

Prices for Emission Reductions

Host Country Committee
Steering Committee meeting
4-5 October 2005



Types of GHG Commodities

Kyoto Protocol

- Assigned Amount Units:
- Certified Emission Reductions
- Emission Reduction Units

EU Emissions Trading Scheme

- EU Allowances



Risk in CDM/JI projects

1. CARBON ASSET RISK

- **Regulatory risk:** additionality & baselines, approval, registration, other regulations;
- **Market risk:** expected price of ERs on delivery.
- **Country risk:** will the country ratify? will country transfer ERUs as agreed upon?

For LULUCF: non-permanence and replacement risk

Compounded by uncertainties, time delays & costs thereof;



Risk in CDM/JI projects

2. PROJECT RISK

- Construction risk: will it start on time?
- Performance risk: will it perform as expected?
- Financial, business regulatory: financial closure?
- Contract: contracts in place, enforceable, durable?
- Counterparty: are signatories creditworthy?
- Generic country risk: political, foreign exchange convertibility.



CFB Experience in Allocating Risks

- CFB offers choice: VER or CER contracts.
- Encourages informed decision-making by sponsors to sell VERs or CERs;
- For both VER or CER contracts: project risk borne mainly by project sponsor.



Allocating Risks: VER Contracts

- Buyers assume all carbon asset risks; are thus exposed to (i) risk that projects may never be registered by the EB, and (ii) all VERs may not be converted to CERs;
- Payment made on delivery of VERs => certainty of cash flow;
- VER prices are discounted accordingly.



Allocating Risks: CER/ERU Contracts

- Sellers assumes most of carbon asset risk;
- Payment typically made on delivery of CERs into registries; buyer is immune to upstream carbon risks.
- Nevertheless, risks impact overall portfolio.



Prices of EUA vs CER/VERs

- EUAs don't have delivery risks – issued by national governments;
- CERs/ERUs: generated by projects - lead time, cost, uncertainty
- Fungibility with EU ETS
- CDM Registration (CERs) and additional regulatory risk of VERs;



World Bank Pricing Policy

- Bank's role in market development
 - Project accepted according to strategic CFB objectives
 - carbon assets in technologies or countries that have yet to benefit from carbon finance;
 - carbon assets in sectors, using a programmatic approach, or
 - in activities of large scale where Bank intermediation is key to opening the market or bringing the project to the market; and
- promoting synergies between carbon finance, sustainable development and poverty alleviation



World Bank Pricing Policy

- If project does not meet strategic objectives, then Bank
 - Offers market prices at ERPA stage
 - CFB encourages seller to seek other buyers
 - World Bank buyer of last resort



Work Program of pricing committee

Draft Terms of Reference in your folders: comments on this;

Decisions: