



MDG CARBON FACILITY

Leveraging Carbon Finance For Sustainable Development



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Introduction

Climate change has emerged as one of the most important issues facing the global community in the 21st Century. It poses a serious threat to development and poverty reduction, and the effects will be felt most strongly by the poorest people in the least developed countries, who rely on the natural environment for their livelihoods. Indeed, climate change threatens to significantly undermine efforts to achieve the Millennium Development Goals (“MDGs”).

Assisting developing countries with their efforts to cope with the impacts of global climate change and to create more sustainable, less greenhouse gas intensive development paths is an important focus for UNDP. Major new investments will be needed over the next 15 years to tackle a wide range of environmental issues that are central to developing countries’ ability to eliminate poverty and reach the MDGs. A recent report commissioned by the Poverty-Environment Partnership - a network of more than 30 international development and environment organizations - estimates that US\$60–90 billion per year will be required to address the environmental issues that bear most directly on poverty reduction in developing countries. Typically, sustainable energy and environment-related activities have constituted only a few percent of total official development assistance, or around US\$3–5 billion per year in recent years. Clearly, additional financing mechanisms will be needed to fill the gap.

Carbon Finance in Developing Countries

A range of market-based instruments to address environmental issues has emerged in the past decade, including the use of compliance and voluntary emission offsets in the area of climate change. In the compliance sector, the Kyoto Protocol, through the Clean Development Mechanism ("CDM") and Joint Implementation ("JI"), has in a very short time spurred a rapidly expanding, multibillion-dollar international market. Financial flows from emission offset markets could become a major source of financing for sustainable development.

In its design, the CDM was intended to offer significant benefits for developing countries in terms of increased capital flows, additional technology transfers and reduced costs of achieving sustainable development objectives. However, early signs indicate that the CDM is unlikely to deliver the broad-based benefits that many expected it would, at least in the near to medium term.

The diversity of project types and sectors currently encompassed by CDM has been limited, with the majority of offsets to date flowing from 'end of pipe' interventions that generate few or no sustainable development benefits.

Similarly, geographic coverage of the CDM has been narrowly distributed, with the large developing countries dominating the number of registered projects to date, while the least developed countries have had minimal participation.

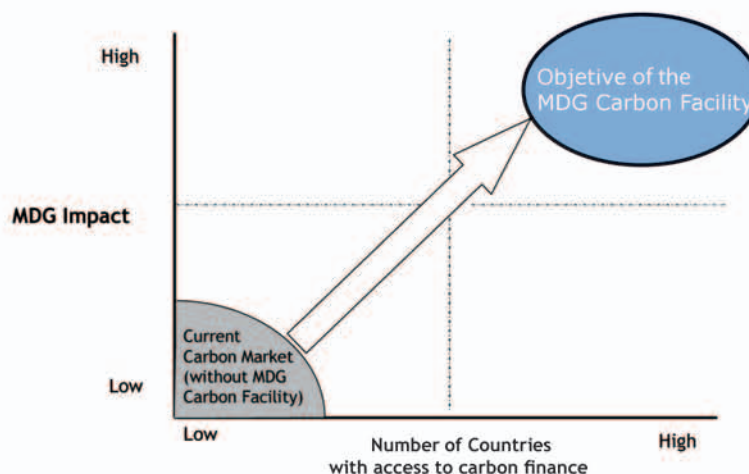
UNDP believes that much more needs to be done to direct carbon finance to a higher number of developing countries, as well as to a broader range of activities that can provide real sustainable development benefits.

The MDG Carbon Facility's Mission

To help leverage the potentially significant benefits of carbon finance for the developing world, UNDP has established the MDG Carbon Facility (the "Facility"), an innovative mechanism for the development and commercialization of emission reduction projects. The core objectives of the Facility are:

- Broadening access to carbon finance by enabling a wider range of developing countries to participate, particularly those countries that are presently under-represented.
- Promoting emission reduction projects which contribute to the MDGs, yielding additional sustainable development and poverty reduction benefits.

