STRATEGIC ORIENTATION FOR THE FUTURE OF THE PARTNERSHIP FOR MARKET READINESS: NOTE ON PILOTING MARKET-BASED INSTRUMENTS

INTRODUCTION

1. In October 2013, the PMR Secretariat presented a note on the *Strategic Orientation for the Future of the PMR* (PMR Note PA7 2013-2), which explores several opportunities for future work of the PMR, building on its past three years of operation. One possible opportunity is related to piloting performance-based payments for emission reductions from scaled-up crediting programs and other mechanisms to enhance the PMR's function as a global platform for promoting market-based instruments.

2. Drawing on Participants' general feedback on the Strategic Orientation document[1], and on this topic in particular, the PMR Secretariat has prepared this note with the objective of describing the rationale behind piloting, and presenting a process for moving forward. The PA will have an opportunity to discuss this proposal and provide further feedback during PA8 in Mexico City.

3. This note is structured in six sections:

    - Section I provides background on the idea of creating a fund to pilot performance-based payments for emission reductions from scaled-up crediting programs and other market-based instruments in countries that have made significant progress toward market readiness. It also discusses the definition of, and the rationale behind, piloting for such payments.
    - Section II looks at the experience gained and the lessons learned from the World Bank's Forest Carbon Partnership Facility's (FCPF) management of a process to move from readiness to implementation, similar to the one that the PMR is exploring.
    - Section III reviews the work program of the World Bank's Carbon Partnership Facility's Carbon Asset Development Facility (CADF) highlighting the complementary nature of this existing facility and its initial conceptual work on scaled-up crediting.
    - Section IV provides an overview of the activities proposed under Implementing Country Participants' Market Readiness Proposals (MRPs) and makes a preliminary identification of programs that could be incentivized by the creation of a piloting fund.
    - Section V discusses some of the gaps that the creation of a fund to pilot the implementation of market-based instruments could bridge in the absence of international demand for emission reductions, and of globally agreed rules and procedures.
    - The final section of this note presents possible next steps for consideration by the Partnership Assembly (PA).

[1] The PMR Secretariat has compiled feedback on the Strategic Orientation document shared by Participants during PA7 as well as written comments submitted following the meeting. A compilation of this feedback was circulated to PMR Participants on February 18, 2014.

I. PILOTING: BACKGROUND, DEFINITION AND RATIONALE

4. During PA7 in Marrakech, Participants expressed keen interest for the PMR to support piloting, as this is one of the original and core objectives of the Partnership. But Participants also called for a clear definition of what it would mean to pilot under the PMR. Indeed, there is a concern that there is a gap between market readiness, i.e., "being ready to pilot" a market-based instrument, and implementation, i.e., actually "piloting" a market-based instrument through emission reductions transactions. This note provides a preliminary response to address this concern and to better understand this gap.

5. Piloting under the PMR is understood to be two things:

   i. First, it is meant to designate the set of activities developed by a country to test one or more core readiness component(s) included as part of the implementation of its MRP. In that sense, the PMR is already supporting piloting through the grants that are being allocated as part of the current PMR process and that finances not only the setting up of systems for data collection and management, MRV, registries, etc., but also the actual testing of these core readiness components. In this case, piloting is not limited to any instrument in particular: it can refer to any element that serves as a building block and is being tested as a "pre-requisite" to the implementation of a market-based mechanism. Piloting in this context is still part of market readiness preparation.

   ii. The second meaning of piloting under the PMR, which is the object of this note, refers to the potential to incentivize emission reductions through the provision of finance to purchase assets from scaled-up crediting programs and other market-based instruments. In this sense, piloting refers to performance-based payments for cost-effective emission reductions through commercial transactions, and offers the possibility of testing the implementation of market-based instruments *per se*. Piloting is targeted more specifically at emission reductions generated through market-based instruments that are directed towards the international carbon market rather than other instruments of a more domestic nature, such as an ETS or a domestic offset scheme. Seen from another angle, piloting is the experimentation of activities that go beyond "no-regret measures" and that offers sufficient incentives to entice large-scale programs within a country to get ready for future, still hypothetical, systems of financial incentives for international emission reductions.

6. It is important to recognize that this second type of piloting can generate lessons and valuable learning beyond a market-based approach. In so far as the approaches tested and implemented will consist in performance-based payments for independently verified emission reductions, they will be directly applicable for shaping flows of public climate finance as well. There is a widely recognized understanding that performance-based instruments will form an important component of future climate finance flows. For example, in its Governing Instrument, the Green Climate Fund (GCF) specifically mentions the inclusion of "results-based financing approaches, including, in particular for

incentivizing mitigation actions, payment for verified results, where appropriate."[2] Therefore, the piloting effort described in this document would remain relevant and valuable irrespective of expectations regarding the future of market demand for international emission reductions.

7. There seems to be a wide recognition among PMR participants and others that a point has been reached where piloting is required in order to make progress in understanding how market-based instruments can work for large-scale programs, and what they can deliver. Part of the ambition behind this piloting effort is that, in turn, it could generate momentum in the international negotiations on market mechanisms. Some Participants observed that bridging the gap between market readiness and providing finance for the purchase of emission reductions will entail significant effort and may require significant support. Section IV of this note provides a preliminary analysis of where PMR Implementing Country Participants are situated on the spectrum of readiness to implement, and the extent to which financing could assist in moving from one phase to the other.

