as well as to assist developing country Parties that are particularly vulnerable to the adverse impacts of climate change to meet the costs of adaptation.” The Executive Board issues one certified emission reduction (CER) for each verified and certified tonne of CO\textsubscript{2} equivalent emission reduction achieved by a CDM project activity.

2. The Conference of the Parties (COP) at its seventh session\textsuperscript{1} decided and the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (COP/MOP) at its first session\textsuperscript{2} confirmed that:

   (a) The share of proceeds to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to assist in meeting the costs of adaptation shall be 2 per cent of the CERs issued for a CDM project activity;

   (b) CDM project activities in least developed country Parties shall be exempt from the share of proceeds to assist in meeting the costs of adaptation;

   (c) The Adaptation Fund shall be financed from this share of proceeds and other sources of funding.

B. Provisions for afforestation and reforestation project activities

3. These same provisions apply to temporary certified emission reductions (tCERs) and long term certified emission reductions (lCERs) issued for afforestation and reforestation project activities under the CDM,\textsuperscript{3} except that small-scale afforestation and reforestation project activities are exempt from the share of proceeds to assist in meeting the costs of adaptation regardless of their location.\textsuperscript{4} The non-permanence of removals by afforestation and reforestation projects is addressed by tCERs and lCERs.\textsuperscript{5} The modalities for applying, to tCERs and lCERs, the share of proceeds to assist in meeting the costs of adaptation have not yet been agreed. For example, will

\textsuperscript{1} Decisions 17/CP.7, paragraph 15 and 10/CP.7.
\textsuperscript{2} Decisions 3/CMP.1 and 28/CMP.1.
\textsuperscript{3} Decision 19/CP.9.
\textsuperscript{4} Decision 12/CP.10.
\textsuperscript{5} A CDM afforestation or reforestation project must elect to receive either tCERs or lCERs. The net anthropogenic greenhouse gas removals by sinks achieved by the project activity must be certified at five-year intervals. A project activity that elects to use tCERs receives tCERs equal to the net anthropogenic greenhouse gas removals by sinks achieved \textit{since the start of the project} after each certification, but the tCERs expire at the end of the commitment period after the one during which they were issued. A project activity that elects to use lCERs receives lCERs equal to the Net anthropogenic greenhouse gas removals by sinks achieved \textit{since the previous certification}, but the lCERs do not expire until the end of the project’s crediting period. If there has been a decrease in the carbon stocks since the previous certification, a corresponding fraction of the previously issued lCERs must be replaced.
the share of proceeds be collected once or from each issuance of tCERs and lCERs? Will the share of proceeds be collected from the permanent units that ultimately replace the tCERs and lCERs?

4. An Annex I Party that uses tCERs or lCERs for compliance must replace them with valid Kyoto units (assigned amount units (AAUs), emission reduction units (ERUs), removal units (RMUs), CERs, new tCERs, or unexpired ICERs) when they expire. Because a project activity can only earn ICERs or ICERS during its crediting period, the tCERs/lCERs from a given CDM afforestation or reforestation project activity ultimately must be replaced by permanent Kyoto units (AAUs, CERs, ERUs or RMUs).

5. The need to replace tCERs and lCERs means that their prices are likely to be lower than those for CERs. The risk that lCERs will need to be replaced during a given period depends partially on factors specific to the project activity, so ICER prices are likely to vary by project activity. The replacement requirement for tCERs does not depend on the project characteristics, so the prices of tCERs are expected to be less variable than those of ICERs. In addition, the prices of tCERs are expected to be lower than those of ICERs because tCERs are expected to expire and need to be replaced sooner.

6. In short, all CDM project activities, except small-scale afforestation and reforestation CDM project activities and CDM project activities located in a least developed country, will be subject to a levy of 2 per cent of the CERs, tCERs or lCERs issued to assist in meeting the costs of adaptation although details of its application to tCERs and lCERs remain to be decided. In this document “CERs” will include tCERs and lCERs unless tCERs and lCERs are explicitly referenced.

C. Share of proceeds to cover administrative expenses

7. At COP/MOP.1 Parties decided\(^6\) that the share of proceeds to cover administrative expenses of the CDM shall be:

(a) USD 0.10 per CER issued for the first 15,000 tonnes of CO\(_2\) equivalent for which issuance is requested in a given calendar year;

(b) USD 0.20 per CER issued for any amount in excess of 15,000 tonnes of CO\(_2\) equivalent for which issuance is requested in a given calendar year.

