

The World Bank Carbon Partnership Facility

QUESTIONS AND ANSWERS

Updated July 25, 2008

Disclaimer: This document is confidential and has been provided to the recipient for information purposes only. The information in this document is subject to change, and no representation or warranty is made as to the completeness or accuracy of the information contained herein. This document has not been and will not be submitted to, nor has it been nor will it be approved by, any governmental authority of any country. This document does not constitute an offer to participate in the Fund. This document neither constitutes nor includes a prospectus to offer securities. This document is being distributed only to specific entities that have professional experience in matters relating to carbon finance and is not being distributed through mass communication media or addressed to the general public. This document must not be distributed, published, reproduced or disclosed (in whole or in part) by recipients to any other person.

The World Bank's proposal to create the Carbon Partnership Facility (CPF) was approved by its Board of Directors on 25 September 2007. The Bank is now developing this vehicle in a consultative and collaborative process with interested partners. It is proposed to establish the CPF as a partnership between governments as well as public and private sector entities from developed, developing countries and countries with economies in transition alike. The Facility would help with the development and implementation of mitigation programs in developing countries and countries with economies in transition and with the related creation of emission reductions in exchange for purchase commitments from private and public buyers in developed countries.

The CPF aims to promote long-term investments in low-carbon growth by purchasing emission reductions primarily in the post-2012 period. It is designed to scale up carbon finance through programmatic and sector-based approaches to greenhouse gas mitigation that will catalyze a downward shift in emission trends in certain sectors at the country level.

This note should be read together with the draft CPF Term Sheet.

1. What is the objective of the CPF?

The objective of the CPF and the next phase of the Bank's engagement in carbon finance is to use the carbon market to support large-scale greenhouse gas mitigation in the post-2012 period without jeopardizing developing countries' economic growth prospects. The CPF would aim to have a catalytic effect in certain sectors or types of technologies, and work alongside the private

sector to open reduction opportunities in particular segments. Operations would also be carried out in close collaboration with host country governments.

2. What is the basic design of the CPF?

The CPF will consist of two instruments structured as World Bank-managed Trust Funds:

- (i) A *Carbon Asset Development Fund* (CAFD) which will hold funds generated from fee payments from buyer and seller participants as well as donor contributions. Its purpose would be to develop programs that will yield emission reductions for their later purchase on behalf of the buyer participants in the carbon fund. The fee amount is yet to be determined; and
- (ii) A *Carbon Fund* which will use financial contributions from buyer participants (governments or public and eligible private entities) to pay for emission reductions as they are received.

3. What are “programs” and how will the portfolio be structured?

Programs are bundled carbon assets that provide maximum homogeneity by, for example, using the same methodology, a common regulatory system, and/or being located in the same country, etc. The Bank is already working to prepare some programs and is likely to develop demonstration pilot programs to test and explain the concept.

Once the Facility is declared operational the portfolio structure and criteria that the programs need to satisfy would be established. The portfolio criteria would be defined in consultation with participants and partners in the Facility and in accordance with the key technologies and sectors expected to represent the most important opportunities for development of emission reduction programs. The portfolio and program selection criteria may be amended in consultation with the participants and partners.

4. What are the portfolio and program selection criteria?

The portfolio and program selection criteria that the programs need to satisfy are proposed to include energy generation, energy efficiency, waste management, oil and gas sector and transportation. These are set of preliminary criteria for further consultations.

5. How would CPF operations be structured?

The CPF would organize its operations through programs (or projects that are part of defined programs) and a series of tranches of the carbon fund. Each program would be developed in accordance with the portfolio and program selection criteria. The Trustee would open tranches of a target size, among other things, to manage contributions from buyers and distributions of ERs to the buyer participants. For example, the Trustee will open the first tranche for subscription by buyers and starts accepting programs proposed by sellers. Once the first tranche has reached its target size, the Trustee would open a second tranche. The programs

accepted by the Trustee would be allocated to one or more of the tranches with the objective of broadly matching the supply of emission reductions with demand, i.e. the capitalization of the carbon fund. Buyers can participate in more than one tranche and sellers can propose one or more ER programs.

