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 E-Consultations Item #5

Update on Operationalization of the Carbon Transaction Platform

PURPOSE AND ACTION REQUIRED

Members of the Assembly and the Council are invited to:

<input checked="" type="checkbox"/> Take note of the updates on operationalization of the Carbon Transaction Platform	<input checked="" type="checkbox"/> Provide feedback on operationalization of the Carbon Transaction Platform
<input type="checkbox"/> Endorse _____	<input type="checkbox"/> Other (please specify)

CONTEXT/BACKGROUND

The Council authorized the Secretariat to establish the Carbon Transaction Platform (CTP) as a program of GGGI at its Fifteenth Session on 27 October 2022 [[C/2022/DC/5](#)]. The overall design of the CTP was described in the Proposed GGGI Carbon Transaction Platform: For Council Approval, and attached to the Council document Carbon Transaction Platform: Draft Recommendations [[A/2022/2-C/2022/2](#)]. This document presents an update to the Council on the operationalization of the CTP.

SUMMARY

Development of governance principles
 The Secretariat determined that a set of governance principles can help ensure that the CTP supports Article 6 carbon transactions that are in the mutual interests of buyers and sellers. All CTP operational decisions will be required to align with these principles. The seven governance principles are presented in this document, and will benefit from feedback of the Council in response to this update.

Operationalization of the Article 6 Readiness Facility
 The structure of the Article 6 Readiness Facility has been further detailed through an Information Memorandum for the Article 6 Readiness Facility, which is attached to this document.

Operationalization of Carbon Trust Funds
 The Secretariat has made substantial progress in establishing the first Carbon Trust Fund by developing key fund documentation, including an Information Memorandum and Fund Rules.

Resource mobilization
 Discussions have been ongoing with a wide group of partners for potential contributions to and participation in the CTF. The Secretariat is targeting contributions of USD 50M to the Article 6 Readiness Facility and USD 500M to Carbon Trust Funds by 2027.

Update on Operationalization of the Carbon Transaction Platform

22 September 2023

Background

1. The Council authorized the Secretariat to establish the GGGI Carbon Transaction Platform (CTP) as a program of GGGI at its Fifteenth Session on 27 October 2022 [C/2022/DC/5]. Council determined that the objective of CTP activities is to enable the governments of both sellers and buyers among its Members and partners to develop, advance and scale up Article 6 carbon transactions in the mutual interests of buyers and sellers.
2. The overall design of the CTP was described in the Proposed GGGI Carbon Transaction Platform: For Council Approval, and attached to the Council document Carbon Transaction Platform: Draft Recommendations [A/2022/2-C/2022/2]. The proposal paper described the scope of CTP activities, both related to the provision of Article 6 technical assistance (through an Article 6 Readiness Facility) and operational support for the trading of internationally transferred mitigation outcomes (ITMOs) through the establishment of GGGI Carbon Trust Funds.
3. The purpose of this document is to provide an update to Council on the operationalization of the CTP, focusing foremost on the development of a set of governance principles. The document also provides information on activities related to the operationalization of the Article 6 Readiness Facility and GGGI Carbon Trust Funds, as well as on initial resource mobilization activities. Finally, the document outlines expected CTP developments in 2024-2025.

Renaming of the Carbon Transaction Platform

4. During the course of engagement with stakeholders on the establishment of the CTP, it emerged that many international carbon market participants understand the term ‘platform’ to be related to digital services that support either the measurement or trading of emissions reductions. Examples of services that employ such nomenclature include the UNFCCC’s United Nations Carbon Offset Platform¹, Plan A’s Sustainability Platform², Sylvera’s Carbon Ratings and Analytics Platform³, Terrascope’s Carbon Reduction Platform⁴, and the Saudi Arabia Carbon Trading Platform⁵. This confusion risks reducing the value of GGGI’s CTP by having it understood as a service focused on either data analytics or the secondary exchange of ITMOs between sellers and buyers, missing the support that will be provided to GGGI Members and partners through readiness, origination, and transaction-related activities.
5. Further, there is risk of name confusion with the Carbon Market Platform, launched in 2015 under Germany’s G7 Presidency.⁶ The Carbon Market Platform has a wider scope in bringing countries together through annual Strategic Dialogues that facilitate strategic exchange and aim to enhance market-based action.
6. The Secretariat therefore decided that the name of the Carbon Transaction Platform should be changed to the **Carbon Transaction Facility** (CTF), which will provide an identical scope of Article 6 support to GGGI Members and partners as the CTP through a Readiness Facility and Carbon Trust Funds (i.e., the only change is to the name of the CTP). Using this new name will

¹ <https://unfccc.int/climate-action/united-nations-carbon-offset-platform>.

² <https://plana.earth/>.

³ <https://www.sylvera.com/product>.

⁴ <https://www.terrascope.com/home>.

⁵ <https://www.trade.gov/market-intelligence/saudi-arabia-carbon-trading-platform>.

⁶ <https://www.oecd.org/environment/cc/carbon-market-platform/>.

align GGGI's CTF with similar vehicles that provide carbon market readiness and transaction support, including those operated by multilateral development banks that refer to such vehicles as either a 'Fund' or 'Facility'. This document will refer henceforth to CTF instead of the former CTP, without any other changes intended, explicitly or implied.

Update of Activities

Governance

7. As part of CTF operationalization activities, the Secretariat carried out consultations with experts on the governance structures of various trust funds to identify potential gaps in the CTF's governance structure. Through these consultations, the Secretariat found that most trust funds (both carbon and non-carbon trust funds) are designed to explicitly represent buyers, and where efforts have been made to address the 'uneven bargaining table', this has been done so through providing funding for external consultants to support sellers. No funds identified by the Secretariat have positioned themselves as equally supportive of both sides of a transaction.
8. Given that a clear and overarching objective of the CTF is to bring GGGI Members and partners to the table in an equitable fashion and to support Article 6 carbon transactions that are in the mutual interests of sellers and buyers, the Secretariat determined that a set of governance principles could help ensure that this objective is met. A set of governance principles were subsequently developed, which are listed and summarized below. The governance principles are intended to provide guidance to the Council as it oversees the implementation of the CTF in its role as GGGI's governance organ. The complete set of suggested governance principles is included in the draft governance framework for the CTF, attached as Annex 1.
9. The suggested governance principles for the CTF are:
 - a. **Promoting achievement of the Paris Agreement:** In order to protect its reputation and align the CTF with the mandate provided to it by Council [[C/2022/DC/5](#)], GGGI must ensure that the activities and transactions facilitated by the CTF advance the principles and objectives of the Paris Agreement.
 - b. **Respecting national circumstances:** The CTF aims to position itself as a trusted facilitator between potential buyers and sellers. To accommodate and respect the unique national circumstances and priorities of all countries, the CTF should operate on a principle of non-interference, recognizing the autonomy of its participating sovereign countries.
 - c. **Fostering predictability and stability:** To minimize the risks and uncertainty associated with international carbon markets, this principle can guide governance processes, managerial decisions, and individual activities towards the overarching aim of lowering risk, fostering predictability, and instilling trust.
 - d. **Upholding fairness and impartiality:** To mitigate any risk of bias, the CTF should commit to absolute neutrality in all its activities, ensuring fair representation of both buyers and sellers in its management of Carbon Trust Funds and the facilitation of individual transactions.
 - e. **Empowering stakeholders:** In recognition of the diverse circumstances of potential participants and to respond to the challenge of capacity shortfalls in some countries, the CTF should emphasize the importance of empowerment and knowledge sharing in all its activities.
 - f. **Promoting transparency:** Transparency is key for building the trust of market participants and supporting efficient market operation. The CTF should adopt a policy of transparency, while also protecting any information that, if disclosed, could potentially harm the national interests of participant countries, or other confidential data.

- g. **Ensuring integrity and accountability:** To avoid conflicts of interest and to ensure that its actions are neutral and serve the best interests of all participant parties, the CTF should adopt a principle of unconditional integrity and accountability.
10. The Secretariat would welcome any feedback GGGI Council may have on the governance principles in response to this update document. Subsequent to such feedback, the governance principles will be further operationalized by the Secretariat through rules, procedures, and guidelines. All CTF operational decisions should align with these principles to ensure consistency with overarching objectives and that competing interests are appropriately balanced.
11. The Secretariat also recognizes that the management and operation of Carbon Trust Funds constitutes a new service offered by GGGI. Given the potential risks associated with this expansion of GGGI's service offerings, the Secretariat engaged external legal support to assess the risks to GGGI as trustee of Carbon Trust Funds. The risk assessment also identifies possible mitigation measures for all identified risks. The risk assessment is attached to this document as Annex 2.

Operationalization of the Article 6 Readiness Facility

12. The structure of the Article 6 Readiness Facility, as outlined in document [[A/2022/2-C/2022/2](#)], has been further detailed in 2023. This detail is primarily provided in the Information Memorandum for the Article 6 Readiness Facility, which is attached as Annex 3. The Secretariat is also currently developing the Article 6 Readiness Facility Rules, which will require approval by the Director General.
13. The Information Memorandum provides further detail related to the:
- a. scope of technical assistance to be provided through the Readiness Facility;
 - b. selection and review processes for countries and activities to receive technical assistance through the Readiness Facility; and
 - c. administration arrangements for the Readiness Facility.
14. The Secretariat has also further documented the envisaged process for transitioning activities from the Article 6 Readiness Facility to one or more Carbon Trust Funds. A key output of activities carried out through the Readiness Facility will be the development of short Mitigation Activity Idea Notes (MAINs). MAINs will contain information including a short description of the mitigation activity, estimated volume of mitigation outcomes that the mitigation activity will generate, basic transaction terms of the mitigation activity proponent and the host country, and estimated technical assistance needs related to the mitigation activity. To transition from the Readiness Facility to a Carbon Trust Fund, a 'matchmaking' process will take place, in which MAINs are presented to all Carbon Trust Funds operated through the CTF and fund participants are provided with an opportunity to review MAINs and indicate whether they would like to support further development of the mitigation activity.

Operationalization of Carbon Trust Funds

15. Following Council's establishment of the CTF in October 2022, the Secretariat has advanced the operationalization of CTF Carbon Trust Funds through extensive analysis and consultations, as well as through the ongoing development of the first Carbon Trust Fund. These activities are further detailed in the following paragraphs.
16. The Secretariat engaged external legal support to develop recommendations for the compliant procurement of ITMOs by GGGI. The consultancy found that GGGI-managed Carbon Trust Funds can procure ITMOs on behalf of fund participants, and that such procurement is not subject to the competitive process as defined in GGGI's procurement regulations and rules. GGGI

Carbon Trust Funds can therefore directly procure ITMOs through GGGI's internal pipeline of mitigation activities, provided that they align with the investment criteria of the respective fund. The final report on recommendations for compliant ITMO procurement by GGGI is attached as Annex 4.

17. Extensive documentation was gathered from carbon trust funds operated by comparator organizations, including multilateral development banks, to support analysis on the design of CTF carbon trust funds. Most carbon trust funds reviewed are Kyoto Protocol-era funds that focused on the procurement of Certified Emissions Reductions, including through pre-payment financing models. Only two other organizations have started to develop ITMO-purchasing funds. Based on this research, the Secretariat developed an internal technical document titled Designing international carbon trust funds for the Paris Agreement-era: Challenges and considerations.
18. The Secretariat has made substantial progress in developing the first CTF Carbon Trust Fund. The Director General is authorized to establish GGGI Carbon Trust Funds, pursuant to Council decision [[C/2022/DC/5](#)], and will make use of this authority to establish the first Carbon Trust Fund.
19. The progress in establishing the first Carbon Trust Fund is summarized below:
 - a. GGGI drafted an Information Memorandum for the Carbon Trust Fund, which outlines core design elements such as fund objectives, investment criteria (country selection criteria, mitigation activity criteria, and portfolio restrictions), the scope and approach to ITMO procurement, and administration arrangements. The Information Memorandum was updated based on discussions with the first prospective fund participant. The Information Memorandum is attached as Annex 5.
 - b. Using external legal support, the Secretariat further developed the Information Memorandum into a Fund Rules document. The Fund Rules formalize the objectives and investment criteria that regulate fund activities, and contain provisions that deal, for example, with the application of GGGI's operational policies and procedures to the operation of the Fund; Fund administration arrangements; Fund records and reporting requirements; indemnification of GGGI as Trustee; and processes for resolving disputes and managing conflicts of interest.
 - c. Based on the Fund Rules, a Contribution Agreement was also developed with external legal support.
20. All fund documentation notes that the Carbon Trust Funds will operate within the overall structure of the CTF, with ultimate governance oversight provided by GGGI's Assembly and Council.

Resource mobilization

21. The CTF covers all GGGI's Article 6 carbon pricing programs, which currently encompasses four programs funded by the governments of Norway, Sweden, Germany, and Australia. Discussions have been ongoing with a wide group of partners for potential contributions to, and participation in, the CTF. Interest is high within the donor community, both among governments that intend to support readiness and to purchase ITMOs, as well as those that only intend to provide support for technical assistance through the Article 6 Readiness Facility.
22. To ensure fairness and to provide the most benefit for GGGI Members and partners, the Secretariat has determined that any participant to a Carbon Trust Fund (i.e., those using the CTF as a vehicle to purchase ITMOs) must also contribute to the Article 6 Readiness Facility. This will enable readiness support to reach widely across GGGI Members and partners, creating the best chance for the development of mitigation activities that can generate ITMOs for potential buyers and catalyze flows of carbon finance to seller countries.

23. Potential contributions to the CTF from both current GGGI partners and new contributors have been identified across at least five countries. As specified above, the Secretariat intends to make participation in a Carbon Trust Fund conditional upon a minimum five-year contribution to the Article 6 Readiness Facility, given that successful ITMO procurement by Carbon Trust Funds is a direct result of technical assistance provided through the Readiness Facility.
24. The Secretariat is targeting USD 50M in contributions to the Article 6 Readiness Facility by 2027, and USD 500M in contributions to CTF Carbon Trust Funds by 2027.

Development of the CTF over 2024-2025

25. The Secretariat envisages that the Article 6 Readiness Facility Rules will be finalized in Q1 2024. The Readiness Facility is expected to be an open-ended facility that can accept ongoing contributions. Following the establishment and initial capitalization of the Readiness Facility, the Secretariat will be ready to start providing Article 6 technical assistance to Member and partner host countries. Allowing time for set up, this is expected to be by the end of Q2 2024 at the latest.
26. The Secretariat is aiming to establish the first CTF Carbon Trust Fund by the end of 2023. The establishment of the Carbon Trust Fund will enable the Secretariat to provide support to the development of mitigation activities in GGGI Member and partner host countries, and for GGGI (as Trustee) to enter into Mitigation Outcome Purchase Agreements with mitigation activity proponents. The timing of the first delivery of ITMOs is dependent upon both the relevant host country's overall state of readiness to engage in Article 6, as well as the status of the mitigation activity.
27. The Secretariat expects to continue its engagement with other partners regarding the establishment of further Carbon Trust Funds under the CTF over the course of 2024-2025.

/End

Annex:

1. Draft governance framework for the Carbon Transaction Facility
2. Assessment of risks to GGGI as trustee of Carbon Trust Funds
3. GGGI ARTICLE 6 READINESS FACILITY Information Memorandum
4. Report on recommendations for compliant ITMO procurement by GGGI: Final Report
5. GGGI CARBON TRUST FUND Information Memorandum

Draft governance framework for the Carbon Transaction Facility

September 2023

1. BACKGROUND

This document describes the draft governance framework for the Carbon Transaction Facility (“CTF”), and is attached as an annex to the Update on Operationalization of the Carbon Transaction Platform document submitted by the Secretariat to the Council ahead of its Sixteenth Session.

The Secretariat acknowledges that the Council authorized the Secretariat to establish the CTF through decision [\[C/2022/DC/5\]](#). The Secretariat has developed this draft governance framework to provide guidance to the Council as it oversees the implementation of the CTF in its role as GGGI’s governance organ, and the Secretariat would therefore welcome feedback from the Council in response to this document. The draft governance framework encompasses the draft governance structure of the CTF (including both the Article 6 Readiness Facility and Carbon Trust Funds), a set of governance principles (“**Governance Principles**”), and a description of relevant accountability mechanisms.

2. GOVERNANCE STRUCTURE OF THE CTF

All operations of the CTF will be subject to regular management oversight by GGGI’s Director-General, with ultimate governance oversight provided by GGGI’s Assembly and Council. The CTF will be managed by the Carbon Pricing Unit in the Investment and Policy Solutions Division (IPSD). The overall CTF governance structure is illustrated in Figure 1.

The governance structure of the Article 6 Readiness Facility (“**Readiness Facility**”) will comprise the Readiness Facility Committee, the Readiness Facility Manager, and a Readiness Facility Team. The Readiness Facility Committee will include representatives of all contributing participants to the Readiness Facility.¹ The Readiness Facility Team, led by a Readiness Facility Manager, will be responsible for day-to-day operations. The Readiness Facility will be administered pursuant to the Readiness Facility Rules.

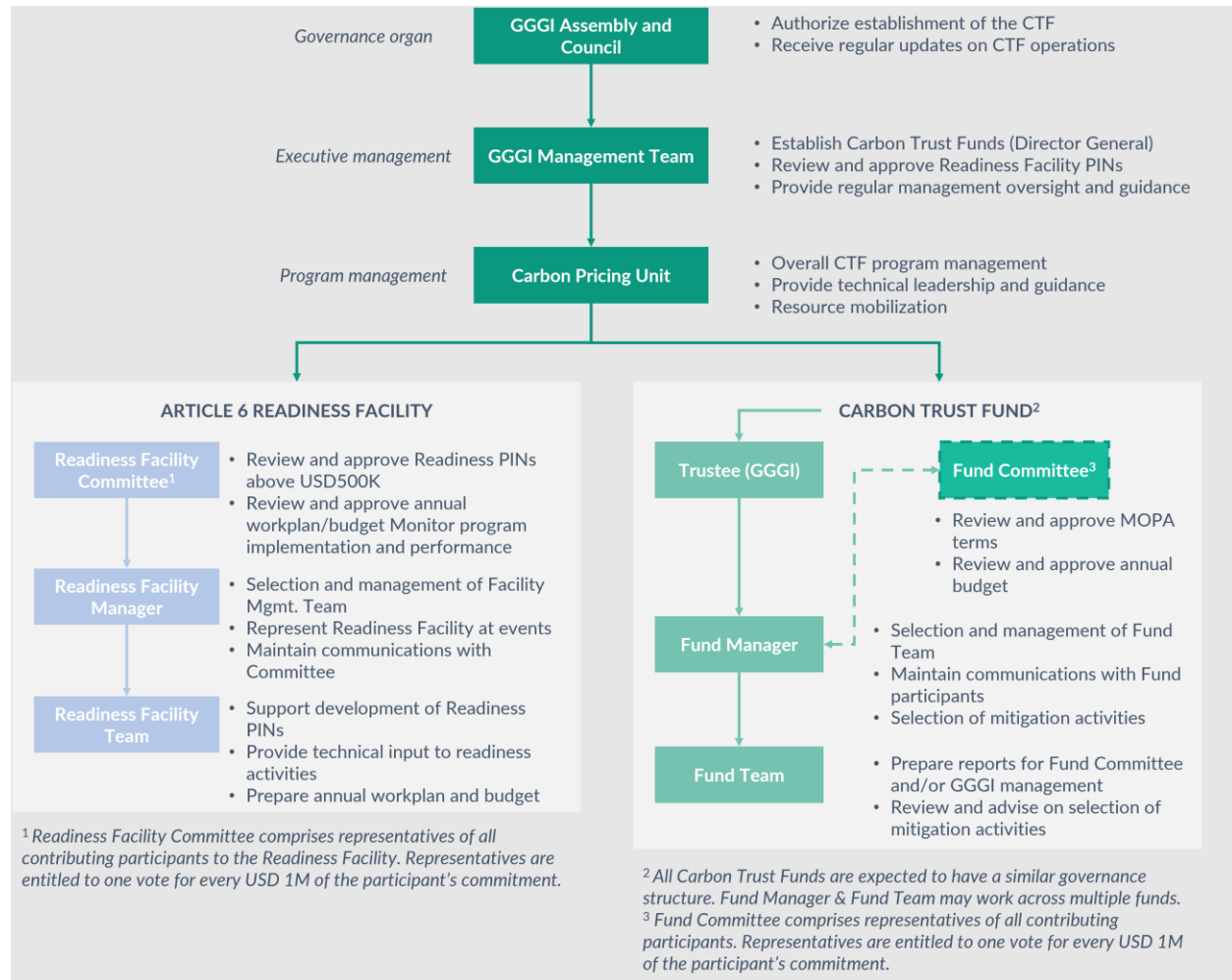
The governance structure of each Carbon Trust Fund will comprise the Trustee (i.e., GGGI), a Fund Committee, a Fund Manager, and a Fund Team. The Fund Committee shall be comprised of one representative of each contributing participant, as nominated by the participant.² The

¹ Each member of the Readiness Facility Committee shall be entitled to one vote for every USD 1M of the commitment of its nominating participant on each matter submitted to a vote at a Readiness Facility Committee Meeting.

² Each member of the Fund Committee shall be entitled to one vote for every USD 1M of the commitment of its nominating participant on each matter submitted to a vote at a Fund Committee Meeting.

administration of each carbon trust fund will be governed by a set of Fund Rules, which specify the roles and responsibilities of each actor.

Figure 1. Governance structure for the CTF.



3. GOVERNANCE PRINCIPLES

Pursuant to Council decision [[C/2022/DC/5](#)], GGGI's objective in undertaking CTF activities is to enable the governments of both sellers and buyers among its Members and partners to develop, advance and scale up Article 6 transactions in the mutual interests of buyers and sellers. The Governance Principles outlined below are intended to help ensure that this objective is met by:

- providing guidance to the Council as it oversees the design and implementation of the CTF in its role as governance organ;
- providing guidance to the Secretariat as it operationalizes the CTF, including by ensuring that operational decisions align with the Governance Principles; and
- fostering and sustaining trust in the CTF among relevant stakeholders to promote greater participation in CTF activities.

As principles, they do not determine specific outcomes, but instead require further operationalization through rules, procedures, and guidelines. All operational decisions should

align with these principles to ensure consistency with overarching objectives and across relevant activities, and with competing interests balanced accordingly.

The Governance Principles are:

1. Promoting Achievement of the Paris Agreement
2. Respecting National Circumstances
3. Fostering Predictability and Stability
4. Upholding Fairness and Impartiality
5. Empowering Stakeholders
6. Promoting Transparency
7. Ensuring Integrity and Accountability

The Governance Principles are further detailed in Table 1 below.

Table 1. Governance Principles for the CTF.

Principle	Promoting Achievement of the Paris Agreement
Challenge	While the CTF aims to serve as a support and matchmaking platform to mobilize carbon finance under Article 6 of the Paris Agreement and promote carbon transaction readiness and purchasing activities with interested donors and buyers, the intense scrutiny that has traditionally faced carbon markets will also extend to the activities of the CTF. Because cooperation under Article 6 and any resulting transactions will be driven by sovereign countries, and relevant GGGI activities should aim “to enable ... its Members and partners to develop, advance and scale up Art. 6 carbon transactions in the mutual interests of buyers and sellers”, there is a risk that incentives and outcomes are misaligned with the objectives of the Paris Agreement. Any resulting Article 6 activities that demonstrably undermine the Paris Agreement could tarnish the perceived integrity of the CTF and lead to reputational damage for GGGI.
Rationale	In order to protect its reputation and align the CTF with its own Establishing Agreement, GGGI must ensure that the projects and transactions facilitated with the CTF advance the principles and objectives of the Paris Agreement. This includes the long-term temperature goal of Article 2(1)(a) and the aspiration to “achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases in the second half of this century” in Article 4, as well as the need for emission transfers under Article 6 to contribute to an overall mitigation of global emissions (OMGE). Signaling this commitment with a principle can help steer operational decisions of the CTF and the elaboration and substance of more specific rules, procedures and guidelines, but given the abstract nature of general principles, only the latter – and their faithful observance – will be able to offer the necessary assurance.

Example(s)	A growing number of organizations in the public and private sector are choosing to publicly document their commitment to the Paris Agreement and to advancing its goals across the full range of their activities, supply and value chains, and so forth. Although GGGI was established prior to adoption and entry into force of the Paris Agreement, its establishing agreement spells out its parties' intention to contribute "to the successful outcome of the United Nations process on sustainable development and attainment of other internationally agreed goals."
Links to GGGI Governance	Preamble and Article 2 of the Agreement on the Establishment of the Global Green Growth Institute; Para. 4 of the Decision on Establishment of the Carbon Transaction Platform
Principle	Respecting National Circumstances
Challenge	Every participating country, whether a buyer or seller, has unique national circumstances and priorities. Accommodating these differences to ensure mutual trust can be challenging and requires maintaining a delicate balance between common and particular interests, while respecting national sovereignty and autonomy.
Rationale	The CTF aims to position itself as a trusted facilitator between potential buyers and sellers, leveraging the status of GGGI as an established, competent and reliable actor in international carbon finance. To address the foregoing challenge, the CTF should operate on a principle of non-interference, recognizing and respecting the autonomy of its participating sovereign countries. By ensuring that decisions are taken with the consent of all parties involved, the CTF can secure the trust of its participants and also better align with the decentralized, party-driven process of the Paris Agreement and its parent convention, the United Nations Framework Convention on Climate Change (UNFCCC). Because transactions under the CTF will align developed country buyers with developing country sellers, it also helps increase the flow of finance for green economic growth in the latter while allowing the former to increase the ambition of their decarbonization efforts.
Example(s)	This principle builds on the general concept of state sovereignty, which stipulates that states have supreme authority within their territory, so that any decisions affecting their jurisdiction require prior consent; it also reflects principles of the Paris Agreement and the UNFCCC, notably the principle of Common but Differentiated Responsibilities and Respective Capabilities (CBDR-RC), which recognizes the diversity of national circumstances and priorities. Finally, it builds on established practices in financial, commodity and other markets, where decisions to enter into any contract have to be taken by the parties to that transaction or their authorized representatives, and facilitators such as brokers or agents have to respect that autonomy in order to secure the trust of their clients.