8. These arrangements are to be reviewed at the next session of the COP/MOP.

9. The share of proceeds to cover administrative expenses takes the form of cash rather than CERs, at least initially. Cash payments were specified because continued operation of the CDM needed immediate funds and a predictable cash flow. Collection and sale of CERs as the share of proceeds to cover administrative expenses might yield more, or less, revenue. But the time

\(^6\) Decision 3/CMP.1, paragraph 37.
needed to implement a system to sell the CERs collected would certainly have delayed receipt of urgently needed funds.\footnote{At its twenty-third meeting, on 22-24 February 2006, the Executive Board adopted a revised registration fee structure. The new registration fee is the share of proceeds to cover administrative expenses applied to the expected average annual emission reduction for the project over its crediting period. The maximum registration fee is USD 350,000 and no registration fee is collected for projects with an expected average annual reduction of less than 15,000 t CO$_2$e. The registration fee is deducted from the share of proceeds to cover administrative expenses and hence is effectively an advance payment of the share of proceeds for the first year. The registration fee advances the flow of funds for the operation of the CDM.}

10. The COP/MOP decision relating to the share of proceeds for administrative expenses does not limit its decision on the share of proceeds to assist in meeting the costs of adaptation; the share of proceeds to assist in meeting the costs of adaptation could be collected as CERs reflecting decisions 17/CP.7, 19/CP.9 and 12/CP.10 or as a cash payment if so specified by a future COP/MOP decision.

\section*{II. Scope of the note}

11. This document was prepared as background information to facilitate discussions at the UNFCCC Adaptation Fund workshop, 3–5 May 2006, Edmonton, Canada\footnote{This note was prepared based on a background paper prepared by Mr. Erik Haites, Margaree Consultants.}. It provides an overview of:

\begin{itemize}
  \item[(a)] Relevant procedures in the CDM registry and international transaction log (ITL) relating to the management of the holding account for the Adaptation Fund
  \item[(b)] Options for monetizing the share of proceeds for the Adaptation Fund
  \item[(c)] Possible levels of funding given options for monetization at different prices
  \item[(d)] Options to ensure clear separation of management/reporting of the funds from the share of proceeds versus other sources of funds for the trustee account for the Adaptation Fund.
\end{itemize}

12. In addition to this paper, the three other background papers have been prepared by the secretariat to assist discussions at the workshop:

\begin{itemize}
  \item[(a)] Summary of submissions on specific policies, programme priorities, eligibility criteria and possible arrangements for management of the Adaptation Fund
  \item[(b)] Overview of existing institutional arrangements for managing funds
  \item[(c)] Overview of existing programmes and policies to assist adaptation activities (including an overview of existing decisions relating to assistance for adaptation).
\end{itemize}
III. Procedures in the CDM registry

13. The CDM registry must include an account for holding and transferring CERs collected as the share of proceeds to assist in meeting the costs of adaptation. This will be called the Adaptation Fund holding account, although in practice it might be convenient to have multiple accounts in the CDM registry for the Adaptation Fund. When the CDM registry administrator is instructed by the Executive Board to issue CERs for a project activity, the quantity of CERs corresponding to the share of proceeds to assist in meeting the costs of adaptation are forwarded to this Adaptation Fund holding account.

14. The organization responsible for managing the Adaptation Fund holding account in the CDM registry has not yet been specified by a decision of the COP/MOP. The COP/MOP will need to designate an institution to be responsible for selling the CERs collected as the share of proceeds to assist in meeting the costs of adaptation, for managing the Adaptation Fund holding account in the CDM registry, and for remitting the proceeds from the sale of those CERs to the designated trustee account for the Adaptation Fund. That institution could be the institution responsible for administration of the Adaptation Fund or some other qualified institution.

15. When CERs from the Adaptation Fund holding account are sold, the buyer will want them transferred to a specified account in the national registry of an Annex B Party so that they can be resold or used for compliance. The institution responsible for managing the Adaptation Fund holding account must initiate those transfers and execute them in accordance with the rules of the CDM registry and the international transaction log (ITL). If it was also responsible for remitting the revenue from the sale to the Adaptation Fund trustee account, it would initiate the transfer after the proceeds had been received. Otherwise it would initiate the transfer on instructions from the institution responsible for selling the CERs and remitting the proceeds to the Adaptation Fund trustee account.

