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## **Subsidiary Body for Implementation**

**Thirty-eighth session**

**Bonn, 3–14 June 2013**

Agenda item 7(a)

**Matters relating to the mechanisms under the Kyoto Protocol**

**Review of the modalities and procedures of the clean development mechanism**

## **Report on the workshop on the review of the modalities and procedures of the clean development mechanism**

**Note by the secretariat**

### *Summary*

This document provides a summary by the co-chairs of the workshop on the review of the clean development mechanism (CDM) modalities and procedures as requested by Parties in decision 5/CMP.8, which was held in Bonn, Germany, on 8 and 9 June 2013. Discussions aimed to facilitate the identification of changes to the modalities and procedures to be prepared by the Subsidiary Body for Implementation for recommendation to the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol at its ninth session. Discussions were focused on issues relating to governance, accreditation, the project cycle and methodologies under the CDM.

## Contents

	<i>Paragraphs</i>	<i>Page</i>
I. Introduction .....	1–7	3
A. Mandate .....	1–5	3
B. Scope of the report.....	6	3
C. Possible action by the Subsidiary Body for Implementation .....	7	3
II. Workshop structure and participation .....	8–11	3
III. General discussion on the future of the mechanism .....	12–16	4
IV. Discussions during break-out sessions .....	17–37	5
A. Executive Board.....	20–22	5
B. Accreditation and designated operational entities.....	23	6
C. Participation requirements .....	24	7
D. Validation and registration.....	25–27	7
E. Monitoring, verification and issuance.....	28	9
F. Methodologies .....	29–30	9
G. New section in the clean development mechanism modalities and procedures for programmes of activities.....	31–32	10
H. Other matters .....	33–37	10

## **I. Introduction**

### **A. Mandate**

1. At its eighth session, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) reiterated that, pursuant to decision 3/CMP.1, the first review of the modalities and procedures for the clean development mechanism (CDM), as set out in the annex to decision 3/CMP.1 (CDM modalities and procedures), shall be carried out by the CMP at its ninth session.
2. In this context, the CMP requested the Subsidiary Body for Implementation (SBI) to prepare, at its thirty-ninth session, recommendations on possible changes to the CDM modalities and procedures for the consideration of the CMP at its ninth session, with a view to the CMP adopting a decision on this matter at that session.<sup>1</sup>
3. The CMP also requested the CDM Executive Board (the Board) to submit recommendations on possible changes to the CDM modalities and procedures, drawing upon the experience gained by the Board, the secretariat and stakeholders in the implementation of the CDM, for consideration by the SBI at its thirty-eighth session.<sup>2</sup>
4. The CMP also invited Parties and admitted observer organizations to submit to the secretariat their views on possible changes to the CDM modalities and procedures.<sup>3</sup>
5. To facilitate the progress of the review of the modalities and procedures for the CDM, the CMP also requested the secretariat to organize a workshop, prior to the thirty-eighth session of the SBI, ensuring broad participation of developing country Parties.<sup>4</sup>

### **B. Scope of the report**

6. This report presents a summary by the co-chairs of the workshop referred to in paragraph 5 above.

### **C. Possible action by the Subsidiary Body for Implementation**

7. The SBI may wish to take note of the information contained in this report in the context of elaborating recommendations on possible changes to the CDM modalities and procedures for consideration by the CMP at its ninth session.

## **II. Workshop structure and participation**

8. The workshop on the review of the CDM modalities and procedures was held in Bonn, Germany, on 8 and 9 June 2013, with financial support generously provided by the Governments of Norway and Sweden. The workshop was chaired by Mr. Giza Martins (Angola) and Ms. Emi Hijino (Sweden).
9. The workshop was attended by a total of 137 participants, including 24 participants from intergovernmental and non-governmental organizations. Of the registered Party

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<sup>1</sup> Decision 5/CMP.8, paragraph 14.

<sup>2</sup> Decision 5/CMP.8, paragraph 12. See document FCCC/SBI/2013/INF.1.

<sup>3</sup> Decision 5/CMP.8, paragraph 10. See document FCCC/SBI/2013/MISC.1 and Add.1.

