

## MEXICO PMR PROJECT IMPLEMENTATION STATUS REPORT (ISR)

### ISR 02 COVERING PERIOD 10/2018-09/2019

The PMR Project Implementation Status Report should be prepared by the Implementing Country or Technical Partner, with the support of the Delivery Partner and/or the PMR Secretariat. For any questions related to the preparation of the PMR Project Implementation Status Report, please contact the PMR Secretariat at: [pmrsecretariat@worldbank.org](mailto:pmrsecretariat@worldbank.org).

#### 1. SUMMARY INFORMATION

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| Implementing Country/Technical Partner: | Mexico   |
| Reporting Period:                       | From 01/10/2018 to 09/30/2019  |
| Report Date:                            | 01/10/2019   |
| Implementing Agency:                    | General Directorate for Climate Change Policies, Ministry of Environment and Natural Resources (SEMARNAT)  |
| Contact Person:                         | <ul style="list-style-type: none"> <li>• Yutsil Guadalupe Sangines Sayavedra, General Director, Semarnat (Focal Point)</li> <li>• Victor Hugo Escalona Gomez (PMR Coordination)</li> </ul> |

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| Grant Executed By:                     | World Bank   |
| Grant Effectiveness and Closing Dates: | 07/01/2017 – 06/30/2020  |
| Grant Amount (USD):                    | USD 3,000,000  |
| Funding Mobilized (USD):               | <ul style="list-style-type: none"> <li>• Government of Mexico: USD 570,000</li> <li>• IKI Projects for ETS Support: “Proyecto SiCEM” (financed by BMU, implemented by GIZ in Mexico): EUR 2,500,000 (USD 2,870,000)</li> </ul> |
| Funding Committed (USD) as of 09/30/18 | USD 417,306.55   |

#### 2. OVERVIEW

*Please provide a general description of the progress made towards the Grant's Objectives and Activities (as per the [Project Development Objective\(s\) Indicator\(s\)](#) and [Intermediary Results Indicator\(s\)](#) included in the World Bank's Project Paper's Results Framework). Please also highlight critical issues as well as pending actions that may require the PA or the PMR Secretariat's attention.*

The PMR Partnership Assembly endorsed Mexico's MRP in 2013 and awarded funding for US\$3 million to support market readiness activities. The focal point for the PMR is the Ministry of Environment and Natural Resources (SEMARNAT). The National Housing Commission (CONAVI) participated in PMR activities as coordinator of one of the three original components.

The grant was initially to be managed by the Climate Change Fund, but due to changes in the fund operation SEMARNAT decided to proceed with a Bank-executed project in April 2017.

Building upon Mexico's MRP, the implementation work program was updated and refined into the following main areas:

- a. Support the development of a National Emissions Trading Scheme, based on: (i) capacity building of private and public sector entities; (ii) ETS pilot phase readiness, with a particular focus on an emissions registry and offsets.

The first activity included the implementation of a Simulation Exercise in 2018 to give participants a firm grasp on ETS concepts and design elements to improve communication between authority and stakeholders. It also included the execution of the ETS Academy 2019 to build capacities among government officers.

The Climate Change Law was amended according to the goals and content of the Paris Agreement. Amongst other critical provisions, the amended Law now mandates SEMARNAT to design and implement a National ETS, starting with a pilot phase. During 2018, there was a change of government, with a strong focus on social issues. The draft law was reviewed by the current administration and submitted for second public consultation process.

The regulation ("Bases Preliminares") for the Pilot Phase of the ETS was published on October 1<sup>st</sup>, 2019, with the support of PMR. The pilot will run for three years, expected to start on January 1<sup>st</sup>, 2020.