Figure 1: Objective of the MDG Carbon Facility



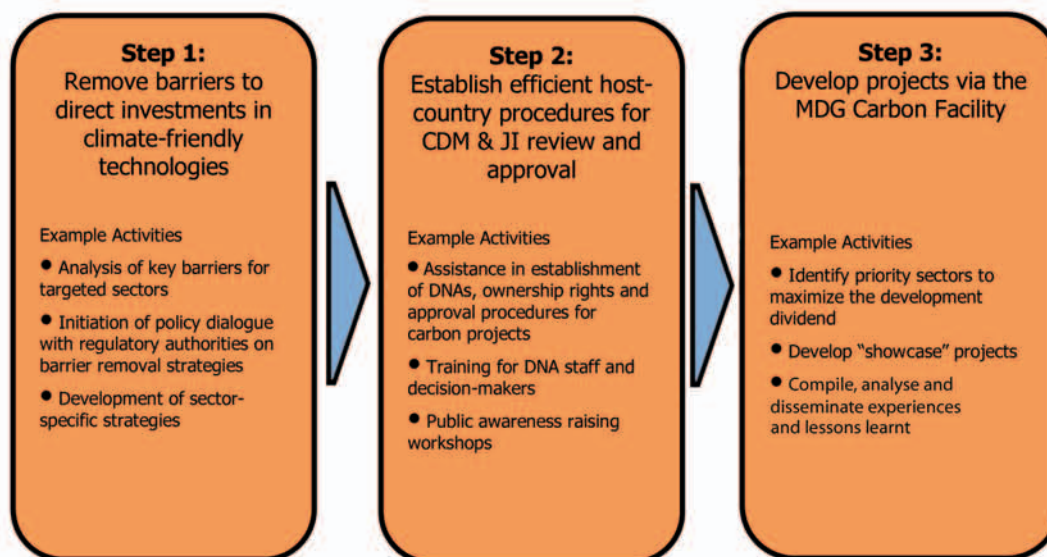
The Facility aims to bring about market transformation with respect to carbon finance in developing countries - affecting the transition from a pre-market to a fully market-enabled environment that supports emission reduction projects with high MDG benefits and attracts substantial direct investment from the private sector. Indeed, experience suggests that one effective means of increasing private sector interest in, and understanding of, carbon finance has been the availability of 'showcase' projects in host countries. Once market capacity has been developed in a particular country and a critical mass of high-MDG emission reduction projects has been established, UNDP will exit that market, having achieved its market development and MDG objectives.

The Facility forms part of UNDP's comprehensive, three-step approach to capacity development in carbon finance.

On a country by country basis, this approach commences with barrier removal, then addresses the establishment of efficient host-country procedures, and finally culminates in the development of emission reduction projects by the Facility. Over the last few years UNDP has already engaged in the first two steps of this approach in multiple countries, creating the enabling environment for the Facility to operate effectively.

The Facility will be active in both the compliance and voluntary sectors. Initially, the Facility will focus on the compliance market, leveraging the existing CDM and JI regulatory infrastructure and generating carbon credits that can be used by governments, businesses and other entities to meet their Kyoto commitments. A second, subsequent voluntary component will allow the Facility to work with smaller projects and to develop new, high-MDG project technologies.

Figure 2: UNDP Approach to Leverage Carbon Finance for Sustainable Development

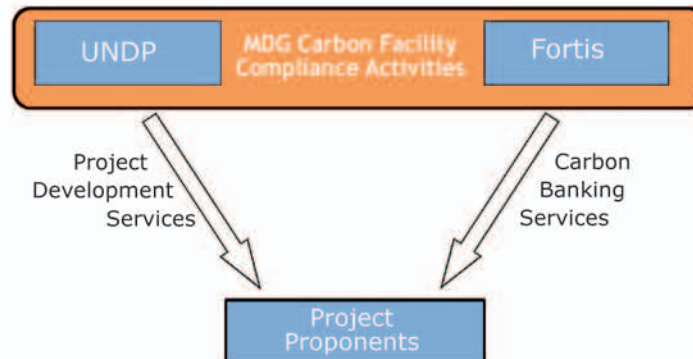


What is the MDG Carbon Facility?