To provide certainty of long-term carbon revenues, purchase commitments would be for at least 10 years beyond 2012.

6. Would the CPF also develop pre-2013 carbon assets?

To the extent that programs yield emission reductions in the pre-2013 period, the CPF would deliver these. However, it is not the aim of the CPF to develop pre-2013 assets and pre-2013 emission reductions are therefore expected to represent only a relatively small share of delivery; the focus of the CPF is for the post 2012 period.

7. How would pricing for emission reductions work?

The Facility would use a pricing approach that is transparent, reflects the transaction risk profile, e.g., the asset type, the market segment and the length of the contract, and the risk allocation between the buyers and the seller in each transaction. It may use both fixed and variable pricing elements, e.g., indexation and specific inflation/currency devaluation-based price corrections. Such a pricing approach would be developed in consultation with the Participants, and it would be used for individual programs within different technologies or sectors, while seeking an overall coherence of pricing across the Facility.

8. Who would participate in the CPF?

The CPF would be a partnership between buyers, sellers and partners. Sellers and buyers would be governments and private sector entities from developed and developing countries and countries with economies in transition. Both buyers and sellers would be "Participants"¹ of the CPF. Sellers and buyers would participate on an equal basis: sellers would pledge emission reduction opportunities for development into carbon assets while buyers would pledge to purchase these emission reduction assets. The equivalence between financial contributions and emission reduction volumes are yet to be defined.

¹ The word Participant here bears no relation to its definition per CDM modalities and procedures.

The CPF is open for participation by partners and donors. The partners would be host country governments where emission reduction programs are under development. Partners would play an important role in identifying programs for the CPF and providing advice on operation of the CPF, and if elected by other partners, they would also participate in the partnership committee as non-voting members. Donors would contribute to the carbon asset development fund to support low-carbon development.

8. Who would be buyer participants?

Buyer participants could come from governments and the private sector, including those that have undertaken emission reduction commitments under international or regional regulatory systems, as well as financial institutions. Buyers from the private entities need to be accepted by the Trustee and must meet a number of criteria to show that they are sophisticated investors that understand the risks and have financial capacity to participate in the CPF.

9. Can smaller countries and their entities participate in the CPF as sellers?

The CPF objective of scaling up carbon finance may indeed require special arrangements to ensure that small countries and sellers of small amounts of emission reductions could participate. For example: 1) the Facility could develop programs comprised of small-scale activities of different emission sources and sellers, possibly through an intermediary; such programs could straddle different countries, e.g., a regional energy efficiency program; 2) small sellers could participate in the CPF as a consortium that bundled its commitments to sell; the consortium would be represented in the CPF either by a member or a selected representative; 3) emission reductions from small sellers could be accepted alongside larger programs; this would give these entities access to the services of the Facility without requiring CPF participation. While pointing out that the CPF is not the only carbon finance vehicle in the Bank or on the carbon market, the Bank will consult with small developing countries to explore the above options and strengthen the inclusiveness of the Facility.

10. What are the roles of the host country governments?

As the CPF aims to have a catalytic effect in certain sectors and targets programmatic emission reduction activities, the partnership with host country governments is critical in ensuring successful identification and operation of the programs. The host country government or its agency could potentially participate in the CPF as a seller participant by committing to sell emission reductions from public sector programs to the carbon fund; or it can participate as a partner. Consultations are under way to seek the possibility for a host country government to be a program coordinator representing a number of seller entities in the facility.

11. How would the CPF be financed?

The CPF would be supported by a carbon asset development fund to be established by the Bank. Contributions to the carbon asset development fund would be made in equal parts by buyers and sellers through a fee on carbon transactions. The carbon asset development fund may include donor contributions to support low-carbon development. Payments for emission reductions would be made by a carbon purchase fund, which would aggregate the purchase commitments of buyers.