Links to GGGI Governance	None apparent.
Principle	Fostering Predictability and Stability
Challenge	Any market entails risks, such as the possibility that a party fails to deliver on agreed terms (counterparty settlement risk), or the risk that external shocks alter supply and demand dynamics and lead to price extremes or excessive volatility. By involving sovereign nations as parties and being premised on carbon as the underlying commodity, Article 6 transactions entail an additional layer of political risk: changes in governments, policy shifts, or geopolitical tensions can impact ongoing or potential carbon transactions, and also alter the fundamental demand for emission reduction activities. The sovereign nature of parties to such transactions also renders traditional enforcement mechanisms obsolete. High levels of – real or perceived – uncertainty and risk tend to deter investment and increase costs. With the CTF, GGGI can leverage its reputation and resources to foster greater predictability and stability and lower perceived risk, thereby promoting trust in the process and stimulating market activity.
Rationale	As a part of the governance principles, this principle can guide governance processes, managerial decisions and individual activities towards the overarching aims of lowering risk, fostering predictability and instilling trust. Like all principles, it requires operationalization through more specific measures. These may include mechanisms to identify, assess, disclose and mitigate market and political risks through due diligence procedures, enhanced dialogue with stakeholders, and, over the longer term, potentially the provision of different mechanisms such as guarantees or clearing and settlement platforms.
Example(s)	Sharing of knowledge and promotion of standardized approaches are important pathways through which existing transaction platforms – such as financial and commodity exchanges – help improve the predictability and stability of markets otherwise prone to greater volatility and risk. In various markets, counterparty and settlement risks are mitigated through prescribed use of clearance or settlement platforms and escrow accounts that only enable transactions to proceed when all parties to the transaction have met their contractually agreed obligations. Guarantee mechanisms, predominantly used in financing contexts, help lower capital costs by reducing a broad range of risks – including political risks – facing investors; a prominent example includes the Multilateral Investment Guarantee Agency (MIGA) operated by the World Bank.
Links to GGGI Governance	None apparent.
Principle	Upholding Fairness and Impartiality
Challenge	Trade relations and individual transactions between sovereign states have traditionally been vulnerable to power imbalances, notably between

	<p>economically more advanced economies and developing countries. Likewise, as an international organization comprised of a subset of countries that are further differentiated in contributing and participating members, GGGI could be exposed to suspicion of favoritism or prioritization of certain countries’ interests over those of others. Any imbalances, whether real or perceived, can in turn influence interest in Article 6 transactions as well as the way the CTF and its decisions are viewed by countries and the broader public.</p>
Rationale	<p>To mitigate any risk of bias, the CTF should commit to absolute neutrality in all its activities, ensuring fair representation of both buyers and sellers in its management of carbon trust funds and the facilitation of individual transactions. This principle of equitable representation can help ensure that the interests of all participating countries, irrespective of their political and economic status, carry equal weight and consideration. Specific features of the CTF, such as a fair and orderly process to resolve disputes or appeal decisions, can further advance this principle and promote equity in its operation. Impartiality also extends to the choice of mitigation policies, measures and technologies underlying facilitated Article 6 activities and transactions, where the CTF should exercise caution not to influence the preferences of the participants unless not doing so risks undermining the first principle, promoting achievement of the Paris Agreement.</p>
Example(s)	<p>Fair and equitable treatment is an established tenet of international trade and investment law, contained in several multilateral and bilateral investment and free trade agreements, where it prohibits discriminatory treatment. Fairness and impartiality are also core tenets of financial markets and their governance, where e.g. the U.S. Regulation on a National Market System (NMS) and the Markets in Financial Instruments Directive (MiFID) require fair access to relevant services and non-discriminatory treatment among market participants. Similarly, when real estate agents represent both buyers and sellers in the same transaction (“dual agency”), they are required to remain strictly neutral and represent both parties’ interests equally, and must require and ensure prior informed consent by both parties.</p>
Links to GGGI Governance	<p>GGGI Core Value: Inclusiveness; Article 10.6 of the Agreement on the Establishment of the Global Green Growth Institute.</p>
Principle	Empowering Stakeholders
Challenge	<p>In a newly forming market such as that created under Article 6 of the Paris Agreement, parties to transactions are likely to face capacity constraints that introduce asymmetries in market readiness and prevent full and effective participation. Developing nations, in particular, which will typically act as sellers in relevant transactions, tend to cite lack of human, technical and financial resources and the resulting shortfalls in administrative capacity as a major obstacle to meaningful participation in the carbon market. Because of the long lead times and high transaction costs faced by participants in current piloting activities, such capacity constraints weigh particularly heavily in the context of the nascent Article 6 market.</p>

	Another aspect under this principle is that of stakeholder presence and effective participation in the process related to the CTF, while recognizing the boundaries referred under the Transparency principle below.
Rationale	In recognition of diverse circumstances and to respond to the challenge of capacity shortfalls, the CTF should emphasize the importance of empowerment and knowledge sharing in its activities. Such activities and the equal access to information they provide help level the playing field for all participants in CTF transactions, and thereby foster trust and participation. By offering all relevant services on one platform, the CTF can operationalize this principle through existing Article 6 readiness activities and the future Readiness Facility, offering technical support and guidance to countries facing relevant barriers to help them understand and navigate the complexities of the emerging carbon market under Article 6.
Example(s)	Many bilateral and multilateral arrangements related to carbon markets, such as the World Bank Partnership for Market Implementation (PMI), International Carbon Action Partnership (ICAP), the Global Carbon Market project of the German Agency for International Cooperation (GIZ) or indeed the Article 6 readiness activities facilitated by GGGI, are specifically aimed at building capacity and market readiness for carbon trading. With a substantial share of its activities geared towards advising and assisting countries looking to participate in the carbon market through its Readiness Facility, the CTF will already pursue empowerment and knowledge sharing from the outset. Given the importance of adequate capacities for prospective country hosts of Article 6 activities in the developing world to acquire the required confidence for active market participation, and the proven capability of GGGI to offer administrative support through its in-country presence, this principle can signal the commitment to empowerment and knowledge sharing.
Links to GGGI Governance	None apparent.
Principle	Promoting Transparency
Challenge	Like predictability and impartiality, transparency is key for trust of market participants. Some degree of transparency – for instance with prices in the carbon market, but also concerning governance processes – is important for efficient market operation, as it affords prospective parties to a transaction the information needed to confidently enter active market positions, rather than assume a defensive stance that can also undermine liquidity. Still, while the need for transparency in the operations of the CTF is crucial for stakeholder confidence and efficient market functioning, it must be balanced against the sensitivity of sovereign data and potentially affected national interests. Another aspect that requires consideration is that of commercially sensitive information. Many participants in Article 6 transactions are likely to want information on certain aspects of the transaction, such as the negotiated price, to remain confidential.

Rationale	The CTF should adopt a policy of transparency that respects national sensitivities and confidentiality requirements. While maintaining transparency to foster trust and confidence, it should also protect any information that, if disclosed, could potentially harm the national interests of participant countries or other confidential data.
Example(s)	Existing policy and regulatory frameworks of compliance emissions trading systems have already had to navigate the challenging task of balancing enhanced transparency for efficient market operation and improved stakeholder trust with the need to protect certain data related to emitting activities and carbon market transactions because of the confidential information their disclosure would reveal. Some system administrators, such as the California Air Resources Board (ARB), disclose detailed information on emissions, primary and secondary market activity, and even revenue use, whereas others anonymize most information. Similarly, exchanges for securities, commodities and carbon variously disclose data on market activities, but in formats that prevent identification of the origin of individual bid and offer positions. Such best practices can underpin a commitment by CTF to transparency in its operations, including its trust fund management, transaction matchmaking and price discovery services.
Links to GGGI Governance	Article 13 of the Agreement on the Establishment of the Global Green Growth Institute; Disclosure Policy of the Global Green Growth Institute
Principle	Ensuring Integrity and Accountability
Challenge	The CTF will be acting in multiple capacities: as a manager of trust funds that purchase carbon credits, as a matchmaker for carbon transactions that assists both buyers and sellers, and as a provider of capacity building services primarily for host countries of Article 6 activities. The varied roles and responsibilities of the CTF, coupled with the wide range of participating countries, may lead to potential conflicts of interest which have to be managed in order to secure the integrity of the CTF and the services it provides.
Rationale	To manage the attendant reputational risk, the CTF should adopt a principle of unconditional integrity and accountability to avoid conflicts of interest and ensure that its actions are neutral and serve the best interests of all participant countries. Operationalization of this principle may entail elaboration of policies or guidelines that call for avoidance and disclosure of potential conflicts of interest. Securing the prior informed consent of parties to CTF transactions can help protect GGGI against subsequent claims of a conflict of interests.
Example(s)	Examples that reflect implementation of these principles are disclosure requirements for financial advisors mandating them to disclose any potential conflicts of interest to their clients, and fiduciary duties of brokers that require them to act in their clients' best interests and avoid conflicts of interest. In the U.S., for instance, the Securities and Exchange Commission (SEC) Regulation on Best Interest (Reg BI) requires brokers to act in the best

	<p>interest of retail customers when making recommendations, and in Europe, the Markets in Financial Instruments Directive (MiFID II) has stringent requirements related to conflicts of interest, requiring investment firms to establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organization of the firm. Similarly, dual agency clauses in retainer agreements for real estate agents representing both buyers and sellers call for transparent disclosure of the potential conflict of interest and require the informed consent of both parties. These examples illustrate how actors can be enabled to promote the interests of two parties to a transaction in a mutually beneficial manner.</p>
<p>Links to GGGI Governance</p>	<p>GGGI Core Value: Integrity; Article 10.7 of the Agreement on the Establishment of the Global Green Growth Institute; Regulations 2.2 and 10 of the Financial Regulations of the Global Green Growth Institute; Regulation 4.1 of the Procurement Regulations of the Global Green Growth Institute</p>

4. ACCOUNTABILITY MECHANISMS

All proposed CTF activities will be subject to the regular governance oversight of the GGGI Assembly and Council. GGGI also has mechanisms for internal review through the activities of its Impact and Evaluation Unit and Internal Audit function.

GGGI is required under its Establishment Agreement to act in a transparent manner, and GGGI's Disclosure Policy provides that it is GGGI's policy to publicly disclose information concerning its governance organs and their decisions as well as operational activities in the absence of a compelling reason to consider such information as proprietary, privileged, or confidential. Subject to compliance with GGGI's Disclosure Policy, the Secretariat will facilitate public access to CTF documents where appropriate, including documents with information relating to the selection of Readiness Facility activities, the selection of mitigation activities, reports of any Readiness Facility and/or Fund Committee meetings, lessons learned through operation of the CTF, and evaluations of the CTF.

GGGI's Compliance Review Mechanism is available to any person or group of persons that believes that GGGI has failed to comply with any of its regulations, rules, policies and procedures and that this failure has or threatens to adversely affect such person(s).

Assessment of risks to GGGI as trustee of Carbon Trust Funds

September 2023

1 BACKGROUND

This assessment of risks to GGGI as trustee of Carbon Trust Funds is attached as an annex to the Update on Operationalization of the Carbon Transaction Platform document submitted by the Secretariat to the Council ahead of its Sixteenth Session. The Secretariat recognizes that the management and operation of Carbon Trust Funds constitutes a new service offered by GGGI. Given the potential risks associated with this expansion of GGGI's service offerings, the Secretariat engaged external legal support to assess the risks to GGGI as trustee of Carbon Trust Funds.

The assessment of risks to GGGI as trustee of Carbon Trust Funds are summarized below, with risk mitigation actions provided for all identified risks. These risks will be addressed by the Secretariat, under the authorization provided by the Council in decision [[C/2022/DC/5](#)] to the Director-General to establish Carbon Trust Funds.

2 SUMMARY OF RISKS

The below table summarizes the key potential risks to GGGI as trustee of Carbon Trust Funds that have been identified through this assessment, and lists actions to mitigate these risks.

Risk	Description	Risk mitigation actions
Perceived or actual conflict between GGGI's role as Fund trustee / manager and as advisor to governments	<p>GGGI (and its business units) will be acting in multiple capacities: as a manager of trust Funds that purchase carbon credits, as a matchmaker for carbon transactions that assists both buyers and sellers, and as a provider of technical assistance and readiness services primarily for host countries of Article 6 activities.</p> <p>These varied roles and responsibilities, coupled with the wide range of participating countries, may lead to potential conflicts of interest and this may compromise the integrity of the Fund.</p>	<ul style="list-style-type: none">• Development of the Governance Principles for the Carbon Transaction Facility (CTF), specifically the Governance Principle of ensuring integrity and accountability, will help to guide Fund operations.• Provide in the Fund Rules that the Trustee, Fund Manager, Fund Committee, and Participants shall perform their roles consistently with the Governance Principles.• Approval for the terms and conditions of Mitigation Outcome Purchase Agreements (MOPAs) is the responsibility of Fund participants (through the Fund Committee), and not the trustee.

Risk	Description	Risk mitigation actions
	<p>Governments will not want to buy into a Fund that has appearance of conflict.</p> <p>Further, any appearance of conflict may compromise GGGI's role as a trusted advisor to host countries. We also note the focus of GGGI's Establishment Agreement and public-facing policies on integrity, and the appearance of conflict could undermine these.</p>	<ul style="list-style-type: none"> • Existing GGGI documents highlight the importance of conflict management, including the GGGI Code of Conduct, which indicates that staff have knowledge of the importance of managing conflicts and processes for dealing with this. • Including in the Fund Rules: <ul style="list-style-type: none"> – Conflict of interest disclosure provisions. – Other provisions to ensure transparency of Fund management – e.g., disclosure of documents in line with GGGI's Disclosure Policy. • Dealing with conflict-of-interest risk in the Information Memorandum (IM), in a similar manner to the Climate Action Catalyst Fund (CACF) or Asia Pacific Carbon Fund (APCF) of the Asian Development Bank. • Providing as much information as possible to all parties during MOPA negotiations.
<p>ITMO price perceived to lack fairness and transparency</p>	<p>GGGI may be exposed to reputational risks associated with the perception that the Fund is not pricing internationally transferred mitigation outcomes (ITMOs) fairly. ITMO pricing presents two related risks:</p> <p>Perception that ITMO price is too low:</p> <ul style="list-style-type: none"> • Where ITMOs are given a low price, GGGI may be criticized for not pricing ITMOs fairly for Mitigation Activity developers and relevant Host Countries. 	<ul style="list-style-type: none"> • Including in the Fund Rules a requirement that when negotiating the price paid for ITMOs under a MOPA, the Trustee will act in accordance with the Governance Principles, and will endeavour to negotiate a price for ITMOs that: <ul style="list-style-type: none"> – strikes an appropriate balance between providing a sound investment for Participants whilst appropriately incentivizing and supporting Host Countries and Mitigation Activity Proponents to engage in Article 6 markets; and – has regard to any relevant information on prices for Mitigation Outcomes in the Host Country where available.

Risk	Description	Risk mitigation actions
	<ul style="list-style-type: none"> Host Countries may perceive involvement with the Fund as a risky operation where prices appear too low.¹ <p>Perception that ITMO price is too high:</p> <ul style="list-style-type: none"> Where ITMOs are given a high price, GGGI may face criticism for favoring Mitigation Activity developers over the interests of Participants (to whom GGGI owes a fiduciary duty as trustee). <p>These risks feed into the risks of the perception of conflicts of interest between GGGI's role in assisting buyer and seller countries simultaneously.</p>	<ul style="list-style-type: none"> Approaching MOPA negotiations with mitigation activity developers in a fair and reasonable manner. This should involve providing as much information as possible to all parties during negotiations.² Making MOPA training available to all parties to a MOPA, and other relevant Host Country stakeholders. GGGI does not currently intend to draft a standalone pricing policy. This is due to challenges associated with determining a reference price for ITMOs given the nascent state of the Article 6 market. However, as clearer ITMO reference prices emerge over time, GGGI will consider preparing a transparent and standalone pricing policy, noting that variations between countries and activity types can be expected to continue to create complexity when determining pricing. GGGI's experience in global carbon markets and in-country presence indicate that GGGI will have a strong sense of what market standard ITMO prices are in relevant Host Countries as these emerge.
<p>Deviation from GGGI's established financial and other regulations and rules results in process failure or confusion</p>	<p>Deviations from GGGI's established processes in its financial regulations and other rules may lead to confusion and poor accounting practices.</p>	<ul style="list-style-type: none"> Providing in Fund Rules clear processes for ITMO procurement and financial accounting, including budget arrangements, that align with the GGGI financial regulations and rules. Fund will be managed by GGGI team with strong knowledge of and experience working in accordance with GGGI processes. Fund Rules provide that Fund will operate in accordance with applicable GGGI policies. GGGI is experienced with operating other trust Funds.

¹ See evaluation of the Transformative Carbon Asset Facility (TCAF) at page 32: https://www.tcafwb.org/sites/default/files/2021-05/TCAF_1st%20Eval_April%202020_FINAL%28CLEAN%29.pdf

² The Prototype Carbon Fund (PCF) avoids the appearance of investor-client conflict, managing risk by providing as much information as possible to all parties during negotiations: see page 26 of the PCF evaluation: <https://openknowledge.worldbank.org/server/api/core/bitstreams/63ce74a7-dcc0-5abd-b4a2-2e9b58fae65d/content>

Risk	Description	Risk mitigation actions
Financial / human resource challenges associated with GGGI's multiple roles in Fund operation	<p>GGGI will play the role of trustee and Fund manager for a novel Fund. This will involve additional human and financial resources for the CPU. This has potential negative impacts for:</p> <ul style="list-style-type: none"> • CPU's capacity to undertake carbon pricing support activities. • GGGI's budgeting and finance available for GGGI to support its other activities. • Potential slowing of the process of translating readiness activities into MOPAs, given that GGGI will have primary responsibility for identifying activities for the Fund to invest in: this is a resource-intensive task and can contribute to slow progress in investments (particularly where the Fund covers a large array of sectors).³ 	<ul style="list-style-type: none"> • The Fund IM envisages several aspects of Fund operation that will help to limit the resource-intensity of GGGI's role, most particularly (i) allowing calls for activities to be made; (ii) enabling Fund participants to refer potential transactions to the Trustee (this is in addition to calls and the ability of the Trustee to identify activities of its own volition); and (iii) limiting the scope of eligible activities to energy-related activities (in the case of the first Carbon Trust Fund). • Ensuring the Fund Manager and Fund Team is well resourced with adequate staff ahead of Fund operationalization. To ensure adequate resources are available to operate the Fund, the Fund Rules provide that GGGI may request contributions from participants from time to time, with respect to the financial requirements of the Fund. • Development by CPU of framework procurement agreements with service providers with expertise in relevant carbon pricing areas (including legal and regulatory, governance framework development, infrastructure, sustainable development, and origination and structuring of mitigation activities) to reduce procurement timelines. • GGGI is experienced with providing support across multiple carbon pricing activities. • Consultancy Report on Recommendations for Compliant ITMO Procurement by GGGI found that ITMOs fall outside of GGGI's procurement rules which removes resource requirements associated with applying these rules.
GGGI restructure	<p>The Fund will be managed through GGGI's CPU. A restructure at GGGI, abolition of this team, or departure of key operational personnel will materially impact GGGI's capacity to operate the Fund and this may require GGGI to resign as trustee and to end the Fund.</p>	<ul style="list-style-type: none"> • Ensure carbon pricing unit is a well-resourced team with a number of personnel with appropriate experience – this may require upskilling GGGI staff members and adding to the team. • Develop list of key personnel and contingency plans for when these personnel resign.

³ See page 32 of the TCAF evaluation at: https://www.tcafwb.org/sites/default/files/2021-05/TCAF_1st%20Eval_April%202020_FINAL%28CLEAN%29.pdf

Risk	Description	Risk mitigation actions
		<ul style="list-style-type: none"> Clearly documenting Fund processes and procedures and making publicly available evaluations and other lessons learned. Provisions for early termination of the Fund included in the Fund Rules.
<p>Communication across GGGI business units and with Host Country governments</p>	<p>The Fund will depend on mitigation activity pipeline generated from within GGGI where available. This depends on good communication between GGGI's Fund Manager and the various GGGI teams working on Article 6 projects across countries. Communication with the Readiness Facility team will also be critical.</p> <p>It will also require good lines of communication with relevant contacts in Host Countries.⁴</p> <p>Failure of these lines of communication will result in delays in investing in Mitigation Activities, with resulting performance impacts for the Fund and reputational impacts for GGGI.</p> <p>Further, changes in personnel in country and/or the time limited nature of in-country programmes that do not necessarily align with pipeline development could result in a disconnect between the in-country program and pipeline development.</p>	<p>Intra-GGGI communication</p> <ul style="list-style-type: none"> Build internal procedure for communication of potential mitigation activity opportunities from in-country / readiness teams to the Fund Manager. Undertake awareness raising across GGGI about the launch of the Fund and provide periodic updates on its activities. Clear delineation of tasks for GGGI as Trustee and Fund manager – to be set out in Fund Rules. Fund Manager / Fund team member(s) participate in iGrow meetings as appropriate. <p>Host Country communication</p> <ul style="list-style-type: none"> Maintain strong in-country engagement with Host Country teams, including good contact with relevant government contact points (which may change given that multiple departments are often involved in climate policy).

⁴ As noted in the Previous Consultancy Report on Recommendations for Compliant ITMO Procurement, an evaluation of the TCAF identified a number of factors contributing to slow progress on translation from 'preliminary program information notes' (Pre-PINs) for projects to emission reduction purchase agreement (ERPAs), including that the Trustee faced difficulties involving the right point of contact in host countries, given that climate policies frequently involve several ministries/departments.

Risk	Description	Risk mitigation actions
<p>Fund unable to meet its investment mandate due to lack of available Mitigation Activities in the market, or failure to select and contract Mitigation Activities in a timely manner</p>	<p>There is a risk that the Fund will not be able to source mitigation activities that align with its selection criteria, and will not be able to translate these into ITMOs for participants. This is a consequence of multiple factors. For example:</p> <ul style="list-style-type: none"> • The ITMO market is nascent and there are currently very few Article 6 mitigation activities underway. Many countries are still at an early stage of Article 6 readiness and are not prepared to implement Mitigation Activities. The development of Article 6 governance frameworks take considerable time and resources and countries may not be positioned to engage in Article 6 markets in a timely manner as a result. • There is also a degree of uncertainty in relation to the Article 6 Rules: although the Article 6 Rules are agreed, there is still development of Article 6 mechanisms underway and this could have an impact on mitigation activities – for example, Parties are still deciding whether emissions avoidance activities can be eligible. 	<ul style="list-style-type: none"> • Building internal pipeline through GGGI’s Article 6 technical assistance activities. GGGI’s strong in-country presence in potential Host Countries will help to build this pipeline. • Requirement for participants to make a minimum contribution to the Readiness Facility. • Targeting readiness resources toward developing activities that will meet the Fund selection criteria as set out in the IM and Fund Rules. • Ensure the Fund Rules enable calls (RFPs) and enable participants to refer activities to the Trustee. • Build good lines of communication between the Fund Manager, Trustee and the various in-country teams helping countries prepare for Article 6 engagement. • Build broad portfolio for the Fund through non-restrictive mitigation activity, country and portfolio criteria so that the Fund can invest across multiple countries and mitigation activity types. However, note also the need to balance the ability of the Fund to invest across a broad range of activities (e.g., different countries, different activity types) with the need to ensure that the Article 6 Rules are upheld, including those in relation to sustainable development safeguards.
<p>Non-delivery of ITMOs</p>	<p>The Fund will contract with mitigation activity developers who may not ultimately deliver ITMOs for distribution by the Fund. This could be for a range of reasons including:</p> <ul style="list-style-type: none"> • The activity not resulting in generation of mitigation outcomes (i.e. performance risk); 	<p>Operational actions</p> <ul style="list-style-type: none"> • Readiness support through the Readiness Facility and GGGI’s other capacity building work with potential Host Countries.

Risk	Description	Risk mitigation actions
	<ul style="list-style-type: none"> • non-compliance by the Host Country (deliberate or otherwise) with the Article 6 Rules resulting in units being generated that cannot be characterised as ITMOs; • Host Country selling the ITMOs elsewhere; • Non-compliance of Mitigation Activity developer with Host Country requirements (e.g. where the activity does not meet jurisdictional criteria for registration, or where the developer does not obtain appropriate environmental permits for undertaking the activity). <p>As the Fund IM notes, the Fund’s performance ‘will be determined by the Fund’s success in contracting and collecting ITMOs under MOPAs’. Failure to do so will not only affect Fund performance but will also have negative reputational impacts for GGGI due to its role as Trustee and Fund Manager.</p>	<ul style="list-style-type: none"> • Building good relationships with mitigation activity developers through in-country teams, who can have a degree of oversight of activities and support ongoing monitoring and reporting. • Technical assistance allocation within the Trust Fund to provide mitigation activity preparation support, including feasibility studies, alignment of mitigation activity design documentation with UNFCCC and/or Host Country Article 6 requirements, and financial structuring. <p>IM</p> <ul style="list-style-type: none"> • The Fund IM makes clear that no guarantees can be given on the number of ITMOs they will receive, or the price of ITMOs; and there is no guarantee that the Fund will be able to acquire ITMOs at attractive prices (or at all). This clear wording mitigates risk of reputational impacts to GGGI flowing from non-delivery by drawing clear expectations for Participants about what the Fund will achieve. <p>Fund Rules</p> <ul style="list-style-type: none"> • Drafting clear selection criteria in the Fund Rules that help the Fund to identify high quality activities that are less likely to fail on ITMO delivery. • The objectives of the Fund, as stipulated in the Fund Rules and IM, are broader than simply delivering ITMOs to participants: for example, contributing to sustainable development progress globally, and enhancing the confidence of seller countries to participate in Article 6 markets on an equitable basis. <p>Approach to MOPA drafting</p> <ul style="list-style-type: none"> • Providing payment on delivery (rather than up front) where feasible for the mitigation activity developer.

Risk	Description	Risk mitigation actions
		<ul style="list-style-type: none"> • Appropriate conditions precedent:⁵ this may include, for example, that GGGI has completed due diligence on the activity developer; has confirmed there are no third-party step-in rights in relation to the project; and has received copies of any approvals / permits needed to undertake the project. • Requiring the mitigation activity developer to provide regular reports to GGGI on the project and its compliance with the Article 6 rules. • Contractual protections for non-performance, including immediate termination rights for GGGI upon deliberate delivery failure or failure to deliver ITMOs by a particular date.
<p>Negative sustainable development impacts of mitigation activities</p>	<p>If contracted mitigation activities are undertaken in a manner that does not, for example, respect local communities, the principle of free prior and informed consent, and have respect for sustainable development safeguards, then this activity will likely receive negative community perception that will flow back to GGGI as supporter of the activity through a MOPA.</p>	<ul style="list-style-type: none"> • Requiring that mitigation activities supported through the Fund adhere to the Article 6 Rules, and comply with GGGI's Operational Policies and Procedures, including the GGGI Sustainability and Safeguard Rules, GGGI Anti-Corruption Policy, and GGGI Rules on Child Protection. <ul style="list-style-type: none"> – Article 6 Rules impose environmental integrity criteria requirements and safeguards around sustainable development and human rights. Therefore, if the Host Country is complying with Article 6, it will be applying safeguards to the activities that reduce the likelihood that they will negatively impact local communities.⁶ • Building into MOPAs very clear requirements around respecting communities, FPIC, adherence with Article 6 Rules (as implemented by the Host Country) and compliance

⁵ This mitigation action is identified in the CACF IM.

⁶ For example, participating countries need to provide in initial reports (among other things) a description of how each cooperative approach will:

- Minimize and, where possible, avoid negative environmental, economic and social impacts;
- Reflect the eleventh preambular paragraph of the Paris Agreement, acknowledging that climate change is a common concern of humankind, Parties should, when taking action to address climate change, respect, promote and consider their respective obligations on human rights, the right to health, the rights of indigenous peoples, local communities, migrants, children, persons with disabilities and people in vulnerable situations and the right to development, as well as gender equality, empowerment of women and intergenerational equity; and
- Be consistent with the sustainable development objectives of the Party, noting national prerogatives.

Risk	Description	Risk mitigation actions
		<p>with GGGI's Operational Policies and Procedures, including the GGGI Sustainability and Safeguard Rules, GGGI Anti-Corruption Policy, and GGGI Rules on Child Protection.</p> <ul style="list-style-type: none"> • GGGI's strong in-country presence and good relationship with communities indicates that GGGI may be able to have a good on-the-ground presence to monitor appropriate behaviours by mitigation activity developers. • Access to GGGI's Compliance Review Mechanism for any person or group of persons that believes that GGGI has failed to comply with any of its regulations, rules, policies, and procedures and that this failure has or threatens to adversely affect such person(s).
<p>Participants losing interest in the Fund / Fund unable to attract sufficient participants for commercial viability</p>	<p>If participants lose interest in the Fund, or the Fund cannot attract a sufficient number of participants to scale, this will limit the efficacy of the Fund to support mitigation activities and deliver on its objectives, with flow on negative reputational impacts for GGGI.</p> <p>The Fund as currently envisaged is limited to sovereign participants and while this has operational benefits, one risk associated with this is that it limits the number of entities who can provide financial support for the Fund.</p>	<ul style="list-style-type: none"> • Initial participant is a resource partner for a GGGI Article 6 global program, therefore providing comfort that the Fund will have initial support and funding. • GGGI's status as an intergovernmental organisation with many member countries provides GGGI with a solid network of potential participants to engage with. • Providing in Fund Rules that participants who exit the Fund may transfer/assign their interest to others. • Providing in Fund Rules that contributions are unable to be withdrawn by participants without the Trustee's consent which may be withheld in its discretion. • Strong advertising of the Fund and the outcomes of its work (e.g. through publicly available evaluation reports and IM to interested parties). • Considering enabling both private and public sector participation in the Fund. This is however subject to the caveat that enabling private participation in the Fund entails a number of logistical challenges for Fund operation, for example potential challenges related to ITMO distribution.
<p>Fund expense overrun</p>	<p>Fund rules/regulations commonly provide for a cost cap on administrative expenses. Where the</p>	<ul style="list-style-type: none"> • Include in the Fund Rules an administrative expense cap, but with appropriate carve outs (for example, excluded expenses related to Fund Participants or members of the Fund Committee in connection with Fund Committee meetings). This approach will help

Risk	Description	Risk mitigation actions
	Trustee's administrative costs exceed the cost cap, then the Trustee must bear the excess costs.	to balance the risks to GGGI of overrun, as against the interests of Participants in having certainty as to the amount of administrative expenses they will be liable for.
Participants do not pay contributions when due, resulting in Fund having insufficient Funds	If Participants default on their contributions, then the Fund will be unable to procure ITMOs for delivery. This is an immediate financial risk, but will have flow on performance and reputational impacts for GGGI due to the failure of the Fund to delivery on its investment mandate and objectives.	<ul style="list-style-type: none"> • GGGI's good relationship with the initial Fund participant, and the participant's support for the Fund, indicates that the participant is at low risk of default. • Conducting due diligence on all potential participants. • Default provisions in the Fund Rules. The Fund Rules provide that if participants fail to pay their contributions when due (Defaulting Participants), their right to receive ITMOs are suspended and then following notice periods, Defaulting Participants will cease to be a participant and their interest in the Fund will be first offered to other participants and then to other persons acceptable to the Trustee.
Participants and mitigation activity proponents may fail to adhere to the Article 6 Rules.	<p>Given the uncertainties that surround some aspects of Article 6 (e.g. authorization and corresponding adjustments), there is a risk that participating countries will be non-compliant with the Article 6 rules (for example, a Host Country failing to apply corresponding adjustments). If this were to occur, this would compromise the integrity of the Fund as it would not be delivering on its objectives.</p> <p>Failure to apply corresponding adjustments poses a particular risk, because this would result in double counting of emissions reductions between Host Countries and Participants (who use these toward their NDCs).</p>	<ul style="list-style-type: none"> • Provision of readiness support (through the Readiness Facility) to potential Host Countries to aid understanding of Article 6 requirements, and to develop robust governance frameworks for managing Article 6 participation. • Closely monitoring Article 6 negotiations for further guidance from the Conference of the Parties serving as the Meeting of the Parties to the Paris Agreement (CMA). • Building into Fund Rules and MOPAs requirements for participants and mitigation activity developers to adhere to the Article 6 rules (including any future relevant decisions of the CMA). • Providing in MOPAs for a degree of monitoring and oversight by GGGI of mitigation activities (e.g. reporting and auditing provisions in the MOPA) that are consistent with requirements for other international carbon projects.

