

MEXICO PMR PROJECT IMPLEMENTATION STATUS REPORT (ISR)

ISR 02 COVERING PERIOD 10/2017-09/2018

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.

1. SUMMARY INFORMATION

Implementing Country/Technical Partner:	Mexico
Reporting Period:	From 01/10/2017 to 09/30/2018
Report Date:	01/10/2018
Implementing Agency:	General Directorate for Climate Change Policies, Ministry of Environment and Natural Resources (SEMARNAT)
Contact Person:	<ul style="list-style-type: none"> • Juan Carlos Arredondo Brun, General Director, Semarnat (Focal Point) • Victor Hugo Escalona Gomez (PMR Coordination)

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"> • Government of Mexico: USD 570,000 • IKI Projects for ETS Support: “Proyecto SiCEM” (financed by BMU, implemented by GIZ in Mexico): EUR 2,500,000 (USD 2,870,000)
Funding Committed (USD) as of 09/30/18	USD 272,350

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) participates in PMR activities as coordinator of one of the three components.

The grant was 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 (as per update offered by Mexico and discussed with the PA during its 16th Assembly Meeting):

1. Support the development of policies-based crediting mechanisms, in this case, a NAMA for urban development that covers transportation and housing.
This component will foster mitigation in urban sites considering common features in new housing developments, streetlights, domestic water distribution, drainage systems and waste management. The Urban NAMA design will incorporate methodologies that allow it to become a Crediting NAMA, thus being able to obtain economic benefits by participating in carbon markets.
2. Support the development of a National Emissions Trading Scheme, based on: (i) capacity building of private and public sector entities; (ii) development of technical infrastructure for the ETS, with a particular focus on an emissions registry and related information processing capabilities, and (iii) ETS regulation design and development including the core regulation, verification standards, and offsets protocols.
The first activity included the implementation of a Simulation Exercise to give participants a firm grasp on ETS concepts and design elements to improve communication between authority and stakeholders.

Over the past twelve months there has been a major milestone for carbon pricing in Mexico. 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. The pilot will run for three years, starting on January 1st, 2019. With the support of the PMR, the ETS regulation has been drafted, and by the time of this report is pending the public consultation period before its publication, which is expected in November 2018.

3. IMPLEMENTATION REPORT BY COMPONENT

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

<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>
<p><i>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).</i></p> <p>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.</p> <p>Since the endorsement of the MRP by the PMR PA, Mexico has announced that carbon pricing will be continued by the implementation of an ETS. Based on international experience, Mexico considers that an ETS is the most cost-effective option for some sectors to achieve meaningful mitigation results that will help the country to comply with national mitigation targets.</p> <p>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.</p> <p>Some adjustments were made from the original MRP to the activities now scheduled. The components have not changed although the attention is primarily focused on supporting the ETS implementation. The support to develop a crediting NAMA is still considered and under way as part of the grant activities. The main elements of the updated and refined implementation work program were presented by Mexico and discussed with the PA during its 16th Assembly Meeting.</p>	

Implementation Progress by Component

A. Component 1: Urban NAMA	
Status:	<p>Pending</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 pursuing aggressive action to curb greenhouse gas (GHG) emissions growth through sustainable economic development. To achieve these goals, the country is instituting a range of actions, including the deployment of sustainable urban environments.</p> <p>The Urban NAMA will be designed around an MRV system that is simple enough to deploy quickly and at a manageable cost, and for the last topic it is necessary the financial design for a crediting NAMA, comprising: Implementing costs, Financing needs and Financial Mechanisms. The final activity comprises the design and implementation of a pilot project. The component builds on Mexico’s experience with the Housing NAMA supported by the NAMA Facility.</p>
Comments:	<p><i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i></p> <p>The National Housing Commission is the agency from the Government of Mexico in charge of the Urban NAMA; at the time of the report CONAVI and SEMARNAT are developing the terms of reference for the activities included in the component.</p>
B. Component 2: Support to ETS Design & Piloting Roadmap	
Status:	<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 design and development of the ETS through 3 sub-components. In turn, these sub-components are part of a comprehensive ETS Design & Piloting Roadmap prepared by SEMARNAT to guide the ETS development process (see section 5).</p> <p>i) Development of Emissions Reductions Registry</p> <p>The emissions reductions registry will support the ETS by providing the platform for 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.</p>

	<p>ii) Regulatory development for the ETS offset program (offset protocol development)</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.</p> <p>iii) Capacity building: ETS Simulation Exercise with Private Sector</p> <p>SEMARNAT recognized the need for building capacity on ETS design and operation among the authority and the stakeholders. On August 2016, 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 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"> • The first simulation exercise in the Latin American region gathered over 100 companies • 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. • Three exercises that simulated 12 calendar years in total • Training introduction workshops, call center for participants • Active engagement from all participants • Final exercise included award ceremony for top performers <p>Reports on the simulation can be found in: http://www.mexico2.com.mx/medio-ambiente.php?id=51</p>
<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. For the other activities, the registry and the protocol development, a regulation is being drafted in</p>

	order to have the legal framework to develop the TORs, the regulation for the pilot is scheduled for publishing on November 2018..
C. Component 3: <i>Please fill in the title of the relevant component, as per the Project Paper's Results Framework.</i>	
Status:	Pending/Under implementation/Completed <i>Please choose one of the above options.</i> <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>
Comments:	<i>Please describe the reason(s) for the early/timely/delayed achievement of the expected results.</i>

If necessary, please add components in the table above.

4. PROGRESS, CHALLENGES, AND LESSONS LEARNED

<p>Important policy or regulatory developments related to the Grant's objectives and activities:</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 President Enrique Peña Nieto 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> <p>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.</p>

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) is time, but SEMARNAT is working together with the PMR team to have robust contracts, and clear deliverables among all grant's components.

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.

The Pilot will run for three years, from 2019 to 2021 as the work plan indicates. Some aspects for the ETS are being pushed to the formal phase, such as benchmarking. The offset program will be developed during the pilot, to work together with project developers to have it ready for 2022.

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 requirement for a pilot phase, some technical aspects of the ETS such as cap setting, reserves, and allocation plan and method needed to be adapted as the work progressed. These elements are already considered in the draft regulation for the ETS pilot phase.

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 PRM activities and engagements on carbon pricing, as a way to cope with the new mandates from the amended climate change law. The training of the SEMARNAT staff, conducted through the PMR, ICAP and via collaboration with DEHst helped improve the skills and understanding around an ETS.

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 is a challenge in itself. Given the timing of the ETS pilot phase and the timeframe of the grant, there is a need to update the plans for the TORs and to be able to have them ready on time, considering that an update is needed as a pilot must now exist and was not originally proposed for the ETS implementation.

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 is 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 will have to be adjusted.

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 allowances or offsets from the ETS would be useful to compensate the carbon tax.

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 the Ministry of Finance to open an account, and become another participant, however is does not represent a big challenge for the registry itself, but it could

happen after the pilot phase once a working offsetting program or mechanism has been developed or introduced into the ETS.

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 has 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 ETS simulation exercise is one of the ways in which SEMARNAT engages with a wide range of stakeholders, some of whom have limited or no knowledge of carbon pricing instruments. This creates a level playing field for all stakeholders to be better prepared to engage in conversations and consultations. A second phase for the simulation is planned for next year.

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.*

As with any stakeholder engagement process, the main challenge has been dealing with opposition to the ETS. Multiple arguments were presented, and some concessions on the content of the draft regulation were made. In order to deal with concerns and issues from the stakeholders, multiple presentations and work sessions took place.

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

Nonetheless, the political opposition is the biggest challenge, the main achievement as mentioned previously was to find common ground between stakeholders and the authority. 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 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).
- Regulation: Drafting of regulation for pilot program and standard for verification. Scheduled for publishing on November 2018.

2019

- ETS Pilot Program: Starting on January 1, 2019
 - First Free Allocation: October 2019
- Offset program: Development and /or adaptation of offset protocols
- ETS Simulation exercise two: Starts on First Quarter 2019.

2020

- ETS Pilot Program:
 - Second free allocation: October 2020
 - First Compliance: November 2020

2021

- ETS Pilot Program:
 - Pilot evaluation
 - Drafting of regulation for future phases