### 3. IMPLEMENTATION REPORT BY COMPONENT

#### ***Differences between the Objectives/Activities in the Market Readiness Proposal and the Grant Agreement***

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| <p>Are there any important and material differences between the objectives/activities proposed in the Market Readiness Proposal and endorsed by the Partnership Assembly of the PMR and those agreed to in the Grant Agreement with the Delivery Partner and described in the Project's Results Framework?</p> | <p>Yes</p> <p><i>Please choose one of the above options.</i></p> |
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*If yes, please explain the reasons for these changes and how the revised objectives/activities will contribute to market readiness (i.e., the establishment of core technical components and/or the piloting of specific activities related to carbon pricing and the use of market-based instruments). Please also provide details about when and how the PA was informed about and endorsed the change(s).*

The Government of Mexico (GoM) works on a carbon pricing strategy that goes beyond the initial efforts of adopting a carbon tax on fossil fuels importation and commercialization. The objective is to pursue further and more ambitious mitigation goals aligned with the Climate Change Law and Mexico's NDC.

Since the endorsement of Mexico's MRP, the country has gone through various milestones related to carbon pricing. Some of them include: becoming a member of the Carbon Pricing Leadership Coalition (CPLC); applying to become an observer of the International Carbon Action Partnership (ICAP); issuing declarations for carbon markets collaboration with the Canadian provinces of Ontario and Quebec and through the Carbon Pricing in the Americas; launching a ETS simulation exercise, and initiating the development of a National ETS.

Last year adjustments were made from the original MRP to the activities now scheduled. The components were adjusted and focused for supporting the ETS design and implementation. The main elements of the updated and refined implementation work program were presented by Mexico and discussed with the PA during its 16<sup>th</sup> Assembly Meeting, however, at the time NAMA support was still considered, but due to the urgency to prepare for the launch of the ETS Pilot Phase, the components were reconsidered to support completely that activity.

**Implementation Progress by Component**

| <b>A. Component 1: CAPACITY BUILDING</b> |   |
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| Status:                                  | <p>Ongoing</p> <p><i>Please choose one of the above options.</i></p> <p><i>Please describe the progress made towards the achievement of the expected results, as per the date of the Report, in relation to each of the Intermediary Results Indicators.</i></p> <p>Mexico is preparing to launch the Pilot Phase of the ETS on January 2020. There is need to build capacities and develop skills among stakeholders.</p> <p>On August 2016, the Government of Mexico signed an MOU with the Mexican Stock Exchange to launch an ETS Simulation as a capacity building exercise for the private and public sectors. The simulation required the service of a software provider for an electronic tool to serve as a registry, auction platform, and trading platform for allowances issued within the simulation. Participants were able to learn about the organization and operation of an ETS, and about the differences with other carbon markets (voluntary and CDM for example).</p> <p>The exercise started in December 2017, with preliminary training workshops during November 2017; the Simulation ran for 7 months and</p> |

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|                  | <p>was finalized in June 2018. The exercise included in-person trainings, webinars, and continuous support for the participants, the simulation was implemented through three simulated phases, each of them comprising compliance periods from 3 to 6 years.</p> <p>Key Achievements:</p> <ul style="list-style-type: none"> <li>• The first simulation exercise in the Latin American region gathered over 100 companies</li> <li>• Participating sectors: energy, power generation, aviation, chemical, iron and steel, mining, car manufacturing, cement, pulp and paper, glass, construction, food and beverages, finance and others.</li> <li>• Three exercises that simulated 12 calendar years in total</li> <li>• Training introduction workshops, call center for participants</li> <li>• Active engagement from all participants</li> <li>• Final exercise included award ceremony for top performers</li> </ul> <p>Reports on the simulation can be found in:<br/> <a href="http://www.mexico2.com.mx/medio-ambiente.php?id=51">http://www.mexico2.com.mx/medio-ambiente.php?id=51</a></p> <p>In 2019, Mexico prepared the ETS Academy, a three day workshop focused on learning the key steps to design the ETS pilot phase and how it should be adapted for Mexican reality, learning from international experiences.</p> <p>Key Achievements:</p> <ul style="list-style-type: none"> <li>• Over 30 participants from the Federal Administration, including Ministry of Environment, Finance, Economy, National Forestry Commission, National Institute of Ecology and Climate Change, PEMEX, CFE, among others.</li> <li>• Presence of international experts from, North America, Asia and Europe to share lessons learned with their respective systems.</li> <li>• Government discussion for next step planning</li> </ul> <p>A second ETS Academy is scheduled for the 1<sup>st</sup> quarter of 2020.</p> <p>This component is also supporting the design and development of a communications strategy and further training activities to facilitate the kick-off of the pilot phase</p> |
| <p>Comments:</p> | <p><i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i></p> <p>The budget for this component is being revised in order to focus on achievable deliverables.</p>   |