Risk	Description	Risk mitigation actions
<p>Perception that Fund is contracting mitigation actions in Host Countries with less ambitious NDCs</p>	<p>If Host Countries supported through the Fund are not perceived to have strong NDC targets, GGGI may face reputational damage due to the perception that the Fund is not properly supporting its objectives, which include raising NDC ambition.</p>	<ul style="list-style-type: none"> • Applying the Country Selection Criteria and Mitigation Activity Criteria to the selection of Mitigation Activities. <ul style="list-style-type: none"> – The selection criteria include a requirement that the Host Country meets the participation requirements under the Article 6 rules (which include that participation will contribute to NDC implementation and long-term goals of the Paris Agreement); and may include that the mitigation activity contributes to transformational change towards decarbonization in the Host Country. • Provision of readiness support (through the Readiness Facility) to potential Host Countries to develop robust governance frameworks for managing Article 6 participation. This includes the development of an Article 6 strategy to ensure that Article 6 participation supports NDC ambition-raising, for example through a “positive list”. • GGGI will consider conducting an NDC ambition assessment as part of due diligence on all potential transactions.
<p>Fund not supporting NDC implementation in Host Countries</p>	<p>The objectives of the Fund include raising NDC ambition. This will be achieved for Participant countries through purchase of ITMOs.</p> <p>Because of the requirement to apply Corresponding Adjustments, there is also a risk that the Fund is seen to be detracting from Host Countries’ ability to meet their own NDCs, which would compromise GGGI’s status as a supporter of developing and emerging economies.</p> <p>However, this risk is tempered by the fact that over the long term, GGGI’s support through the Fund will help NDC implementation and ambition in these countries.</p>	<ul style="list-style-type: none"> • Clearly publish objectives of the Fund as being to support NDC implementation and raise NDC ambition; and the Governance Principle of promoting achievement of the Paris Agreement. • Applying the Country Selection Criteria and Mitigation Activity Criteria to the selection of Mitigation Activities. <ul style="list-style-type: none"> – The selection criteria include a requirement that the Host Country meets the participation requirements under the Article 6 rules (which include that participation will contribute to NDC implementation and long-term goals of the Paris Agreement); that all relevant reports to the UNFCCC are submitted in accordance with the Article 6.2 Guidance; that the Mitigation Activities comply with the requirements of the Article 6.2 Guidance; and that the mitigation activity contributes to transformational change towards decarbonization in the Host Country.

Risk	Description	Risk mitigation actions
		<ul style="list-style-type: none"> • Collaborating with other units in GGGI to focus separately on helping enhance NDC implementation in Host Countries. • Provision of readiness support (through the Readiness Facility) to potential Host Countries to develop robust governance frameworks for managing Article 6 participation. This includes the development of an Article 6 strategy to ensure that Article 6 participation supports NDC implementation and ambition-raising, for example through a “positive list”. • Potentially support mitigation activities through the Readiness Facility that are outside the scope of a Host Country’s NDC, with a view towards bringing them within the scope of updated NDCs. For example, readiness support may focus on extending the scope of the NDC, including through the application of MRV to sectors that are outside the scope of the current NDC.
<p>Uncertainty regarding nature of ITMOs</p>	<p>ITMOs are yet to be regulated in many jurisdictions, and the legal characterisation of ITMOs is currently unclear.</p> <p>As a result, at the end of the Fund term, the assets to be distributed amongst Participants may include rights related to ITMOs that have not been created yet.⁷</p> <p>This could lead to operational complexities when distributing ITMOs and could negatively impact Participant’s / mitigation activities involvement in the Fund (e.g. if by virtue of regulations being introduced in a Participant, they must pay a large fee for the import of ITMOs).</p>	<ul style="list-style-type: none"> • Engagement of legal consultants (Gilbert + Tobin) under Previous Consultancy Report on Recommendations for Compliant ITMO Procurement to understand legal nature of ITMOs. • Monitoring regulatory developments with respect to Host Countries and participant jurisdictions. • Updating the Fund IM with information about the legal nature of ITMOs should this be further detailed, jurisdictional regulations, and any resulting fees or otherwise that could apply to ITMO purchases.

⁷ The ACPF Information Memorandum notes this risk in respect of CERs: it provides that at the end of the ACPF’s term, the assets to be distributed amongst Participants may include rights related to CERs that have not been created yet. It is unknown how these rights would be treated under international regulatory regimes and or the Participants’ national legal and regulatory regimes.

Risk	Description	Risk mitigation actions
Liability of GGGI as trustee	<p>GGGI will be acting as trustee of the Fund. In typical circumstances the liability of the trustee would be limited to the extent that it is able to indemnify itself out of the property of the Fund except to the extent that the liability arises from negligence, fraud or willful misconduct on the part of the trustee.</p> <p>The Fund is structured to ensure a robust legal and governance framework that will minimize any legal and reputational risk to GGGI.</p>	<ul style="list-style-type: none"> • The Fund Rules provide that the trustee is indemnified out of the Fund Property. This ensures that the liabilities of the Fund are separate from the liabilities of GGGI and GGGI Member and partner governments. • The Contribution Agreement contains a customary limitation of liability provision. • Each document to which GGGI executes in its capacity as trustee of the Fund will contain an appropriate limitation of liability clause which covers indemnification out of the Fund Property. For example, every MOPA with Mitigation Activity Proponents will limit recourse of such counterparties to the Fund Property only.
UK law application	<p>As the Fund Rules are governed by UK law (as is common practice for many trust funds, including carbon trust funds), the trustee and the Fund will need to comply with UK law and principles. This includes the fiduciary duties imposed on trustees such as the duty to act in the best interests of Participants.</p>	<ul style="list-style-type: none"> • The IM and Fund Rules clearly outline and define the investment objectives and strategy of the Fund, and the Governance Principles. This helps ensure that the trustee's and Participant's goals are aligned and thereby reduces the risk that the trustee is acting contrary to the best interests of the Participants. • Fund Manager to maintain regular communication with Fund participants.



Annex 3

GGGI ARTICLE 6 READINESS FACILITY

Information Memorandum

DRAFT

Dated September 2023

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INFORMATION MEMORANDUM FOR THE ARTICLE 6 READINESS FACILITY

The Global Green Growth Institute (“**GGGI**”) desires to establish the Article 6 Readiness Facility (the “**Readiness Facility**”), through which GGGI will provide technical assistance and Article 6 readiness support to GGGI Member and partner countries that intend to engage in voluntary cooperation under Article 6 of the Paris Agreement.

The Readiness Facility will operate within the overall structure of the Carbon Transaction Facility (“**CTF**”), which the GGGI Council authorized the Secretariat to establish pursuant to decision C/2022/DC/5.¹ The overall design of the CTF was described in the Council document A/2022/2-C/2022/2.²

This Information Memorandum is intended to provide background information and a summary of the terms and key design elements of the Readiness Facility. In the event of any inconsistency between this Information Memorandum and the Readiness Facility Rules and/or the Contribution Agreements, the Readiness Facility Rules and/or the Contribution Agreements shall prevail.

1 BACKGROUND AND RATIONALE

1.1 Article 6 readiness needs

International carbon trading under Article 6 of the Paris Agreement stands to play a crucial role in achieving the long-term temperature goal adopted by Parties at COP21 in 2015. The use of Article 6 market mechanisms has the potential to reduce the cost of implementing nationally determined contributions (“**NDCs**”) by more than half – equivalent to approximately USD 250 billion per year by 2030 – and accelerate the implementation of global mitigation action.³

Countries are increasingly indicating that they intend to utilize Article 6 market mechanisms. A 2021 analysis found that 77% of countries who submitted updated NDCs anticipate the use of Article 6, with almost half of these being countries in Sub-Saharan Africa or Latin America.⁴ For host countries, Article 6 provides an opportunity to unlock international flows of carbon finance that can be used to increase the ambition of climate targets while delivering sustainable development co-benefits.

However, potential host countries need both capacity and confidence to be fully engaged in this new international carbon market. An Article 6 readiness survey of GGGI Member and partner country governments conducted in early 2022 found that although countries are eager to engage in cooperative approaches under Article 6, uncertainties and risks temper how and when they are likely to undertake transactions.⁵ 48% of countries felt there were not equal opportunities for buyers and sellers in the Article 6 market. Concerns were raised that the market disproportionately

¹ <https://gggi.org/wp-content/uploads/2022/11/C2022DC5-Decision-on-Establishment-of-the-Carbon-Transaction-Platform.pdf>. Note: the CTF was previously referred to as the Carbon Transaction Platform.

² <https://gggi.org/wp-content/uploads/2022/09/Agenda-10.-Carbon-Transaction-Platform-Recommendations-1.pdf>.

³ IETA, University of Maryland, and CPLC (2019). The Economic Potential of Article 6 of the Paris Agreement and Implementation Challenges.

⁴ Michaelowa et al. (2021). Article 6 readiness in updated and second NDCs. Perspectives Climate Group and Climate Focus.

⁵ GGGI (2022). Global Survey on Article 6 Readiness Report. <https://gggi.org/wp-content/uploads/2022/11/GGGI-Global-Survey-on-Article-6-Readiness-Report.pdf>.

favors the needs of buyers, making potential host countries less confident about their ability to participate in and benefit from cooperative approaches.

Readiness support for Article 6 is essential for overcoming these barriers and enhancing the capacity and confidence of host countries. Given its role as a trusted adviser to Members, GGGI is well positioned to deliver such support through the Readiness Facility. GGGI works through country teams that are embedded in government offices and responds directly to the needs and requests of host governments. This business model ensures that all programming is host country-led and sensitive to different national contexts and needs. GGGI's role as trusted adviser is critical to building the necessary confidence in potential host countries to play a more meaningful and equitable role in the development of the international Article 6 market.

1.2 GGGI's role in global Article 6 readiness

As GGGI drives to deliver on its Strategic Outcomes, carbon pricing has come to play an increasingly important role in supporting Members and partners transition towards a green growth model of sustainable development. The proposed activities of the Readiness Facility are aligned with this broader strategic vision. Support for Article 6 readiness is incorporated within GGGI's Strategy 2030, covered under the cross-cutting Carbon Pricing Programmatic Solution (PS11).⁶ GGGI's Council authorized in October 2022 the establishment of the CTF to provide both technical assistance (through the Readiness Facility) and support for the trading of internationally transferred mitigation outcomes ("ITMOs") through Carbon Trust Funds,⁷ agreeing that the CTF activities are aligned with GGGI's overall goals.

GGGI is currently at the forefront of global efforts to support potential host countries with Article 6 readiness. GGGI's Article 6 programs involve working with governments to both establish the required frameworks for market participation (including a commitment and ability to apply corresponding adjustments) and identifying and preparing potential ITMO-generating activities, including with private sector mitigation activity proponents. This contrasts with other programs, which often start with activity identification and then seek government engagement or leave governments to develop governance frameworks on their own. GGGI's approach ensures early government buy-in and avoids such potential bottlenecks to market catalyzation.

2 OBJECTIVES AND PRINCIPLES OF THE CTF

2.1 Objectives

The overall objective of the Readiness Facility is to accelerate global greenhouse gas ("GHG") emission reductions by increasing access to international carbon market mechanisms, specifically under Article 6, by enhancing the capacity and confidence of countries, particularly host countries.

Activities under four outputs are expected to contribute to the achievement of the Readiness Facility's overall objective:

- a) raised awareness and enhanced capacity of stakeholders to engage in Article 6 cooperative approaches;
- b) governance frameworks and institutional strengthening for Article 6 developed;

⁶ GGGI (2021). Strategy 2030 Addendum. https://gggi.org/wp-content/uploads/2021/02/MPSC_2021_5_Strategy-2030-Addendum.pdf.

⁷ Decision C/2022/DC/5. <https://gggi.org/wp-content/uploads/2022/11/C2022DC5-Decision-on-Establishment-of-the-Carbon-Transaction-Platform.pdf>.

- c) increased multi-directional knowledge sharing; and
- d) mitigation activities originated and mitigation activity idea notes (“**MAINS**”) prepared.

Indicative activities under each of these outputs are shown in the Theory of Change, further detailed in Section 4 and illustrated in the Annex.

The Readiness Facility will build on and leverage the existing support provided by GGGI in relevant areas such as the development of NDCs and long-term low-emission development strategies (“**LT-LEDS**”), design of Measurement, Reporting, and Verification (“**MRV**”) systems, and the mobilization of green investments through the development of national financing vehicles and project pipelines.

To maximize project pipelines in supported countries, the Readiness Facility may also run open calls via a Request for Proposals process, seeking projects that align with national priorities and are additional to unconditional NDC commitments.

The Readiness Facility will also coordinate activities with other relevant development partners and seek opportunities for synergy.

2.2 Governance principles

A set of overarching governance principles (“**Governance Principles**”) will guide GGGI’s operation of the Readiness Facility. The overarching Governance Principles for the Readiness Facility are as follows:

- a) Promoting achievement of the Paris Agreement;
- b) Respecting national circumstances;
- c) Fostering predictability and stability;
- d) Upholding fairness and impartiality;
- e) Empowering stakeholders;
- f) Promoting transparency; and
- g) Ensuring integrity and accountability.

3 READINESS FACILITY SETUP AND GOVERNANCE

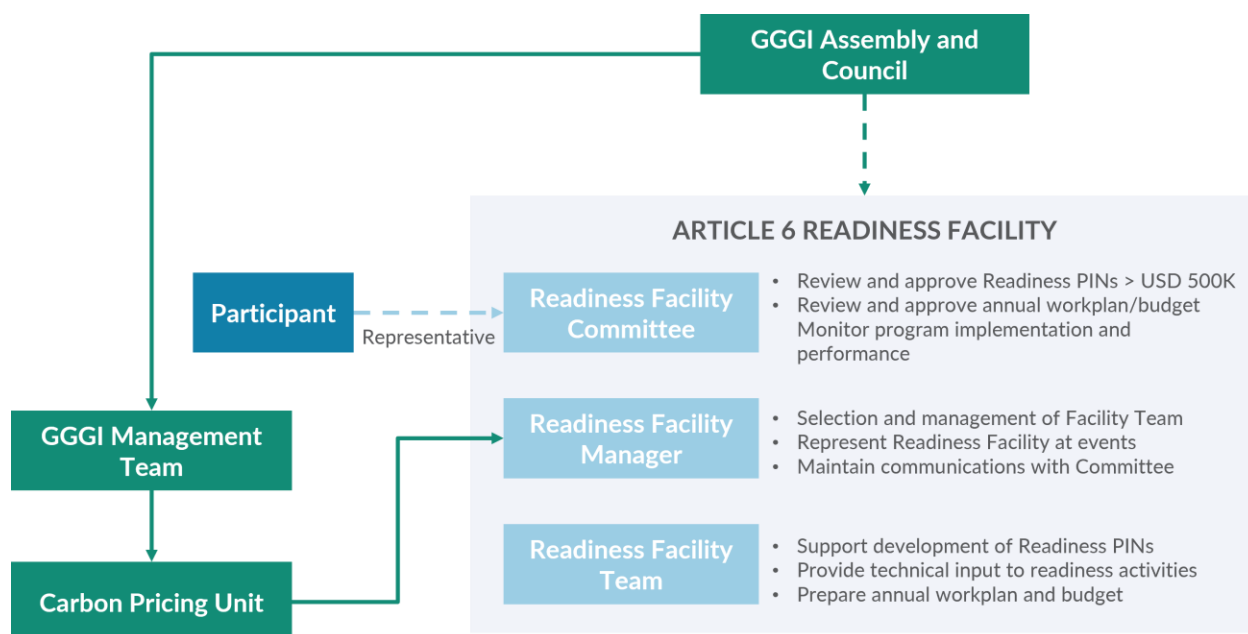
3.1 Contributing participants

The Readiness Facility will be established as a multi-participant Facility that receives contributions from a variety of donors (“**Participants**”), including both governments and non-profit organizations. A Contribution Agreement will be signed between each Participant and GGGI to register the specific contribution of the participant to the Readiness Facility.

3.2 Governance

The governance structure of the Readiness Facility comprises the Readiness Facility Committee, Readiness Facility Manager, and Facility Management Team. Readiness Facility operations will be subject to regular GGGI governance and management oversight. The Readiness Facility governance structure is illustrated in Figure 1.

Figure 1. Readiness Facility governance structure.



Readiness Facility Manager

GGGI will appoint a Readiness Facility Manager, who will be located within GGGI’s Carbon Pricing Unit.

The Readiness Facility Manager will have overall responsibility for the day-to-day operations of the Readiness Facility, including:

- the selection and management of staff;
- representing the Readiness Facility’s interests at international fora and maintaining contact with Participants;
- overseeing the review and selection of Readiness Facility activities;
- seeking to ensure consistency of the Readiness Facility’s operations with the Paris Agreement and Article 6 Rules, GGGI’s Operational Policies and Procedures, and the Governance Principles; and
- collecting, organizing, managing and disseminating the knowledge and information obtained by GGGI in the course of its operation of the Readiness Facility.

Readiness Facility Team

The Readiness Facility Team shall be headed by the Readiness Facility Manager, and will comprise staff designated from GGGI’s Carbon Pricing Unit. The Readiness Facility Team will provide advice to the Readiness Facility Manager on:

- the implementation of the Readiness Facility;
- proposed Annual Budgets and work plans for the forthcoming year, prior to submission to the Readiness Facility Committee at their annual Readiness Facility Committee meeting;
- the review and selection of Readiness Facility activities; and

- d) suggested methods to enhance the effectiveness of the Readiness Facility, including revisions to policies and procedures.

The Readiness Facility Team will also provide technical input and guidance to readiness activities implemented through the Readiness Facility.

Readiness Facility Committee

The Readiness Facility Committee shall be comprised of one representative of each Participant, as nominated by the Participant and notified to the Readiness Facility Manager in writing within thirty (30) calendar days of executing a Contribution Agreement. Nominated representatives of each Participant for the Readiness Facility Committee shall be officers, directors, employees or officials of that Participant. Elected members of the Readiness Facility Committee who cease to be officers, directors, employees or officials of the Participant who elected them, will no longer be eligible for membership of the Readiness Facility Committee.

The Readiness Facility Committee will be responsible for:

- a) approving Readiness Facility disbursements above USD 500,000;
 - a. The process for selecting and approving Readiness Facility activities and disbursement of funds is outlined in Section 5.2.
- b) approving the Annual Workplan and Budget;
 - a. The Annual Workplan and Budget will contain information including:
 - i. Regular knowledge sharing activities and events.
 - ii. Approved Readiness Facility activities.
 - iii. Scoping of new Readiness Facility activities.
 - iv. Development of knowledge products.
- c) defining priority countries of intervention; and
- d) monitoring program implementation and performance.

The administration of the Readiness Facility will be governed by the Readiness Facility Rules. The Readiness Facility Rules may be amended from time to time. Amendments to Readiness Facility Rules must be unanimously approved by the Readiness Facility Committee and approved by GGGI's Director-General.

3.3 Meetings of the Readiness Facility Committee

The Readiness Facility Committee will meet, at a minimum, once per year. Meetings of the Readiness Facility Committee shall be called by the chairperson of the Readiness Facility Committee or GGGI, provided that at least fourteen (14) calendar days' written notice is given to each member of the Readiness Facility Committee stating the matters to be considered and the place, date and time of the meeting. Readiness Facility Committee members represented at a Readiness Facility Committee Meeting holding a majority of all the votes of the Readiness Facility Committee shall constitute a quorum for the transaction of business at that meeting.

3.4 Voting rights of Participants

Each member of the Readiness Facility Committee shall be entitled to one vote for every USD 1 million of the Commitment of its nominating Participant on each matter submitted to a vote at a Readiness Facility Committee Meeting. The members of the Readiness Facility Committee shall make every effort to make decisions by consensus at Readiness Facility Committee Meetings. If all efforts at consensus have been exhausted and no agreement has been reached, every matter

submitted to a Readiness Facility Committee Meeting shall be decided by the majority of the votes cast by the members of the Readiness Facility Committee at that meeting.

Subject to compliance with the Governance Principle of ensuring integrity and accountability, a representative of GGGI may attend Readiness Facility Committee Meetings as an observer and may express its views on issues under discussion at such meetings, but without voting rights to any decision by the Readiness Facility Committee.

3.5 Contribution arrangements

Contributing participants will provide an initial minimum contribution to the Readiness Facility for the first five years of the fund operations, in accordance with a Contribution Agreement. Following the execution of a Contribution Agreement, GGGI shall provide the respective Participant with a written notice which contains the aggregate sum of the Commitments of all Participants in the Readiness Facility under their respective Contribution Agreements and the number of voting rights held by the Participant's nominated member of the Readiness Facility Committee.

Readiness Facility Participants will be issued a Readiness Facility Contribution Request from time to time in accordance with the relevant Contribution Agreement, having regard to the financial requirements of the Readiness Facility. Participants will be given at least sixty (60) days' notice of any demands for the payment of a Readiness Facility Contribution.

Contributions shall be administered in accordance with the Governance Principles and GGGI's applicable policies and procedures, which may be amended from time to time, including its financial management, disbursement and safeguard policies, its framework to prevent and combat fraud and corruption, and its due diligence procedures.⁸ GGGI shall administer the contributions through its own organization, services, officers, staff and consultants engaged by GGGI, and the reporting lines of such staff and consultants shall be in accordance with GGGI's regulations, rules, policies and guidelines.

GGGI shall open and maintain a separate interest-bearing account ("**Account**") denominated in US dollars in which contributions from Readiness Facility Participants shall be held. If the contribution received is in a currency other than US dollars, GGGI will convert the contribution into US dollars and transfer it to the Account. GGGI shall have no liability to the Participant from which contributions have been received for any exchange or other losses in connection therewith.

3.6 Readiness Facility duration

The Readiness Facility is proposed to be established for a set duration. It is proposed to operate from the Readiness Facility operational date, through to 31 December 2035.

Key milestones:

Readiness Facility Commencement Date: 1 November 2023.

Readiness Facility Operational Date: the date that the Readiness Facility commences operation, which is the date that GGGI receives the initial Contribution from a Participant that has executed a Contribution Agreement.

⁸ All policy documents are available at <https://gggi.org/policy-documents/>.

Readiness Facility Operating Period: the period between the Readiness Facility Operational Date and 31 December 2035, the latter being the date by which GGGI has completed all activities supported through the Readiness Facility, and completed all relevant reports.

Readiness Facility Closing Date: 31 December 2035.

One year before the end of the Readiness Facility Operating Period, Participants may decide to extend the Readiness Facility Operating Period and the Readiness Facility Closing Date. Any such extension is also contingent upon GGGI consenting in writing to continue to carry out Readiness Facility management duties, as per the Readiness Facility Rules.

3.7 Post-termination

Following the termination of the Readiness Facility, after paying or adequately providing for the payment of all liabilities, and upon receipt of such releases, indemnities and refunding agreements as it may deem necessary for its own protection, GGGI shall distribute the remaining Readiness Facility Property in cash or in kind, or a combination of both, among the Participants according to their respective rights (and such distribution shall include the repayment to a Participant of any prepaid Contributions that have not been applied by GGGI to the operations of the Readiness Facility).

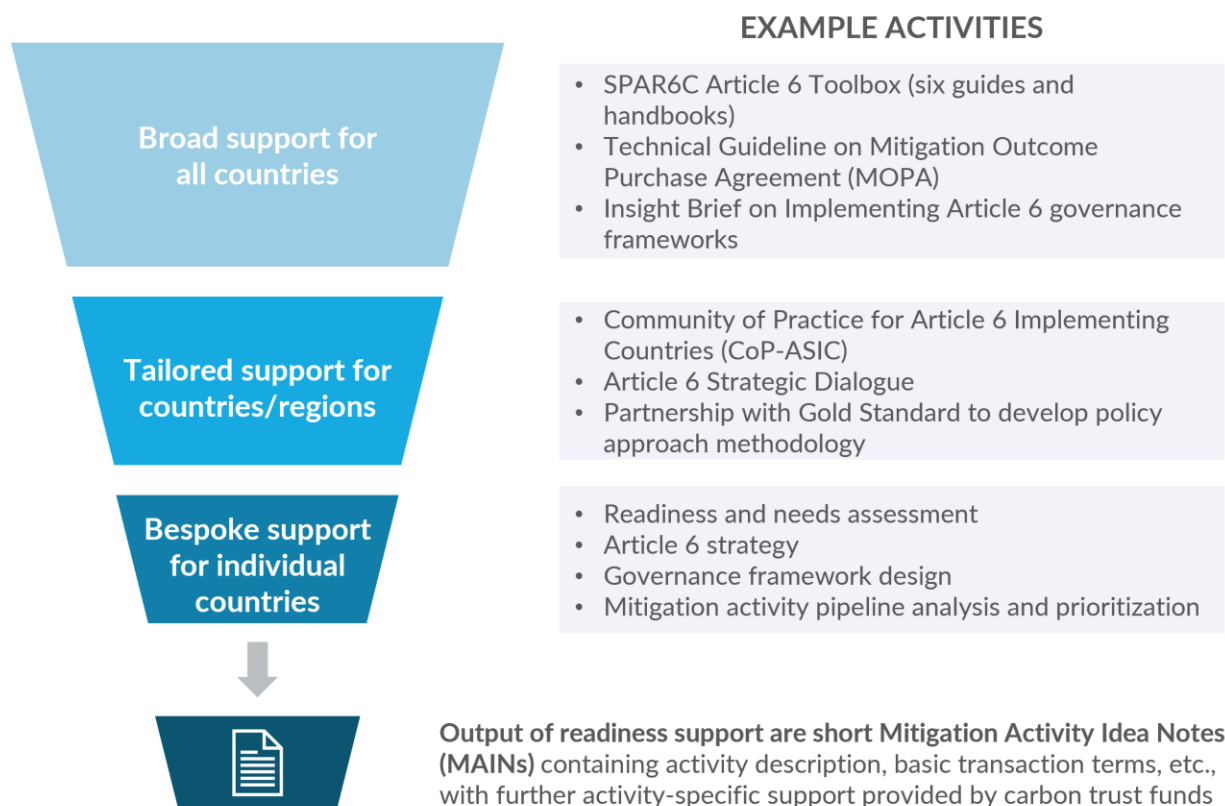
4 PROPOSED ACTIVITIES

4.1 Scope of support

The Readiness Facility will operate within the overall structure of the CTF. Readiness Facility activities will focus on the provision of Article 6 readiness support for Host Country governments and technical assistance for mitigation activity origination. Readiness support provided through the Readiness Facility will not extend beyond the development of MAINs for specific mitigation activities. Further transaction support activities will be provided through Carbon Trust Funds.

The overall scope of potential Readiness Facility support is broad. Support will range from bespoke readiness activities for individual countries, through to support for all countries or groupings of countries at a regional or global level (Figure 2). The broad scope of Article 6 readiness support provided through the Readiness Facility will ensure that scarce donor contributions are utilized efficiently, allowing for greater effectiveness than can be achieved through smaller, standalone technical assistance programs.

Figure 2. Scope of support provided through the Readiness Facility.



Activities for individual countries will be tailored based on identified needs and host country requests.