10. How would the cash flow or payment structure work?

While exact details will be finalized in consultation with potential participants, the Bank intends to develop a financial model that would allow participants to assess the cash flow against the returns (in terms of emission reductions). The payment (for buyer participants) is likely to consist of an upfront and annual fee (for program development, etc.) and periodic payments when emission reductions are delivered. Exact amounts will depend on the specifics of each emission reduction program included in the Facility portfolio and its delivery scales and timing.

Seller participants' contributions to the Carbon Asset Development Fund would be deducted from payments against the emission reduction purchase agreements (ERPAs). Work is underway to determine the fee that the Facility would charge.

11. How would the CPF be governed and managed?

The CPF would be managed by the World Bank. Its governance structure would comprise an annual participants meeting and a partnership committee consisting of buyer and seller representatives, as well as partners as non-voting members. As needed, suitable consultative groups and other governance arrangements may be established to provide guidance on development of particular types of assets, or, to meet the needs of a given special window. As part of its role, the partnership committee would provide, *inter alia*, broad guidance to the World Bank on strategic aspects of the CPF, for example, involvement in certain markets or regimes, the kinds of programs that the CPF would support as well as on the pricing approach and general ERPA terms and conditions, etc

12. What would the role of the Bank be?

The Bank would convene and administer the CPF and manage its day-to-day activities as the trustee of the Facility. The Bank would also commit carbon finance expertise and technical assistance. The Bank's particular interest is in programs that have high mitigation potential and promote sustainable development. The Carbon Finance Unit of the Bank is expected to anchor the CPF, and the Bank's regional departments are expected to play a strong role in its operations.

13. How would the Bank manage the CPF?

In its endeavor to create a *partnership*, the Bank expects participants in the Facility to play a continually active role. At the Facility level, there would be annual meetings of the Participants, and a partnership committee of elected representatives whose role would be to advise the Bank and make certain decisions on its operation, e.g., regarding the pricing approach. Participants would be expected to provide feedback or suggestions as necessary. It is currently the intention that the Bank would decide, in collaboration with seller participants and host governments, which programs it would pursue, develop and get ready for presentation to participants.

14. What kinds of carbon assets would the CPF develop?

The CPF would support broad types of technologies and related interventions that can be bundled together in investment programs. Examples include renewable energy and/or energy efficiency programs, rehabilitation of power plants, clean power generation technologies, and programs in the transport and urban sectors. The Bank is in the process of identifying potential pilot programs, including through consultations with the governments and entities of developing countries and countries with economies in transition. The objective is to identify several pilots and develop them to the extent possible by the time the Facility becomes operational.

15. Under which regulatory regime would the CPF operate?

The CPF is likely to focus on the mechanisms under the UNFCCC and Kyoto Protocol, but would be open to develop emission reductions for a variety of regimes and carbon markets as they develop. It would aim to develop compliance-grade carbon assets and, in specific agreement with the participants, for depositing such assets into different – or even multiple - regimes. Through its work on methodologies and/or experience with emission reduction programs, the CPF would create know-how that future climate change regimes may use.

16. What would the target size of the CPF be?

The development of large scale emission reduction opportunities will require significant resources. Commensurate with this challenge, the CPF would need to mobilize resources in the billion dollar range. The CPF would start program development when the CADF has received a certain amount of contributions, with each potential buyer participant contributing a minimum amount, and become fully operational when the first tranche of its carbon purchase fund has reached a certain amount in purchase commitments. The target size for the Facility over the first five years of operation is expected to be in the billion dollar range.

17. What is the life of the CPF?

Unlike current carbon funds that are closed for investment after a certain capitalization threshold, the Bank may open new CPF tranches continuously to enable participation at any time. However, to manage delivery risk, the Bank would reserve the right to admit new participants and strike a broad balance of buying and selling interests.

18. Why would buyers participate in the CPF?

The CPF would provide buyers with an opportunity to receive a future stream of carbon credits. The flexible pricing approach could reward buyers for taking early risks. Long streams of significant volumes of carbon credits would enable buyers with large compliance obligations to plan their offsetting requirements according to planned investments.