| <b>B. Component 2: ETS PILOT PHASE READINESS</b> |  |
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| Status:  | <p>Ongoing</p> <p><i>Please choose one of the above options.</i></p> <p><i>Please describe the progress made towards the achievement of the expected results, as per the date of the Report, in relation to each of the Intermediary Results Indicators.</i></p> <p>This component supports the design and development of the ETS through 3 sub-components. In turn, these sub-components are part of a comprehensive ETS Design &amp; Piloting Roadmap prepared by SEMARNAT to guide the ETS development process (see section 5).</p> <p><b>a) Support for the design of a pilot ETS Registry</b></p> <p>The emissions reductions registry will support the ETS by providing the platform for trading emission allowances and allow offsets to enter the program, it will cover emissions reductions as stated in the Climate Change Law as well as reductions from sectors not regulated by the ETS, including from the forest sector among others. The registry will be based on an existing registry software that will be adapted to national needs.</p> <p>The terms of reference are on final review to launch procurement process in October 2019.</p> <p><b>b) Support the design of offsets protocol schemes</b></p> <p>This activity will complement the ETS regulation by supporting the development of offsets protocols; it will have to follow the ETS regulation for offsets usage within the program. A study for emissions reduction potential was carried out in order to prioritized the sectors so be eligible for offset crediting, and to allocate funds for protocols development.</p> <p>Terms of reference are on final review to launch procurement process in November 2019.</p> <p><b>c) Support the design of MRV standards schemes</b></p> <p>This activity will support SEMARNAT to develop MRV regulation regarding offset projects, it will support the government with analysis to be used as inputs for the drafting of the Verification Standard for offset projects, this regulation will be followed by the Verification Bodies accredited to verify emission reductions from eligible offset projects. Semarnat will seek using international existing standards as reference.</p> <p>The subcomponent will also support the electronic platform that will allow the government to register offset projects.</p> <p>Terms of reference are on final review to launch procurement process in 4Q 2019.</p> |

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| <p>Comments:</p>  | <p><i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i></p> <p>This component is meant to support the ETS efforts in Mexico managed by the Climate Change Office in SEMARNAT. The delay for this component is due to the delay for the publication of the ETS regulation, due to government change.</p>   |
| <p><b>C. Component 3: MANAGEMENT AND ADMINISTRATION</b></p> |   |
| <p>Status:</p>  | <p>Under implementation</p> <p><i>Please choose one of the above options.</i></p> <p><i>Please describe the progress made towards the achievement of the expected results, as per the date of the Report, in relation to each of the Intermediary Results Indicators.</i></p> <p>This component supports the contract for three consultants that will carry out activities to help SEMARNAT with the implementation of the Pilot Phase for the duration of the PMR project:</p> <ul style="list-style-type: none"> <li>a. Offset and MRV program implementation and project coordination</li> <li>b. Stakeholder engagement and Advisory Committee organization</li> <li>c. Registry implementation and RENE support</li> </ul> |
| <p>Comments:</p>  | <p><i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i></p> <p>Terms of reference are finalized, procurement process to start on October 2019.</p>  |