GGGI works through country teams that are usually embedded in government offices and directly responds to the needs and requests of host governments. This business model ensures that all programming is host country-led and sensitive to different national contexts and needs. GGGI's role as trusted adviser is critical to building the necessary confidence in potential seller countries to play a more meaningful, equitable role in the development of the market.

4.2 Output-level activities

4.2.1 Awareness-raising and capacity-building

Despite host countries' interest in engaging in international carbon markets, general understanding of market mechanisms tends to be low, particularly in developing countries. Governments must have a fundamental understanding of the benefits and risks of participation, and the strategies available to maximize benefits while minimizing potential risks. Moreover, the Article 6 rules – and specifically requirements around authorization and reporting – require a much more involved role for host country governments. To address these challenges, the Readiness Facility will implement the following indicative activities:

- conduct stakeholder mapping across government, private sector and civil society;
- assess existing national capacities and experience with carbon market mechanisms and identify needs for Article 6 capacity building;

- a. potential areas include market dynamics, Article 6 participation requirements, mitigation activity selection and/or development, transaction models;
- c) collaborate with relevant partners such as the Article 6 Implementation Partnership, World Bank, UNDP, Joint Crediting Mechanism and UNFCCC Regional Collaboration Centers (RCCs);
- d) develop tools to facilitate government decision making processes;
- e) develop Article 6 awareness raising and capacity building program (including knowledge products, discussion groups and workshops); and
- f) deliver Article 6 awareness raising and capacity building program.

Output: Raised awareness and enhanced capacity of stakeholders to engage in Article 6 cooperative approaches.

4.2.2 Development of governance frameworks

Beyond confidence and willingness to participate, countries must be ready and able to meet the Article 6 participation requirements outlined in the Article 6 rules. Such requirements include having access to a registry, and establishing institutional arrangements for Article 6 engagement (specifically for authorization and reporting). In addition, countries will need to make strategic Article 6 engagement decisions. To make such decisions, host countries should develop an overall Article 6 and NDC compliance strategy to help guide later actions such as the authorization and transfer of ITMOs.⁹ However, it is not sufficient for an external party to create such a strategy in isolation, which is then presented to government as a comprehensive solution. This approach has been tried and tested in the past and rarely gains traction with a host country government. Instead, it is necessary to employ an engaged approach that regularly brings together stakeholders and explains the decisions that need to be made, asking what information will be needed to help make such decisions. Providing host country governments with the options that result from such a consultative and engaged process will enable and empower the government to make the decisions themselves. The final strategy and operational documents are therefore a reflection of the government's own decisions. The following types of indicative activities, using the above-described approach, will be carried out under the Readiness Facility to support the development of governance frameworks for Article 6:

- a) conduct readiness assessment for engagement in Article 6;
- b) establish cross-ministerial Article 6 Steering Committee;
- c) establish regulatory framework for Article 6;
- d) develop Article 6 strategy to guide engagement and decision-making;
 - a. determine criteria for authorizing Article 6 activities;
- e) support technical decisions required for Article 6 engagement (e.g., accounting approach, choice of standards);
- f) develop processes and procedures for Article 6;
- g) design and implement Monitoring, Reporting and Verification (MRV) systems to facilitate reporting to the UNFCCC; and
- h) establish tracking and registry system with appropriate functionality for managing Article 6 activities.

⁹ See GGGI (2022). Guidance on governance models for host country engagement in Article 6: Version 2.0.

Output: Governance frameworks and capabilities for Article 6 developed.

4.2.3 Origination and preparation of mitigation activities

In addition to building the capacity of relevant stakeholders to participate in Article 6 approaches and establishing robust governance frameworks to guide engagement, a further key requirement of Article 6 readiness is the identification and origination of potential mitigation activities (including projects, programs, or other policy-based approaches). Because carbon projects can be technically complex, host countries are likely to need technical assistance to originate, assess, and select mitigation activities for potential trading. Through the Readiness Facility, GGGI will provide support for the origination and preparation of potential mitigation activities, similar to the support currently provided through GGGI's existing carbon pricing programs as well as its green investment services. The Readiness Facility will not support more detailed design of mitigation activities; instead, if a potential buyer is identified, support for the further development of a mitigation activity will be provided through the relevant Carbon Trust Fund, or other means. Indicative mitigation activity origination and preparation activities provided through the CTF will include:

- a) analysis of priority sectors and mitigation activities, in consultation with key stakeholders;
- b) development of mitigation activity longlist, including mitigation potential, alignment with national priorities;
- c) originating mitigation activities through ideation, consultation and high-level design and assessment, preparation of Mitigation Activity Idea Notes (MAINs) for potential mitigation activities;
- d) conducting informational sessions (through webinars and external engagements) with project developers in countries that are ready to participate but do not have any activities, in partnership with participating governments utilizing parallel Article 6 programs (like the UNFCCC Regional Collaboration Centres) where possible; and
- e) once MAINs are available, sharing them with Carbon Trust Funds for consideration and discussion, with the aim of identifying buyer interest.

Output: Mitigation activities originated and MAINs prepared.

4.2.4 Knowledge sharing and exchange

Confidence on the part of host countries to participate in the international carbon market – a fundamental requirement for market development – will grow only as the rules and norms of the market become clearer with time and experience. Therefore, through the Readiness Facility, participants will be given the opportunity to discuss perspectives and provide lessons learned on operationalizing Article 6, including through the establishment of a Readiness Facility Forum with both host and acquiring country membership.

In addition to the dedicated Readiness Facility Forum, other knowledge sharing forums may be carried out at a national, regional, or global level, and will focus on the exchange of experiences and lessons learned between countries. Such forums differ from capacity building initiatives, including those delivered through entities such as the UNFCCC RCCs, given that the emphasis is on the multi-directional sharing and exchange of knowledge relevant to Article 6 implementation. As host countries increasingly demand support that extends beyond basic capacity building events, the value of platforms for knowledge sharing and exchange will continue to increase.

Given the broad regional representation of GGGI Members and partners, and the fact that GGGI is embedded in host country governments, the Readiness Facility is well placed to carry out

knowledge sharing and exchange activities. GGGI has a proven track record in convening relevant stakeholders and using such forums as a key means to accelerate the implementation of Article 6 in countries. Indicative activities to be carried out under this workstream will include:

- a) establishing a Readiness Facility Forum, with membership comprising of both host and acquiring country stakeholders, to carry out knowledge sharing activities on an ongoing basis;
- b) establishing, facilitating, and running national, regional, and global knowledge sharing forums to share experiences around mitigation activity development, including those being supported by GGGI in its Member partner countries. To maximize synergies and minimize costs for all participants, efforts will be made to ensure that such knowledge sharing events coincide with other major events (such as UNFCCC-organized conferences);
- c) facilitating technical and strategic dialogue between buyers and sellers on key topics as the market develops to understand perspectives of different market participants. Topics could include understanding 'environmental integrity'; interpretation of the Article 6 Rulebook; transitioning of Kyoto-period credits; or others;
- d) taking stock on needs and challenges by engaging regularly with GGGI Member and partner countries as they navigate their participation. Roundtable discussions in the context of GGGI Council or Readiness Facility meetings, for example, could be used to collect firsthand feedback;
- e) developing global knowledge products, with reports such as the GGGI Global Survey on Article 6 Readiness, Technical Guideline on Mitigation Outcome Purchase Agreements, and Guidance on Governance Frameworks for Article 6, or other assessment tools or activities developed through the Readiness Facility, to be shared through GGGI's networks, such as the Green Growth Knowledge Platform (GGKP); and
- f) exchanging and facilitating communication and information flows between buyers and sellers on the journey to a transaction and the challenges from both sides so that others may learn from these experiences.

Output: Increased multi-directional knowledge sharing between countries.

5 COUNTRY AND ACTIVITY SELECTION

5.1 Country selection criteria

The Readiness Facility is expected to provide Article 6 readiness support through the Readiness Facility to countries that meet the following criteria:

- a) is a Party to the Paris Agreement; and
- b) is a developing and emerging economy GGGI Member or partner country.¹⁰

5.2 Activity selection process

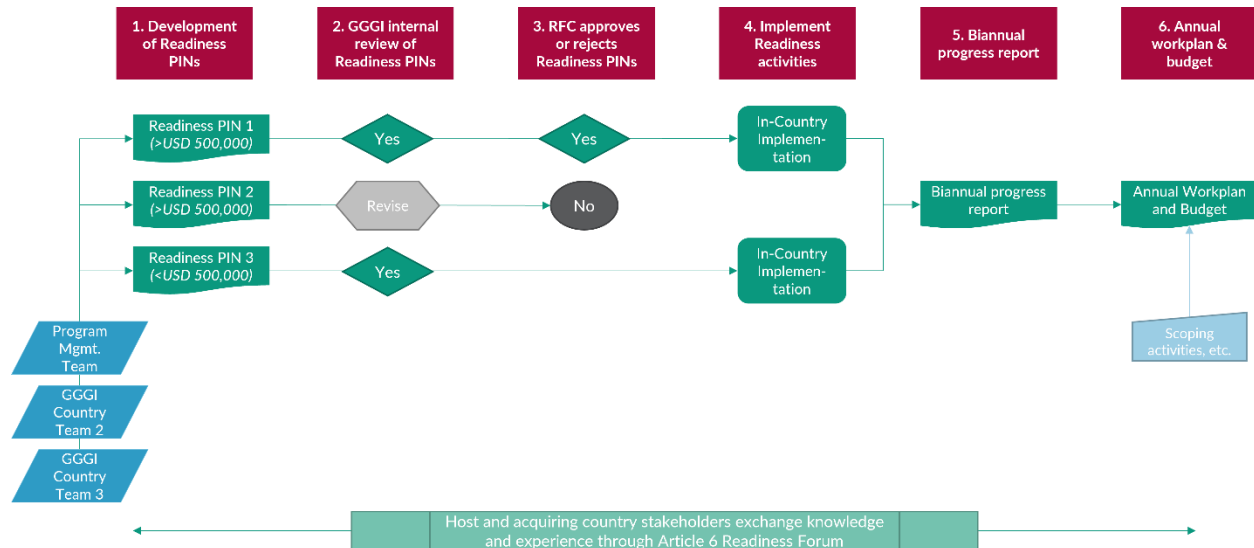
Readiness Facility activity proposals will be developed in Readiness Project Idea Notes (PINs).

The process for country selection differs depending on the size of the funding allocated through the Readiness Facility:

¹⁰ Developing and emerging economy countries are defined as those on the OECD's DAC list of ODA recipients: <https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/daclist.htm>.

- a) up to USD 500,000: Internal GGGI review process;
- b) above USD 500,000: Internal GGGI review process, and review by the Readiness Facility Committee.

Figure 3. Example activity selection and reporting process.



The process for selecting Readiness Facility activities and approving disbursements is illustrated through an example in Figure 3, and further outlined in the steps below.

1. Development of Readiness PIN

- i. Action: Facility Management Team and relevant thematic experts advise and support Readiness PIN development to ensure that PIN outlines proposed readiness activities and identifies main actors needed to execute the proposed project.¹¹
- ii. Exit: Readiness PIN and supporting documentation prepared and submitted for GGGI internal review.

2. Review of Readiness PIN

- i. Action:
 - i. Readiness PIN reviewed by relevant GGGI internal stakeholders (including thematic experts) through a PIN review meeting chaired by Head of Carbon Pricing Unit.
 - ii. Feedback provided in PIN Review meeting to be addressed before submission to GGGI Management Team for approval.
- ii. Exit: Readiness PIN approved by GGGI Management Team.

¹¹ GGGI thematic experts cover areas including but not limited to MRV, green investment services (GIS), gender and social inclusion (GESI), energy, transport, climate-smart agriculture, and adaptation and resilience. Relevant thematic experts will be consulted as part of the Readiness PIN development process, and will also review the PIN (see **Error! Reference source not found.**).

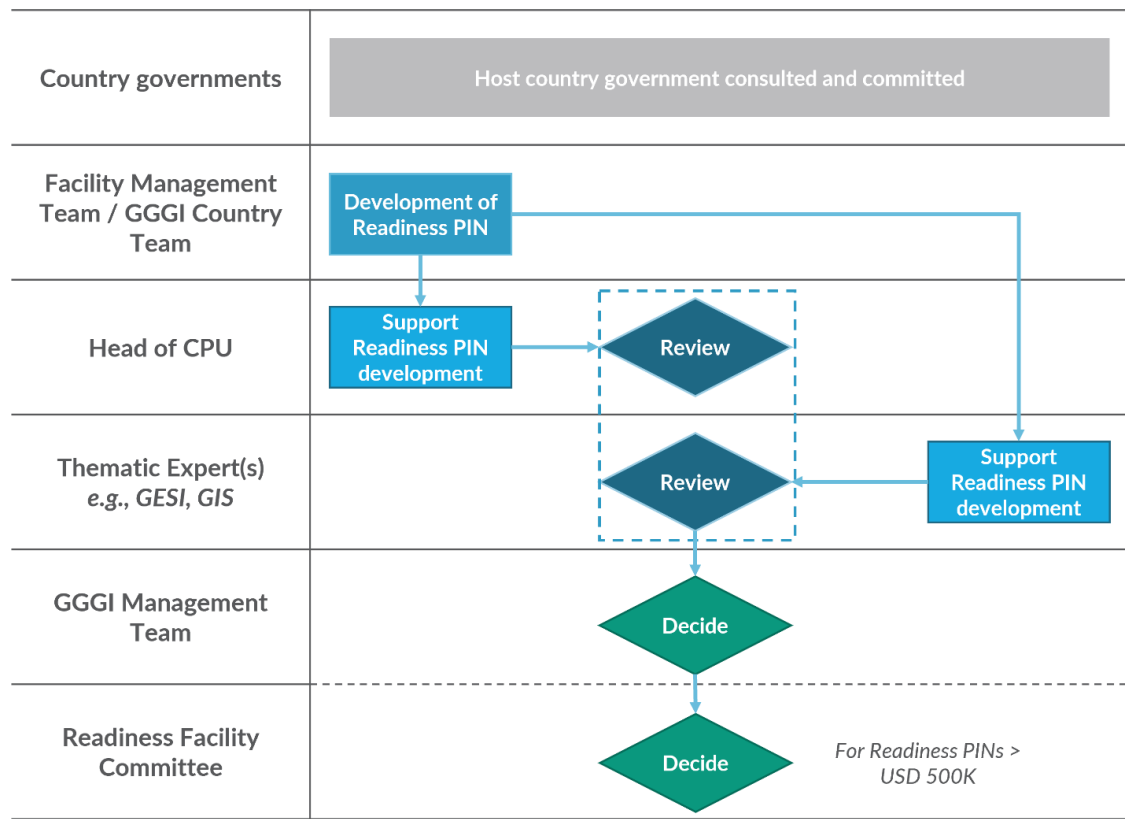
3. Above USD 500,000: Decision on approval of Readiness PIN by Readiness Facility Committee

- i. Action:
 - i. Readiness PINs submitted to Readiness Facility Committee on a continuous basis. Readiness Facility Committee participants may provide one round of feedback via written communication within 30 days. Feedback will be visible to all other participants.
 - ii. Readiness Facility Committee review Readiness PINs and make decision on approval or rejection. Approval of Readiness PINs will be subject to a two-thirds majority vote, although efforts will be made to achieve consensus.
- ii. Exit: Readiness PIN approved or rejected by Readiness Facility Committee.

The development and review of Readiness PINs involve consultation with a number of relevant stakeholders. These stakeholders include the host country government, the Head of the Carbon Pricing Unit, and relevant GGGI thematic experts. Relevant thematic experts may include gender and social inclusion (“**GESI**”) or green investment services (“**GIS**”) specialists, as well as sectoral experts.

The stakeholder consultation and review process for Readiness PINs developed through the Readiness Facility is illustrated in Figure 4.

Figure 4. Stakeholder consultation and review process for Readiness PINs.



6 ADMINISTRATION ARRANGEMENTS

6.1 Expenses

GGGI may use Readiness Facility Property to pay or reimburse it or any other person, including GGGI, for all Administrative Costs attributable to the Readiness Facility. The Readiness Facility shall not incur, or reimburse GGGI for, costs and expenses exceeding the 13% expense cap.

6.2 Monitoring and reporting

The Readiness Facility Manager will submit the following reports to Readiness Facility Participants:

- Annual Report on the Readiness Facility's activities and performance; and
- Annual Financial Statements.

The scope of the Annual Report on the Readiness Facility's activities and performance will be determined in consultation with Participants and set out in the Readiness Facility Rules.

The Readiness Facility Manager will maintain the records and accounts, in accordance with its standard procedures that identify the contributions made, the commitments to be financed out of the available funds, the eligible activities, and all related administrative costs of the Readiness Facility. The Readiness Facility Manager will provide Participants with audited financial statements on these records and accounts by the end of June following each fiscal year. An external financial audit will be undertaken annually by GGGI's external auditor in US Dollars with the cost of the audits to be borne by the Readiness Facility as administrative costs.

Consistent with the Governance Principle of promoting transparency and ensuring integrity and accountability, the Readiness Facility shall be subject to periodic evaluation on the effectiveness of its operation.

A monitoring, evaluation, and learning framework will be developed by GGGI in consultation with Participants, for formal approval by the Readiness Facility Committee.

6.3 Accountability mechanisms

All proposed Readiness Facility activities would be subject to regular oversight by GGGI's governance organs.

GGGI is required under its Establishment Agreement to act in a transparent manner, and GGGI's Disclosure Policy provides that it is GGGI's policy to publicly disclose information concerning its governance organs and their decisions as well as operational activities in the absence of a compelling reason to consider such information as proprietary, privileged, or confidential.

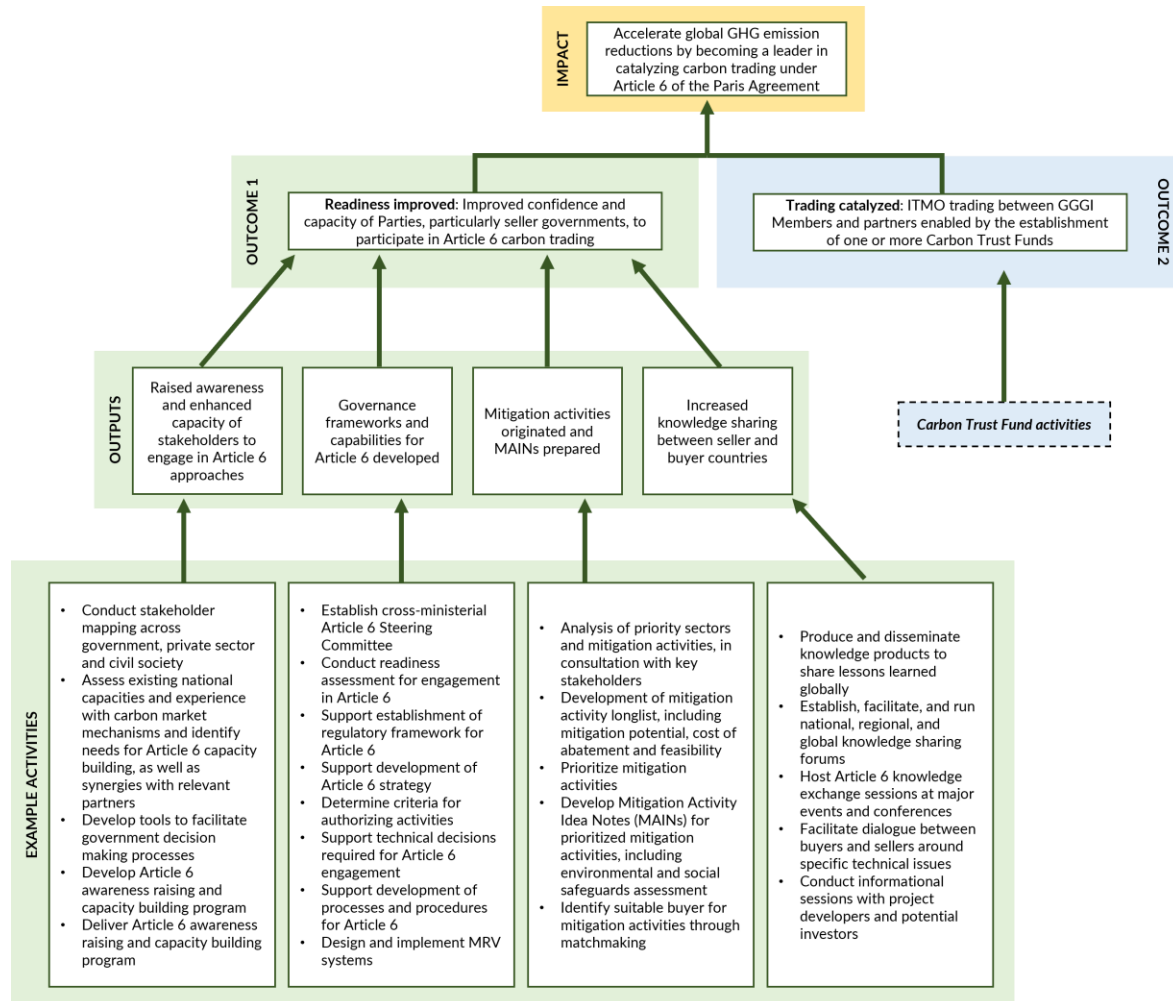
Subject to compliance with GGGI's Disclosure Policy, the Readiness Facility will facilitate public access to Readiness Facility documents where appropriate, including documents with information relating to the selection of activities, reports of any Participants' meetings, and lessons learned through operation of the Readiness Facility.

GGGI's Compliance Review Mechanism is available to any person or group of persons that believes that GGGI has failed to comply with any of its regulations, rules, policies and procedures and that this failure has or threatens to adversely affect such person(s).

ANNEX

Theory of change

Figure 5. Theory of change for the Carbon Transaction Facility.





Annex 4

Report on recommendations for compliant ITMO procurement by GGGI

Final Report

27 March 2023

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1 Introduction

GGGI has been implementing the Mobilizing Article 6 Trading Structures (**MATS**) Program, with funding from the Swedish Energy Agency (**SEA**), since 2020. The MATS Program aims to scale up international carbon trading under the mechanisms established through Article 6 of the Paris Agreement. The objective of the Program is the completion of Internationally Transferred Mitigation Outcome (**ITMO**) transactions between GGGI countries and SEA.

In 2022, GGGI established the Carbon Transaction Platform (**CTP**). Under the CTP, GGGI is seeking to establish a fund (ITMO Fund), or series of funds, to procure ITMOs on behalf of participating countries or private entities. The fund(s) will be managed by GGGI (as an international organization). The first such ITMO Fund (Trust Fund 1) will be established with SEA as the initial participating entity. It is intended that other purchasing entities will join Trust Fund 1 in due course, and/or that other funds for different participating entities will follow.

This report is intended to clarify the appropriate regulatory framework for the procurement of ITMOs by an ITMO Fund and to recommend a compliant process for such procurement. We use Trust Fund 1 as an example but consider the findings of this report to be applicable to further trust funds. Analyses of EU and Swedish law are provided as a case study for SEA as the first participant in the Fund. However, it is not intended that procurement, nor this analysis, be restricted to Trust Fund 1 or SEA as the sole purchasing entity. Key recommendations are provided at section 2. The methodology for undertaking the analysis that supports these recommendations is set out below.

1.1 Fund review

To assess the legal characterization of carbon credits by different funds and institutions and the procurement process involved in purchasing those carbon credits, this analysis reviewed documentation from the following funds (together, **Funds**):

1.1.1 Funds affiliated with the World Bank and/or International Bank for Reconstruction and Development (IBRD)

- Forest Carbon Partnership Facility (**FCPF**)*;
- BioCarbon Fund*;
- BioCarbon Fund Initiative for Sustainable Forest Landscapes (**ISFL**);
- Transformative Carbon Asset Facility (**TCAF**);
- Prototype Carbon Fund (**PCF**);
- Community Development Carbon Fund (**CDCF**);
- Carbon Fund for Europe;

1.1.2 Funds affiliated with the Asian Development Bank (ADB)

- Japan Fund for the Joint Crediting Mechanism (**JFJCM**)*;
- Asia Pacific Carbon Fund (**APCF**)*;
- Climate Action Catalyst Fund (**CACF**)*;
- Future Carbon Fund (**FCF**)*;

1.1.3 Funds affiliated with the European Investment Bank (EIB)

- EBRD-EIB Multi-lateral Carbon Credit Fund (MCCF)*;
- Post-2012 Carbon Fund;

1.1.4 Funds affiliated with a single country or private entity

- EIB-KfW Carbon Programme;
- Nordic Environment Finance Corporations Carbon Fund (NeCF); and
- The Swedish CDM and JI Programme (Sovereign Fund).

We note that the establishing instrument and/or fund regulations were only available for review for those Funds with an asterisk (*). For the Funds for which the establishing instrument and/or fund regulations were unavailable, our analysis was based on information notes and evaluations, where available.

Our review was supplemented through interviews with the following personnel:

- Lasse Ringius (ex-IFC now GGGI);
- Nishant Bhardwaj (ex-ADB now GGGI);
- Anne Smeby Ebjan (NEFCO); and
- Sandra Lindström and Nils Westling (SEA).

Based on the comparison of the approaches of different funds and the response to the questions outline for the interviews, we have summarized key areas of convergence and divergence between the funds at section 6.1, and pros and cons of different approaches taken by different funds at section 6.2.

1.2 Legal and Regulatory Review

We next reviewed the legal characterization of, regulatory treatment, and legislative and regulatory mechanisms underpinning the following types of carbon credits under EU and Swedish law, as an example given that SEA is the initial participant in Trust Fund 1, for the purposes of analyzing how they differ from ITMOs:

- Certified Emissions Reductions (CER);
- Verified Carbon Units (VCU) and Verified Emissions Reductions (VER) (both voluntary carbon credits (VCC));
- UK Allowances (UKA);
- Article 6.4 Emission Reductions (6.4ERs); and
- internationally transferred mitigation outcomes under Article 6.2 (ITMO).

In considering the legal nature of these carbon credits, we have looked at the legal characteristics of each type of credit as well as any classification applicable to them under EU law and Swedish law (or other applicable national laws). For VCCs we have also looked at the treatment of the credits by the voluntary registry in which they are issued, transferred and retired or cancelled.

Section 3.1 summarizes our findings with respect to the legal nature and key features of the selected carbon credits and considers how ITMOs compare to these other credit types. Section 3.2 provides a more detailed summary of requirements for the creation of ITMOs under Article 6 of the Paris Agreement and the guidance on cooperative approaches referred to in Article 6.2 agreed at COP26 in Glasgow in 2021 (Decision 2/CMA.3), which were further elaborated in guidance from the Conference of the Parties to the Paris Agreement (CMA) at

COP27 in November 2022 (**Decision 6/CMA.4**).¹ We refer to these decisions collectively as the ‘**Article 6.2 Guidance**’.

1.3 Review and summary of procurement law and regulations applicable to ITMOs

We next reviewed Swedish and EU procurement law and regulations to identify the potential applicability of Swedish and EU procurement law for the procurement of ITMOs by a fund managed by GGGI (as an international organization) on behalf of SEA, as an example, and the key requirements to be complied with in such case.

Based on our review of Swedish and EU procurement law, relevant SEA legal advice, and interviews with members of the SEA carbon procurement team, we set out relevant legal requirements which ITMO procurement by GGGI on behalf of SEA for Trust Fund 1 must comply with at section 4. **Error! Reference source not found.**

We also undertook a review of the following GGGI internal policies which are relevant to fund establishment and ITMO procurement (set out at section 4.1):

- Establishing Agreement;
- Financial Regulations;
- Procurement Regulations and Rules; and
- Disclosure policy.

Our review of GGGI’s procurement regulations and rules was supplemented with interviews with the GGGI legal and procurement team.

1.4 Implications for ITMO Fund design and ITMO procurement

Based on our analysis in each of the activities set out above, we summarize at section 5 the potential applicability of Swedish and EU procurement law for the procurement of ITMOs by a fund managed by GGGI on behalf of SEA, as the initial participant, and the key considerations. In section 7, we set out practical considerations that GGGI should have regard to when establishing an ITMO Fund more broadly, including management of legal uncertainty relating to the legal characterization of ITMOs.

1.5 Qualifications and assumptions

We note the following qualifications and assumptions that we have applied when preparing this report:

- Our review of funds is limited to the fund documents in the index of documents, unless specified otherwise in this report.
- Our review is limited to EU procurement law, Swedish procurement law and Swedish private and public law, as relevant examples for Trust Fund 1, at a general level. This means that we have not made any in depth investigations as regards specific legal issues pertaining to, for example, trust, tax, insolvency, tort, criminal or family law.

¹ Decision 6/CMA.4 ‘Matters relating to cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement’ (**Decision 6/CMA.4**).