8. During PA7, concerns were expressed about the role that the PMR could have in piloting and how the Partnership could support it while also maintaining the collegial, open, and near apolitical atmosphere of the forum. Participants also expressed concern about the PMR becoming a transactional fund and about the PA playing a role as quality assurer or regulator. Section IV provides an initial explanation of how the institutional setting would work in order to avoid jeopardizing the good spirit of the forum, and how the PA can *facilitate* quality assurance but not *verify* or *guarantee* it.

9. Participant feedback also suggested that a piloting mechanism that is independent, but with strong ties to the PMR, could strike the right balance. It was acknowledged that the World Bank has significant experience with piloting emission reductions transactions, which could be leveraged to create a specific fund to pilot the implementation of market-based instruments. In particular, the experience of the FCPF provides useful insights on a possible approach to transition a market instrument from concept to reality, from readiness to pilot implementation. The next section describes the process that the FCPF has put in place and discusses some of the lessons that have been learned from managing a single initiative that has both a readiness and piloting fund.

II. FOREST CARBON PARTNERSHIP FACILITY (FCPF): EXPERIENCE AND LESSONS WITH MANAGING A READINESS FUND AND A CARBON FUND

i. Background

10. The FCPF, which became operational in June 2008, is a global partnership focused on reducing emissions from deforestation and forest degradation, forest carbon stock conservation, sustainable management of forests and enhancement of forest carbon stocks (REDD+). The FCPF has created a framework and processes for REDD+ readiness, which helps countries prepare for future systems of financial incentives for REDD+.

---

[2] GCF Governing Instrument, paragraphs 40 and 55.

11. The FCPF has two separate but complementary funding mechanisms to support countries and achieve its strategic objectives — the **Readiness Fund** and the **Carbon Fund**. Both funds are underpinned by a multi-donor trust fund of governments and non-governmental participants, including private companies.[3] Contributors to the Readiness Fund are known as Donor Participants. Contributors to the Carbon Fund are known as Carbon Fund Participants.[4] Developing countries (which participate in both funds) are known as REDD Country Participants.

    a. The **Readiness Fund** supports participating countries as they prepare for REDD+ by developing necessary policies and systems, including adopting national REDD+ strategies[5]; developing reference emission levels (RELs); designing measurement, reporting, and verification (MRV) systems; and setting up REDD+ national management arrangements, including proper environmental and social safeguards. The purpose of the Readiness Fund is to assist countries in moving from a planning stage to a phase of REDD+ Readiness preparation. There are currently 44 REDD Country Participants in the Readiness Fund being supported by US$360 million.

    b. The **Carbon Fund** is designed to pay for emission reductions (ER) from REDD Country Participants. Such performance-based payments play an essential part in valuing standing forests more than cut forests. While the Carbon Fund was established at the time of set up of the FCPF, it became fully operational in May 2011 when the targeted capitalization was reached. It is currently capitalized at US$465 million and expected to pay for ERs from about six large REDD+ programs developed by REDD Country Participants.

ii. Overview of REDD Country Participant Process of Engagement

Readiness Fund

12. Similar to the Market Readiness Proposals prepared by PMR Implementing Country Participants, each REDD Country Participant prepares a national Readiness Preparation Proposal (R-PP). The R-PP provides a framework for a country to set a clear plan, budget, and schedule to achieve "REDD Readiness" to undertake REDD activities within the country's specific context. An ad hoc Technical Advisory Panel (TAP) performs an independent assessment of each R-PP to support and inform the Participants Committee decision to allocate grants to REDD countries. R-PPs often exceed the

---

[3] As of December 2013, the Partnership has grown to include 44 forest developing countries, 18 financial contributors (including two private companies and one NGO), active observers from indigenous peoples and civil society, and several international organizations as delivery partners.

[4] All public sector Carbon Fund Contributors are also Donor Participants, while non-governmental Carbon Fund Participants are not Donor Participants to the Readiness Fund.

[5] REDD+ strategies are designed to set the framework for real and verifiable emission reductions.

standard grant allocation made through the FCPF (US$3.8 million) and are generally co-financed by other development partners.

Transitioning from REDD + Readiness to Piloting REDD+ Implementation

13. To facilitate a country's implementation of its Readiness Preparation Proposal (R-PP), countries undertake a self-assessment exercise, the outcome of which is documented in a "Readiness Package" (R-Package). This self-assessment is guided by a common framework to measure countries' relative progress on core readiness activities, which was developed over two years of discussions by the FCPF's decision-making body – the Partnership Committee (PC) – and informed by country experiences to date in formulating and implementing their R-PPs and existing good practices.[6]

14. Assessing a countries' preparedness for implementing happens in two phases: (i) a national multi-stakeholder self-assessment (resulting in the R-Package), and (ii) an assessment of the R-Package by the PC with input from a Technical Advisory Panel (panel of independent experts), the Delivery Partner (e.g., World Bank, UNDP, IDB), and others. A country's R-Package, therefore, consists of the following: a summary of the readiness preparation process; a report of the multi-stakeholder self-assessment process; the assessment results of the national multi-stakeholder assessment; and references to key outputs of the readiness preparation process (i.e., the REDD+ Strategy, Reference Emission Levels/Reference Levels, etc.).

15. The R-Package has three objectives: assess progress on readiness preparation; demonstrate commitment to REDD+, and generate feedback and guidance to countries toward readiness. The R-package process is voluntary and not a reporting requirement under the FCPF Readiness Fund. It becomes mandatory if a country aims to participate in the Carbon Fund—that is, a country's R-Package needs to be endorsed by the PC[7] – before an Emission Reductions Program Document (ERPD) can be considered by the Carbon Fund.[8]

16. At the heart of this readiness assessment is a thorough self-examination by REDD country stakeholders to take stock of the activities implemented during the REDD+ readiness preparation phase and assess progress on REDD+ readiness. The R-Package, and the outcomes of its assessment, provide the Carbon Fund with additional information to ensure consistency of an ER Program with the national REDD+ readiness preparations and of ER Program activities (likely to be of subnational scope) with overarching safeguards requirements. The R-Package documents the country's progress, captures lessons learned, assesses remaining gaps, and identifies activities for the way forward to

[6] The Readiness Assessment Framework was adopted in 2013.

[7] A country's R-Package is assessed against nine subcomponents and 35 related criteria. The rationale, diagnostic questions and guidance notes for each subcomponent help countries identify what to consider when addressing the criteria and information/documentation to support and inform the assessment.

[8] Note: the PC's endorsement of the R-Package is a necessity, but not the only requirement for an ER PD to be considered. The Carbon Fund has its own selection criteria.

transition to the implementation of performance-based activities. With its comprehensive overview of the progress made in REDD+ readiness, the R-Package can also be used by REDD+ countries to attract additional funds from external sources to scale up activities, or by donors or other international initiatives as a tool to gauge progress on REDD+ readiness and to inform decision-making on support for REDD+.

17. A comprehensive readiness assessment provides an opportunity for REDD+ countries to demonstrate their commitment to REDD+. The assessment helps countries to identify remaining gaps and further needs, while generating feedback and guidance to countries from multiple stakeholders and the FCPF Participants Committee. The scope of the R-Package and its assessment is national and encompasses all core readiness activities (regardless if financed by the FCPF or other development partners) including REDD+ organization, consultation and strategy preparation, design of reference levels and monitoring systems, as well as cross-cutting issues such as governance, and environmental and social safeguards. As such, the R-Package captures the important relationships among different readiness preparation activities and helps to ensure consistency across components. Because circumstances are different in each country, the readiness assessment accommodates specific country circumstances by focusing on relative progress.

Carbon Fund

18. A subset of FCPF REDD countries are expected to make substantial progress in their readiness preparation activities and prepare Emissions Reduction Programs for the Carbon Fund (the current capitalization would allow about six large programs to be financed on the basis of verified ERs). Several countries are currently actively preparing Emission Reduction Program Idea Notes (ER-PIN) to seek financing from the Carbon Fund Participants for the development of an Emission Reduction Program Document (ERPD), on the basis of which an Emission Reduction Payment Agreement (ERPA) would be signed between the REDD Country and the Carbon Fund. Prior to signing an ERPA the country will have sought endorsement of the R-Package from the FCPF Participants Committee (based on the assessment described above).

19. The Carbon Fund’s payments are intended to provide an incentive to the recipient countries and various stakeholders—including forest-dependent indigenous peoples, other forest dwellers or the private sector—within each of these countries, to achieve long-term sustainability in financing forest conservation and management programs. Payments are made only to countries that achieve measurable and verifiable emission reductions. ERs are independently verified.

20. The Carbon Fund includes arrangements to accommodate a range of different funding motivations. While all FCPF Carbon Fund Participants are purchasing emission reductions pro-rata to their contribution, Participants can choose whether to *a priori* cancel their emission reductions or, to reserve the right to use their emission reductions for future obligations.

