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Definition and reporting system of Climate Finance

1 What is Climate Finance?

Technology transfer and financing is necessary support for climate change mitigation and adaptation in developing countries and it was agreed to increase financing by USD 100 billion a year in 2020, through public and private and multilateral and bilateral, including alternative source. This is called as Climate Finance. Mobilization of USD100 billion a year is a very challenging target. Many types of financing and policy measures for encouraging the Climate Finance, including direct public finance, co-finance of public and private finance, risk mitigation by the public for private investment, incentives to low carbon investment including emission trading, tax incentives, removal of negative incentives (subsidies) and regulation for in-efficient investment are considered. It is better to have common definition of Climate finance to consider effective and efficient measures and implement and monitor its amount and performance.

Climate Finance consists of mitigation and adaptation finance. This paper focuses on the mitigation finance.

2 A Proposal – Finance with MRV

Objective of Climate Finance for mitigation is to push GHG emission reduction project and activities forward. It is very simple and natural to define that "Climate Finance is the finance which is intended to support GHG emission reductions and its reduction is confirmed". Any finance such as "public and private" and "multilateral and bilateral" can be Climate Finance when it supports the investment cost of GHG emission reduction and its reduction is confirmed. "Direct financial support" to investment cost, including the finance through local finance system and international capital market from institutional investors, shall be Climate Finance. Tax, policy reforms or other measures shall be defined as the supporting measures for improving investment climate of Climate Finance.

A technical key to determine Climate Finance is whether we can measure the reduction simply and objectively. We have a lesson from the definition of Official Development Aid. ODA are defined by three conditions, say "provided by government", "promotion of the economic development and welfare of developing countries" and "concessional". "Degree of concession" is calculated by a methodology of Grant Element

(GE) and ODA requires "GE shall be over 25%". Calculation formula of GE is very objective because GE is calculated by measurable figures such as interest rate, grace period and repayment period.

MRV (Measurement, Reporting and Verification) is a technical instrument to confirm GHG emission and GHG emission reduction objectively and we can use MRV to define the Climate Finance. An idea of the definition of Climate Finance is "Any finance which support the investment cost of GHG emission reduction project and activities and its reduction is confirmed objectively by MRV"

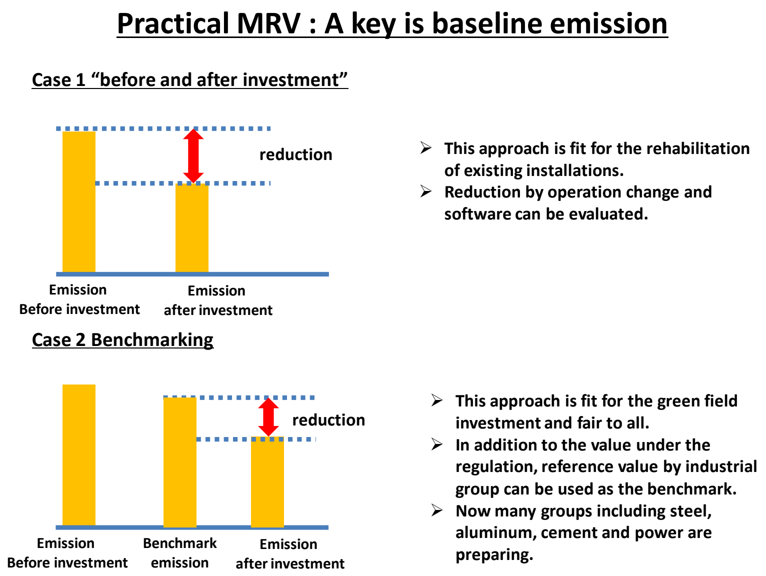
3 Appropriate MRV for Climate Finance

MRV for Climate Finance is required to be simple, objective and practical. The most common and widely used MRV for GHG emission reduction is CDM MRV. More than 200 methodologies has been developed for covering varieties of reduction projects and activities and around 7,000 projects have been approved as CDM. However, it is still developing phase and is at "learning by doing stage". It is said that CDM methodologies are too rigid and complicated or there is a gap from real business practices. Therefore CDM reform was proposed and is under consideration. Appropriate MRV for Climate Finance shall be synchronized with the way of the evaluation at the real business situation.