16. The CDM registry must make public the following information, by serial number, for the Adaptation Fund holding account (and all other CDM registry accounts) for each calendar year:

   (a) The total quantity of CERs in the account at the beginning of the year;
   (b) The total quantity of CERs issued;
   (c) The total quantity of CERs transferred and the identity of the acquiring accounts and registries;
   (d) The total quantity of CERs cancelled in due to withdrawal or suspension of the accreditation of a designated operational entity;
   (e) Current holdings of CERs in the account.

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9 Annex to decision 17CP.7, appendix D, paragraph 3 (d).
10 Annex to decision 17CP.7, paragraph 66.
11 An Annex B Party is a Party listed in Annex I of the United Nations Framework Convention on Climate Change that has ratified the Kyoto Protocol and has a quantified emission limitation or reduction commitment listed in Annex B of the Protocol.
12 Annex to decision 17CP.7, appendix D, paragraph 12.
17. Thus the standard reporting requirement for the CDM registry will provide a detailed record of the transactions involving CERs, by serial number, collected as the share of proceeds to assist in meeting the costs of adaptation – the CERs forwarded to the Adaptation Fund holding account, all transfers from the Adaptation Fund holding account together with the identities of the acquiring accounts, any CERs cancelled, and the CERs remaining in the Adaptation Fund holding account at the end of the year.

IV. Options for monetizing the share of proceeds for the Adaptation Fund

18. This section provides for an overview of options for monetizing the share of proceeds to assist in meeting the costs of adaptation. The COP/MOP could choose a specific option or provide general guidance to the designated institution on what it wishes to achieve, (e.g. fund maximisation, predictability, etc.) and let the institution choose the best means to monetize the share of proceeds.

19. As a percentage of the CERs issued, the share of proceeds to assist in meeting the costs of adaptation must be sold and the proceeds must be remitted to the Adaptation Fund trustee account. Options for selling the CERs collected as the share of proceeds are discussed below.

20. One alternative is to define the share of proceeds to assist in meeting the costs of adaptation in monetary terms rather than as a percentage of CERs issued. This would however imply a modification to decision 3/CMP.1.

A. Monetary definition of the share of proceeds to assist in meeting the costs of adaptation

21. The COP/MOP could decide to modify decision 3/CMP.1 to define the share of proceeds to assist in meeting the costs of adaptation in monetary terms rather than as a percentage of CERs issued as is currently the case for the share of proceeds to cover administrative expenses. The project participants would pay the specified share of proceeds for adaptation in cash before the CERs to be issued are forwarded to their registry accounts.

22. No CERs would be collected for the Adaptation Fund holding account in the CDM registry. In effect the project participants buy the CERs collected as the share of proceeds to assist in meeting the costs of adaptation with the cash payment, so they receive all of the CERs issued.

23. Collecting the share of proceeds for adaptation as cash rather than CERs simplifies the monetization process because it is no longer necessary to sell CERs. It also provides revenue to the Adaptation Fund trustee account a little sooner (probably a few months on average) because the money is received when the CERs are issued rather than after the CERs collected as the share of proceeds to assist in meeting the costs of adaptation are sold. Finally, it produces a more predictable revenue stream for the Adaptation Fund trustee account because the revenue is not affected by fluctuations in the prices of CERs.

24. The disadvantage of collecting the share of proceeds as cash rather than CERs is that it may not maximize the revenue for the Adaptation Fund trustee account. The cash amount specified by the COP/MOP determines an implicit price for the CERs that would otherwise be collected. If the market price is higher than this implicit price for the CERs, less revenue is collected for the Adaptation Fund trustee account. If the market price is lower, more revenue is
collected for the Adaptation Fund trustee account. Because the market prices of CERs will fluctuate, the cash collected will rarely be equivalent to exactly 2 per cent of the CERs issued.

B. Options for selling CERs collected as the share of proceeds to assist in meeting the costs of adaptation

25. Regardless of which institution is assigned the responsibility, the options for selling the CERs collected as the share of proceeds to assist in meeting the costs of adaptation in the Adaptation Fund holding account in the CDM registry include:

(a) Direct sale of the CERs to Annex B Parties by the institution responsible for their sale;

(b) Periodic auctions of the CERs conducted by, or on behalf of, the institution responsible for their sale;

(c) Sale of the CERs using an exchange or similar institution that regularly sells CERs;

(d) Use of a broker to sell the CERs.