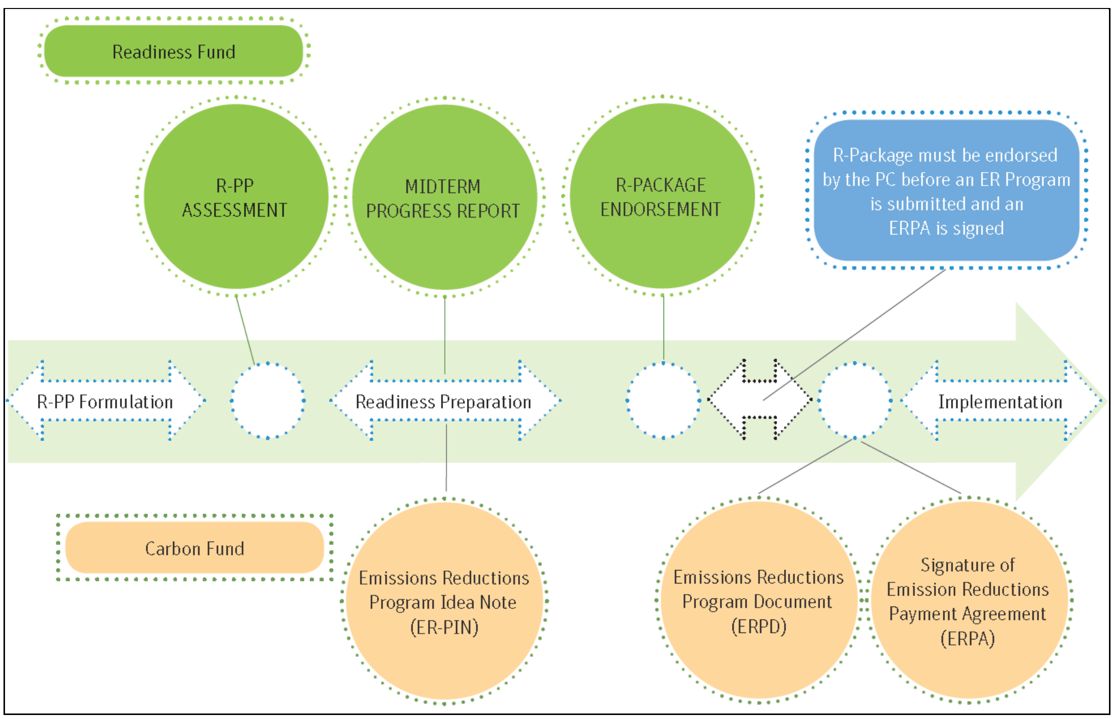
The Methodological Framework

21. Central to piloting under the Carbon Fund is the Methodological Framework which, following two years of discussions, was adopted in December 2013. The Framework provides technical guidance to

countries preparing an ERP for inclusion in the Carbon Fund. Independent experts, the FCPF Secretariat, private companies, civil society, indigenous peoples, and a working group of FCPF participants drafted the Framework. Consensus on this document means that there is an agreed-upon approach for providing results-based financing to countries who achieve verified emission reductions through REDD+ activities.

22. The Framework does not consist of detailed calculation methods or protocols. Instead it provides overarching guidance and acts as a standard that is designed to achieve a consistent approach to carbon accounting and programmatic characteristics. As a result, Carbon Fund Participants use a set of 37 criteria and 72 indicators to elaborate requirements for emission reductions programs to be piloted. This decision was made in consideration of trade-offs among a number of factors: simplicity of methods, flexibility to pilot approaches and encourage innovation, consistency of ERs, and predictability of assessment of ER programs. Elements included in the Methodological Framework include: level of ambition, carbon accounting, safeguards, sustainable program design and implementation, and ER program transactions.

Figure 1 - The FCPF Readiness Preparation and Carbon Finance Processes



iii. Early Lessons from FCPF Experience

23. Several early lessons from the FCPF's experience are particularly relevant in relation to a potential purchasing fund that could support the piloting of programs being developed by PMR Implementing Country Participants.

  i. **Readiness and design of pilot ER programs offer strong synergies and can advance in parallel:** Providing countries with a process to assess the quality of their readiness for piloting is important. Countries that are designing and piloting the implementation of ER Programs under the FCPF are demonstrating how readiness processes inform the design of such programs. It is important that these readiness assessments be flexible enough to apply to countries' specific contexts. At the same time, piloting presents an opportunity to advance knowledge exchange and work on elements that are relevant to national readiness preparations, such as baseline scenarios and MRV. Real situations call for realistic solutions, which in turn give focus and momentum to the readiness work. In the context of the FCPF, readiness is increasingly understood as a continuum, and there are strong synergies and feedback between readiness, and designing and piloting the implementation of emission reduction programs. It is critical that mechanism exists at an early stage to facilitate this cross fertilization.

ii. **Methodological issues require a balance between simplicity and robustness:** The Methodological Framework that has been developed and will be piloted under the FCPF Carbon Fund is viewed by Carbon Fund Participants as a critically significant standard to guide the preparation and implementation of future emission reduction programs. The discussions held in 2012 and 2013 under the FCPF to design the Methodological Framework, highlighted the complexity of the issues and the difficulty of ensuring that future emission reduction programs are not only technically robust but can also be implemented in reasonable time frames.

iii. **To have a Methodological Framework or not:** An important initial decision surrounding piloting within the FCPF Carbon Fund was whether or not a Methodological Framework was required. On one hand, each potential pilot would reflect the unique circumstances and context of the country that proposed it; establishing one set of rules seemed prohibitive to the piloting process. On the other hand, it was important that some standard for emission reductions be agreed to and be followed for all pilots in order to underpin the integrity of the work. In the end, the FCPF agreed to a hybrid approach. The Methodological Framework represents a set of guiding criteria and indicators for countries to follow. It allows enough flexibility to accommodate unique circumstances but also provides a standard against which all pilot programs can be measured. It is important to note that reaching this agreement was possible, in part, because all pilots will achieve their emission reductions through a single approach: reduction in forest loss.

IV. **Agreeing to the Methodological Framework**: Reaching agreement on the framework was a lengthy process. Forming a working group with representatives from the PC and the Carbon Fund was critical for ensuring the interests from both funds were addressed.