The added value of the CPF to both buyers and sellers is intended to be realized through the Bank's focus on the *partnership* model, where buyers and sellers together partake in the sale, purchase and development of carbon assets.

19. Why would sellers participate in the CPF?

The CPF would provide sellers with the certainty of significant and long-term revenues from emission reductions, which could help finance investments. Because of the flexible pricing mechanisms of the CPF, sellers could benefit from possible upsides in the carbon market. Sellers could also benefit from technical assistance through the Carbon Asset Development Fund as well as from the policy and methodology work that would be associated with the CPF programs.

The added value of the CPF to both buyers and sellers is intended to be realized through the Bank's focus on the *partnership* model, where buyers and sellers together partake in the sale, purchase and development of carbon assets.

20. Are there other benefits of participation in the CPF?

Buyers and sellers could also be interested in a broader partnership for which the CPF could provide a basis. This could include dissemination and application of technologies based on the experience gained from participating in the CPF as well as sharing of management experience and business models. The CPF would assist governments in creating and sharing knowledge related to carbon asset development, or different regulatory approaches or systems.

21. When will the CPF be operational, what are the next steps?

Relevant documentation will be made available to potential participants during the course of its development.

22. How would the CPF work vis-à-vis the Bank's current carbon funds?

The Bank's current carbon funds were designed to help catalyze the carbon market and deliver largely compliance-grade Kyoto assets to their participants. Between 65 and 75 percent of the emission reductions purchased by these funds are scheduled to be delivered by 2012, with the remaining volumes delivered shortly thereafter, generally by 2015, or 2017 at the latest.

Of the US\$2.1 billion under management in 10 carbon funds and facilities, about US\$1.6 billion has been committed, with the remainder expected to be committed over the next two years. Most of the existing funds are designed to be phased out after the delivery of emission reduction assets to participants. The remaining funds are either small or designed to operate in difficult niche markets, such as the Community Development Carbon Fund (CDCF) and the BioCarbon Fund (BioCF), or are geared towards specific market conditions, such as the Umbrella Carbon Facility (UCF). The CDCF and BioCF may continue to be needed in the future to meet specific demands that the private sector typically bypasses. A second tranche of the BioCF became operational in March 2007. Additional tranches are contemplated for the UCF. However, the UCF was not designed to deal with long-term emission reduction programs, but to facilitate large volumes of Kyoto-compliant emission reductions from single projects. These project-related reductions have relatively quick turn-around times in a market characterized by certainty of demand.

While effective in helping to meet the demands of today's carbon market, the existing funds are generally ill-suited to help shape tomorrow's carbon markets. By contrast, the CPF is designed to develop emission reductions and support their purchase over long periods after 2012. Its objective and business model are based on the need to prepare large-scale, potentially risky investments with long lead times, which require durable partnerships between buyers and sellers. It is also based on the need to support long-term investments in an uncertain market environment, possibly spanning several market cycles. The CPF is intended to be adequately flexible to accommodate changing needs and interests from a large variety of buyers and sellers, thus preventing a proliferation of carbon funds to meet special interests.

23. Why is the Bank involved in carbon finance? Do we need this after thirteen years of engagement?

The threat of climate change to long-term development and the ability of the poor to escape from poverty are of particular concern to the Bank. The carbon finance activities of the Bank are a natural extension of the Bank's mission to reduce poverty. The Bank makes every effort to ensure that developing countries and countries with economies in transition can participate in the international responses to climate change and benefit from the emerging carbon market.

24. What role has the Bank played in the development of the carbon market?

The Bank has been a catalyst and facilitator in the carbon market for over 10 years. Through its carbon funds the Bank develops methodologies and business models for carbon trading and demonstrates how to achieve greenhouse gas reductions cost-effectively while contributing to sustainable development. The Bank has pursued a balanced approach between stimulating demand in the early stages of the market and supporting sellers in tapping new and additional sources of funds from carbon trading to support their sustainable development.