26. Each of these options is discussed below.

1. Direct sale to Annex B Parties

27. The institution responsible for selling the CERs collected as the share of proceeds could offer them to Annex B Parties at a price equal to the high end of the market, for example the market price for CERs from “Gold Standard” project activities.\(^\text{13}\)

28. Many Annex B Parties have announced that they plan to purchase CERs (and other Kyoto units) to contribute to compliance with their emission limitation commitments. Their purchases are likely to be much larger than the quantity of CERs collected as the share of proceeds.\(^\text{14}\) Annex B governments may be willing to pay a small premium for CERs from the Adaptation Fund holding account to ensure the success of the Fund.\(^\text{15}\) The transaction costs of such direct sales are likely to be minimal since the sales involve no intermediaries.

\(^{13}\) The Gold Standard is a voluntary standard for CDM projects. To meet the standard, a project must pass three screens – project type (renewable energy or energy efficiency), additionality and baseline, and sustainable development. Currently CERs from Gold Standard projects command a premium price. See www.cdmgoldstandard.org.

\(^{14}\) Table 1 below indicates that the quantity of CERs collected as the share of proceeds for adaptation assistance is projected to be between 15 and 50 million through 2012. During the first four months of 2005 Annex B governments purchased over 30% of the CDM credits sold. With total annual sales of over 100 million, Annex B government purchases are about 30 million per year (Lecocq, Franck and Karan Kapoor, 2005. \textit{State and Trends of the Carbon Market 2005}, CF-Assist program of the World Bank Carbon Finance Business and International Emissions Trading Association (IETA), Washington, D.C., May 9, pp. 20-21).

\(^{15}\) CERs not purchased by Annex B governments could be offered to other buyers at the same price, but it is unlikely to be willing to pay a premium for them.
29. Determining the price at which to sell the CERs is the main issue associated with this option. Annex B Parties probably would be willing to pay a small premium to contribute to the success of the Adaptation Fund. If they consider the price to be too high they can purchase the units they need in the market and the Adaptation Fund will be left to sell its CERs at the market price. A price at the high end of the market, such as the market price for CERs from Gold Standard project activities, likely would be acceptable to Annex B Parties. Since the prices of CERs for most project activities would be lower, this would maximize the revenue to the Adaptation Fund. The lower transaction costs relative to the other options also would benefit the Adaptation Fund.

30. Since market prices for CERs, including those from Gold Standard project activities, will vary over time, the price would need to be set by the institution responsible for selling the CERs rather than COP/MOP. Due to changes in market prices, a price set by COP/MOP could be well above the market with the result that few of the CERs collected as the share of proceeds for adaptation assistance are sold. Or the price set by COP/MOP could be well below the market with the result that the revenue collected for adaptation assistance is not maximized.

31. To ensure transparency, details of the individual transactions would need to be public. The CERs purchased by each government will be known from the annual reports on the transactions of the Adaptation Fund holding account. The price and the revenue received by the Adaptation Fund trustee account from each transaction should also be public.

32. If it is well implemented, this is probably the best option. It should maximize the prices for the CERs sold and it should involve the lowest transaction costs. It should be possible to sell all of the CERs collected as the share of proceeds for adaptation assistance to Annex B governments. But any CERs not purchased by Annex B governments could be sold using one of the other options. The only potential disadvantages are that the payment process may be slower than under some of the other options and that it may be difficult to implement for IERs and tCERs because afforestation and reforestation project activities currently can not qualify as Gold Standard project activities.  

2. Auctions

33. Auctions of CERs collected to assist in meeting the costs of adaptation could be conducted at regular intervals, perhaps semi-annually initially increasing to quarterly, and possibly monthly, as the quantity collected increases. The frequency of the auctions should be set so that the quantity of CERs sold at each auction is sufficiently small relative to other transactions that the auction does not affect the market price.

34. Selling the CERs collected from each issuance as a separate “lot” in the auction would provide maximum transparency; the buyer and the purchase price would be known from the auction, the CER transfer from the Adaptation Fund holding account to the buyer’s account could be verified from the CDM registry, and remittance of the purchase price to the Adaptation Fund trust account could be audited.