III. LEVERAGING THE CARBON PARTNERSHIP FACILITY'S CARBON ASSET DEVELOPMENT FUND'S WORK PROGRAM

24. The World Bank's Carbon Partnership Facility (CPF) was established in 2007 specifically to catalyze large-scale, long-term investments in clean technology programs that will help developing countries

in their efforts to move to lower carbon development paths. The CPF is comprised of two related but distinct trust funds: (i) the Carbon Asset Development Fund (CADF) to prepare and implement emission reductions programs; and (ii) the Carbon Fund to purchase carbon credits from the emission reductions programs.

25. The CPF's mission is to innovate in developing scaled-up crediting mechanisms, utilizing programmatic modalities that go beyond the project-by-project approach. The CPF collaborates with governments and market participants on investment programs and sector-based interventions that are consistent with low-carbon economic growth and sustainable development priorities. The CPF prepares carbon finance programs and purchases emission reductions to support these initiatives, and is developing innovative methodologies in areas such as energy efficiency and city-wide approaches.

26. The CADF has a current program on the conceptual work to design New Market Mechanism (NMM) pilots that the creation of a carbon purchasing fund could also leverage. Against the backdrop of the UNFCCC process[9] to establish a "new market mechanism" under the authority of the CoP and to consider a "framework for various approaches," including markets, the CADF is supporting the design of conceptual ideas, or "blueprints", that could lead to emission reductions programs that try to anticipate and inform the modalities and procedures of the new market mechanism and the requirements for its use as a compliance instrument. Conceptual work funded by the CADF and related to the design of NMM pilots, is targeting broad segments of the economy with substantial potential for GHG mitigation and where opportunities to develop NMM programs have been pre-identified. These segments include the power sector, cement, transport, cities and supply- and demand-side energy efficiency and already take account, to a large degree, of opportunities arising from the programs that will be developed under the PMR.

27. In addition to conceptual work in several sectors, specific work programs have been developed:

    i. NMM for mitigation actions in cities: A multi-disciplinary study titled "Lowering cities' carbon emissions: examining new carbon crediting options" is underway to explore options for cities and suggest a design framework for piloting city-wide mitigation actions under the NMM.

    ii. Economy-wide policy MRV: The CADF is exploring innovative approaches to monitoring and GHG accounting for economy-wide policies, such as carbon tax and/or fossil fuel subsidy reform.

    iii. Concurrent with the conceptual work, initial ideas for NMM pilots at the country level are also being identified.

[9] UNFCCC, 2011, Outcome of the work of the Ad Hoc Working Group on Long term Cooperative action Under the Convention, Decision 2/CP.17

IV. PRELIMINARY ASSESSMENT OF THE PMR IMPLEMENTING COUNTRY PARTICIPANTS THAT MAY SEEK FINANCIAL SUPPORT TO PILOT SCALED-UP CREDITING MECHANISMS

28. One of the main objectives of the PMR, as specified in its Governance Framework, is to pilot innovative market-based instruments in order to generate experience and knowledge that could be shared with the UNFCCC and the international community. A number of Implementing Country Participants have expressed interest in exploring scaled-up crediting programs at the sectoral or national level. While the PMR Trust Fund provides support to design these programs and build market readiness infrastructure, it is clear that without signals of viable international demand for emission reductions and assurance for downstream payments, these countries will be unwilling to go beyond readiness preparation and move toward implementation by generating GHG emission reductions.

29. The lack of international demand for GHG emission reductions has affected several countries' choices and the level of ambition they had initially envisaged in their MRPs for the development and implementation of market-based instruments. The Moroccan Government, for example, has clearly indicated in its Draft MRP that they are following developments in the international carbon market very closely and that *"if […] international signals, especially regarding the demand for carbon credits, become positive, the Government will be ready to go further and achieve the next tranche of activities that will allow the development and operationalization of a [scaled-up emission reductions crediting] mechanism."* Other Implementing Countries have adopted a similar "wait-and-see" approach, and others have decided to change their course of action, in part or in whole, to create components of domestic demand for credits. The PMR country practice shows that, in the absence of international demand for credits, several countries have concluded that it would be excessively risky for them to venture too far into the implementation of scaled-up GHG emission reductions crediting programs and have decided to focus on "no-regrets" approaches instead.

30. The opportunity to pilot emission reductions transactions in connection with a payment facility would be very important in order to show the international community what works, in practice, and what does not. It would also go a long way in creating international demand for credits and encouraging Implementing Country Participants to move forward with experimentation of market-based instruments to create emission reductions. The hands-on experience generated through such piloting would be invaluable in helping define the next generation of carbon markets. It would be difficult to imagine how the PMR could fulfill its entire purpose without having such piloting incentives in place.

31. The table below provides an overview of the activities that are proposed or envisaged in all PMR Implementing Country Participants:

Table 1 - PMR Implementing Country Participants: Proposed Activities

Participant	Country Context	PMR Support to:
Brazil	• Reduce emissions by 36.1%-38.9% below business-as-usual (BAU) by 2020 as part of voluntary commitment.	• Explore options for various types of carbon pricing systems in order to select suitable instrument for implementation.