2 Summary of advice and recommendations

2.1 Advice on procurement questions

Question	Answer	Relevant section of report
<p>How are ITMOs characterized for the purposes of public procurement?</p>	<p>The legal characterization of ITMOs is uncertain, however, ITMOs as units have characteristics suggesting they are intangible assets.</p> <p>Contracts for ITMOs may contain elements of both supplies and services.</p> <p>ITMOs are currently unregulated under EU public procurement law, but may be regulated as financial instruments in future. Depending upon how they are procured (e.g. if by forward contract) that contract could constitute a derivative which would invoke the characteristic of a financial instrument.</p>	<p>Section 3 and 5.</p>
<p>Do particular legal requirements for contracting apply to ITMOs under EU or Swedish law in the case of Trust Fund 1 if SEA is a participant?</p>	<p>If ITMOs are to be procured by a contracting authority or a body governed by public law, then that entity would need to undertake procurement in compliance with EU and Swedish public procurement laws, which generally requires a competitive process.</p> <p>However, exemptions apply that may allow direct procurement of ITMOs. Relevantly, under these exemptions, direct procurement can be undertaken where there is no competition for ITMOs for technical reasons.</p> <p>Financial services in connection with financial instruments fall outside the scope of EU public procurement regulations. If ITMOs are characterized as financial instruments under EU law, then their procurement will accordingly fall out of scope. Similarly, derivative transactions of ITMOs will be out of scope of procurement regulations because these are regulated as financial instruments.</p>	<p>Section 3 Error! Reference source not found.</p>
<p>Is GGGI required by law to apply EU and Swedish public procurement laws to Trust Fund 1 if SEA is a participant?</p>	<p>No. GGGI is not a contracting authority or a body governed by public law.</p>	<p>Section 4.</p>
<p>Will the Trust Fund 1 meet SEA's expectations if it</p>	<p>Yes. Given that SEA's election of GGGI falls under an exemption from the public procurement regulations and</p>	<p>Section 4.</p>

operates in accordance with GGGI's procurement policies?	that GGGI's procurement rules have been EU-Pillar assessed, SEA will likely be comfortable with GGGI applying its own procurement rules.	
Where an ITMO Fund applies GGGI's procurement policies to ITMO procurement, does this mean that ITMOs have to be procured through a competitive process?	<p>No.</p> <p>ITMO procurement (in the form of a unit, or in the form of mitigation activities) is outside the scope GGGI's procurement regulations and rules, so the competitive process in these policies does not need to be followed.</p> <p>If it is inside the scope of those regulations, then the ITMO Fund can still procure ITMOs without competition through 'direct procurement' exceptions in its procurement rules relating to an absence of a competitive marketplace, or procurement of financial services.</p>	Section 5.
Can an ITMO Fund procure ITMOs through GGGI's internal pipeline?	Yes, because of the answer above.	Section 5.

2.2 Recommendations for compliant procurement

To ensure that ITMO procurement by an ITMO Fund is compliant the participant's jurisdiction's law (for example, Swedish and EU law for SEA as the initial participant in Trust Fund 1), and meets the participant's requirements, GGGI should ensure that the purposes of the Fund are clearly geared toward ITMO procurement for the purposes of activities that align with GGGI's and the participant's objectives. These purposes as well as the mitigation activity and ITMO procurement criteria should be spelled out clearly in the fund regulations, and should facilitate a fair process for selecting mitigation activities. GGGI as Fund Trustee (or the fund manager) should have an influential role in decision-making processes when selecting mitigation activities and ITMOs for procurement, so as to mitigate risk of the fund participants facing criticism for exercising a significant degree of influence over fund decision-making. We would also recommend designating the fund manager or an independent party (rather than the participant) with responsibility for making final decisions about the pricing of ITMOs under MOPAs.

As noted above, we are of the view that ITMO procurement falls outside of the scope of GGGI's internal procurement rules. However, to ensure that even if it falls within scope, that it is subject to an exception that allows for direct procurement, GGGI should monitor market development of mitigation activities under Article 6.2, as this will influence whether the exception on the basis of 'no market supply' applies. In the case of ITMO Funds which have EU entities as participants, it will also be important to monitor EU regulatory developments for whether ITMOs become classified as 'financial instruments' as this will influence whether the financial services exception applies to ITMO trading by the Fund in future.

2.3 Governance and operational approaches for the ITMO Fund

We recommend that GGGI's approach to establishing and operating an ITMO Fund entails the following elements:

Governance structure

- Both sole participant and multiple participant funds have benefits and risks, and both approaches are feasible.
- A simple governance structure (trustee, fund manager, participant(s), board) with responsibilities of each body clearly set out in fund regulations. Some levels of management may not be necessary for a single-participant fund (e.g. a separate board).
- Particular government regulations of the participant in each instance will need to be considered. If, by way of example, a sole participant fund on behalf of SEA is established, compliance with Swedish Government Appropriation Directives and alignment with SEA's objectives will be essential.

Fund objectives

- Fund objectives should be clearly articulated up front and there should be an avoidance of multiple potentially competing objectives. A sole participant fund will need to be clearly aligned with the participant's own investment mandate, objectives and priorities.

Procurement / mitigation activity selection criteria

- As ITMO procurement likely falls outside the scope of GGGI's internal procurement regulations and rules (or alternatively, is subject to an exception under those rules), an ITMO Fund can and should establish a separate process for selecting mitigation activities for the fund.
- Mitigation activity selection criteria should be clearly set out in fund regulations (e.g. in an investment mandate schedule). Criteria must align with Article 6.2 requirements at a minimum and be attuned to additional participant requirements (e.g. related to integrity, safeguards). Potential mitigation activities should be thoroughly assessed against the selection criteria and due diligence undertaken of the activity participants and activity to ensure activities are of high environmental integrity and align with fund procurement requirements (this can be assisted through relying on robust assessment throughout the mitigation activity development pipeline if also being undertaken separately by GGGI).
- An ITMO Fund may source ITMOs through mitigation activities that already receive support from GGGI (i.e. GGGI's 'pipeline' of mitigation activities). An ITMO Fund can also source ITMOs through putting out open calls to the public for mitigation activities that do not already receive GGGI's support, or putting out calls for procurement of ITMOs as units on the market.
- If an ITMO Fund is to source mitigation activities from GGGI's pipeline, then it will be important for GGGI to establish and maintain a strong pipeline of mitigation activities, in order to ensure a reliable stream of ITMOs for the ITMO Fund. Calls for mitigation activity proposals are unlikely to be useful as a sole mechanism for sourcing mitigation activities for the fund, particularly given that ITMO mitigation activities are in early stages of development and there will not be a large pool of activities established and ready to respond to a call. Instead, calls should be possible as a back-up to pipeline activities.
- With respect to GGGI's process for building this pipeline of activities, we understand that GGGI does not typically put out open calls for proposals when seeking to undertake new activities in member countries. However, GGGI's process for sourcing opportunities to assist with mitigation activities (or other capacity building activities) is a distinct process from how an ITMO Fund sources mitigation activities or ITMOs. In other words, GGGI could choose to refrain from using calls when seeking out opportunities to develop activities in other countries, but separately, the ITMO Fund could use calls to source established mitigation activities or ITMOs for procurement once there is more of a market for these.
- An ITMO Fund may require mitigation activity developers who receive financing from the ITMO Fund to comply with GGGI's internal operational policies – including its procurement regulations and rules – in relation to how those developers go about procuring goods, works and services for the mitigation activities themselves.
- Portfolio criteria can be used to manage risks associated with investing across mitigation activities in different countries, sectors, activity types and scales.

Communication with participants

- Good lines of communication between trustee and participant(s) are important. At a minimum, annual meetings of participants should take place, with more frequent meetings of the board (or between the trustee and sole participant if that model is adopted) to provide guidance on fund operations and to progress activity approval.

Contributions

- Flexibility for participants to make their contributions in accordance with their own budgeting constraints is important and should be provided for in fund regulations.

Mitigation Outcome Purchase Agreements

- Mitigation Outcome Purchase Agreements (**MOPAs**) should incorporate participation requirements under the Article 6.2 Guidance, and ensure that ITMO acquisition is contingent on authorizations and corresponding adjustments by host countries under the Article 6.2 Guidance. Procedures must be developed and implemented to ensure that corresponding adjustments are made which must also reflect how corresponding adjustments are achieved if the trustee of the fund is the purchaser of ITMOs, as it is the participant who is required to make corresponding adjustments when acquiring ITMOs for use towards its NDC (in addition to the first transferring party, i.e. the party where the mitigation activity takes place). These procedures should be addressed both in the fund regulations as well as being built into participation agreements and MOPAs.
- An ITMO Fund would benefit from having flexibility to adopt a range of purchasing approaches for MOPAs (e.g. pre-payments, payment upon delivery, spot, forwards, options) to support mitigation activities at different stages of readiness. An investment mandate may set out guidance on how a portfolio might be weighted.
- Approaches to negotiating MOPAs with host countries and project proponents should not underprice ITMOs, and will need to strike a balance between providing a sound investment for participants and not disincentivizing host countries from engaging.

Opt-out provisions

- Limited opt-out provisions for specific mitigation activities are recommended for multi-participant funds to balance flexibility for fund participants with the need for funding certainty for GGGI as trustee. Alternatively, opt-in provisions can be used to mitigate against risk of fund progress being delayed due to lack of interest by one participant.

Capacity-building

- Capacity-building and early engagement with ITMO mitigation activity developers, including through maintaining a strong presence in host countries, is critical to ensure activities proceed to ITMO delivery. Providing up-front payments to mitigation activity developers through an ITMO Fund will assist with early development and may mitigate delivery risk, particularly given the nascent state of the ITMO market.

Managing legal uncertainty

- Each ITMO Fund information memorandum (which sets out the scope of the investment opportunity and key risks and mitigants) will need to recognize the inherent risks in participation in carbon markets, and in particular in Article 6 activities given their novel state and the untested and evolving legal interpretation of ITMOs.

Transparency considerations

- Funds should be careful to ensure that procurement of mitigation activities or ITMOs as units is undertaken in a way that minimizes the risk of the participant facing criticism for using the Fund to circumvent its obligations under public procurement regulations.
- . Steps that GGGI can take to mitigate such risk are:
 - setting out clear and transparent mitigation activity selection criteria in the fund regulations;
 - ensuring a fair approach to pricing of ITMOs in MOPAs; and
 - providing transparency to the public as much as possible around fund activities and evaluation processes.
- GGGI should also design an ITMO Fund in a way that tempers the participant's control over fund decision-making processes and thereby minimizes risk to the participant of facing criticism in relation to its degree of control over the fund, including by:
 - Making payments from the ITMO Fund from a designated account (rather than directly with participant funds).
 - Conferring the fund manager with a degree of control over the process for procuring mitigation activities (in accordance with mitigation activity criteria clearly spelled out in the fund regulations) and negotiating MOPAs, so that the participant does not have full control over these processes (however, we consider that it will still be appropriate for the participant to provide final sign-off on procurement decisions, provided that this is based on recommendations from the fund manager).
 - Conferring the fund manager or an independent party (rather than the participant) with responsibility for making final decisions about the pricing of ITMOs under MOPAs.
 - Structure MOPAs so that the ITMO Fund Trustee takes title to the ITMOs before these are disbursed and later transferred to the participant (at which point, the participant takes title).
 - Consider including in fund regulations conditions on the participant's use of ITMOs (however, given that ITMOs can only be used for specific purposes, we do not consider this to be a high priority).

3 Legal & regulatory framework applicable to ITMO procurement

3.1 Legal characterization of, regulatory treatment, and legislative and regulatory mechanisms underpinning carbon credits under EU and Swedish law

3.1.1 Overview

We have undertaken a review of the legal nature of the following carbon credits:

- Certified Emissions Reductions (**CER**);
- Verified Carbon Units (**VCU**) and Verified Emissions Reductions (**VER**) (both voluntary carbon credits (**VCC**));
- UK Allowances (**UKA**);
- Article 6.4 Emission Reductions (**6.4ERs**); and
- internationally transferred mitigation outcomes under Article 6.2 (**ITMOs**).

This section summarizes our consideration of other carbon credits, and sections 3.1.4 and 3.2 below consider the characteristics of ITMOs. We have included analysis on the Swedish position to provide an example of national approaches. The EU and Swedish analysis is relevant to SEA's potential participation in Trust Fund 1.

3.1.2 Our review indicates that in general, the legal nature of carbon credits is often unclear and must be determined by reference to national law, though many jurisdictions still lack a definitive characterization. Characterization of emissions allowances and CERs

The EU regulatory framework for carbon credits distinguishes between voluntary and compliance market carbon credits (the latter being “emissions allowances” that are tradeable on the EU Emissions Trading Scheme (**EU ETS**), referred to as “EU allowances”).

The legal characterization of “emissions allowances” at the EU level is unspecified and is largely left to individual member states. An EU allowance appears to have a hybrid nature that makes it both a public/administrative right and a private property right, depending on its use. For the purposes of trading, the Markets in Financial Instruments Directive (**MiFID**) II recognizes allowances (to the extent recognized for compliance under the EU ETS) as a financial instrument. Additionally, derivative contracts relating to emissions allowances (whether settled physically or in cash) are financial instruments. Financial instruments listed under MiFID II fall within the scope of EU regulation.

Prior to 2013, CERs were emissions allowances that could be traded under the EU ETS. There is currently no classification of 6.4ERs or ITMOs under EU law. Whilst we can see a pathway for 6.4ERs to be treated similarly to CERs, ITMOs will be more difficult to characterize as they can potentially represent a ton of CO₂-e (or equivalent non-greenhouse gas (**GHG**) metric) in a unitized form or the accounting treatment of the transfer of that unit. If in future the EU were to recognize 6.4ERs and/or ITMOs as emissions allowances, we expect that it will regulate ITMOs as it did CERs pre-2013 (i.e. as financial instruments under EU law).

The legal characterization of an emission allowance under Swedish law, as an example of national law within the EU relevant to Trust Fund 1, follows the characterization at the EU-level and is explicitly stated in law to be a financial instrument (chapter 1, section 4 of the Securities Market Act (*Sw. lagen 2007:528 om värdepappersmarknaden*)). The Swedish legislator has, however, not provided any further guidance as regards to the legal classification of allowances from a private or public law perspective, but refers to allowances according

to the EU legislation, as fungible, dematerialized and tradable instruments.² Furthermore, legal literature on the subject is scarce. It should be noted that emission allowances for accounting purposes have most commonly been defined as financial assets. Emissions allowances are also specifically regulated under Swedish VAT and income tax law (turnover or capital asset depending on the purpose of the ownership) whilst voluntary allowances are not. Swedish commentators have argued that all allowances (voluntary and compliance) typically should be seen as negotiable instruments under Swedish law (*Sw. värdepapper*), although not all are considered as financial instruments for the purpose of MiFID.³ It is also argued that they can be regarded as means of payment and that allowances that are allocated gratuitously and are not credit-based (e.g. EU allowances), always constitute state subsidies or business grants, under Swedish law whilst credit-based allowances never do.⁴

In regards to the procurement of emissions allowances and CERs, the Swedish and EU public procurement regulations distinguish between a public contract of works, supplies or services. Whether a particular type of procurement constitutes procurement of works, supplies or services under the Swedish and EU public procurement regulations must be assessed on a case-by-case basis. A CER in and of itself may, provided the CER is somehow materialized fall under the definition of “supplies” under the Swedish and EU public procurement regulations. However, a contract for CERs will likely also include services falling under the definition of “services” under the Swedish and EU public procurement regulations. For example, if the CER is generated through constructing a wind power project, the services could, inter alia, be consultancy services related to managing the wind power project, supervising the project, or monitoring the progress of the project etc. A contract for CERs will accordingly likely include elements of both supplies and services, i.e., constitute a mixed contract which shall be awarded in accordance with the provisions applicable to the type of procurement that characterizes the main subject of the contract in question. Even if the CER may classify as supplies, the contract will thus likely include services related to the CER to such extent that the contract will classify as a services contract rather than a supplies contract based on the so called preponderance principle meaning that it is the highest of the estimated values for the supplies or services that determines which provisions are to be applied. There are several examples of public procurements of CERs in Sweden where the procurement has been classified as a procurement of services.⁵ The material regulations applicable to supplies and services are though generally the same.

The EU has developed a single classification system for public procurements aimed at standardizing the references used by contracting authorities and entities to describe the subject of procurement contracts. The system consists of Common Procurement Vocabulary codes (so called CPV-codes) and is adopted by Commission Regulation (EC) No 213/2008 of 28 November 2007 amending Regulation (EC) No 2195/2002 of the European Parliament and of the Council on the Common Procurement Vocabulary (CPV) and Directives 2004/17/EC and 2004/18/EC of the European Parliament and of the Council on public procurement procedures, as regards the revision of the CPV. CERs will likely fall under the CPV-code 90731210-5 - Purchase of CO2 emission credits⁶ with the following CPV-code structure:

- 90000000-7 - Sewage, refuse, cleaning and environmental services
- 90700000-4 - Environmental services
- 90730000-3 - Pollution tracking and monitoring and rehabilitation
- 90731000-0 - Services related to air pollution

² European Commission, Directorate-General for Climate Action, Reins, L., Ballesteros, M., Bart, I., et al., *Legal nature of EU ETS allowances: final report*, Publications Office, 2019, <https://data.europa.eu/doi/10.2834/014995>, p. 47.

³ Emil Elgebrant, *Ägande & värde av utsläppsrätter och andra liknande handelsobjekt*, Stockholm 2012.

⁴ *Ibid.* p. 313.

⁵ See, for example, the Air Navigation Services of Sweden's procurement of emission reduction certificates with ref. no. D-2014-009921 and Å-2014-000431, Swedavia AB (publ.) procurement of climate compensation with ref. no. SDA 2014-000232, and Blekinge Institute of Technology's procurement of climate compensation with ref. no. 260-0379-2011.

⁶ CPV-code 90731210-5 - Purchase of CO2 emission credits was, for example, used by the Air Navigation Services of Sweden in its procurement of emission reduction certificates with ref. no. Å-2018-007872.

- 90731200-2 - Transboundary air pollution management or control services
- 90731210-5 - Purchase of CO2 emission credits

3.1.3 Characterization of VCCs

The legal characterization of VCCs ultimately depends on the legal treatment in each jurisdiction, given the absence of any overarching classification. One constituting character of VCCs is that they are generated outside of a statutory framework: that is, they are generated in accordance with standards administered by non-governmental organizations. The terms and conditions for the standard registries provided guidance on how the registry will recognize VCCs in individual user accounts, with users only able to hold and retire or cancel VCCs to which they hold all legal title and beneficial ownership rights (unless expressly acting in an agency or authorized custodial capacity).

VCC treatment under specific jurisdictions indicates they can be a form of intangible property or a bundle of contractual rights. For instance, under English law, the courts appear to recognize VCCs as intangible property where the market treats VCCs as property. However, there is still some uncertainty around the precise characterization absent a definitive statement. Another argument for the fact that VCCs could be considered intangible property is that VCCs are considered to represent a finite resource, namely the reduction or removal of 1 tCO₂-e from the atmosphere, and it is from this that the VCC derives its value.

However, VCCs can also be considered a bundle of rights: a VCC can be generated in respect of a project, but, depending on the rules of the voluntary standard, it might also be retracted if the project is found not to have complied with the rules of the standard. This approach indicates the possibility for significant fragmentation across the VCC market, given the legal treatment of VCCs would depend on each individual contract and the voluntary standard's rules. This will also impact the transferability of VCCs, as this will be defined by the governing law and terms of the contract (rather than regulation applying more broadly).

It is important to note that the characterization of a VCC is distinct from a transaction in a VCC. Where a person transacts in a derivative of a VCC, this will inevitably be caught by the financial regulation in a country. Under EU law, for instance, derivatives flowing from any emissions allowance are regulated as financial instruments under MiFID II and futures, forwards, options or swaps of VCCs that are cash-settled⁴ or capable of being cash-settled could be considered financial instruments that would qualify as financial contracts and investment services under MiFID II. The same considerations apply as regards Swedish classification of VCCs.

For the context of Trust Fund 1, the Swedish legislator has not provided any further guidance as regards the legal classification of VCCs and it is not clear whether it should be regarded as a tangible or intangible property. It should be noted that voluntary allowances for accounting purposes have most commonly been defined as financial assets. Swedish commentators have argued that all allowances (voluntary and compliance) typically should be seen as negotiable instruments under Swedish law (*Sw. värdepapper*), although not all are considered as financial instruments for the purpose of MiFID II.⁷

3.1.4 Characterization of ITMOs

We have not identified attempts by the EU or Sweden to classify ITMOs at this time, however, we would expect that treatment of ITMOs will be similar to that of VCCs and CERs, and that Sweden will follow any EU decision

⁷ Section C of Annex I in Directive 2014/65/EU (also referred to as MiFID II).

regarding classification. We also note that there have been two Swedish examples of public procurement of ITMOs being classified as public procurement of a service contract in MOPAs.⁸

Section 5.2 sets out implications of the characterization of ITMOs for the application of GGGI's procurement regulations and rules when purchasing ITMOs through the ITMO Fund.

3.2 ITMO characteristics under Article 6 of the Paris Agreement

The essential characteristics of ITMOs and how mitigation activities are to be implemented and reported on are set out in Decision 2/CMA.3, and were further elaborated in guidance from the Conference of the Parties to the Paris Agreement (CMA) at COP27 in November 2022 (Decision 6/CMA.4)⁹ (we refer to these decisions collectively as the 'Article 6.2 Guidance').

The Article 6.2 Guidance is significant for ITMO Fund operation in two respects:

- Firstly, it will be necessary for the ITMO Fund Regulations to contain mitigation activity selection criteria that ensure that ITMOs purchased by the ITMO Fund are generated by mitigation activities that meet the criteria in the Article 6.2 Guidance. These include requirements that activities meet the environmental and sustainable development safeguards in the Article 6.2 Guidance.¹⁰
- Second, both host countries where mitigation activities take place, and ITMO Fund participants who receive ITMO distributions, must satisfy the particular participation requirements under the Article 6.2 Guidance, and have the necessary infrastructure in place for authorizing and tracking ITMOs through a registry, applying corresponding adjustments where appropriate, and meeting the reporting requirements under the Article 6.2 Guidance.¹¹

Accordingly, below, we set out the key defining features of ITMOs, and the participation requirements that countries must satisfy in order to participate in Article 6.2 cooperative approaches.

3.2.1 Key defining features of ITMOs

The concept of an 'ITMO' is established by Article 6.2 of the Paris Agreement, which provides that parties '*shall, where engaging on a voluntary basis in cooperative approaches, that involve the use of internationally transferred mitigation outcomes towards nationally determined contributions, promote sustainable development and ensure environmental integrity and transparency, including in governance, and shall apply robust accounting to ensure, inter alia, the avoidance of double counting*'. This is to be done consistently with guidance adopted by the CMA.

ITMOs represent units of carbon emission reduction or removal, generated through undertaking mitigation activities. To become an 'ITMO', a unit (or mitigation outcome) must be 'transferred' between the GHG inventories of the two parties, so that the reduction or removal in emissions from one country's inventory is transferred to that of the other participating party. Under the Article 6.2 Guidance, to be classified as an ITMO, a unit must be:¹²

⁸ The Swedish Energy Agency's procurement of emission reduction units that can be transferred under the framework of article 6 of the Paris Agreement – Dominican Republic with ref. no. 2021-3580 and the Swedish Energy Agency's procurement of emission reduction units suitable for the framework of Article 6 of the Paris Agreement – Republic of Ghana with ref. no. 2021-38618.

⁹ Decision 6/CMA.4 'Matters relating to cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement' (Decision 6/CMA.4).

¹⁰ Decision 2/CMA.3, Annex, Chapter III.

¹¹ Decision 2/CMA.3, Annex, Chapters III and IV.

¹² Decision 2/CMA.3, Annex, paragraph 1.

- real and verified;
- additional. This generally means that the activity would not have occurred if not for the incentives offered by participating in Article 6.2 cooperative approaches (i.e. they would not be financially viable without revenue from the sale of mitigation outcomes),¹³ taking into account all relevant national policies, and that the activity represents mitigation that exceeds any mitigation required by law or regulation;
- generated from emission ‘reductions’ or ‘removal’ activities, including mitigation co-benefits resulting from adaptation actions and / or economic diversification plans or the means to achieve them, when internationally transferred;
- measured in tCO₂e in accordance with the methodologies and metrics assessed by the Intergovernmental Panel on Climate Change and adopted by the CMA or in another non-GHG metric determined by participating parties which is consistent with the parties’ NDCs;
- from a cooperative approach referred to in Article 6.2 of the Paris Agreement that involves international transfer of mitigation outcomes authorized for use toward an NDC;
- generated from activities which are undertaken from 2021 onwards; and
- ‘authorized’ for a particular use. This may be for international mitigation purposes other than achievement of an NDC (referred to as ‘international mitigation purposes’) or authorized for other purposes as determined by the first transferring participating party (referred to as ‘other purposes’) (together, ‘international mitigation purposes’ and ‘other purposes’ are referred to as ‘other international mitigation purposes’).

Under the Article 6.4 Guidance, ITMOs must also be uniquely identifiable (the vintage of an ITMO, transferring and using parties, nature of the underlying activity, and the relevant sector must be identifiable).¹⁴

With respect to the requirement for ITMOs to be generated from emissions reductions or removals, the Article 6.2 Guidance does not define what emissions reductions or removals are. However, ‘emission reductions’ generally refers to the reduction in the amount of GHG emissions that would otherwise have been emitted referable to a baseline scenario (e.g., changing plant and equipment or processes to reduce emissions). Emissions removals refers to activities that remove GHG emissions from the atmosphere and sequester them for permanent storage – either biologically or technologically. The SBSTA is currently considering whether ITMOs could include emissions avoidance activities: this will be considered further in the lead up to COP28 in 2023.

It should be noted that there are two types of units that can be units that can be generated under Article 6.4 of the Paris Agreement (**A6.4ERs**), but only one of these is considered an ITMO:

- **Authorized A6.4ERs** – A6.4ERs authorized for use towards achievement of NDCs and/or for other international mitigation purposes. These are classified as ITMOs, and therefore, are subject to the rules of transfer under Article 6.2, including requirements to apply corresponding adjustments.
- **Mitigation contribution A6.4ERs** – A6.4ERs not specified as authorized for use towards achievement of NDCs and/or for other international mitigation purposes. These may be used, inter alia, for results-based climate finance, domestic mitigation pricing schemes, or domestic price-based measures, for the purpose of contributing to the reduction of emission levels in the host Party. These units are not ITMOs and are not subject to the Article 6.2 Guidance.

¹³ West African Alliance on Carbon Markets and Climate Finance, *Blueprint for Article 6 Readiness in member countries of the West African Alliance* (June 2022) page 32.

¹⁴ Decision 6/CMA.4, Annex I, paragraph 4.

3.2.2 Environmental integrity safeguards that apply to mitigation activities

Mitigation activities are also required to meet certain environmental integrity standards in the Article 6.2 Guidance.¹⁵ For example, the initial reports that must be submitted for each cooperative approach,¹⁶ must include information on how the cooperative approach ensures environmental integrity, including:¹⁷

- That there is no net increase in global emissions within and between NDC implementation periods;
- Through robust, transparent governance and the quality of mitigation outcomes, including through conservative reference levels, baselines set in a conservative way and below 'business as usual' emission projections (including by taking into account all existing policies and addressing uncertainties in quantification and potential leakage);
- By minimizing the risk of non-permanence of mitigation across several NDC periods and how, when reversals of emission reductions or removals occur, the cooperative approach will ensure that these are addressed in full;
- A description of how each cooperative approach will:
 - Minimize and, where possible, avoid negative environmental, economic and social impacts;
 - Reflect the eleventh preambular paragraph of the Paris Agreement, acknowledging that climate change is a common concern of humankind, Parties should, when taking action to address climate change, respect, promote and consider their respective obligations on human rights, the right to health, the rights of indigenous peoples, local communities, migrants, children, persons with disabilities and people in vulnerable situations and the right to development, as well as gender equality, empowerment of women and intergenerational equity;
 - Be consistent with the sustainable development objectives of the Party, noting national prerogatives;
 - Apply any safeguards and limits set out in further guidance from the CMA; and
 - Contribute resources for adaptation and deliver overall mitigation in global emissions (**OMGE**), if applicable (these are not mandatory requirements for Article 6.2 participation, but are 'strongly encouraged' under the Article 6.2 Guidance).¹⁸

3.2.3 Participation requirements

The participants in an ITMO Fund (or the country parties they represent), as well as the host countries where mitigation activities funded by the ITMO Fund take place, will need to meet the participation requirements in the Article 6.2 Guidance in order to receive ITMOs. Each participating party must:¹⁹

- be a Party to the Paris Agreement;
- have prepared, communicated and be maintaining an NDC;²⁰

¹⁵ Decision 2/CMA.3, Annex, paragraph 17.