It seems to take longer time for the development of a new appropriate MRV for Climate Finance or waiting for reformed CDM MRV. Practical way is to accept varieties of MRV including CDM MRV when it is considered as reasonable one but is in line with key principles to be agreed by parties and shared by other stakeholders. A good practice we have is "Common approach for environment consideration" by export credit agency (ECA). Each ECA has own environment due diligence guideline under the Common Approach. As the Common Principles for Climate Finance, I suggest the below,

- Simple, objective and practical
- Encourage the low carbon investment
- Taking into account of the different investment climate and keeping flexibility

Common Principles looks like a compass for navigation. When we worried how we should evaluate the reduction appropriately ("we lose the way"), we should see Common Principles and determine following Common Principles. Common Principles shall be based on the real business and personal practices; "how does investor think about reduction?", "how do housewives evaluate the benefit of energy efficiency at home appliances?", or "how do sellers demonstrate the benefit of energy saving for potential buyers?". Mostly we compare the energy consumption of new appliances with their own one or other similar alliances which are available now. When there is gap between MRV for Climate Finance and real business customs, it provides irrelevant message to business and citizens.



One of the technical difficulties of CDM MRV is base line setting. The best way to avoid the technical difficulty and set base line by transparent manner is the adoption of ex ante energy efficiency standard as the baseline. In other words, diffusion of MRV may accelerate the adoption of energy efficiency standard system.

4 Monitoring and reporting of Climate Finance

Funds flow of Climate Finance and its performance shall be monitored and reviewed. We may have lessons and these lessons are useful for improving Climate Finance. A platform for monitoring Climate Finance is necessary. One of the practical options is OECD DAC reporting system which is very comprehensive system and covers cross boarder multilateral, bilateral (both ODA and public finance) and private finance. OECD member countries have long track record of reporting finance from their country to developed country directly and indirectly.

However, channels of the private finance flows are very complex, like subsidiary in the third country investment to the projects in developing countries, and funds owned by governments and the private in emerging economic county may support the reduction in other developing countries. The best way is the construction of comprehensive platform to monitor the flow of the finance based on the OECD reporting system.

When finance is provided by international banks, it is necessary to determine the rule who is contributor. An option to identify the nation which makes contribution is "home country rule" like banking regulation by BIS (Bank International Settlement),

5 Governance

We have to evaluate GHG emission reductions by different technologies and at different situation neutrally and objectively by using MRV. But it may cause conflicts of interest among member countries. One of the practical options is setting up independent experts group which propose MRV for Climate Finance and review reductions and report to a committee by member parties.

Expert group should be a team consists of experts from various fields, such as technology, finance and investment, policy measures and legal matters but be practitioners. Experts shall participate by their own personal capacity and not representatives of any national, stakeholders groups, industry or companies. And business groups like IETA (International Emission Trading Association), WBCSD (World Business Council for Sustainable Development), UN institutions and multilateral banks and bilateral institutions are expected to support their consideration.

6 Further development potential

MRV can be a condition of identification of Climate Finance but it is applicable to determine the amount of incentives to projects and activities too. This will provide positive impacts on the reforms of the budget control system for using tax revenue efficiently. It is also applicable to new international finance mechanism such as Green Climate Fund. (See Performance Base Incentive Scheme at page 11 on "Market Base Solutions for Climate Change.
https://unfccc.int/files/cooperation_support/financial_mechanism/long-term_finance/application/pdf/climate_finance_and_mrv__mgssi_.pdf)

The first step for scaling up of Climate Finance is MRV.

This paper is presented by Takashi Hongo, Senior Fellow, Mitsui Global Strategic Studies Institute, following the discussion at the First Meeting of Experts on Long-term Finance in Manila.

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Finance with MRV) and development of J-MRV for GREEN.

He is a member of various committee and study groups for Japanese government and local government such as a member of Technology Assessment Committee of NEDO (New Energy and Industrial Technology Development Organization of Japanese government), a member of Kita-Kyushu City MRV Committee (K-MRV) and made knowledge contribution for IEA, IREAN, ADB Institute, IPCC, UNEP FI, OECD, ICAO, Globe International and so on. He is Board of Directors of IETA, Special Advisor to Global Water Reuse and Recycle Association.