Participant	Country Context	PMR Support to:
	• Mitigation plans cover forestry, agriculture, energy, iron, steel, & other industry, transportation, mining, & building sectors.	• Build monitoring, reporting, and verification (MRV) capacity.
Chile	• Reduce GHG emissions growth rate by 20% below BAU compared with 2007. • Market instruments identified as important for meeting the mitigation objective.	• Build capacity and understanding within government and across stakeholders on market based approaches. • Design domestic ETS pilot within the energy sector. • Support creation of an MRV and GHG registry system.
Colombia	• Low carbon strategy is one of three pillars for climate agenda under National Development Plan (2010-14). • Participation in international crediting mechanism is considered a means to attract climate financing and scale up emission reductions.	• Explore options to use market instruments to reduce emissions from the transport sector.
Costa Rica	• Carbon neutrality goal by 2021. • Promote and use market instruments domestically to reduce emissions.	• Design and develop a domestic carbon market, including building domestic market "infrastructure."
Mexico	• Reduce emissions by 51 $MtCO_2e$/yr in 2012 compared to BAU as part of domestic commitment. • Voluntary commitment of up to 30% reduction from BAU by 2020, conditional on international support, including carbon markets.	• Develop and implement crediting NAMAs in selected sectors (e.g., housing, appliances, public transport, solid waste & cement). • Set up registry/tracking system for GHG reductions.
Peru	• National Strategy for Climate Change focuses on curbing deforestation, increasing renewable and hydro-sourced energy to 40% of national mix, and improving methane capture from waste.	• Map readiness needs and capacity gaps in various NAMAs to select suitable sectors for a market instrument. • Develop market readiness "infrastructure" and prepare for piloting.
China	• Climate change strategy is integrated into social and economic development planning. • Action on climate change mitigation acts as catalyst for restructuring key aspects of economy, including the power sector • A national ETS is targeted to launch between 2016 and 2020.	• Design and prepare for a national ETS, including work on cap setting, allocation, MRV, mechanisms for price containment, market oversight and a legal framework. • Analytical work targeted at the inclusion of state-owned enterprises and the power sector into the national ETS.
India	• Reduce GHG emissions intensity by 20-25% compared with 2005 levels by 2020 as part of voluntary commitment.	• Build an integrated GHG data management system and develop and off-grid Renewable Energy Certificate (REC) program. • Expand sectoral coverage of the Perform Achieve and Trade (PAT) system.
Indonesia	• Reduce emissions by up to 26% and 41% with international support by 2020 as part of voluntary target.	• Explore various types of market instruments, build domestic carbon market "infrastructure." • Pilot MRV framework in power plants and cement industry.
Thailand	• Per the National Renewable Energy Development Plan, reduce energy intensity by 8% in 2015; 15% in 2020; and 25% by 2030 compared with 2005 levels	• Create an Energy Performance Certificate (EPC) scheme. • Pilot a Low Carbon City Program (LCC).
Vietnam	• Reduce energy consumption per unit of GDP by 2.5-3% per year by 2020 and reduce GHG emissions relative to BAU scenario by 2-3% per year from 2020 to 2030. • Increase share of renewable energy to 5.6% by 2020 and to 11% by 2050. • Reduce emissions from the energy sector by 10% relative to BAU (and 20% with international	• Design and pilot market instruments in the steel, solid waste, and power (EE) sectors and establish a GHG registry and MRV system.

Participant	Country Context	PMR Support to:
	support) by 2020	
Jordan	• Develop renewable energy, and enhance water and waste management as part of national priority. Explore integrated approach for urban areas (city-wide approach).	• Explore scaled-up crediting for NAMAs in renewable energy, water (energy efficiency in pumping, waste water treatment) and/or solid waste management sectors. • Support capacity building for data collection, baseline setting and an MRV system.
Morocco	• Implement climate change mitigation policy as part of National Plan against Global Warming.	• Build carbon market infrastructure, including GHG registry and MRV framework. • Explore integration with international market and pilot carbon market-based approaches in selected sectors.
South Africa	• Reduce reliance on fossil fuels and the carbon intensity of the growing economy while ensuring economic growth, increased employment, and reduced poverty and inequality. • Reduce domestic emissions by 34% by 2020 and 42% by 2025 from business as usual, subject to the availability of adequate financial and technological support.	• Refine design features of proposed carbon tax and complementary offset mechanism, and strengthen MRV capacity.
Turkey	• Exploring options for crediting NAMAs and domestic ETS. National Climate Change Action Plan identifies market-based approaches as a key tool to achieve carbon mitigation • 2012 National legislation requires energy and industry sector installations to report GHG emissions.	• Implement robust, installation-level MRV system based on the MRV law. • Lay out road map toward implementation of domestic ETS.
Ukraine	• Reduce emissions by 20% by 2020 and by 50% by 2050. • ETS is key part of the proposed Law on Energy Efficiency Regulation.	• Design installation-level MRV for energy sector and lay out road map toward implementation of domestic ETS.

32. Based on this table, potential candidates to pilot scaled-up crediting mechanisms at a sectoral or national level include Indonesia, Mexico, Morocco, Jordan, Peru and Vietnam[10]. Other countries such as Costa Rica and Colombia have left the door open to pilot performance-based payments for international credits, if they decide to link their activities to the international carbon market. In all cases, further work will be required to analyze the gaps that exist between readiness and pilot implementation, and how they can be filled.