<sup>4</sup> Decision 5/CMP.8, paragraph 13.

representatives: 25 per cent were from Parties included in Annex I to the Convention and 75 per cent were from Parties not included in Annex I to the Convention; 83 per cent were men and 17 per cent were women.<sup>5</sup>

10. The workshop consisted of plenary panel discussions and break-out sessions covering the inputs made by the Board in its recommendations, as referred to in paragraph 3 above, and in the submissions from Parties and admitted observer organizations referred to in paragraph 4 above. The Chair of the Board, Mr. Peer Stiansen, presented the Board's recommendations. The break-out sessions were structured according to issues relating to governance, accreditation, the project cycle and methodologies. Each of the break-out sessions was supported by two experts engaged in the implementation of the CDM.

11. The workshop agenda and workshop presentations are available on the UNFCCC website.<sup>6</sup>

### **III. General discussion on the future of the mechanism**

12. Two panel discussions were held during the workshop. An opening panel discussion, entitled "looking to the future, building on the past", provided an opportunity for workshop participants to consider the achievements of the CDM in its first 10 years of operation and how these achievements can be built upon in the future. The discussion also addressed opportunities and challenges arising from the ongoing discussions on the international climate regime. A second panel, entitled "innovating the CDM", gave an opportunity to discuss recent developments in the CDM and how further innovations could be introduced.

13. During the panel discussions, participants referred to the "incredible journey" that the CDM has made from the time of the adoption of the Kyoto Protocol, when the CDM was just an idea, to the growth of the CDM into a mechanism estimated to have channelled over USD 215 billion of investment into developing country Parties. Participants considered that the CDM has contributed a great deal to raising the awareness of business decision makers concerning investment opportunities that reduce greenhouse gas emissions. The value of new approaches, such as programmes of activities (PoAs) and standardized baselines, was emphasized by participants. Many participants also stressed the sophistication of the monitoring, reporting and verification under the CDM. Participants praised the leadership shown by the actors in the CDM in pioneering result-based financing approaches that could be used in other areas of climate finance.

14. Some participants emphasized that the CDM system had demonstrated its ability to implement change. Others noted that more profound changes in the mechanism, and assurance of its continued growth, would necessitate changes in the CDM modalities and procedures. Some participants were of the view that further change is now urgent, given the need to scale up mitigation activities and the current lack of demand for certified emission reductions (CERs). It was also stressed that many alternatives to the CDM, both under and outside of the Convention, are now emerging.

15. Participants stressed the importance of the CDM having a place in the future international climate regime. Recognizing the current strengths of the mechanism, some participants referred to the need for "evolution rather than revolution" in the CDM. However, it was also mentioned that the CDM should not develop in isolation and that the

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<sup>5</sup> Decision 23/CP.18 requests the secretariat to provide information on the representation of women at UNFCCC sessions.

<sup>6</sup> <[http://unfccc.int/meetings/bonn\\_jun\\_2013/workshop/7674.php](http://unfccc.int/meetings/bonn_jun_2013/workshop/7674.php)>.

relationship with other market mechanisms (including under the Convention), funds and nationally appropriate mitigation actions (NAMAs) needs to be clarified by Parties.

16. A number of potential directions for improving the CDM were raised by participants, including:

- (a) Simplifying the mechanism and reducing transaction costs, including through greater use of PoAs, standardized baselines, positive lists of technologies that are automatically deemed additional and simplified treatment for certain categories of project activities;
- (b) Increasing participation in the CDM, including by enhancing the regional distribution of CDM project activities and PoAs to cover countries that have not yet greatly benefited from the mechanism;
- (c) Enhancing confidence in the mechanism, including in relation to additionality;
- (d) Improving the governance and simplifying the administration of the CDM;
- (e) Introducing the concept of net mitigation to the implementation and use of the CDM;
- (f) Increasing the visibility of the sustainable development benefits of the mechanism;
- (g) Strengthening the engagement of designated national authorities (DNAs) in the CDM in guiding the implementation of the mechanism in their country;
- (h) Clarifying the relationship between the CDM and other market-based mechanisms, funds and NAMAs.

#### **IV. Discussions during break-out sessions**

17. This chapter provides a summary of the ideas raised during the workshop relating to possible changes to the CDM modalities and procedures. It is structured so as to link, as far as possible, the issues raised during the workshop with the corresponding sections of the CDM modalities and procedures.

18. It should be noted that not all of the ideas raised and reflected in the subsequent sections would require changes to the CDM modalities and procedures.