The Facility's compliance activities represent an innovative collaboration between UNDP and an international financial services provider, Fortis Bank ("Fortis"), offering prospective emission reduction projects a comprehensive "one-stop-shop" package of services. UNDP and Fortis will each contribute their particular area of expertise, UNDP providing project development services and Fortis purchasing and marketing carbon credits. UNDP's collaboration with Fortis will encompass an initial pipeline of projects generating carbon credits during the first Kyoto commitment period from 2008 to 2012.



Figure 3: Overview of the roles of UNDP and Fortis in the MDG Carbon Facility



UNDP's Role in the Facility

UNDP's role in the Facility is to offer project development services, including performing due diligence, providing technical assistance for CDM or JI project approval, and establishing the monitoring system for project emission reductions. As a development organization, UNDP does not seek to generate profits from the Facility, however UNDP will apply a flat-rate cost-recovery fee in order to recover its direct costs. In providing its services, UNDP will leverage its proven expertise in environmental project development, its extensive local presence and its in-depth understanding of each country's sustainable development goals.

To determine eligibility for the Facility, UNDP, with assistance from Fortis, will perform the Facility's due diligence process; determining the commercial, technical and regulatory viability of the prospective project. This rigorous, standardized process assesses each prospective project against criteria in five main areas: carbon potential, technical feasibility, finance and legal (including Know Your Customer), MDGs and environment, and country risk.

For prospective projects that satisfy the Facility's due diligence process, UNDP's technical assistance will then include:

- Assisting with the development of a baseline study
- Assisting with the performance of stakeholder consultations
- Assisting with the preparation of the project design document (PDD)
- Engaging an independent third party validation or determination of the project
- Providing strategic advice in relation to obtaining host country approval of the project
- Assisting with registration or final determination of the project
- Assisting with the development and implementation of a monitoring plan and its oversight during the project's first year of operation
- Assisting with the project's pre-verification and engaging an independent third party to perform the initial verification report and the first verification.



Fortis' Role in the Facility

Fortis' role in the Facility is to provide carbon banking services, comprised of purchasing and marketing the carbon credits generated by the Facility's projects. Fortis was selected by UNDP following a rigorous and competitive tender process aimed at obtaining the best possible terms for the Facility's projects.

A key aspect of the Facility is standardized, competitive pricing across all its projects, irrespective of their particular characteristics. In this way, as long as each project satisfies the Facility's due diligence, project types will be able to participate in the Facility which - due to their geography, technology or size - are otherwise currently under-represented in the broader marketplace. Importantly, the Facility's pricing is fixed at the outset of the project cycle, thereby protecting project proponents in developing countries from price volatility in the carbon market.

In addition, UNDP and Fortis will combine in helping project proponents overcome the different capital constraints faced in many developing countries.

To this end, UNDP will advance its costs and UNDP's cost-recovery fee will only be collected once UNDP has reached pre-defined service milestones. In parallel, Fortis will make advance payments to project proponents to cover the cost of the cost-recovery fee.

Project types targeted by the Facility

A wide range of project types that meet development objectives will be eligible for the Facility. Initial screening has indicated the potential for attractive projects based on diverse mitigation technologies, including renewable energy, energy efficiency, fuel switching, agricultural waste management and bio-fuels, and capture of fugitive emissions from landfills.

Several project categories will be ineligible due to their limited contributions to the MDGs or other factors inconsistent with the Facility's objectives. These categories include nuclear energy, large-scale hydropower, geosequestration (including enhanced oil recovery), shifting of electric power loads, and the capture and destruction of industrial gases.

As indicated above, proposed projects will be screened for their ability to contribute to sustainable development while also producing certifiable emission offsets. For instance, a renewable energy project might create local employment and help improve local air quality as well as generating carbon credits. Similarly, a landfill gas capture-and-use project might promote better waste management and recycling, watershed protection, energy generation and job creation as well as producing marketable credits from the destruction of methane.



Table 1: Project types (compliance and voluntary) initially targeted by the MDG Carbon Facility

Methane Mitigation Sector	Renewable Energy	Energy Efficiency Sector	Bio-sequestration Sector	Transport Sector	Cleaner Energy Sector
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