V. BRIDGING GAPS TO HELP TRANSITION FROM READINESS TO IMPLEMENTATION

i. Rationale for the establishment of a carbon purchasing fund

33. If piloting scaled-up emission reductions programs remains a key interest for the PMR, in the absence of international demand for emission reductions in the short to medium term, a reliable approach to enable piloting is to establish a carbon purchasing fund. The objectives of a purchasing

[10] Tunisia may also be a candidate but has not yet formally joined the PMR. Tunisia will present an Expression of Interest and an Organizing Framework for the Scoping of PMR Activities at PA8 in Mexico.

fund would be to (i) test large-scale approaches that require a mix of policies and investments, integration with national development strategies, use of innovative financial structures, and multi-stakeholder engagement; and (ii) provide early lessons through piloting a variety of approaches. Large-scale programs would need to fit into an Implementing Country Participant's national mitigation strategy and national accounting system, and would be chosen with sufficient diversity to generate learning value. The practical experience generated from the piloting programs could be very informative for the international community in general, the UNFCCC and, possibly, the Green Climate Fund (GCF).

34. Until an international market for carbon reemerges and funding from the private sector becomes available again, it is expected that financing for a carbon purchasing fund would largely come from public funding, which can help bridge the gap and create sufficient demand so as to generate the experience that is essential for the design of the next generation of market-based to scale up climate change mitigation.

ii. Key issues to be addressed in designing a carbon purchasing fund

a. Moving from readiness preparation to piloting

35. As a growing number of countries advance to the implementation of their MRPs in the coming years, they will transition from preparation (under the PMR Trust Fund) to the application of components that are essential for piloting crediting or performance-based financing instruments. During that period, one priority task for the PMR will be to examine critical issues at the interface between market readiness and piloting, in particular readiness assessments of baselines, MRV systems for scaled-up emission reductions programs, valuation approaches for emission reductions, and other related methodological work.

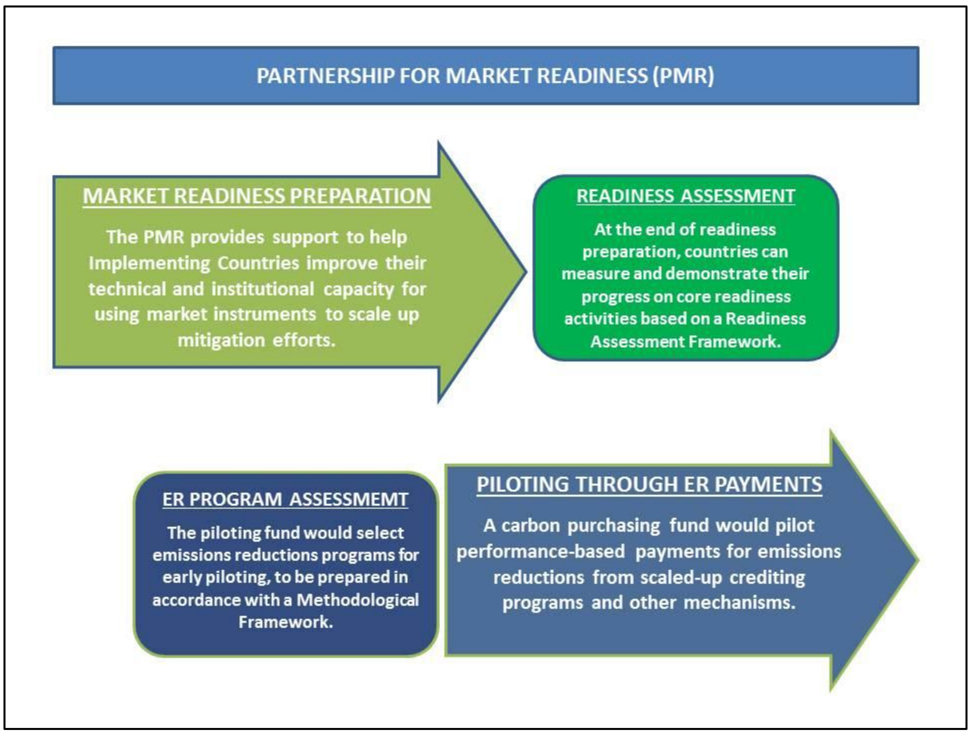
36. The FCPF experience shows that there is a significant gap between a "REDD Readiness Proposal" and the implementation of an emission reduction program. To fill that gap, the FCPF has adopted a methodological framework to provide technical guidance to countries in preparing programs that will move from readiness to carbon transactions. In the context of the PMR, the elaboration of such a methodological framework has already started. For example, the guidelines on baselines for scaled-up crediting programs and the MRV guidance note that is currently being developed will be useful tools. Overall the PMR technical work program aims to support countries' to reach the three "C"s (credibility, consistency and comparability) and will be a good basis for the PMR to contribute to a methodological framework to move from readiness to designing and piloting the implementation of emission reduction programs.