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16 The project type screen is limited to renewable energy and energy efficiency projects.

17 The quantity of CERs collected as share of proceeds should increase exponentially over at least the first seven years. CERs are collected for each issuance. Assuming registered project activities request an issuance on average of once a year, the quantity of CERs issued will increase exponentially as the number of registered project activities rises. The number of registered project activities should continue to rise at least through the initial seven year crediting period.
35. If the price of issued CERs differs by project activity, selling the CERs collected from each issuance as a separate lot should capture the price differences for the benefit of the Adaptation Fund. As discussed above, prices for tCERs and ICERs should differ from those for CERs. If the market considers issued CERs (tCERs) to be equivalent regardless of the project activity from which they originate, selling them as separate lots should not be a disadvantage.

36. A minimum lot size is probably needed to keep the transaction costs reasonable. Based on the standard transactions for European Union Emissions Trading Scheme (EU ETS) allowances, such a minimum might be between EUR 10,000 and EUR 50,000. The CERs (tCERs) collected from several small-scale CDM project activities may need to be combined and sold as a single lot to meet the minimum lot size. Prices of issued ICERs should reflect the risks associated with the project activity, so the ICERs from different project activities might need to be sold as separate lots regardless of the lot size.

37. The advantages of an auction are the ability to sell all CERs, tCERs and ICERs collected using the same mechanism and the high level of transparency. The delay between receipt of the CERs, tCERs and ICERs in the Adaptation Fund holding account and their sale at auction may be a disadvantage. The costs of an auction may be higher than the costs of other options.

38. The auction could be conducted by the institution responsible for the sale of the CERs collected as the share of proceeds to assist in meeting the costs of adaptation or a suitably qualified organization could be contracted to administer the auction on its behalf. The Chicago Board of Trade has conducted an annual auction of SO2 allowances on behalf of the United States Environmental Protection Agency more than 10 years. The United Kingdom conducted an auction of emission reduction targets in 2002. At least three countries participating in the EU ETS plan to auction some allowances. The state of Virginia auctioned NOx allowances in 2004. Thus it should be possible to find several organizations qualified to administer an auction, and the cost can be reduced by asking such organizations to bid for the work.

3. Exchanges

39. The Asia Carbon Exchange conducts monthly sales of CERs, at present mainly contracts for future delivery (forward contracts). Currently it is the only institution that regularly sells CERs. Five exchanges in Europe – ECX, EEX, EXAA, Nord Pool and Powernext – currently handle spot trades (immediate delivery) of EU ETS allowances. As the quantity of CERs issued rises, one or more exchanges may provide spot trading for CERs. Then the CERs collected as the share of proceeds to assist in meeting the costs of adaptation could be sold through the exchange.

40. Exchanges trade only standard commodities. CERs, tCERs and ICERs would be separate commodities. Within each commodity the issued units would need to be considered equivalent by buyers and sellers. If the prices of issued CERs or tCERs differ due to the nature of the project activity, the host country, or other factors exchange trading may not develop. As discussed above, prices of issued ICERs should reflect the risks associated with the project activity, so exchange trading of ICERs is unlikely. Even though tCERs may be considered a commodity, exchanges may not offer spot trading of tCERs if the anticipated trading volume is too low.

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18 During 2003 and 2004 EU allowances were trading in lots of 5,000 at prices between EUR 5.00 and EUR 10.00. During 2005 the standard lot size increased to 10,000 and prices were generally more than EUR 20.00. The 2003/2004 data can be used as a basis for estimating a reasonable minimum lot size with the understanding that the average lot size will be substantially higher.
41. Most transactions on an exchange involve standard lots, for example 10,000 CERs. Other quantities (odd lots) are traded, but the realized price per unit may be lower due to price discounts or higher administrative costs. The CERs collected from an issuance will rarely be a standard lot. The institution responsible for selling the CERs would need to determine whether to sell odd lots to enhance transparency or to combine CERs from several issuances into standard lots.