¹⁶ With respect to timing of this report, it is to be submitted no later than authorization of ITMOs from a cooperative approach or where practical (in the view of the participating Party) in conjunction with the next biennial transparency report due pursuant to decision 18/CMA.1 for the period of NDC implementation: see Decision 2/CMA.3, Annex, paragraph 18.

¹⁷ Decision 2/CMA.3, Annex, paragraph 18. Similar obligations apply in relation to regular reports.

¹⁸ Decision 2/CMA.3, Annex, paragraph 37.

¹⁹ Decision 2/CMA.3, Annex, Chapter II.

²⁰ As required under Article 4.2 of the Paris Agreement.

- have arrangements in place for authorizing the use of ITMOs towards achievement of NDCs pursuant to Article 6.3 of the Paris Agreement (which requires that the use of ITMOs to achieve NDCs must be voluntary and ‘authorized’ by participating Parties);
- have arrangements in place that are consistent with the Art 6.2 Guidance and relevant decisions of the CMA for tracking ITMOs;
- have provided the most recent national inventory report;²¹ and

Its participation must contribute to the implementation of its NDC and long-term low-emission development strategy, if it has submitted one, and the long-term goals of the Paris Agreement.

It should be noted that the Article 6.2 Guidance recognizes the special circumstances of the least developed countries (**LDCs**) and small island developing states (**SIDs**), where the participation requirements relate to NDCs, with other aspects of their special circumstances to be recognized in further decisions.²²

3.2.4 Fungibility of ITMOs, including the type of activities eligible to generate ITMOs and the ways in which ITMOs can be used

Based on the characterization of ITMOs under the Article 6.2 Guidance, the generation of ITMOs will be possible to the extent to which activities are authorized as cooperative approaches. Activities that are eligible to generate ITMOs will be those agreed upon by Parties to a bilateral agreement, or those activities authorized by a host Party.

Whether it will be possible to freely transfer ITMOs between multiple emissions trading or carbon crediting schemes will depend on whether there is mutual recognition of the specific type of ITMOs in each country’s domestic scheme rules. Where the ITMO has been generated under a bilateral agreement, the agreement will typically structure the authorization for the ITMO for use only by the receiving Party (and not necessarily subsequent transferring parties). This means the relevant ITMO may not be highly fungible, given the potential for its restricted use.

ITMOs can only be used towards a receiving Party’s NDC or for other international mitigation purposes; the latter has been left intentionally broad, providing country Parties with discretion to authorize uses. In general, other purposes are understood to reference the voluntary carbon market, while international mitigation purposes are commonly understood as referring to international schemes such as CORSIA.

²¹ This is required in accordance with decision 18/CMA.1.

²² Decision 2/CMA.3, Annex, paragraph 5.

4 Case Study: Relevant regulations that apply to GGGI and SEA in the case of Trust Fund 1

4.1 Application of Swedish and EU procurement laws to GGGI

4.1.1 Contracting by GGGI is not generally subject to public procurement laws

Our analysis of Swedish and EU law indicates that Swedish and EU public procurement regulations will not apply to GGGI's acquisitions of supplies, services or works for Trust Fund 1 on behalf of the SEA, on the basis that GGGI is neither a contracting authority, nor a body governed by public law. The Swedish and EU public procurement regulations do, however, apply to SEA and SEA's acquisitions of supplies, services or works.

We are advised that SEA's election of GGGI falls under an exemption in the Swedish and EU public procurement regulations (our assignment does not cover an analysis of this question). Provided SEA correctly appoints GGGI for Trust Fund 1 on the basis of an exemption in the Swedish and EU public procurement regulations, GGGI (or the Fund) will not have to follow the Swedish and EU public procurement regulations, even though the procurements are undertaken on SEA's behalf.

However, should SEA exercise influence over GGGI's (or the Fund's) procurement activities to such an extent that SEA is able to arbitrarily control GGGI's (or the fund's) procurement activities, SEA risks criticism for trying to circumvent the public procurement regulations by using GGGI (or the Fund) as a middleman. This could be the case if, for example, SEA selects projects or suppliers within GGGI's (or the Fund's) procurement activities. In that scenario, a potential supplier or interested party may challenge the transaction claiming that the exemption allowing SEA to elect GGGI is not applicable since in practice it is SEA who is performing the procurement activities and that SEA is just trying to circumvent the public procurement regulations by using GGGI (or the Fund) as an intermediary. Should this situation occur, SEA's risk for criticism may be reduced if GGGI (or the Fund) were to follow the Swedish and EU public procurement regulations. The situation has however not been tried by case law, therefore the legal situation is unclear.

Options for operating ITMO Funds in a manner that will mitigate the risk of a participant being criticized in this way are set out in section 7.2.

4.1.2 Specific circumstances in which GGGI may be legally required to apply public procurement regulations

For completeness, we note that there are some arguments in legal literature suggesting that the public procurement regulations could apply to GGGI under very specific circumstances (despite GGGI not being a contracting authority or body governed by public law).²³ The argument is based on two reports applying the Agreement of Government Procurement ("GPA").²⁴ While unadopted, the report concerning the procurement of a sonar mapping system illustrates the situation as follows:

The Antarctic Support Associates ("ASA"), a private company not regulated by the GPA, conducted a procurement for a sonar mapping system for the benefit of National Science Foundation ("NSF"), an agency of

²³ Arrowsmith, *the law on public and utilities procurement*, 3rd edition, 2014 p. 372–373.

²⁴ Report of the panel GPR.DS1/R of April 23, 1992, *United States – Procurement of a Sonar Mapping System* and report of the panel WT/DS163/R of May 1, 2000, *Korea – Measures Affecting Government Procurement*.

the United States Government regulated by the GPA. The procurement was carried out by ASA following a contract between NSF and ASA according to which ASA shall, among others, provide products and services to NSF. Following the procurement, ASA entered into contract with a supplier of the sonar mapping system. The European Community raised a complaint concerning the procurement by NSF of the sonar mapping system.

The panel reviewing the complaint pointed out that under normal circumstances a contract between two private companies would not in principle be regarded as government procurement and would fall outside the scope of the GPA. In the specific case at hand, however, the panel concluded that the procurement was in fact a government procurement by NSF. This conclusion was based on numerous factors, namely, among others, that payment for the system would be made with government money; that NSF would reimburse ASA's costs for the system; that the amount of the purchase was specifically determined by the Government with the maximum permissible price legislatively prescribed; that NSF would take title to the system and the system never became ASA's property; that NSF would on expiry of the contract be free to use or dispose the system as it saw fit; that NSF retained control over the procurement process and the concluded contract; and that ASA had no commercial interest in the transaction by way of profit motive or commercial risk.

The argument in the legal literature is that similar factors to those detailed above should also be relevant for the purpose of extending and applying the EU public procurement regulations to similar situations.²⁵

That said, we are unaware of any case from the CJEU where the CJEU has actually applied these factors and extended the scope of the EU public procurement regulations in a manner similar to the panel's extension of the GPA regulations above.

4.1.3 GGGI is an EU-pillar assessed organization

GGGI is eligible to receive funding from the budget of the European Union and has been pillar assessed for the following pillars: internal control, accounting, external audit, procurement, grants, exclusion from access to funding, publication of information on recipients, and protection of personal data. The pillar assessment has the effect that GGGI's internal regulations, policies and procedures to implement EU funds are considered to ensure a level of protection of the financial interests of the EU equivalent to the one that is provided for when the Commission implements the budget itself. This has the following two relevant implications:

- the successful pillar assessment of GGGI's procurement rules and regulations indicates that SEA would be comfortable with GGGI applying GGGI's own procurement regulations and rules when conducting procurement processes on behalf of SEA.²⁶
- GGGI is not obligated to follow the additional public procurement regulations in the *Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union* (Financial Regulation) applicable to public contracts against payment of a price paid in whole or in part from the budget of the European Union.

4.2 Relevant regulations that apply to SEA as the initial participant

As an agency of the Swedish Government, SEA's decision-making around whether and how it contributes to Trust Fund 1 will need to align with Swedish Government requirements, including SEA's governing regulation and annual appropriation directives. These instruments are relevant to:

²⁵ Arrowsmith, *the law on public and utilities procurement*, 3rd edition, 2014 p. 373.

²⁶ Interview with GGGI (15 December 2022).

- the types of funds that SEA can invest in; and
- the required or preferred mode of investment in relation to timing to align with budget cycles and expenditure by the Government.

We set out these relevant considerations below.

4.2.1 Overview

SEA is accountable to the Swedish Government for its operations, and the Swedish Government prescribes requirements for SEA's operations according to the Instrument of Government (1974:152) (Sw. *Regeringsformen* (1974:152)), which it implements through annual appropriation directives and regulations.²⁷ The Government also allocates funding to SEA in accordance with Chapter 9, Articles 1–10 of the Instrument of Government, the Budget Act (2011:203) (Sw. *Budgetlagen* (2011:203)) and Regulation (2011:223) on appropriations (Sw. *Anslagsförordning* (2011:223)).

SEA must comply with annual appropriation directives issued by the Government which set out, among other things, the objectives of SEA's operations; the amount of funding SEA has at its disposal; and how that funding is to be distributed between SEA's different activities (including investment activities under the Paris Agreement).

In practice, while appropriation directives of the Swedish Government govern SEA's rights and obligations at a governmental level, at the internal level, SEA makes decisions on fund participation and investments through a two-step process: firstly, approval of fund participation (or a single major investment) is given by SEA's general director. Second, we understand from interviews that once SEA has entered into a fund, the general director delegates the power to represent SEA in the fund to certain SEA representatives.

In addition, SEA is governed by the principle of public access,²⁸ and generally, all documents stored with SEA that have been received or prepared by SEA are public documents and must be provided to the public on request, unless an exception applies.²⁹

4.2.2 Appropriation direction for budget year 2023

The appropriation directive for the budget year 2023 (**Appropriation Directive**),³⁰ sets out SEA's objectives as follows:

- SEA shall actively contribute to establishing a robust regulatory framework for international cooperation under Article 6 of the Paris Agreement for the purpose of developing credible instruments with high environmental integrity.
- SEA's efforts shall be directed towards method development where special focus should be on measurement, reporting and verification of climate benefit and the contribution to sustainable development.
- SEA's efforts shall also be directed towards preparatory and capacity-building for the implementation of pilot projects and concrete Article 6 collaborations.

²⁷ The principal regulation for SEA being Regulation (2014:520) with instructions for the Swedish Energy Agency (Sw. *Förordning* (2014:520) *med instruktion för Statens energimyndighet*).

²⁸ The principle of public access is established in the second chapter of the Press Freedom Act (1949: 105).

²⁹ Although the principle of public access is the rule, there are exceptions where the public is not entitled to access certain information. Exceptions are regulated in the Public and Privacy Act (2009: 400). Upon request for access to public documents a confidentiality test is performed.

³⁰ Appropriation Directive for the budget year 2023 regarding grant 1:12 Contributions to international climate investments (Sw. *Regleringsbrev för budgetåret 2023 avseende anslag 1:12 Insatser för internationella klimatinvesteringar*).

- The efforts shall contribute to change at sector level and primarily be aimed at low- and middle-income countries and at energy-related emissions.
- SEA must strive to implement concrete development efforts in international cooperation.

The Appropriation Directive also requires SEA to report annually on how its objectives are being met and how it has contributed to sustainable development (with a particular focus on gender equality).

4.3 Relevant GGGI regulations and policies

Any procurement of ITMOs by GGGI on behalf participants under the CTP would need to comply with relevant GGGI internal rules and policies. Accordingly, this section sets out relevant provisions in GGGI's:

- Establishment Agreement;
- Financial regulations;
- Procurement regulations and rules; and
- Disclosure policy.

4.3.1 GGGI's objectives and activities in the Establishment Agreement

All activities of GGGI, including establishing and operating an ITMO Fund, will need to be consistent with GGGI's core objectives and activities as set out in the Agreement on the Establishment of GGGI (**Establishment Agreement**).³¹

Under Article 2, GGGI's objective is to promote sustainable development of developing and emerging countries, including the least developed countries, by:

- supporting and diffusing a new paradigm of economic growth: green growth, which is a balanced advance of economic growth and environmental sustainability;
- targeting key aspects of economic performance and resilience, poverty reduction, job creation and social inclusion, and those of environmental sustainability such as climate change mitigation and adaptation, biodiversity protection and securing access to affordable, clean energy, clean water and land; and
- creating and improving the economic, environmental and social conditions of developing and emerging countries through partnerships between developed and developing countries and the public and private sectors.

Article 4 enables GGGI to participate in the following activities:

- supporting developing and emerging countries with capacity building to design and implement green growth plans at the national, provincial, or local level to facilitate poverty reduction, job creation and social inclusion;
- pursuing research to advance the theory and practice of green growth, drawing particularly from the experience of governments and industries;
- facilitating public-private cooperation to foster an enabling environment for resource-efficient investment, innovation, production and consumption, and diffusion of best practices;
- disseminating evidence-based knowledge and enhancing public awareness of green growth and sustainable development; and
- performing any other activities relevant to the objectives of the GGGI.

³¹ GGGI, 'Agreement on the Establishment of the Global Green Growth Institute' (2017), available at: <https://ggi.org/wp-content/uploads/2017/10/Agreement-on-the-Establishment-of-the-GGGI.pdf>

4.3.2 GGGI's financial regulations

The Financial Regulations provide for the establishment of the GGGI General Fund, Working Capital Fund, Capital Expenditure Fund and Reserve Funds. Relevantly, the Financial Regulations also provide for the establishment of 'earmarked funds' and 'dedicated trust funds' at reg 6.3 of GGGI's Financial Regulations, which provides that:³²

- The core funds of GGGI shall at all times and in all respects be held, used, committed or invested entirely separate from earmarked funds. Each earmarked contribution, its resources and accounts shall be kept entirely separate from other earmarked contributions.
- The core funds of GGGI shall under no circumstances be charged with or used to discharge losses or liabilities arising out of operations or other activities of any earmarked funds. Resources pertaining to any earmarked fund shall under no circumstances be charged with or used to discharge losses or liabilities arising out of operations or other activities pertaining to any other earmarked fund.
- In the operations or other activities of any earmarked funds, the liability of GGGI shall be limited to the resources pertaining to that earmarked fund.
- The Council shall, from time to time, decide on the minimum overhead percentage for dedicated trust funds and earmarked funds.
- Dedicated trust funds and accounts and earmarked funds may be established by the Director-General with respect to restricted contributions provided to finance dedicated activities. The Director-General shall establish such a funds or accounts [sic.] provided the dedicated activities to be financed by the fund or account are aligned with GGGI's strategy.³³ The purpose and limits of each such fund or account shall be clearly defined by the Director-General and shall be reported to the Council. Unless otherwise authorized by the Council, these funds and accounts shall be administered in accordance with the Financial Regulations (our emphasis).

Interviews with GGGI confirmed that the GGGI Director-General has authority to establish trust funds and the terms and conditions of their operation, and to amend these terms and conditions (with Council approval). Interviews also noted that in practice, amendments to fund terms and conditions that govern fund operation will also need approval from fund participants (for example, SEA).

Under reg 2.2 of the Financial Regulations, the Director-General is fully responsible and directly accountable to the Council for all aspects of the GGGI's activities. Under reg 2.2(b), the Director-General may delegate to personnel³⁴ any powers or responsibilities under these Financial Regulations, in whole or in part, through written delegation and, unless expressly prohibited by these Financial Regulations, such delegation may include the power to further delegate. Delegated power and responsibilities shall follow the Financial Regulations. Amendment of and exceptions to the Financial Regulations may only be made with approval of the Council (and the Director-General is responsible for preparing any amendments for Council approval).

How GGGI sources its finance through contributions from member and non-government sources, and regulates its expenditure, is also set out in GGGI's Establishment Agreement and Financial Regulations.³⁵ The Financial

³² Note that these fund types are not explicitly defined in the Financial Regulations.

³³ GGGI's strategy to 2030 deals at 6.1 with Programmatic Global Operational Priorities and provides that In order to ultimately increase public and private sector capital flows toward the development of green investment projects that enhance Members green growth transformation, GGGI will give priority to (among other things) programs that 'Support the development of innovative financing mechanisms to raise additional non-traditional funds for green investments, such as NFVs, bankable projects, carbon markets, green bonds, public-private partnerships, and de-risking instruments': <https://gggi.org/gggis-strategy-2030/>

³⁴ Although 'personnel' is not defined, it likely refers only to GGGI personnel.

³⁵ If there is conflict between provisions of the Financial Regulations and the Establishment Agreement, the Establishment Agreement shall prevail.

Regulations set out methods and measures to safeguard GGGI's assets, secure the accuracy and reliability of accounting data, promote operational efficiency and standardization across GGGI. They govern the financial administration of all GGGI activities, and provide specifically for: GGGI's work program and budget; resourcing (including contributions from members); appropriations; funds; financial statements and accounts;³⁶ and internal control and oversight measures.³⁷

We have not set these further aspects out in detail, given that we expect that the processes for these matters will need to be clearly set out in ITMO Fund regulations, and will often differ from those contained in the GGGI financial regulations (for example, the processes for receiving contributions from ITMO Fund participants and making distributions). These design elements will require Council approval.

4.3.3 GGGI's procurement regulations and rules

GGGI's Procurement Regulations (issued by the Council) and Procurement Rules govern the activities of GGGI carried out for procuring goods, works and Services.

These regulations and rules set out general procurement principles and requirements; the decision-making structure for procurement contracts, with the Director-General providing final approval, and review of proposals by a 'contract review committee'; requirements for preparing and evaluating tenders; and contracting approaches.

Our analysis of the application of these policies to ITMO procurement by an ITMO Fund is set out below in 5.

4.3.4 Transparency and disclosure policies

Article 13 of GGGI's Establishment Agreement requires the organs of GGGI to develop a comprehensive disclosure policy which ensures transparency in the work of GGGI, including (among other things) the criteria and methodology for country program selection.³⁸ Accordingly, an ITMO Fund should operate in a manner that 'ensures transparency in the work of the GGGI'.

We note that GGGI has established a 'Disclosure Policy' which applies to all recorded information in possession of or maintained by GGGI. Information is defined as including printed and electronic materials. It sets out guiding principles, the categories of information to be made public, the types of information to be treated as proprietary, privileged, or confidential.³⁹

³⁶ GGGI uses the IFRS and must prepare financial statements and accounts in accordance with the Financial Regulations. The financial period, for the purposes of accounting for revenue earned and expenses incurred in respect of GGGI's activities, shall consist of a single calendar year.

³⁷ Financial Regulations reg 8.12. Accounts and financial management of the fund will be subject to annual audit. Internal auditing also applies (see Art 10).

³⁸ See GGGI, 'Disclosure Policy' (dated 31 October 2018) available at: <https://gggi.org/policy-documents/>

³⁹ Dated 31 October 2018.

5 Analysis of application of GGGI procurement regulations and rules to ITMO procurement

5.1 Overview

Based on our review of GGGI’s Procurement Regulations and Rules, and approaches to procurement taken by other carbon funds, it is strongly arguable that:

- ITMO procurement (in the form of a unit, or through procurement of mitigation activities and other ancillary activities) by GGGI on behalf of ITMO Fund participants (including SEA) is not subject to GGGI’s Procurement Rules and Regulations; and
- even if it is, GGGI can rely on ‘Direct Procurement’ exceptions in the Rules to procure ITMOs through a non-competitive process.

As a result, GGGI may procure ITMOs for an ITMO Fund (as units, or as mitigation activities):

- from its internal pipeline of mitigation activities that GGGI provides assistance to; or
- from mitigation activities outside of GGGI’s pipeline (for example, if GGGI puts out a limited call for ITMOs from mitigation activities, but does not subject this call to the same competitive requirements set out in GGGI’s Procurement Regulations and Rules).

Below are our key findings, and our reasons for each finding:

Finding	Summary of reasons
GGGI’s Procurement Regulations and Rules will not apply to ITMO procurement	<p>ITMO procurement does not classify as an activity ‘carried out for procuring goods, works and services for GGGI’ because:</p> <ul style="list-style-type: none"> • ITMOs as units are unlikely to classify as ‘Goods’ because they are not tangible items. • Mitigation activities that generate ITMOs are unlikely to classify as ‘Services’ because they are not technical services for projects or administrative support services. • Mitigation activities that generate ITMOs are unlikely to classify as ‘Works’ because they are not ‘the construction, reconstruction, demolition, outfitting, repair or renovation of premises or related infrastructure where there are elements of both Goods and Services present’. • ITMOs (or mitigation activities) will be procured on behalf of the ITMO fund participants, not ‘for GGGI’. <p>Further, this conclusion is consistent with the approaches taken by a number of carbon funds. We describe these at 5.4.</p>
If the Regulations and Rules <u>do</u> apply, ITMOs can be procured through Direct Procurement Contracts (i.e. without competition)	<p>Whilst our view is that GGGI Procurement Regulation and Rules will not apply, in the event that they did apply, the following ‘exceptional circumstances’ apply under the Rules that allow Direct Procurement:</p> <ul style="list-style-type: none"> • There is ‘no marketplace’ for ITMOs as a unit and in the form of mitigation activities. • Procurement activities for a GGGI Fund may be characterized as a ‘financial service’. If ITMOs are regulated as financial instruments, trading of ITMOs on behalf of fund participants is a ‘financial service’.

Finding	Summary of reasons
	<ul style="list-style-type: none"> Alternatively, the Director-General can approve procurement for a fund as a circumstance that justifies Direct Procurement.

We set out our reasoning below.

5.2 Likely legal characterization of ITMOs

Here, we include analysis of ITMOs' likely characterization under EU and Swedish law, by way of example for Trust Fund 1. We have not identified attempts by the EU or Sweden to classify ITMOs at this time, however, we would expect that treatment of ITMOs will be similar to that of VCCs and CERs, and that Sweden will follow any EU decision regarding classification. On this basis, below, we set out the likely characterizations of ITMOs, both generally, and in the Swedish and EU jurisdictions.

5.2.1 ITMOs as intangible assets

Consistent with ISDA's analysis of VCCs, whether ITMOs will be generally capable of being recognized as intangible property will depend on the jurisdiction and national laws.

However, by analogy with ISDA's consideration of VCCs, it is possible to conceptualize ITMOs as intangible assets in the sense that they represent exclusive access to a finite resource, being certification (or verification) that the holder of the person who holds an ITMO in their registry account has directly or indirectly reduced or removed a unit of carbon dioxide equivalent from the atmosphere (in line with applicable rules and requirements).⁴⁰

5.2.2 ITMOs as bundles of contractual rights

Like VCCs, in each jurisdiction, ITMOs will be recorded by a registry administrator and will be subject to the contractual framework of the relevant registry. In this way, consistent with ISDA's characterization of VCCs, ITMOs may be characterized as representing a bundle of private law contractual rights documented under the relevant service contracts with the verifier and registry rules that the particular mitigation activity developer was required to adhere to. This bundle of contractual rights (and potentially also tortious rights) would be rights against the mitigation activity developer, verifier, particular legal framework under which the mitigation activity was undertaken, and the registry administrator.

5.2.3 ITMOs as financial instruments under EU law

Under EU law, a financial instrument is defined as any instrument specified in Section C of Annex I in Directive 2014/65/EU (also referred to as MIFID II).⁴¹

In Annex I financial instruments are, among others, options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash as well as emission allowances consisting of any units recognized for compliance with the requirements of Directive 2003/87/EC (Emissions Trading Scheme).

⁴⁰ See the International Swaps and Derivatives Association, 'Legal Implications of Voluntary Carbon Credits' (December 2021) section 3.11, available at: <https://www.isda.org/2021/12/01/legal-implications-of-voluntary-carbon-credits/>.

⁴¹ C.f. Article 4(15) of Directive 2014/65/EU.

ITMOs as such are not explicitly listed as a financial instrument in Section C of Annex I in Directive 2014/65/EU, however, there is potential for this to be done in future.

5.2.4 ITMOs as emission allowances under EU law

If the EU chooses to regulate ITMOs as emission allowances (like it previously classified CERs), ITMOs will be defined under EU Regulation as a ‘fungible, dematerialized instrument that is tradable on the market’.⁴²

As emission allowances, ITMOs would likely be characterized as having a hybrid nature depending on their use, containing elements of both public/administrative rights and intangible, private property rights:⁴³

- They may be considered administrative rights to the extent they are issued by public authorities to private entities or individuals for the purposes of compliance, as well as to the extent they are subject to State control in order to verify that compliance. EU rules establishing that allowances are issued by public authorities point to their definition as administrative or regulatory rights.
- However, once traded, they can be considered private property rights, as they will be freely alienable and transferable without public oversight. The existence of allowances in the EU Registry reflects characteristics linked with their nature as ‘intangible property rights’, and the unique unit identifying code provided to each allowance upon creation that gives them an identifiable character is appropriate to ‘private property’.⁴⁴

Importantly, if treated as emission allowances, ITMOs will also be classified as ‘financial instruments’ under MiFID II.

If the EU regulates ITMOs in the same way as emission allowances, EU member states including Sweden will be able to clearly define the legal nature of ITMOs (as emissions allowances) if they so choose, however, we have not seen any attempt from Sweden to do this to date.

5.2.5 Transactions in ITMOs as financial instruments

It is important to recognize that the classification of an ITMO itself will be distinct from the characterization of a transaction in ITMOs.⁴⁵ Under MIFID II, ‘options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash’ are classified as a type of financial instrument.⁴⁶

Just as ISDA considers that derivatives of VCCs (as distinct from spot contracts) will generally meet the requirements of financial instruments under MIFID II,⁴⁷ we expect that derivatives of ITMOs will equally be classified as financial instruments under EU law, regardless of whether the ITMO itself is classified as a financial instrument.

⁴² Article 40 of the EU Registry Regulation 389/2013.

⁴³ Section 4.3 of European Commission, Directorate-General for Climate Action, Reins, L., Ballesteros, M., Bart, I., et al., *Legal nature of EU ETS allowances: final report*, Publications Office, 2019, <https://data.europa.eu/doi/10.2834/014995>.

⁴⁴ Section 3.1.2.1 of European Commission, Directorate-General for Climate Action, Reins, L., Ballesteros, M., Bart, I., et al., *Legal nature of EU ETS allowances: final report*, Publications Office, 2019, <https://data.europa.eu/doi/10.2834/014995>.

⁴⁵ See the International Swaps and Derivatives Association, ‘Legal Implications of Voluntary Carbon Credits’ (December 2021) section 3.1.3, available at: <https://www.isda.org/2021/12/01/legal-implications-of-voluntary-carbon-credits/>.

⁴⁶ See Annex I Part C section (4). See Annex I of MIFID II available at: <https://www.esma.europa.eu/publications-and-data/interactive-single-rulebook/mifid-ii/annex-i>.

⁴⁷ See the International Swaps and Derivatives Association, ‘Legal Implications of Voluntary Carbon Credits’ (December 2021) section 3.1.3, available at: <https://www.isda.org/2021/12/01/legal-implications-of-voluntary-carbon-credits/>.

The implication of these considerations is that if GGGI enters a contract for the forward purchase of an ITMO, for example, with a mitigation activity developer, in exchange for GGGI providing financial support for the mitigation activity through an ITMO Fund, then this contract itself may be regulated as a derivative under EU law.

5.2.6 ITMOs as goods or services

Having regard to the likely characterizations of ITMOs discussed above, it is important to acknowledge that there are primarily two possible conceptions of ITMOs in general procurement terms, being:

- goods – ITMOs as individual units (for example, this could potentially be done on a spot basis, where GGGI enters a contract for the delivery of a specified number of ITMOs); or
- services – ITMOs in the form of a set of activities that generate ITMOs (for example, where GGGI enters a contract to provide financial assistance to a mitigation activity developer in exchange for that developer delivering the mitigation activity, generating mitigation outcomes, and undertaking any ancillary tasks required to ensure that those mitigation outcomes are recognized as ITMOs and subsequently delivered to the ITMO Fund). We also note in this regard that there have been two Swedish examples of public procurement of ITMOs being classified as public procurement of a service contract under MOPAs.⁴⁸

There is also potential for a contract for ITMOs to contain elements of both goods and services. In the context of Trust Fund 1, this interpretation is consistent with the different characterizations of CERs under Swedish and EU procurement regulations: a CER itself may be classified as ‘supplies’ under Swedish and EU public procurement regulations. However, a contract for CERs will likely also include services falling under the definition of ‘services’ under these regulations. For example, if the CER is generated through constructing a wind power project, the services could, inter alia, be consultancy services related to managing the wind power project, supervising the project, or monitoring the progress of the project etc. A contract for CERs will accordingly likely include elements of both supplies and services.⁴⁹

Similarly, a contract for the supply of ITMOs to an ITMO Fund could (depending on the nature of the contract) entail elements of ITMO as both goods and services.