*If necessary, please add components in the table above.*

#### 4. PROGRESS, CHALLENGES, AND LESSONS LEARNED

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| <p><b>Important policy or regulatory developments related to the Grant’s objectives and activities:</b></p> <p>Developments: <i>Please describe important policy and regulatory developments related to carbon pricing that have occurred during the Reporting Period and/or that are expected in the future.</i></p> <p>During 2017, Mexico’s Congress discussed amendments to the Climate Change Law, after the entry into force of the Paris Agreement. The amendment proposals focused on harmonizing the content of the law with the Paris Agreement and the Mexican NDC. The amendment was initially approved by <i>Cámara de Diputados</i> (Lower Chamber) in December 2017, and by the Senate on April, 2018. The bill was finally signed by the President and enacted by publication in the Official Gazette on July 13, 2018.</p> <p>Before the approval of the amendments, SEMARNAT was working on a draft of the regulation for an ETS, based on the existing legal framework (at that time). The draft regulation for the ETS is completely based on the amended law. The goal for SEMARNAT is to have the regulation by the second half of 2018, and to have a pilot for two years up to 2020, as announced in several forums and events. Therefore, phase 1 of the ETS is expected to start in 2021.</p> |
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Furthermore, on 12 December 2017, at the One Planet Summit in Paris, France, the governments of Canada, Chile, Colombia, Costa Rica, Mexico, as well as the US states of California and Washington and Canadian provinces including Alberta, British Columbia, Nova Scotia, and Québec, announced the Declaration on Carbon Pricing in the Americas. In 2018, the state of Sonora joined the Declaration, as the first subnational government from Mexico choosing to be part of this unique regional collaboration mechanism. The Declaration and platform for cooperation remain open for more jurisdictions to join. The cooperation has identified three priority areas: governance, current work environment, and specific policy challenges.

The regulation for the ETS mandated by law, was published on October 1<sup>st</sup>, 2019, following a series of workshops, and revisions, and a public consultation. The regulation indicates the start of the pilot phase for January 1, 2020, with two compliance periods (two years), the year 2022 serving as a transition year with the next operational phase.

Both the cap and the allocation plan will be published, as stated in the regulation, by December 2, 2020.

*Challenges: Please describe how such developments might affect the achievement of the Grant's objectives and/or the implementation of specific activities under the Grant, either positively or negatively, and how possible policy and regulatory challenges may be addressed going forward. Please also refer back to any potential policy and regulatory challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

The policy and regulatory developments had a positive impact in the grant's objectives, by giving a strong and better legal framework for carbon pricing in Mexico. The legal mandate for an ETS had a positive impact in terms of engaging international agencies in supporting the process for the ETS, including GIZ from Germany, ICAP, and WCI. Their support focuses on data reporting and verification, data analysis, legal advice, cap setting, competitiveness studies, among others.

The big challenge for such an ambitious project (ETS implementation) has been political changes and time constraints, revisions and approvals are time consuming, SEMARNAT had to work together with changing staff among government agencies to socialize the ETS design and operation. Being the top priority, SEMARNAT worked together with the PMR team to dedicate the PMR project funding to the ETS pilot phase preparation and implementation. Mexico moved from a readiness status to implementation during the PMR project, therefore the changes to the work plan. Also, as the regulation was revised a numerous times, the implementation of activities were also affected. SEMARNAT is reviewing the work plan to focus on achievable deliverables, in order to free resources for other PMR projects, and to be able to complete implementation of remaining funds by 2020. Having a regulation in place, and a Pilot officially started, implementation will remain challenge, but with a strong political support.

*Lessons learned: If applicable, please provide a brief description of the lessons learned regarding carbon pricing policy and regulatory developments during the last Reporting Period.*

One of the main lessons learned and achievements from the programme is the consultation process developed with stakeholders from the private sector. The PMR support to the Simulation Exercise opened the door for more direct and technically focused exchanges with private sector representatives, an opportunity that led way to a Working Group. It was through the working group that both parties, government and private sector, were able to discuss their interests when drafting the ETS regulation. The ETS Simulation exercise and the Working Group helped in finding common

ground on usually divergent positions, and positioned the ETS as a feasible option for GHG mitigation in Mexico.

**Important changes in the technical design or approach related to the Grant's activities:**

Developments: *Please describe any important change in the technical design or approach related to the Grant's activities that have been made during the Reporting Period or that are expected in the future.*

Due to the amendments to the Climate Change Law, the draft of the ETS regulation was adapted to be compliant with the new legal framework, as first step to implement an ETS in a Pilot Phase. A draft was finalized in 2018, but it went to a series of revisions from the new staff in the government, including Ministry of Finance. A revised draft was submitted to public consultation on May 2019, and SEMARNAT was granted final approval by the National Regulatory Commission on August 2019.