42. The buyer and seller are usually anonymous when a trade is agreed on an exchange. After the price is agreed, the payment goes to the seller and the commodity is transferred to the buyer via intermediaries. It may be more complex to track the buyer(s) of and total price paid for the CERs from each issuance if they are sold on an exchange because the CERs from a single issuance could be divided into several standard lots, or be combined into a single lot. But if that level of transparency is considered important it should be possible.\(^{19}\)

43. The advantage of exchange trading, if it is available, is that the CERs in the Adaptation Fund holding account could be sold almost immediately after they are received. The transaction costs could be lower than for an auction. The disadvantage is that exchange trading is unlikely to be available for ICERs and possibly tCERs so alternative ways of selling those units would need to be adopted. Exchange trading is unlikely to be viable for the quantity of CERs collected as the share of proceeds to assist in meeting the costs of adaptation, so it may not be available until the spot market for CERs develops. Providing the same level of transparency as for an auction is possible but more complex.

44. One exchange already sells CERs and several others sell similar commodities. The institution responsible for the sale of the CERs collected as the share of proceeds to assist in meeting the costs of adaptation could solicit bids from interested exchanges to sell the CERs (and possibly the tCERs and ICERs) in the Adaptation Fund holding account. The bids should address the sizes of lots, fees to be charged, settlement arrangements, and procedures to ensure transparency.

4. Brokers

45. The institution responsible for selling the CERs in the Adaptation Fund holding account could use brokers to find buyers and help negotiate the sales. As with an auction the CERs collected from each issuance could be sold as a separate transaction to provide maximum transparency.

46. Brokers can be competitive with exchanges. Currently, most transactions for EU ETS allowances are arranged by brokers even though they are traded on several exchanges. Several brokers could be retained to assist with the sale of the CERs in the Adaptation Fund holding account.

47. The advantage of using brokers is that they know the market and so may be able to get better prices for the CERs if the prices are differentiated, as in the case of ICERs, or the market is limited. Brokers can help sell any CERs collected by the Adaptation Fund holding account and

\(^{19}\) Exchange trading is likely only if the prices of issued CERs are virtually identical regardless of the project activity that generated them. If CERs from several issuances are sold as a single lot, it would be reasonable to attribute the realized price to the CERs from each of the project activities. If the CERs from a single issuance are divided into several lots, each lot may be sold at a slightly different price because the sales would occur at slightly different times.
each issuance can be structured as a separate transaction to provide full transparency. The disadvantage is that using brokers may be more costly than the other options.

48. The institution responsible for selling the CERs in the Adaptation Fund holding account could select one or more brokers through a bidding process. The brokers could be selected on the basis of their proposed fees. Their performance could be assessed in terms of the price obtained for the Adaptation Fund holding account CERs relative to the market price for CERs at the time. Different brokers could be used for CERs and for tCERs and ICERs. If several brokers are selected, the CERs from successive issuances could be assigned to them on a rotating basis.

5. Combinations

49. Combinations of the above options for selling the CERs in the Adaptation Fund holding account are possible. If Annex B Parties choose not to purchase all of the CERs in the Adaptation Fund holding account, the balance could be sold using one of the other options. If establishment of a premium price for tCERs and/or ICERs for direct sale to Annex B Parties is difficult, brokers could be retained to help sell them. If exchanges offer spot trading of CERs but not ICERs, brokers could be retained to help sell the ICERs. Similarly, an auction could be used to sell the CERs from issuances that exceed the minimum lot size, and brokers could be retained to help sell the smaller quantities.

50. The best combination of options might change over time given that the volume of CERs collected should rise exponentially for several years. Direct sales to Annex B Parties or a broker might be the best option for the relatively small quantities collected by the Adaptation Fund holding account initially. With a larger quantity of CERs collected as the share of proceeds to assist in meeting the costs of adaptation and a more established CER market, direct sales to Annex B Parties or periodic auctions could be the most efficient option. An exchange may not be a viable option until the market for CERs is sufficiently large to support virtually continuous trading.

V. Possible levels of funding at different prices

51. The revenue generated for the Adaptation Fund by the share of proceeds will depend on the price of CERs and the quantity of CERs issued.