5.3 ITMO procurement is not in the scope of the Procurement Regulations and Rules

ITMO procurement is unlikely to classify as an activity ‘carried out for procuring goods, works and Services for GGGI’ and therefore is not covered by the application provisions of the procurement regulations. Our reasoning for this position is below.

5.3.1 Key application provisions and definitions in the Regulations and Rules

GGGI’s procurement regulations apply to ‘all activities carried out for procuring goods, works and Services for GGGI’, and ‘all projects administered by cooperating institutions that do not have their own, or insufficient, procurement guidelines or for all projects directly supervised by GGGI’.⁵⁰ Key definitions that give context to this application provision are as follows:

⁴⁸ The Swedish Energy Agency’s procurement of emission reduction units that can be transferred under the framework of article 6 of the Paris Agreement – Dominican Republic with ref. no. 2021-3580 and the Swedish Energy Agency’s procurement of emission reduction units suitable for the framework of Article 6 of the Paris Agreement – Republic of Ghana with ref. no. 2021-38618.

⁴⁹ See section 3.1.2.

⁵⁰ Reg 2.3.

- **'Services'** are defined as 'Services performed under a Procurement Contract by a Supplier or Consultant. It is a collective name for Project Consulting Services and Administrative Support Services.' The terms 'Project Consulting Services' and 'Administrative Support Services' are not defined in the Regulations. However, the Rules define **'Consulting Services'** as 'technical services for a project performed by a Consultant'.
- A **'Supplier'** is defined as an 'entity or individual that is responsible for providing goods, Administrative Support Services, or works to GGGI in accordance with a Procurement Contract or Framework Agreement'.
- A **'Consultant'** is defined as an 'entity or individual that is responsible for providing Project Consulting Services to GGGI in accordance with a Procurement Contract or Framework Agreement'.
- A **'Procurement Contract'** is defined as a 'legally binding and enforceable agreement, in writing between two or more parties, creating mutually and equally burdening obligations'.
- A **'Framework Agreement'** is defined in the Procurement Rules as a type of Procurement Contract that 'governs the relationship between GGGI and the Consultant, Supplier or Service Provider generally, and which defines the terms and conditions for subsequent Suborders during a predefined period'.

The Procurement Regulations do not apply to 'Contribution Agreements' or to the 'acquisition of services provided under Engagement Agreements or to Institutional Arrangements' (we explain these terms further below at 5.5).⁵¹

The Procurement Rules contain slightly different application provisions. They apply to 'all activities concerning the procuring of Services, Goods and Works for or by GGGI; except arrangements entered into by GGGI concerning Engagement Agreements, Individual Consultants,⁵² Institutional Arrangements, Contribution Agreements, Honoraria,⁵³ DOAC,⁵⁴ or arbitration and mediation services'. The definitions of 'Contribution Agreement', 'Engagement Agreement' and 'Institutional Arrangement' are similar (albeit not identical) to those in the Procurement Regulations.

The Rules also provide the following further definitions:

- **'Goods'** as meaning tangible items, including assets and expendable items that are purchased, hired, leased or rented.
- **'Services'** as meaning 'Consulting Services' (i.e. technical services for a project performed by a Consultant) and 'Other Services' (i.e. services other than Consulting Services performed under a contract by a Supplier, Service Provider or Consultant), collectively.
- **'Works'** as meaning 'the construction, reconstruction, demolition, outfitting, repair or renovation of premises or related infrastructure where there are elements of both Goods and Services present'.

The Rules are to be followed for all corporate and institutional procurement by GGGI; all projects implemented by other entities that do not have their own procurement rules or procedures or whose rules or procedures are assessed by GGGI to be insufficient; and all projects directly supervised by GGGI.

Under the Rules, where an implementing entity has established procurement rules and procedures that have been assessed by GGGI and deemed adequate and consistent with those of GGGI or otherwise in line with best practices, and such entity has sufficient capacity to assume responsibility for project implementation and supervision on behalf of GGGI, then GGGI may allow that entity's procurement rules and procedures to be

⁵¹ Reg 2.3.

⁵² **'Individual Consultant'** means an individual person who is responsible for providing Services to GGGI. The engagement and use of Individual Consultants is governed by separate rules.

⁵³ **'Honorarium'** – means an ex gratia payment made to a person for his or her services in an unpaid capacity or for services for which fees are not traditionally required. Payment of Honorarium is addressed in more detail in separate guidelines.

⁵⁴ **"Defrayment of Attendance Costs" or "DOAC"** – means defrayment of attendance costs as defined in the General Guidelines on Defrayment of Attendance Costs for GGGI Events.

followed for procurement activities relating to the project; however, all major procurement documentation shall be submitted to GGGI for its prior review and written ‘no objection’ in accordance with the procurement plan to be submitted by the implementing entity and approved by GGGI.

5.3.2 ITMOs as individual units are not ‘Goods’

‘Goods’ are not defined in the Regulations, but are defined in the Rules as meaning ‘tangible items, including assets and expendable items that are purchased, hired, leased or rented’.

Based on the likely characterization of ITMOs discussed above, they will be more readily characterized as intangible rather than tangible items, and therefore are not ‘Goods’ within the meaning of the Procurement Rules.

If ITMOs are regulated in the EU as emission allowances, this position will be supported by the treatment of allowances as intangible property in the context of EU Value Added Tax (VAT) rules. Under VAT Directive 2006/112/EC considers the sale and transfer of allowances as a supply of services (rather than goods): under that Directive, a ‘supply of goods’ is defined as the transfer of the right to dispose of tangible property as owner.⁵⁵ According to a report by the European Commission, it can be inferred from this that the transfer of allowances does not constitute the transfer of the right to dispose of tangible property as owner.⁵⁶

Under Article 24 of the Directive, ‘supply of services’ means any transaction which does not consist of a supply of goods,⁵⁷ and may consist of (among other things) ‘the assignment of intangible property’,⁵⁸ and the VAT Committee have agreed that transfer of allowances falls within the scope of this definition. This supports the classification of allowances as ‘intangible property’.

5.3.3 Activities to generate ITMOs are not ‘Works’

The Procurement Rules define ‘Works’ as ‘the construction, reconstruction, demolition, outfitting, repair or renovation of premises or related infrastructure where there are elements of both Goods and Services present’: the definition of ‘Works’ therefore also does not appear to contemplate the kinds of emissions reduction or removal activities (i.e., mitigation activities) that would be contemplated by a contract for ITMO procurement.

5.3.4 Activities to generate ITMOs are not ‘Services’

Where the supplier of ITMOs is also funded by GGGI to carry out activities to produce the ITMO, this could be construed as performing services in a general sense, depending upon the nature of the contract and what is ultimately being delivered under that contract. However, it is strongly arguable that mitigation activities themselves are unlikely to classify as ‘Services’ within the meaning of the Regulations and Rules.

As we have summarized described above, the Procurement Regulations set out definitions of ‘Services’ by reference to services carried out by ‘Suppliers’ or ‘Consultants’. Further, the Rules define ‘Services’ as meaning ‘Consulting Services’ (i.e. technical services for a project performed by a Consultant) and ‘Other Services’, collectively.⁵⁹

⁵⁵ Article 14.

⁵⁶ See section 3.3.1 of European Commission, Directorate-General for Climate Action, Reins, L., Ballesteros, M., Bart, I., et al., *Legal nature of EU ETS allowances: final report*, Publications Office, 2019, <https://data.europa.eu/doi/10.2834/014995>.

⁵⁷ Article 24.

⁵⁸ Article 25.

⁵⁹ Under the Rules, ‘Consultant’ means an entity providing Consulting Services to GGGI; ‘Service Provider’ means an entity providing Other Services to GGGI; and ‘Supplier’ means an entity that is responsible for providing Goods or Works to GGGI.

Although the definitions of 'Services' under the Regulations and Rules differ slightly (and we note that in case of inconsistency, the Regulations prevail), what can be inferred from the above is that technical services for a project fall clearly within the definition of 'Services' as 'Consulting Services', and that administrative support is also a form of 'Services'. Actually undertaking emissions reduction or removal projects does not clearly fall within the definition of 'Services'.

Given that the Rules must be followed for (1) 'all projects implemented by other entities that do not have their own procurement rules or procedures or whose rules or procedures are assessed by GGGI to be insufficient, (2) all projects directly supervised by GGGI and (3) all corporate and institutional procurement by GGGI', where GGGI directly supervised a mitigation activity that generated ITMOs, it could be expected that the procurement of technical support for that activity would fall within the definition of Services, however, the project itself does not appear to fall within the definition of 'Services'.

It must be acknowledged that the VAT Directive noted above classifies 'the assignment of intangible property' as a type of 'supply of services' in the VAT context, which may lend support to the argument that ITMOs (if regulated as allowances) should equally be classified as 'services' for the purposes of the Rules. However, given that the definition of 'Services' provided in the Regulations and Rules differs substantially from that in the VAT Directive, we consider the VAT Directive to be of limited relevance to the definition of 'services' for the purposes of the Regulations and Rules.

In summary, it is strongly arguable that undertaking mitigation activities are not characterized as 'Services' and therefore, the Regulations and Rules do not apply to procurement contracts for these activities.

5.3.5 Procurement is not undertaken 'for GGGI'

It is unclear from the language of the Regulations whether they are intended to apply where GGGI procures Goods or Services on behalf of another entity (for example, SEA), or where GGGI as Trustee is investing in a mitigation activity on behalf of Fund participants. However, it is strongly arguable that the Rules and Regulations do not apply in such circumstances, and are only intended to apply where goods, services or works are procured for the benefit of GGGI itself.

The Procurement Regulations are stated to govern activities carried out for procuring goods, works and Services 'for GGGI' and the Procurement Rules are stated to apply to all activities concerning the procuring of Services, Goods and Works 'for or by GGGI' (unless an exception applies). These provisions are somewhat inconsistent, but the fact that the Regulations prevail over the Rules in case of inconsistency suggests that these instruments apply only to procurement activities 'for GGGI'.

Further, the focus of the Rules and Regulations appears to be on procurement activities for GGGI's benefit, rather than for GGGI on another entity's behalf. This is reinforced by the definition of 'Procurement' in the Regulations, which defines Procurement as 'all activities rendering a financial commitment for GGGI, except employment contracts and Institutional Arrangements' (i.e., not a financial commitment of, for example, fund participants), and the definitions of Supplier and Consultant in the Regulations and Rules, which both define those parties as entities providing goods or services (as applicable) 'to GGGI'.

In addition, the Procurement Rules provide that staff and other personnel involved in Procurement activities must adhere to the following principles (among others):

- 'all requirements have to be proportional and relevant to GGGI's needs'; and
- 'the requirements meet GGGI's needs for Services, Goods, and Works, whilst generating benefits not only to the organization but should also be cognizant of the incorporation of green growth aspects'.

On this basis, it is strongly arguable that ITMO procurement (whether as a unit, or in the form of procurement of mitigation activities) on behalf of ITMO Fund participants falls outside of the scope of the Procurement Regulations and Rules.

5.4 Approaches to procurement by other carbon funds

The approaches of a number of carbon funds to procurement of emissions reduction activities support the position that ITMO procurement does not fall within the scope of procurement regulations that govern typical 'goods, works and services'. The funds for which fund regulations explicitly refer to procurement policies are described below.

Carbon fund	Approach to procurement policy application
<p>FCPF: ERPAs not subject to procurement policies</p>	<p>The FCPF fund regulations themselves require fund operation to comply with the World Bank's Operational Policies and Procedures, which are simply defined as 'the operational policies and procedures of the Bank that are applicable to the operation of the Facility'.</p> <p>However, according to the Information Memorandum for the FCPF (dated 13 June 2008),⁶⁰ the World Bank requires borrower/grant recipients to follow particular 'Procurement Guidelines' developed by the Bank for the purposes of procuring goods, works and services required for projects financed by the Bank.⁶¹ The Bank's procurement principles under these Guidelines are fair competitive bidding; economy and efficiency in the purchase of goods, works and services; domestic preference to enhance development in the borrower/grant recipient's country; and transparency.</p> <p>The World Bank has published Procurement Guidelines for projects prior to July 2016 on its website.⁶² Although it is not possible to be certain from the FCPF documents that these are the same guideline which apply to the FCPF, the Procurement Guidelines provide the following insight into the meaning of the terms 'goods', 'works' and 'services':⁶³</p> <p><i>References to "goods" and "works" in these Guidelines include related services such as transportation, insurance, installation, commissioning, training, and initial maintenance. "Goods" includes commodities, raw material, machinery, equipment, vehicles, and industrial plant. The provisions of these Guidelines also apply to non-consulting services for which the physical aspects of the activity predominate, are bid and contracted on the basis of performance of a measurable physical output, and for which performance standards can be clearly identified and consistently applied, such as drilling, aerial photography, satellite imagery, mapping, and similar operations. These Guidelines do not refer to consulting (e.g., advisory) services [which are subject to separate Guidelines].</i></p>

⁶⁰ See the Information Memorandum for the FCPF (13 June 2008).

⁶¹ See Annex 2 of the Information Memorandum for the FCPF.

⁶² Available at: <https://www.worldbank.org/en/projects-operations/products-and-services/brief/procurement-policies-and-guidance>.

From our review of the World Bank website, we have not identified separate World Bank guidelines that address procurement of projects by World Bank trust funds.

⁶³ See footnote 3 of the 'Guidelines: Procurement of Goods, Works and Non-consulting services under IBRD Loans and IDA Credits and Grants by World Bank Borrowers' (January 2011, revised July 2014).

Carbon fund	Approach to procurement policy application
	<p>The World Bank requires all goods, works and services related to preparing and implementing a 'readiness plan' financed out of the proceeds of grants under the FCPF Readiness Fund to be procured pursuant to 'Procurement Guidelines' developed by the Bank. An exception to this requirement applies where a different institution from the World Bank assists the country participant to prepare its readiness plan. However, importantly, the Information Memorandum notes that <u>'procurement of emission reductions by the Carbon Fund will not be subject to the Operational Policy on Procurement since payments to be made under ERPAs will be for environmental services performed by the REDD Country Participant, namely Emission Reductions from deforestation and degradation, as opposed the procurement by the country of goods, works and services in the future'</u>.</p> <p>This is a helpful distinction that supports the conception of mitigation activities that generate ITMOs as distinct from goods, works or services.</p>
MCCF: ERPAs not subject to procurement policies	<p>The MCCF general conditions on conduct of fund operations provide that the procurement of goods, works and services in connection with the fund ('excluding, for sake of certainty, under and/or pursuant to any Off-Take ERPA and/or Project ERPA and subject to the requirement with respect to engagement of Carbon Managers or the jurisdiction of establishment of each Carbon Purchasing Intermediary as set forth in the Rules'),⁶⁴ will be governed by EBRD Procurement Rules.</p> <p>Accordingly, 'EBRD Procurement Rules' are defined as the Procurement Policies and Rules for projects financed by EBRD as amended from time to time.⁶⁵</p> <p>The current version of these Procurement Policies and Rules defines:⁶⁶</p> <p>'Goods' as 'tangible products capable of delivery';</p> <p>'Services' as 'services, other than Consultancy Services';⁶⁷ and</p> <p>'Works' as 'building, civil engineering, or construction works'.</p> <p>Based on the wording of the MCCF general conditions, the Procurement Policies and Rules are not intended to apply to procurement of carbon credits through ERPAs for the MCCF.</p>
JCM	<p>The establishing instrument for the JCM provides with respect to fund management structure, that 'activities to be supported by the JFJCM will be identified, designed, processed, approved, and implemented in accordance with applicable ADB policies, procedures, and guidelines, including consulting services and procurement, disbursements, gender equality, social and environmental safeguards, public disclosure, anticorruption and governance, financial management, and reporting'.⁶⁸</p> <p>With respect to Investment Projects and Technical Assistance under the Fund, the instrument provides that 'Goods, works, and other services related to advanced low</p>

⁶⁴ We have not sited a copy of these Rules. Please note that the definitions of terms including Project ERPAs are contained in the Rules and therefore are not set out here.

⁶⁵ See Appendix I of the General Conditions.

⁶⁶ The 2022 version of these policies appear to be available on the EBRD website at: <https://www.ebrd.com/work-with-us/procurement/policies-and-rules.html>

⁶⁷ 'Consultancy Services' means advisory or similar services whereby individuals and/or an entity provides expertise or capability required to achieve the goals of a Bank Operation. 'Bank operation' means any activity or project which the Bank is considering to finance or has financed or committed to finance, directly or indirectly, in whole or in part, from Bank Resources.

⁶⁸ See paragraph 25 establishing instrument for the JCM.

Carbon fund	Approach to procurement policy application
	<p>carbon technologies under the JFJCM will follow ADB member country procurement eligibility restriction. The selection and engagement of consultants under the JFJCM will be carried out in accordance with ADB’s Guidelines on the Use of Consultants (2013, as amended from time to time). Procurement of goods, works, and other services under the JFJCM will be carried out in accordance with ADB’s Procurement Guidelines (2013, as amended from time to time).⁶⁹</p> <p>Accordingly, the ADB’s 2013 procurement guidelines are specified to apply to all contracts for good and works financed in whole or part by ADB.⁶⁹ Under the policy, the responsibility for project implementation and therefore for the award and administration of contracts under the project, rests with the borrower.⁷⁰</p> <p>In this way, the application of the ADB’s procurement policy is focused on governing the activities of borrowers: it does not appear to govern the fund’s approach to procuring projects themselves.</p>
<p>CACF: ADB procurement policy applies to procurement for purposes of projects.</p>	<p>The instrument for the proposed establishment of the CACF requires the trustee to manage the fund in accordance with applicable ‘ADB Policies and Procedures’ which are defined as meaning ‘all applicable ADB policies and procedures, including those concerning anticorruption, gender, social protection, financial management, procurement, consulting services, disbursements, accounting, auditing, and social and environmental safeguards that the Fund and each Mitigation Action contracted by the Fund will be subject to’.</p> <p>While this suggests that the CACF applies ADB’s procurement policies to fund management, the wording of the procurement policy itself suggests otherwise. Although the CACF instrument does not clearly identify the ADB procurement policy that applies to CACF, the ADB has published an updated procurement policy for goods, works, non-consulting and consulting services (dated 2017).⁷¹ The purpose of that policy is to inform those carrying out a project financed by ADB of the principles that govern procurement of goods, works, non-consulting and consulting services required for that project. It does not appear to apply to the process by which a financing agreement is reached between ADB and a borrower (or other grant recipient).</p> <p>Consistent with our comments in relation to the JCM, this policy is focused on governing procurement of services, goods and works ancillary to projects, rather than projects themselves.</p>
<p>NeCF</p>	<p>While we have not had access to English versions of the fund regulations for the NeCF, the ‘Procurement Policy and Procedures’ available on the NEFCO website includes application provisions which provide that:⁷²</p> <p>The Policy sets out the procurement rules to be applied in (a) NEFCO-financed operations and (b) procurement by NEFCO, taking into account that:</p>

⁶⁹ See ADB, ‘Procurement Guidelines March 2013’ available at: <https://www.think-asia.org/handle/11540/6280>

⁷⁰ See ADB, ‘Procurement Guidelines March 2013’, sections 1.2 and 1.5.

⁷¹ ADB, ‘ADB Procurement Policy’ (2017), available at: <https://www.adb.org/documents/adb-procurement-policy>

⁷² Adopted by the Board of Directors of the Nordic Environment Finance Corporation on 23 December 2020 with entry into force as of 1 January 2021. See section 6 of NEFCO, ‘Procurement Policy and Procedures – applicable to projects agreed after 1 Jan 2021’ available at: <https://www.nefco.int/about-nefco/legal-framework-and-guidelines/>.

Carbon fund	Approach to procurement policy application
	<p>the Policy shall apply to procurement financed from trust funds administered by NEFCO to the extent that the Policy does not conflict with the agreements reached with the donors of such funds; and</p> <p>NEFCO may issue specific rules on the applicability of this Policy to certain programs and facilities of NEFCO.</p> <p>The Policy may be supplemented by specific terms in the financing agreements between NEFCO and its clients</p> <p>Any measures or action taken under the Policy are without prejudice to NEFCO's privileges and immunities as set forth in NEFCO's constituent documents or in applicable national or international law.</p>
Post 2012 Carbon Credit Fund	<p>Although we have not reviewed the fund regulations for this fund, according to the website for the fund, the fund will have an obligation that requires that the promoters of projects supported by the Fund to ensure that contracts have been tendered in accordance with the relevant EU and / or national legislation, including publication of tender notices in the Official Journal of the EU, as and where appropriate.⁷³</p> <p>The 'Guide to Procurement for projects financed by the EIB' (September 2018) that is published on the webpage for the fund provides guidance on the arrangements to be made for procuring works, goods and services required for a project, to inform promoters of projects who are financed by the EIB.⁷⁴ This guide does not appear to apply to procurement of projects themselves by EIB funds.</p>
KfW Carbon Fund	<p>Although we have not reviewed the fund regulations for this fund, the webpage for the EIB-KfW Value Added Carbon Fund II noted in relation to procurement that 'Compliance with the EU procurement directives and national laws shall be ensured.'⁷⁵</p> <p>The webpage for the fund also refers to the 'Guide to Procurement for projects financed by the EIB' (September 2018) (described above for the Post 2012 Carbon Credit Fund).</p>

5.5 A carve-out under the application provisions is unlikely to apply

For completeness, we note that if a different view were taken to our analysis above, and ITMO procurement for the Fund does fall within the definition of goods, services or works for the purposes of the Regulations and Rules, then it would be necessary to consider whether any of the carve-outs from the application provisions for 'Contribution Agreements', 'Engagement Agreements' or 'Institutional Arrangements' will apply to ITMO procurement, which are defined as:

- **'Contribution Agreements'** are defined as agreements, Memoranda of Understanding or other forms of written arrangement on the terms and conditions of a financial or non-financial contribution to be provided to GGGI by one or more contributors.

⁷³ See EIB, Post 2012 Carbon Credit Fund available at: <https://www.eib.org/en/projects/all/20070019>

⁷⁴ See EIB, Guide to Procurement for projects financed by the EIB (September 2018) available at: <https://www.eib.org/en/projects/pipelines/all/20070019>

⁷⁵ See EIB, EIB-KfW Value Added Carbon Fund II available at: <https://www.eib.org/en/projects/pipelines/all/20090198>

- **'Engagement Agreements'** are defined as including 'letters of appointment for staff members as defined in the GGGI Staff Regulations, and agreements for secondees, visiting scholars, visitors-on-loan or interns as provided in the GGGI Policy on Opportunities for Visiting Persons to and from GGGI or other relevant GGGI regulations or rules'.
- **'Institutional Arrangements'** are defined as 'a cooperative arrangement between GGGI and one or more other institutions, such as intergovernmental organizations, international non-profit organizations or governments, on the institutional level, in the form of an agreement, MoU or other forms of written arrangement, where each party contributes their own resources to realize a common goal, based on Article 16 of the GGGI Establishment Agreement which provides "GGGI may establish cooperative relationships with other organizations, including international, intergovernmental and non-governmental organizations, with a view to further the objectives of GGGI".' The Procurement Regulations specify that Institutional Arrangements 'shall be narrowly construed and applied, to prevent any procurement activity to fall under the definition'. There are separate 'Rules for Processing and Approval of Institutional Arrangements and Agreements'.

Based on the definitions of 'Contribution Agreement' and 'Engagement Agreement' outlined above, ITMO procurement will not classify as either type of agreement. With respect to 'Institutional Arrangements', in interviews with GGGI's procurement team, it was clarified that the 'Institutional Arrangement' carve-out is intended to cover situations where GGGI enters into a consortium and accordingly transfers money for a project to the consortium. Therefore, we have not considered this further.

Therefore, these carve-outs are unlikely to apply so as to exempt ITMO procurement from the operation of the Regulations and Rules.

5.6 Does an exceptional circumstance apply that enables Direct Procurement of ITMOs?

5.6.1 Direct Procurement as an exception to competitive tendering requirements

Procurement that falls within the scope of the application provisions of the Procurement Regulations and Rules is generally subject to the requirement for competitive tendering.

In particular, the principles in the Procurement Regulations include a principle that the 'overarching scope of GGGI Procurement is to achieve most Value for Money'. 'Value for Money' in this regard is defined to mean 'procurement taking into consideration all life cycle costs, and include e.g.: fitness for purpose; a potential Supplier or Consultant's experience and performance history; flexibility (including innovation and adaptability over the lifecycle of the procurement); CSR; environmental sustainability (such as energy efficiency and environmental impact); maintenance and service; and other whole-of-life costs.' This is echoed in the Procurement Rules, which require all personnel involved in procurement to encourage competitive and non-discriminatory processes.

Accordingly, the Procurement Regulations dictate that GGGI procurement 'shall make appropriate use of competition to achieve most Value for Money, e.g. by open procedures for high value procurement', and the Regulations and Rules together set out a process for this to be achieved. For example, solicitation documents provided to Tenderers are required to provide a clear, non-discriminatory and transparent description of requirements; and the Procurement Rules set out the process that applies to evaluating tenders.

Importantly, the Regulations and Rules provide an exception to the standard competitive tendering process, in the form of 'Direct Procurement Contracts' which are defined as 'an exceptional method to issue a Procurement Contract or Purchase Order without prior competition'.

Under Rule 3.5 of the Procurement Rules, Direct Procurement (i.e. inviting a quote from a single tenderer) may be approved under any of the following circumstances:

- Minor Purchases (i.e. services, goods or works between USD\$0 - \$1,000) or procurement of Low Value Services, Goods or Works (i.e. between USD\$0 - \$10,000).
- There is no competitive marketplace for the requirement, such as where a monopoly exists; where prices are fixed by legislation or government regulation; in countries where there are restrictions to free markets and enterprises; on the spot market; or where the requirement involves a proprietary or unique product or service.
- For reasons of extreme urgency, in so far as is strictly necessary where, brought about by events reasonably unforeseeable by GGGI, the time limits for competitive procedures cannot be complied with, including e.g. if, following a Procurement procedure performed in compliance with these Procurement Rules, no valid Tenders were received in time, and this creates an urgency. The circumstances invoked to justify extreme urgency should not be attributable to poor planning and/or processing delays on the part of GGGI personnel.
- Purchase or lease of real property or office space.
- Financial services (e.g. GGGI's 'Working Capital Fund', etc.), excluding banking services.
- There is a compelling reason to protect confidentiality of certain information which may not be disclosed to the public under the Disclosure Policy, or to protect GGGI safety or security interests.
- The subject item needs to be procured to complete or continue Services, to replace parts or components, or to expand facilities, which were already procured from the considered Consultant, Service Provider or Supplier, for reasons of standardization, compatibility or need to avoid significant establishment or start-up costs, provided that no advantage can be reasonably obtained by further competition.
- The Director-General may approve Direct Procurement in circumstances not covered by the above-mentioned exceptions, based on a recommendation from the Procurement Review Committee. Such cases shall be reported to the Council. (The Regulations require this to also be reported to the Management and Program Sub-Committee.)

The Rules require the Head of Procurement to review the use of Direct Procurement, and for Direct Procurements to be approved in accordance with the DoA. When Direct Procurement is used, GGGI must record the justification and approval with supporting documentation.

5.6.2 Direct Procurement exceptions that apply to ITMO procurement

If, contrary to our above analysis, the Procurement Regulations and Rules do apply to ITMO procurement, a competitive process will need to apply to ITMO procurement processes, unless an exceptional circumstance applies that enables ITMOs to be procured through Direct Procurement (i.e. without competition).

Of the 'exceptional circumstances' in Rule 3.5 outlined above, the following will likely apply to enable Direct Procurement of ITMOs:

- 'There is no competitive marketplace for the requirement, such as where a monopoly exists; where prices are fixed by legislation or government regulation; in countries where there are restrictions to free markets and enterprises; on the spot market; or where the requirement involves a proprietary or unique product or service'.
- 'Financial services (e.g. GGGI's 'Working Capital Fund', etc.), excluding banking services'.
- 'The Director-General may approve Direct Procurement' in other circumstances, based on a recommendation from the Procurement Review Committee.

We describe each of these below.