19. The review of the CDM modalities and procedures is still in its early stages. Participants appreciated the opportunity to share their ideas and deepen their understanding of what changes to the CDM modalities and procedures may be necessary. However, the inclusion of the ideas in this report does not imply any agreement and it should also be noted that there was insufficient time to discuss all of the ideas raised.

##### **A. Executive Board**

20. The following ideas were raised as possible changes to section C of the CDM modalities and procedures:

- (a) Further clarify the strategic and policy-setting nature of the Board's supervisory role. This could be achieved through more fully describing the role of the Board;

(b) Further elaborate the relationship between the Board and its support structure. This could be achieved through including further guidance directly in the CDM modalities and procedures or in other relevant documents;

(c) Include provisions on the skills and expertise needed in the membership of the Board, bearing in mind the need for diversity of skills and expertise in the Board;<sup>7</sup>

(d) Make the process for the nomination of Board members more transparent. This could be achieved through incorporating guidance into the CDM modalities and procedures or through encouraging Parties to share information about their nominations and processes;

(e) Appoint members and/or alternate members from business and civil society to the Board. Such members and/or alternate members could be nominated by Parties. It was noted that all members and alternate members act in their personal capacity;

(f) Remove the distinction between members and alternate members. This does not necessarily imply a reduction in the size of the Board, which should be seen as a separate issue;

(g) Impose time limits on the total years of service of individuals on the Board, rather than on the number and type of terms served on the Board;

(h) Not have individuals on the Board who have a direct interest in the CDM, such as negotiators in the UNFCCC process or representatives of DNAs or of public or private institutions that develop CDM project activities or purchase or trade CERs. This would help to ensure that members and alternate members act independently and remain free from conflicts of interest;

(i) Improve the gender balance of the Board, taking into account that decision 23/CP.18, endorsed by the CMP at its eighth session,<sup>8</sup> adopted a goal of gender balance in bodies established pursuant to the Convention and the Kyoto Protocol;

(j) In order to promote the transparency of the work of the Board, some participants suggested developing guidelines to help the Board to decide in which situations closed meeting sessions would be appropriate, and requiring the Board to provide rationale in its meeting reports when it has conducted parts of the meeting in closed sessions.

21. It was noted that any consideration of changes to provisions regarding nomination, membership, term and the decision-making of the Board should be considered in conjunction with their implications for other matters, such as the quorum of the Board, voting rules and provisions for triggering requests for review of requests for registration and issuance.

22. Participants also stressed that any changes to the CDM modalities and procedures relating to membership should contribute to strengthening the capacity of the Board.

## **B. Accreditation and designated operational entities**

23. The following ideas were raised as possible changes to sections D and E and appendix A of the CDM modalities and procedures:

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<sup>7</sup> It should be noted that, by decision 3/CMP.6, the CMP endorsed the terms of reference for membership of the Executive Board, which include provisions relating to the nature of work of the Board and the skills and expertise that members and alternate members of the Board should possess.

<sup>8</sup> FCCC/KP/CMP/2012/13, paragraph 39.

(a) Simplifying the rules for accrediting operational entities by setting out principles in the main body of the CDM modalities and procedures, and consequently deleting appendix A. It was noted that this would allow the Board to develop and revise the accreditation rules in a more flexible and timely manner;

(b) Elaborating alternative principles of Designated Operational Entities (DOEs) liability to compensate the issuance of CERs resulting from significant deficiencies in validation, verification and certification reports, including by: limiting the scope of liability for DOEs to a quantifiable level; differentiating liability depending on the cause of the excess issuance (e.g. fraud, professional negligence); and looking for further solutions for managing the risk of issuance of excess CERs through reserve pools, deductions of CERs from later issuances from the relevant project activity or levying an amount at issuance akin to a share of proceeds;

(c) Aligning or coordinating the CDM accreditation system with the rules on accreditation in joint implementation (JI), which are currently being reviewed as part of the review of the JI guidelines under the SBI. Coordination could include conducting certain accreditation activities in conjunction with JI;

(d) Removing the requirement for DOEs to have a direct contractual relationship with the project participants to whom it is providing validation or verification processes. This change may reduce transaction costs and increase flexibility;

(e) Removing the reference in the CDM modalities and procedures to the regional distribution of DOEs, noting that: distribution of DOEs is a product of market forces; many DOEs have global operations with local offices; increasing regional distribution of CDM project activities could increase the regional distribution of DOEs; and capacity-building in relation to auditing would be needed to increase regional distribution of DOEs.