52. CDM Highlights\(^{20}\) reports the current price of CERs from registered project activities as EUR 11 to 14 with CERs from “Gold Standard” project activities fetching EUR 15. This range is consistent with the results reported for the February sale on the Asia Carbon Exchange. CERs can be used for compliance with obligations under the EU ETS, so CER prices should converge with the prices of EU ETS allowances, especially post-2007.\(^{21}\) Recent prices for EU ETS allowances range from EUR 24 to 28 with 2008 allowances at the low end of the range.\(^{22}\) The most recent overview of the future market, although slightly dated, estimated the market price for


\(^{21}\) EU ETS allowances for 2005–2007, with few exceptions, cannot be used after this period. CERs can be used for compliance any time after 2005. Thus the price of CERs is expected to converge with the price of EU ETS allowances for 2008 and later vintages. Because of their greater flexibility the price of CERs is expected to exceed that of 2005–2007 EU ETS allowances toward the end of that period.

CERs in 2010 at USD 11.00 /CER (range ± 50 per cent). These data suggest a likely price of EUR 10 to 15 with a low estimate of EUR 5 and a high estimate of EUR 25.

53. There are no public data or forecasts of the prices of ICERs and tCERs.

54. The CDM project activities pipeline includes more than 670 project activities that are expected to generate about 876 million CERs by the end of 2012. Only a small fraction of the estimated CERs generated would be exempt from the levy for the share of proceeds to assist in meeting the costs of adaptation. The above totals include 9 project activities in least developed countries expected to generate 3.4 million CERs by 2012 that are exempt from the share of proceeds for the Adaptation Fund holding account. They also include two reforestation project activities that are expected to generate 0.7 million tCERs or lCERs by 2012. Neither is a small-scale project activity, so they would not be exempt from the share of proceeds for the Adaptation Fund holding account. Thus less than 0.5 per cent of the projected CERs from the current project pipeline would be exempt from the levy for the share of proceeds to assist in meeting the costs of adaptation.

55. The overview of the future market estimated the market demand for CERs in 2010 at 250 million (range 50 to 500 million) for a total demand of 1,250 million (range 250 to 2,500 million) through 2012. These data suggest a low estimate of 750 million CERs (some known project activities do not perform as forecast), a median estimate of 1,250 million CERs and a high estimate of 2,500 million CERs through 2012. The Adaptation Fund holding account would collect 2 per cent of the CERs.

56. Estimates of the CERs generated by project activities in least developed countries and of the ICERs and tCERs generated by afforestation and reforestation project activities are not available. Because they represent a small share of the current project pipeline, they are ignored for the purposes of estimating the revenue generated for the Adaptation Fund by the share of proceeds.

57. The combinations of CER prices and quantities of CERs collected as the share of proceeds to assist in meeting the costs of adaptation to 2012 are shown in table 1. A large supply of CERs is assumed to be consistent with low and median (but not high) prices, while a small supply is assumed to be consistent with median and high (but not low) prices.

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24 See <http://cdm.unfccc.int/Statistics>, accessed 3 April 2006. The totals include 150 registered projects that are expected to generate over 340 million CERs.

Table 1. Possible levels of funding for the Adaptation Fund trustee account to 2012

<table>
<thead>
<tr>
<th>Total quantity of CERs issued through 2012 (million)</th>
<th>Total quantity of CERs collected by the Adaptation Fund holding account through 2012 (million)</th>
<th>Total revenue received by the Adaptation Fund trustee account at various prices per CER (million euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Assumed Price per CER</td>
</tr>
<tr>
<td></td>
<td></td>
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</tr>
<tr>
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</tbody>
</table>

Note: NA This combination of price and quantity is considered to be very unlikely.

58. The combinations suggest the revenue to the Adaptation Fund trustee account from the share of proceeds over the period through 2012 could be EUR 325 million with a range of EUR 125–EUR 750 million. Transaction and administration costs would reduce the revenue available to the Adaptation Fund. ICERs and tCERs from afforestation and reforestation project activities would increase the revenue. These adjustments should be small relative to the uncertainty of the above estimates.

VI. Separate reporting of the funds from the share of proceeds

59. In addition to the revenue from the sale of CERs collected as the share of proceeds to assist in meeting the costs of adaptation, the Adaptation Fund trustee account may receive funds from voluntary contributions or other sources. The accounting systems and financial statements for the Adaptation Fund trustee account should track and report the funds received from different sources. This ensures transparency. And it informs decisions on how to increase the resources of the Adaptation Fund, if necessary.