The Pilot will run for three years, from 2020 to 2022 as the work plan indicates. Some aspects for the ETS are being pushed to the operational phase, such as benchmarking, and auctions. The offset program will be developed during the pilot, to work together with project developers to have it ready during the pilot.

Challenges: *Please describe how such changes might affect the implementation of the Grant's activities, either positively or negatively, and how possible technical design challenges may be addressed going forward. Please also refer back to any potential technical design challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

Given the interest for the offset program from stakeholders in Mexico, the offset program originally planned to be launched on 2022, is moved ahead of schedule, to have the main guidelines within the next 6 to 8 months, with offset protocols to follow. There is no mandate to launch a specific number of protocols, they will be launched as soon as they ready and properly consulted.

Lessons learned: *If applicable, please provide a brief description of the lessons learned regarding the technical design or approach related to the implementation of the Grant's activities during the last Reporting Period.*

SEMARNAT built on the experience from PMR activities and engagements on carbon pricing, as a way to cope with the new mandates from the amended climate change law. The revision carried out during 2019, gave SEMARNAT more time to draft a more robust regulation, and to be able to announce an operational phase after the pilot, to give certainty to operators about the political support to the instrument.

**Key capacity issues (implementation, technical, financial management, procurement) related to the Grant's activities:**

Developments: *Please describe key capacity issues (institutional, technical, financial management, procurement) related to the implementation of the Grant's activities encountered during the Reporting Period or that are expected in the future.*

A challenge for the implementation of the grant's activities came from the amendment to the climate change law. Even though the law provided legal certainty for an ETS in Mexico, the speed at which the ETS must be developed and launched was a challenge in itself. Given the implementation of the ETS pilot phase and the timeframe of the grant, there was a need to update the work plan, to fit the needs of SEMARNAT, and the timeframe of the project.

**Challenges:** *Please describe how such issues are affecting the implementation of the Grant's activities, either positively or negatively, and how possible challenges may be addressed going forward. Please also refer back to any potential challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

The different timing between the PMR programme with Mexico and the new timeframe defined for the ETS is the challenge. The implementation of the ETS pilot was not aligned with the PMR process as they vary in their length and time coverage. The grant period will conclude before the pilot ends, thus terms of reference for the remaining projects were adjusted, and a proposal for funds returning is being finalized, to focus on achievable deliverables.

**Lessons learned:** *If applicable, please provide a brief description of the lessons learned regarding the key capacity issues related to the implementation the Grant's activities during the last Reporting Period.*

**Coordination with other carbon pricing initiatives, including those funded by other donors:**

**Developments:** *Please describe any developments related to other carbon pricing initiatives, including those funded by other donors, that have occurred during the Reporting Period or that are expected in the future.*

As stated before, Mexico launched a Carbon Tax in 2014. The carbon tax regulation indicates that certified emission reductions from the Clean Development Mechanism may be used to compensate the carbon tax. The reason is that the ETS in Mexico is not yet operational and the fiscal regulation had to launch the compensation mechanism in early 2017. In the future, once the ETS is fully operational, the offsets that originate through the ETS could be used to compensate the carbon tax. There are plans to operate the offset registry, as a centralized system that will aid SEMARNAT to manage international transactions with other mechanisms, such as the one from Article 6 from Paris Agreement.

**Challenges:** *Please describe how such developments might affect the implementation of the Grant's activities, either positively or negatively, and how any coordination challenges may be addressed going forward. Please also refer back to any potential coordination challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

The registry for the ETS should allow for offsets to be used not only for ETS compliance, but also as a pool of credits, ready to be approved for international transactions. It could happen after the pilot phase once a working offsetting program or mechanism has been developed or introduced into the ETS, and a rulebook for Article 6 is finalized.

**Lessons learned:** *If applicable, please provide a brief description of the lessons learned regarding coordination with other carbon pricing initiatives during the last Reporting Period.*

**Stakeholder engagement related to the Grant's activities:**

**Developments:** *Please describe any developments related to stakeholder engagement (consultation, participation and disclosure), that have occurred during the Reporting Period or that are expected in the future.*

Stakeholders are fundamental for the overall ETS process. The engagement is coordinated by SEMARNAT primarily through a Working Group. The Group met every two weeks, in average, since January 2018 to discuss different aspects and elements of the ETS; the group participates in the drafting of the ETS regulation by providing and feedback to the content of the draft.