### **C. Participation requirements**

24. The following ideas were raised as possible changes to section F of the CDM modalities and procedures:

(a) Further elaborate the role of DNAs prior to project registration and during project implementation, bearing in mind the distinction between the roles of a host Party government and the DNA;

(b) Include a definition of host Party approval and of the minimum content of letters of approval, including the period of validity for the approval and the conditions under which the letter may be withdrawn by the host Party;

(c) Include guidance regarding how the Board should process the withdrawal of a letter of approval, taking into account the certainty that investors require;

(d) Include provisions requiring DNAs to provide information relevant to project activities, such as national regulations that project activities must comply with and relevant national policies (E+/E-) that are in place in that country.

### **D. Validation and registration**

25. The following ideas were raised as possible changes to section G and appendix B of the CDM modalities and procedures:

(a) Incorporating into the CDM modalities and procedures the work of the Board on additionality, including the elaboration of positive lists, tools for demonstrating additionality, common practice, the “first of its kind” approach and technology penetration rates. It was noted that other aspects of the demonstration of additionality, such as “signal-to-noise” ratio, and a standardization approach, would also need to be considered in such incorporation;

(b) Introducing requirements for reporting and assessing sustainable development co-benefits of CDM project activities set out in project design documents. Concerns were raised about the appropriateness of requiring mandatory reporting of sustainable development co-benefits, including the use of the current voluntary sustainable development tool, and also of attempting to apply international criteria or the same criteria to all host countries. It was noted that there could be increased transaction costs for project participants if mandatory reporting, verification or assessment of sustainable development co-benefits were introduced;

(c) Introducing a requirement that DNAs publish the sustainable development criteria they apply in their country;

(d) Changing the current rules on the length of the crediting period, which would require further analysis as to whether a flexible approach to determining crediting periods could be introduced (based on factors such as technology, project type and barriers); it was also noted that such further analysis would need to take account of the frequency of the reassessment of the validity of baselines and how to apply different lengths of crediting periods when renewing the crediting period for registered project activities;

(e) Excluding certain types of project activities. Discussions raised concerns about whether exclusion based on the technology used and/or the location of the project activity would be appropriate and that, under a market-based mechanism, buyers can choose the CERs that they deem most suitable for their needs;

(f) Further clarifying the treatment of national policies (E+/E-) in the CDM;

(g) Elaborating local stakeholder consultation rules. Views included the need to extend consultation through the project life cycle and concerns about the practicality of this option. It was noted that, if guidance for DNAs on local stakeholder consultation was to be elaborated, respect for national sovereignty would be a key factor and there would need to be a balance between any such international guidance and national legislation. There was a suggestion to introduce guidance with “best practice approaches” and/or templates;

(h) Incorporating the principle of direct communication between stakeholders and the Board and its support structure.

26. Several additional ideas were raised, in particular through the recommendations of the Board, but were not discussed owing to time constraints. These include:

(a) Allowing single project activities to be hosted in more than one Party, taking into account issues such as the allocation of responsibility for project participants, the allocation of emission reductions between host Parties, and the implications for the international transaction log and the CDM registry;

(b) Removing the requirement, when proposing a new methodology, to submit a description of a proposed project activity or PoA and to identify project participants;

(c) Elaborating key principles in the main body of the CDM modalities and procedures for establishing guidelines on methodologies, and deleting appendix C (terms of reference for establishing guidelines on methodologies);



- (d) Revising the list of approaches to baseline methodologies contained in the CDM modalities and procedures to reflect a broader and non-exhaustive range;
- (e) Reviewing the thresholds for the scale of project activities (small scale and microscale);
- (f) Removing the distinction between small-scale and large-scale project activities;
- (g) Simplifying methodologies, in particular by using conservative approaches;
- (h) Developing principles for the management of conservativeness that may be applied consistently across methodologies;
- (i) Introducing the concept of standardized adjustments of baselines that would be automatically applied.

27. Some participants shared their experiences of human rights issues in the context of local stakeholder consultations and CDM project activities.