37. Another question that arises in relation to the transition toward piloting is the establishment of a process to assess the "readiness" of programs. As the experience of the FCPF shows (Section II), in the absence of an international institutional and governance structure to ensure the quality of programs under a multilateral framework like the new market mechanism, the successful transition of a market instrument from concept to reality requires the establishment of a process that can facilitate the assessment of the credibility and consistency of programs. To fill the gap, the FCPF has

set up an innovative process, based on a Readiness Assessment Framework and a Methodological Framework, to ensure that the supply and demand of emission reductions is compatible.

38. In the context of the PMR, the role of the PMR could be to facilitate—not verify or guarantee—the assessment of readiness preparation and emission reduction programs. The readiness assessment process would be performed in large part by the Implementing Country Participants themselves, with the involvement of independent experts for technical advisory (much like the approach used by the FCPF). The assessment of emission reduction programs would be guided by a methodological framework and would be subject to the decisions of the governing body of the piloting fund and underpinned by the World Bank's knowledge and experience on program design, institutional arrangements, financial engineering, procurement, etc. Such a methodological framework would likely be common to the PMR and the carbon purchasing fund although linkages and responsibilities between the two would be articulated in the fund design process (see below).

Figure 2 - Moving from market readiness to pilot implementation



39. The creation of a new carbon purchasing fund would play a catalytic role for emissions reductions from programs developed under the PMR or other initiatives, building on the experience of pioneering initiatives such as the CPF and the FCPF. Accordingly, commitments to the carbon purchasing fund should be made early enough to provide incentives to countries to adopt the necessary policies and systems and undertake the necessary investments. Consistent with the UNFCCC decision on the New Market Mechanism adopted in Durban in December 2011, the readiness, investment and performance-based payment phases would not be purely sequential but would instead overlap to a large extent. Nevertheless, to ensure that carbon finance builds on readiness achievements, the participants in the new carbon purchasing fund would have assessed a

country's readiness progress before a program could enter into an emission reductions payment agreement with the purchasing fund.

40. The carbon purchasing fund's goal would be to contribute to creating a strong framework for any future payment system for scaled-up emissions reduction programs, including funds or markets, by demonstrating and testing performance-based incentive systems, creating high-quality emission reductions, and providing learning opportunities from testing a variety of emission reduction programs.

41. Participating in the carbon purchasing fund would provide implementing countries with: (i) an opportunity to be a front-runner in innovating on large-scale carbon finance; (ii) performance-based payments for verified emissions reductions; (iii) technical assistance and access to cutting-edge knowledge on market-based instruments; (iv) experience with working toward alignment of national mitigation frameworks and systems with emerging international guidance; and (v) new incentives for sustainable activities that contribute to sustainable development goals.

b. Design of the carbon purchasing fund

42. On one hand, the experience of the FCPF shows that the carbon purchasing fund should maintain its autonomy, including independence in the decision-making process, and have its own governance structure. On the other hand, the purchasing fund would certainly benefit from a close relationship with the PMR process. This is due to the fact that some of the potential emission reduction programs supported by the carbon purchasing fund would have benefited from PMR financial and technical support in an earlier stage. Additionally a methodological framework would be relied upon by the carbon purchasing fund helping to support the credibility of the selected programs. A close relationship between the carbon purchasing fund and the broad and inclusive membership that the PMR process provides would create an extremely valuable forum for learning and information exchange, as well as helping to increase the transparency of the carbon fund's transactions.

43. In the design of the carbon purchasing fund, the exact nature of the relationship between the fund and the PMR would be made explicit through a set of principles and/or governance arrangements, to be determined. In that process it will be ensured that the carbon purchasing fund will be open to considering, in principle, funding existing relevant PMR programs. The fund will also consider funding programs under development by the CPF's CADF (Section III).

44. While initially populated with programs from the PMR and the CADF, the carbon purchasing fund would be organized so that, as it develops over time, it could consider funding programs that originate from a broader set of channels. Finding and using synergies with other bilateral and multilateral initiatives that target market design, funding for NAMAs, etc., will be prioritized throughout.

45. Recognition that there is currently no short- or medium-term international demand for emission reductions, while at the same time donors are looking to support results-based climate finance, the carbon purchasing fund would include arrangements to accommodate a range of different funding motivations. This has been successfully accommodated in the FCPF and other World Bank carbon

funds. Regardless of the option, all emissions reductions would be of equal quality and expected to generate real, measurable emissions reductions verified against relevant international standards.

VI. NEXT STEPS AND ACTION BY PA

46. Based on the rationale set forth in this document, as well as complimentary discussions with other stakeholders, the World Bank will draft a design document for a new carbon purchasing fund. If piloting scaled-up emission reduction programs remains a key interest for the PMR, the Secretariat suggests that, to formally contribute to this process, a working group, consisting of interested Contributing and Implementing country Participants, be established to provide a critical round of feedback to the World Bank and to ensure that the issues articulated in this note are incorporated appropriately into the first public draft of the fund's design document. The establishment of this consultative body, with a diverse set of interested participants, would collaborate deeply in the design process.

47. The consultation process between the World Bank and the working group would be carried out primarily through audio- or video-conferences, where minutes would be taken and circulated to all interested country participants, and a face-to-face meeting of the working group would be organized prior to the ninth Meeting of the PA in May in Cologne. The working group would report back to the PA on the inputs and status of the design document.