Grant's activities contemplate the engagement through capacity building approach. The Pilot Phase includes the creation of an Advisory Committee that will be the advisory body composed by members of the regulated sectors, civil society and the academia, which will serve as the space where stakeholders and authorities meet and discuss the effectiveness of the system, and will allow them to propose changes and improvements, subject to authorities' approval.

*Challenges: Please describe how such developments might affect the implementation of the Grant's activities, either positively or negatively, and how any stakeholder engagement challenges may be addressed going forward. Please also refer back to any potential stakeholder engagement challenges that may have been identified in the previous PMR Project Implementation Status Report and, if applicable, explain how such challenges are/have been handled.*

The Advisory Committee is a new idea with environmental issues, similar frameworks are in place in Mexico for economic or competitiveness issues, but not for dealing with climate challenges.

It opens the opportunity for the Government and stakeholders to improve communication, and commitment with the national climate goals.

*Lessons learned: If applicable, please provide a brief description of the lessons learned regarding stakeholder engagement during the last Reporting Period.*

The main achievement of the consultation process, was to find common ground between stakeholders and the authority, which in the end helped to create the Advisory Committee. As a lesson learned for future processes is to continue with the dialogue which has proven to be the most effective way to communicate and provide answers to questions from the future regulated entities.

#### **Other issues related to the Grant's activities**

*Please describe any developments, challenges and lessons learned regarding any other issue related to the achievement of the Grant's objectives and the implementation of the Grant's activities.*

## **5. ADDITIONAL INFORMATION**

*In this Section, please provide any additional information that may be relevant for the achievement of the Grant's objectives and/or the implementation of the Grant's activities. Please also provide any relevant information related to carbon pricing and the use of market-based instruments for climate change mitigation.*

### **Mexico ETS Design & Piloting Roadmap prepared by SEMARNAT to guide the ETS development process**

The next roadmap was prepared and adjusted after the approval of the Climate Change Law amendments.

#### **2017**

- Preparation for ETS Simulation: Development of TORs, Planning, and Procurement Process

- ETS Design: Contracting, development and/or conclusion of projects regarding: Legal analysis, competitiveness, carbon pricing policy mix, cap setting, among others. Stakeholder engagement.
- ETS Simulation started on December 2017.
- Climate Change Law Amendments Proposal and approval by *Cámara de Diputados*

## 2018

- ETS Design: ETS Working group meetings (stakeholders and government). Conclusion of projects: cap setting, competitiveness.
- ETS Simulation ended on June 2018.
- ETS Simulation exercise two: Planning
- Climate Change Law Amendments Proposal and approval by *Cámara de Senadores* (April 2018), and publishing of the Decree in the Official Gazette ([http://dof.gob.mx/nota\\_detalle.php?codigo=5531463&fecha=13/07/2018](http://dof.gob.mx/nota_detalle.php?codigo=5531463&fecha=13/07/2018)).
- Regulation: Drafting of regulation for pilot program and standard for verification.
- On December 1<sup>st</sup>, President Andrés Manuel López Obrador took office.

## 2019

- ETS regulation draft is put on revision
- ETS working group meetings (stakeholders and government). A new series of consultations and workshops were carried out
- Regulation: Drafting of regulation for pilot phase is finalized (May 2019)
- Public consultation (May-July 2019)
- ETS Academy, July 2019
- ETS regulation published on October 1, 2019.
- Publication of the cap and allocation plan to be published no later than December 2

## 2020

- ETS Pilot Program: Starting on January 1, 2020
  - First Free Allocation: October 2020
- Offset program: Development and /or adaptation of offset protocols

## 2021

- ETS Pilot Program:
  - Second free allocation: October 2021
  - First Compliance: November 2021
  - Pilot evaluation
  - Drafting of regulation for future phases

## 2022

- ETS Pilot Program:
  - Transition year: Second and last compliance for the pilot phase
- ETS Operational Phase:
  - Emissions from 2022 will be subject for regulation for the operational phase.

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