## **E. Monitoring, verification and issuance**

28. The idea of the incorporation of the principles from decision 9/CMP.7 on materiality into the CDM modalities and procedures was raised; it was noted that further guidance on how to apply the concept could be elaborated by the Board. Some participants noted that consideration could be given to the application of materiality not only to verification,<sup>9</sup> but also to validation and to PoAs. Setting of thresholds for materiality was also considered. It was suggested that after assessing the reported data on verification, revision of the materiality rules may be beneficial, as would further discussion on the topic.

## **F. Methodologies**

29. The following ideas were raised as possible changes to appendix C of the CDM modalities and procedures:

(a) Including provisions on standardized baselines within the CDM modalities and procedures; bearing in mind the need to include these in a manner that does not constrain the evolution of standardized baselines in the future such as eliminating the validation step for standardized baselines and replacing it with a “checklist” approach or validation at the first verification for certain types of project activities using standardized baselines;

(b) Specifying that a standardized baseline should be mandatory for potential project activities once the standardized baseline has been developed for the country and sector to which the potential project activity belongs, in order to avoid a selection of a baseline by project participants, which could lead to different results for similar project activities, thus undermining the environmental benefits of standardized baselines (concerns were raised about this idea, as it would limit project participants’ flexibility).

30. Participants also noted issues such as to how to manage updating of standardized baselines; and that DNAs could face challenges regarding their capacity due to the increased responsibility of dealing with standardized baseline processes.

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<sup>9</sup> Decision 9.CMP/7, paragraph 3, “the scope of materiality initially covers... the stage of verification by designated operational entities”.

## **G. New section in the clean development mechanism modalities and procedures for programmes of activities**

31. The idea was raised to include a separate section on PoAs in the CDM modalities and procedures, elaborating its unique features and setting out principles, such as the role of the coordinating and managing entities, how to treat monitoring requirements and monitoring periods, and processes for the inclusion of component project activities (CPAs); while allowing sufficient flexibility and recognising the differences between project activities and PoAs.

32. Participants also noted that PoAs have a transformative effect on energy and development, and have the potential for scalability and the potential to lower transaction costs. Participants considered that PoAs could be differentiated by the technology involved and/or country group, although it was noted that differentiation could bring administrative and implementation challenges. Participants considered that while there may be a need in the future to consider whether CDM is the right mechanism for PoAs, migrating PoAs to NAMAs under the Convention would be premature.

## **H. Other matters**

### **1. Consolidation of documentation**

33. The idea was raised to consolidate the following four sets of modalities and procedures for the different project types, and, to the extent possible, all decisions of the CMP relating to the CDM that have created rules, into one document:

- (a) Decision 3/CMP.1, annex;
- (b) Decision 4/CMP.1, annex II;
- (c) Decision 5/CMP.1, annex;
- (d) Decision 6/CMP.1, annex.

### **2. Reflection of current practice**

34. The idea was also raised to reflect in the CDM modalities and procedures the current practice for the regulation and operation of the CDM, including: processes and time frames relating to the development, revision and clarification of methodologies; the process for post-registration changes; the public availability of information from the CDM registry; and the languages in which the decisions of the Board are made available.

### **3. Forestry**

35. The following ideas were raised as possible changes in the modalities and procedures for afforestation and reforestation (A/R) project activities:

(a) Address the reasons for the small proportion of A/R project activities among all CDM project activities, including the issue of non-permanence of A/R CERs (temporary CERs and long-term CERs);<sup>10</sup>

(b) Improve the current rules on monitoring for A/R project activities as monitoring under the CDM can be expensive and challenging. Participants suggested assessing elements of monitoring requirements in order to propose more flexible and more

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<sup>10</sup> Land use, land-use change and forestry under the CDM is currently under discussion by the Subsidiary Body for Scientific and Technological Advice.

cost-effective approaches. It was suggested to analyse practical examples of how such monitoring could be done;

(c) Introduce flexibility in the timing of verification.

36. Participants also discussed the different nature of A/R project activities and REDD-plus<sup>11</sup> activities.

#### **4. Appeals**

37. The issue of an appeals mechanism against decisions of the Board was noted but was not considered because it is currently being considered under another SBI agenda item.

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<sup>11</sup> Policy approaches and positive incentives on issues relating to reducing emissions from deforestation and forest degradation in developing countries; and the role of conservation, sustainable management of forests and enhancement of forest carbon stocks in developing countries.