60. For maximum transparency the accounting system for the Adaptation Fund trustee account should record and be able to report the revenue received from the sale of the CERs collected as the share of proceeds for each issuance. As discussed above, the CERs from each issuance could be sold as a separate transaction, except in the case of small-scale project activities where the CERs from the issuances for several project activities could be sold as a single transaction. In the case of such consolidated transactions, the revenue could be pro-rated among the different small-scale project activities based on the CERs included in the sale.

61. Reporting the revenue received from the sale of the CERs collected as the share of proceeds for each issuance separately would enable the buyer and the purchase price to be matched with the CER transfer from the Adaptation Fund holding account to the buyer’s account. Thus it should be possible to ensure that payment has been received for all CERs transferred from the Adaptation Fund holding account.

62. With that level of detail for the revenue received from the sale of CERs collected as the share of proceeds, the accounting systems and financial statements for the Adaptation Fund trustee account would also be able to track revenue received from other sources at the level of specific contributions.

63. With that level of detail it should be possible to aggregate the revenue from various sources in whatever manner is desired by the COP/MOP, for example by host country for CDM
project activities or Annex I Party for CER purchases and voluntary contributions. The COP/MOP could also decide to use the information on the sources of revenue to help manage the Adaptation Fund. For example, it could use revenue from the share of proceeds and from voluntary contributions to support different types of adaptation projects.

VII. Summary

64. All CDM project activities, except small-scale afforestation and reforestation CDM project activities and CDM project activities located in a least developed country, will be subject to a levy of 2 per cent of the CERs, tCERs or ICERs issued to assist in meeting the costs of adaptation although details of its application to tCERs and ICERs remain to be decided. The CERs (including tCERs and ICERs) collected as the share of proceeds to assist in meeting costs of adaptation are forwarded to the Adaptation Fund holding account in the CDM registry. They are held in that account until they are sold and transferred to an account specified by the buyer in the national registry of an Annex B Party.

65. The COP/MOP will need to designate an institution to be responsible for selling the CERs collected as the share of proceeds to assist in meeting the costs of adaptation, for managing the Adaptation Fund holding account in the CDM registry, and for remitting the proceeds from the sale of those CERs to the designated trustee account for the Adaptation Fund. That institution could be the CDM Executive Board, the institution responsible for the trustee account for the Adaptation Fund, the institution responsible for administration of the Adaptation Fund, or some other qualified institution.

66. The Adaptation Fund needs money, rather than CERs, for its activities. One possibility is to modify decision 3/CMP.1 to define the share of proceeds to assist in meeting the costs of adaptation in monetary terms, as is currently the case for the share of proceeds for administrative expenses, rather than as a percentage of CERs issued.

67. If the share of proceeds to assist in meeting the costs of adaptation continues to be a percentage of the CERs issued, they must be sold and the proceeds must be remitted to the Adaptation Fund trustee account. The options for selling them include:

(a) Direct sale of the CERs to Annex B Parties by the institution responsible for their sale;

(b) Periodic auctions of the CERs conducted by, or on behalf of, the institution responsible for their sale;

(c) Sale of the CERs using an exchange or similar institution that regularly sells CERs;

(d) Use of a broker to sell the CERs.

68. Combinations of the above options for selling the CERs in the Adaptation Fund holding account are possible as well.

69. The COP/MOP could choose a specific option, such as a cash payment or direct sale, or provide general guidance to the designated institution on its objectives for monetization (e.g. fund
maximisation, predictability, etc.) leaving responsibility for transparent implementation with the designated institution.

70. Prices for CERs through 2012 are expected to be in the range of EUR 10 to 15 with a low estimate of EUR 5 and a high estimate of EUR 25. Estimates of the quantity of CERs to be issued by the end of 2012 range from 750 to 2,500 million, with a central value of 1,250 million. Virtually all of the CERs issued would be subject to the levy for the share of proceeds to assist in meeting the costs of adaptation. The combinations suggest the revenue to the Adaptation Fund trustee account over the period through 2012 could be EUR 325 million with a range from EUR 125 to EUR 750 million.

71. The accounting systems and financial statements for the Adaptation Fund trustee account should be able to track the revenue received from the sale of CERs collected from each issuance and from other sources at the level of specific contributions. With that level of detail it should be possible to aggregate the revenue from various sources in whatever manner is desired by COP/MOP, for example by host country for CDM project activities or Annex I Party for CER purchases and voluntary contributions.