5.6.3 Absence of a competitive marketplace for ITMOs as units or as services

The ITMO market is in a nascent state, with the first authorization of mitigation outcomes for use as ITMOs reported to have taken place in November 2022. It is therefore strongly arguable that ITMOs and the mitigation activities and other ancillary activities that generate them currently classify as a ‘unique product or service’ respectively in the meaning of Rule 3.5.

We note, however, that if this exception is relied upon, this exception will only apply until the market for ITMOs becomes better established, at which time, competitive processes under the Regulations and Rules would then need to be complied with, unless further exemptions were expressly stated.

We note in the context of Trust Fund 1 that **Error! Reference source not found.** a similar exemption applies under EU law that allows for direct procurement where there is no competition due to technical reasons under Article 32.2(b) of Directive (2014/24/EU).⁷⁶ For this EU exemption to be met, all four following conditions must be met:

- the subject of the procurement is of technical character;
- due to technical reasons, it is absolutely necessary to award one supplier the contract (for example due to only one supplier holding the capacity to complete the services or deliver the goods);
- there are no reasonable alternatives; and
- the absence of competition is not artificial created by the contracting authority (for example by designing the procurement requirements in a way that only one supplier can meet the requirements).

In our view, the potential for ITMO procurement to meet these criteria would support a position that ITMO procurement is subject to the direct procurement exceptions in the GGGI procurement rules.

5.6.4 Contracts for ITMO procurement as ‘financial services’

The Rules allow Direct Procurement for ‘financial services (e.g. GGGI’s ‘Working Capital Fund’, etc.), excluding banking services’. There are multiple avenues through which ITMO procurement for an ITMO Fund can be classified as a ‘financial service’ for the purpose of this provision.

5.6.4.1 Procurement activities for the purposes of a fund classify as ‘financial services’

The Regulations and Rules do not define ‘financial services’, however, the Rules do list GGGI’s Working Capital Fund (established under reg 6.2 of the Financial Regulations) as an example of ‘financial services’, and specifically carve out ‘banking services’ from being considered ‘financial services’. This implies that certain financial activities relating to funds established by GGGI classify as a form of financial service for the purposes of the Direct Procurement exception.

Absent any further guidance in the Procurement Regulations and Rules (or financial regulations or finance manual) as to how procurement for the purposes of a GGGI fund should be regulated, the fact that the ‘financial services’ exception specifically includes GGGI’s working capital fund as an example supports an argument that Direct Procurement can be used where GGGI is undertaking for the purposes of a GGGI fund (such as the ITMO Fund, as a trust fund established under Reg 6.3 of the Financial Regulations).

⁷⁶ Implemented in Sweden by Chapter 6 Paragraph 14 section 2 of the Swedish Act on Public Procurement.

This position is lent further support from the treatment of investments under GGGI's Financial Regulations. Reg 7.4 deals with investments and enables the Director-General to invest monies not needed for immediate requirements in accordance with investment criteria approved by the Council. Investment losses shall be borne by the fund, trust fund (or other account) from which the investment derives, and the Director-General has further obligations in relation to seeking advice of an Investment Committee and periodic reporting. These investment provisions do not refer to any requirement to apply GGGI's procurement policies.

5.6.4.2 If ITMOs classify as financial instruments, trading in these may be 'financial services'

If EU law classifies ITMOs as a type of emission allowance and therefore a financial instrument, then trading in ITMOs on another person's behalf or managing a portfolio of ITMOs could classify as a financial service for the purposes of EU law. This classification would mean that where an ITMO Fund procured ITMOs as a unit on behalf of European fund participants, this would be subject to the Direct Procurement exception as a 'financial service'.

Insight into the types of activities that could classify as 'financial services' may be drawn from dictionary definitions and from the treatment of the term in different jurisdictions:

- A standard dictionary definition of 'financial services' is 'professional services provided by the financial industry, such as banking, investment, insurance, pensions, mortgages, etc.'
- In the EU context, EU regulations do not appear to define 'financial services', however, the European Commission's webpage 'Overview of financial services legislation' lists legislation covering the areas of financial markets, investment funds, securities markets (including MIFID and MIFIR), post-trade services, banking, insurance, and payment services (among other things). Further, although MIFID II does not define 'financial services', it does define 'investment services and activities' which include (among other things):
 - reception and transmission of orders in relation to financial instruments;
 - execution of orders on behalf of clients (means 'acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients and includes the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of their issuance');
 - dealing on own account (which means 'trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments'); and
 - portfolio management.
- In Australia, 'Australian carbon credit units' are established under legislation and classified as 'financial products'. Under Australian law, an entity carries on a financial services business where it engages in conduct that is intended (or likely) to induce clients in Australia to use a financial service provided by that entity (even if it is likely to have that effect in other places as well). Financial services include (among other things) providing financial product advice (e.g., marketing and promoting), dealing as principal or on behalf of other persons in financial products (e.g., issuing, acquiring and disposing) and providing custodial and depository services (e.g., holding on trust) in relation to financial products.

Relevantly, the above definitions suggest that investment services classify as a type of 'financial service' within the ordinary meaning of the term. Further, managing portfolios of financial instruments (including emission allowances) or concluding agreements to buy or sell these instruments on behalf of clients classify as types of 'investment services and activities' under MIFID II.

Having regard to the above, and absent further guidance in GGGI's policies, one interpretation of the 'financial services' provision in the Procurement Rules is that it is intended to capture these types of 'investment services and activities'.

It is therefore arguable that where ITMOs are regulated as financial instruments, and GGGI deals with ITMOs as units on behalf of ITMO Fund participants (whether on the spot market or otherwise), this will constitute a type of 'financial service' and therefore a contract for the purchase of ITMOs may be undertaken through Direct Procurement in accordance with the GGGI Procurement Rules.

5.6.4.3 Forward contracts for ITMOs will classify as financial instruments

For completeness, we note that regardless of whether ITMOs themselves are classified as financial instruments, contracts for the forward purchase of ITMOs may be classified as financial instruments (depending upon how they are structured) by virtue of the fact that these are derivatives: derivative contracts relating to emissions allowances and VCCs (whether settled physically or in cash) are financial instruments under MIFID II and fall within the scope of EU regulation.

5.6.4.4 Financial services are not subject to public procurement rules

We note that **Error! Reference source not found.** under EU law, financial services fall outside of the scope of EU public procurement rules. If ITMOs are listed in EU regulations as financial instruments, then financial services involving ITMOs will not be regulated under public procurement rules. Further, services relating to derivative transactions will not fall within these regulations. In our view, the potential for ITMO procurement to classify as financial services under EU law would support a position that these fall within the exception in GGGI's procurement rules.

5.6.5 Director-General's power to approve other forms of Direct Procurement

As we have outlined above, the application provisions of the Procurement Regulations and Rules are not clear as to whether they apply (or are intended to apply) to ITMO procurement by a fund administered by GGGI for the benefit of fund participants.

Given this ambiguity, and the fact that an argument may be made that the processes set out in relation to tendering do not apply well for the procurement of mitigation activities, we consider that there may be scope for the Director-General to approve Direct Procurement in circumstances where a dedicated fund procures goods or services for the benefit of fund participants (or similar).

6 Fund approaches to carbon credit procurement

6.1 Key areas of convergence and divergence between funds

Based on our analysis of the Fund documents, we have identified a number of commonalities between the Funds with respect to their design and governance structures and processes for selecting and approving projects. There is, however, a significant degree of variation between the Funds with respect to decision-making responsibilities. Key areas of convergence and divergence are set out below.

6.1.1 Fund design and governance structure

The overall design and governance structure of multi-lateral funds is similar. However, there is some difference between governance structures.

The most common governance structure typically consists of:

- a Trustee (being the administering bank);
- the participants themselves (for both World Bank funds and ADB funds);
- a 'Fund Management Committee' (for certain World Bank funds) / 'Board of Directors' (for ADB funds); and
- a 'Participants' Committee' (for some World Bank funds).

For the Biocarbon Fund, PCF and Carbon Fund for Europe, a 'Fund Manager' is also appointed by the Trustee which is usually a unit within the World Bank and there are limited examples of European funds with external managers. Whereas for most ADB funds, the Trustee essentially also acts as the Fund Manager. The establishing instrument for the FCPF also established a 'Participants' Assembly' (consisting of all participants) in addition to the Participants' Committee and the PCF also established a 'Host Country Committee'. For the TCAF, instead of a Participants' Committee, a 'Facility Board' was established which consisted of participants who had contributed at least \$25 million.

As noted above, ADB funds do not usually provide for a committee to represent the participants (as this is usually managed by the Board), except for the CACF where participants will elect a 'Governing Council' to represent the participants.

For the two sole participant funds reviewed (the JFJCM and Sovereign Fund), the fund design and governance structure varied. The JFJCM is structured similarly to the multi-lateral funds, consisting of a Trustee (being the ADB), a Secretariat and a Fund Manager. The trustee has the responsibility to hold and administer the fund resources, the Secretariat is responsible for managing the JFJCM and the Fund Manager acts as the focal point for technical matters. The JFJCM will also have operations departments responsible for project identification, due diligence, grant administration, project evaluation and submitting grant proposals to the JFJCM Secretariat. Whereas the Sovereign Fund has a single-tier structure with SEA administering the fund on behalf of the Swedish Government.

6.1.2 Splitting of responsibilities and decision making

The roles and responsibilities of each tier of governance varies between the Funds.

6.1.2.1 Trustee

The Trustee typically has the power to manage and invest fund assets, incur and pay reasonable costs, as well as enter contracts (including emission reduction purchase agreements (ERPAs) and MOPAs) to achieve the fund's purposes and monitor the delivery of carbon credits to participants. For World Bank funds where a Fund Manager is appointed, the Trustee's role is somewhat more limited as some responsibilities are delegated to the Fund Manager (such as the power to negotiate ERPAs based on an agreed template and commercial parameters).

6.1.2.2 Participants

The role of participants also varies. World Bank funds typically provide for participants to elect members to serve on a 'Participants' Committee'. The Participants' Committee usually has the authority to provide advice to either the Trustee or Fund Manager on issues relating to the operation of the fund, including setting portfolio and project selection criteria. In some funds, the Participants' Committee will also be involved in project selection. For example, both the BioCarbon Fund and PCF provide the Participants' Committee with the authority to determine whether to object to the inclusion of a project within the fund's portfolio and for the FCPF, the Participants' Committee has the authority to approve the general terms and conditions of ERPAs. In addition, for the FCPF, the Participants' Assembly has the ability to overturn certain decisions of the Participants' Committee by a two-thirds majority. The Host Country Committee, established by the PCF, has the authority to advise the Trustee on matters relating to the equitable sharing of emission reductions between participants and the host country as well as the implementation and development of knowledge sharing.

For ADB funds, participants are typically able to provide advice to the Trustee on issues relating to the operation of the fund, and to make decisions on transactions, at the participant (or Governing Council) level and through board representation. For example, the APCF provides that at annual meetings of participants, the role of participants includes reviewing operations of the fund and providing the Trustee with general policy and strategic guidance on overall operation and management of the fund; providing general guidance to the Trustee on project selection (including any changes to project criteria or portfolio restrictions); reviewing and approving changes to the fund pricing policy and expense cap, and any changes to the upper limit on contributions; and reviewing and approving the annual budget and financial statements. The Board of Directors (which comprises members elected by the participants) is responsible for (among other things) providing general advice to the Trustee on issues relating to fund operation, and approving the terms and conditions of each ERPA agreed by the Trustee.

Participants in ADB funds are not given the power to determine whether to object to the inclusion of a project (however a number of ADB funds do have opt-out provisions, discussed below). Participants will meet annually with most decisions taken by a majority and the Participants' Committee will meet at least annually with decisions also taken by a majority.

Interviews indicate that in practice, the degree of engagement of participants in fund decision-making varies depending on the participants' interests. One interviewee noted that at a general level, private investors may be more interested in financial returns and less focused on particular project outcomes, while governments may be more interested in the co-benefits associated with a particular project. The interviewee also noted examples of governments wanting to know significant detail about proposed projects (for example, the proponent, methodology, and timing of project delivery) before deciding on approval.

6.1.2.3 Advisory / oversight body

The body that has chief responsibility for providing advice to the Trustee on the operation of the fund, as well as to approve the terms and conditions of ERPAs, varies across funds:

- For ADB funds, this role is played by a Board of Directors that is elected by participants. The FCF Board of Directors also has the responsibility to approve a pricing band for carbon credits and approving the fund's VER Policy which is the processes for the creation, verification, documentation, purchase, registration and transfer of VERs.
- For certain World Bank funds, this role is played by a 'Fund Management Committee' which is selected by the International Bank for Reconstruction and Development (IBRD). An exception is TCAF, which does not have a Fund Management Committee: instead, the Facility Board, which consisted of participants who contributed at least \$25 million, plays this role. The TCAF's Facility Board makes decisions on which programs are included in the TCAF as well as the commercial terms associated with each program. In addition, the BioCarbon Fund and the Carbon Fund for Europe Fund Management Committees have the responsibility to provide advice to the trustee on the project selection and portfolio criteria.

The frequency at which the Fund Management Committee or Board of Directors meet is variable. For the FCF and APCF, meetings are held at least annually, for the BioCarbon Fund, meetings are held bi-annually and the for the CACF, meetings are held quarterly. Usually, each member of the Fund Management Committee / Board of Directors is entitled to one vote, with decisions taken by a majority.

6.1.2.4 Voting rights

All establishing instruments reviewed also provide participants with voting rights. For both World Bank and ADB administered funds, the voting rights of participants are proportional to the participant's financial contribution to the fund (for example, one vote per US\$1 million contribution). As mentioned above, ADB funds do not typically have a representative committee for participants and the Board of Directors for each fund is elected by participants. Whereas for World Bank funds, the Fund Management Committee is selected by the IBRD. As the Board of Directors (for ADB funds) and the Fund Manager Committee (for World Bank Funds) is typically responsible for the approval of projects and ERPAs, participants who have contributed more to the fund, will have a greater influence in the overall operation in ADB funds, as they have greater influence on the composition of the Board of Directors. Whereas for World Bank funds, higher contributing participants will have a less influential role in comparison as the Fund Management Committee is selected by the IBRD. Interviews also indicated that while voting provisions should be included in fund regulations, they are generally not used, as decision-making is often done by consensus.

6.1.3 Purpose and objectives of funds

The purpose and objectives of the Funds range from sourcing carbon credits for participants to facilitate compliance with their emission reductions obligations through to developing market infrastructure and capacity building. Most ADB funds contain elements of both, but for funds administered by the World Bank, only the Carbon Fund for Europe had a stated objective relating to compliance. Instead, World Bank funds generally contain an objective to share the knowledge gained by the Trustee in the development of the fund and the implementation of projects as well as to ensure equitable sharing of any benefits between the participants and host country arising from the project. In addition, some World Bank funds contain objectives relating to market development. For example, the CDCF contained an objective to 'expand the reach of the carbon market by supporting smaller-scale projects while working with local intermediaries'.

6.1.4 Scope for procurement

For the majority of the Funds reviewed, the scope for procurement of emission reductions generated by projects is governed by both project criteria and portfolio criteria:

- Project criteria – For ADB funds, project criteria typically requires projects to be located in ADB developing member countries (DMCs), comply with ADB Operational Policy and Procedures, and are financed through ADB. In relation to internal pipeline sourcing, for example, the APCF requires that projects are:
 - financed by ADB through a loan, equity investment or guarantee and have entered into an effective agreement with ADB for financing the project prior to or concurrently with the fund entering an ERPA with the project; or
 - supported with technical assistance from ADB's carbon market initiative and have entered into effective agreements with a third party or parties for financing the project (satisfactory to the trustee).
- Project criteria for funds administered by the World Bank provides that projects must be consistent with UNFCCC/Kyoto Protocol Rules, the particular fund's objectives and principles, as well as relevant national criteria in host countries and relevant policies of the World Bank.
- Portfolio criteria – The portfolio criteria more pointedly defines the scope for procurement for the Funds. Most portfolio criteria places limits on the amount of fund assets that can be financed towards a single project, project type or projects located in a single country. For example, the BioCarbon Fund's portfolio criteria provides that no more than 30% of the fund's assets can be committed to Projects located in the same country and no more than 20% of the fund's assets can be committed to one project. The APCF and FCF also provided limits on the amount of fund assets that could be financed towards non-energy projects.

6.1.5 Process for participants to make contributions

The most common process for participants to make contributions to the fund is for contributions to be made in response to calls made by the Trustee, with participants also given the option to pre-pay their required contribution. However, the term sheet for the Carbon Fund for Europe stated contributions are expected to be made upon signing the participation agreement. Most of the Funds require contributions to be made in cash, however, the PCF, BioCarbon Fund, the MCCF and the Carbon Fund for Europe allow participants to issue and deliver an unconditional promissory note.

Each of the establishing instruments for the FCF, APCF, PCF, BioCarbon, FCPF and APCF provide that if participants fail to pay their contributions when due (Defaulting Participants), their right to receive emissions reductions are suspended and then following notice periods, Defaulting Participants will cease to be a participant and their interest in the fund will be first offered to other participants and then to other persons acceptable to the Trustee.

Interviews noted that managing additional contributions can be challenging where there is not a clear pipeline, and the need for clear plans around timing of delivery of carbon credits and therefore calls for contributions to pay project developers (i.e., aligning ERPA delivery and payment with participant calls).

6.1.6 Share of fund assets

Fund assets are distributed pro rata according to the participant's contribution. The fund assets (i.e., the carbon credits) are typically transferred from the seller to the Trustee and then to participants.

6.1.7 Process for selection and approval of projects

The process for the selection and approval of projects varies between each of the Funds. For some funds, the Fund Manager or Trustee selects projects, such as for the PCF, MCCF and BioCarbon Fund, while for other funds there can be calls for projects. For example, the FCPF allows eligible REDD countries to submit proposals for projects, and the CACF allows for the Fund Manager to call for proposals from the ADB operations department.

The Norwegian Carbon Procurement Facility (**NorCaP**) established by NEFCO is a further example of a facility that identified projects solely through global competitive calls for proposals. It should be noted that the purpose of this facility was to ensure viability of existing CDM projects that had already been implemented and registered, and the facility purchased CERs from most CDM project types.

The approval of projects and ERPAs is typically done by the Board of Directors / Fund Management Committee. However, in some World Bank funds, the Participants' Committee has some input on the approval of projects. For example, the Participants' Committee in the PCF advises on the extent to which Project Agreements should be negotiated before being entered into by the Trustee. They also review all Project Concept Notes for each proposal to determine if it should be included in the fund's portfolio. In addition, participants in the TCAF must approve both the pre-project identification notes (PIN) and final PINs presented by the Trustee, before the project is authorized by the Facility Board for commercial negotiations.

Most World Bank funds also have an activity cycle which is linked to the World Bank's internal pipelines and the selection processes for projects occurs across the World Bank's operational units.

6.1.8 The roles of the fund and participants with respect to pricing negotiations

Participants typically have a limited role with respect to pricing negotiations. For some of the Funds, participants have the ability to provide input on the price to be paid by the fund under an ERPA (e.g., agreed price windows). For example, participants in the APCF approve the fund's pricing policy which the Trustee must act pursuant to when entering an ERPA. However, the price for carbon credits is ultimately approved by the Board of Directors when they approve the ERPA. Similarly, with the FCPF, the Participants' Committee adopts guidance on pricing methodologies for ERPAs, with the Board of Directors giving final approval of the terms of the ERPAs.

It is hard to determine whether there is a difference between multi-participant and sole-participant funds with respect to the role of participants in pricing negotiations. For the JFJCM, the fund grants projects funds rather than entering into ERPAs. For each project, however, the Government of Japan must approve the JFJCM grant amount before ADB's Board of Directors ultimately approves the project. As mentioned below, for the Sovereign Fund, SEA has the power to negotiate ERPAs on behalf of the Swedish Government and there is limited information available for review as to whether SEA has a pricing policy that it must follow when negotiating ERPAs.

6.1.9 Contracting approaches for carbon credit transactions

Most of the Funds utilize ERPAs to procure carbon credits (or MOPAs for the newly developed Article 6 funds). Typically, the ERPAs are entered into by the fund's Trustee, however, whether the Trustee also has the authority to negotiate ERPAs differs between funds administered by the World Bank and funds administered by the ADB. World Bank funds usually defer this power to the Fund Manager, whereas the Trustee for ADB funds usually has the power to both enter and negotiate ERPAs. Both World Bank and ADB funds typically require the terms and conditions of the ERPA to be approved by one of the tiers of governance before the ERPA is entered into by the Trustee.

For the Sovereign Fund, SEA has the power to enter and negotiate ERPAs.

The basis on which ERPAs purchase carbon credits varies among the funds (i.e. whether the fund can purchase on a spot, forward or option basis and whether advance payments are authorized).

The establishing instruments for the APCF, BioCarbon and FCF permit the fund to enter ERPAs which provide for advance payments for the future delivery of carbon credits.

For the FCF, advance payments can only be made for up to 75% of the purchased emission reduction volume. A review of the FCF noted that this fund's results-based carbon finance approach works in two ways: first, advance resources for project development and implementation through pre-purchase of emissions reductions from contracted CDM projects in DMCs; and secondly, a payment of pre-agreed fixed price for each CER purchased. This approach is designed to remove price uncertainty and limit downside for project developers.

As mentioned above, the World Bank funds reviewed typically include an objective to ensure equitable sharing of any benefits between the participants and host country arising from the project. A review of the BioCarbon Fund found that equitable and transparent benefit-sharing plans positively impacted the perceptions of project beneficiaries, and in some cases incentivized them to expand project activities. However, benefit sharing arrangements were not initially incorporated into the BioCarbon Fund's ERPAs and the fund realized that some projects had not fully disbursed the ERPA payments, or the benefits from these payments to the communities. And since evidence of benefit sharing was not a requirement in the ERPA, the BioCarbon Fund could not hold project entities accountable for delaying the distribution of benefits. Such provisions were later incorporated through negotiated ERPA amendments.

6.1.10 Characterization of carbon credits

For the Funds established under a trustee structure, the carbon credits procured form part of the trust property to then be distributed to participants. However, the legal characterization of carbon credits is not expressly stated by any of the Funds, nor is any consideration expressly made in the fund establishing instruments as to the Trustee's legal power to deal with those carbon credits.

6.1.11 Process for distribution and transfer of carbon credits

Most establishing instruments do not describe the process for distribution and transfer of carbon credits to participants in great detail. However, the APCF and FCF both require that the Trustee and participants hold accounts with the applicable registry. The Trustee's registry account is used to hold carbon credits delivered to the fund under ERPAs. The Trustee also maintains a record all carbon credits held by the Trustee, and transfers of carbon credits in and out of the registry accounts. Participants are provided with a quarterly notice of the number of carbon credits that are available for distribution, which is calculated pro rata, and the Trustee will initiate the transfer of such carbon credits to each participant's registry account.

6.1.12 Ability to withdraw from Fund / termination of Fund

Participants are typically expressly prohibited from withdrawing from the fund with the exception of the FCPF which allows participants to withdraw at any time by providing 3 months' notice. Although participants cannot normally withdraw from the fund, the APCF, BioCarbon Fund, FCF, FCPF and PCF allow participants to assign their rights under their participation agreement with the Trustee's consent. The MCCF also permits the assignment of participants' interests but this must be with the unanimous consent of the assembly of participants.

Early termination of the fund can occur via the unanimous consent of all participants or the resignation of the relevant bank as Trustee or ceasing its operations. The PCF also allowed the Trustee to terminate the fund where they determined the group of participants is not sufficiently diverse to achieve one of the IBRD's strategic objectives of the PCF.

For all of the establishing instrument reviewed, upon termination, the fund is completely wound up with a pro rata distribution of the remaining balance of the fund's assets distributed to participants.

6.1.13 Governing law

For multi-lateral funds, the establishing instrument and contribution agreements are typically governed by and construed in accordance with English law, with disputes relating to the establishing charter and/or participation agreements settled by arbitration in accordance with the UNCITRAL arbitration rules.

6.1.14 Indemnification / privileges and immunity

All the establishing instruments reviewed provide the Trustee and relevant administering bank with a right to be indemnified out of fund assets for costs incurred arising out of or in connection with the fund's activities. In addition, the Trustee will typically claim privileges and immunity in all funding and ERPA documents.

6.1.15 Ability for participants to opt-out of receiving carbon credits from certain projects

Typically, once a project has been approved for the fund to enter an ERPA with, participants do not have an ability to 'opt-out' of receiving carbon credits from that project. However, most of the funds administered by the ADB do provide participants with a right to opt-out in certain circumstances.

For example, the APCF permits participant to opt-out of receiving carbon credits from any projects that contravene any law applicable to the participant, with the specific opt-out criteria specified in each participation agreement. Similarly, the FCF permits participants to opt out of receiving carbon credits from a project in two circumstances. First, participants can opt-out if a law in the jurisdiction of the participant prohibits the use of such carbon credits for mandatory GHG reduction obligations. Second, participants can opt-out if the carbon credits to be purchased cannot be used for mandatory obligation in a jurisdiction because the project received a UNFCCC registration date of 1 January 2013 or later.

The CACF, however, provides participants with 'opt-in' rights, whereby participants have autonomy in deciding whether to opt-in to any transaction proposed. The CACF provides participants with the discretion to opt-out of receiving carbon credits from any project.

6.1.16 Application of operational policies and procedures

All of the establishing instruments reviewed provided some form of incorporation of the administering bank's operational policies and procedures. For the CACF, PCF, FCPF and APCF, this incorporation extends broadly to the operations of the fund (for example, requiring fund operations to comply with the bank's operational policies and procedures). For the BioCarbon Fund, in addition to requiring fund operations to comply with the bank's operational policies and procedures, projects supported by the fund must also comply with the bank's operational policies and procedures.

For example:

- The APCF establishing instrument provides that the operations of the APCF shall comply with all applicable ADB Operational Policies and Procedures, including in respect of fund administration and project financing.
- The PCF establishing instrument provides that the operations of the fund shall comply with the World Bank Group Operational Policies and Procedures, except to the extent that such operational policies and procedures may be inconsistent with the guidelines, modalities and procedures adopted by the Parties to the UNFCCC regarding the procurement of services by Independent Third Parties, in which case the latter shall govern.

- The BioCarbon Fund establishing instrument provides that the operations of the fund shall comply with the World Bank Operational Policies and Procedures, except to the extent that such operational policies and procedures may be inconsistent with the International UNFCCC/Kyoto Protocol Rules, in which case the latter shall prevail.

It is important to note that a requirement in the fund regulations for fund operation to comply with administering bank policies and procedures is distinct from a requirement to apply the bank's procurement policies to the project selection process itself.

In other words, depending on the definition of operational policies that is set out in the fund regulations, the operation of a fund could be required to comply with the administering bank's procurement policies with respect to how it procures goods and services for the purposes of operating the fund. Fund regulations could also require funded projects to comply with the administering bank's procurement policies (i.e. for project developers to apply procurement policies in the process of obtaining works for the purposes of carrying out the project).

Some of the funds make this clear by specifying that the bank's procurement policies do not apply to ERPA's. For example:

- As noted in section 5.4, the MCCF establishing instrument provides that the procurement of goods, works and services in connection with the fund are governed by the EBRD's procurement rules, with the exception of ERPA's.
- The FCPF provided a similar exception; purchases of emission reductions by the fund will not be subject to the World Bank's Operational Policy on Procurement on the basis that they are for environmental services performed by the participant (host) country.

6.1.17 Transparency provisions

The Funds may set out specific disclosure provisions in their fund regulations. For example, the Biocarbon Fund provides that 'the Trustee may disclose this Instrument, any Participation Agreement, any other agreements entered into by the Bank as Trustee and information with respect to this fund in accordance with the Bank's policy on the disclosure of information'. For the JFJCM, the establishing charter can only be publicly disclosed once such disclosure has been approved by the Board of Directors and following this approval, ADB will disclose the document to the public in accordance with ADB's Public Communications Policy. The FCPF has broad public disclosure provisions, and provides that subject to compliance with the World Bank's Policy on Disclosure of Information, the information that the Facility Management Team can make available to both participants and the public includes:

- readiness preparation proposal notes, grant agreements, reports on the implementation of grant agreements and other documents submitted by country participants;
- reports and conclusions of the Participants Committee;
- information on projects selected by fund participants;
- where appropriate, findings and advice from the Ad Hoc Technical Advisory Panels established under the Facility;
- information on good practices and lessons of experience learned through operation of the Facility; and
- any other information as deemed appropriate by the Facility Management Team.

6.1.18 Communication with fund participants

Most of the establishing instruments reviewed allow the Trustee to provide the participants with copies of all final documents, which may include project concept notes, project development documents, project appraisal

documents, validation reports and verification reports. For the PCF and BioCarbon Fund, which are both World Bank funds, this disclosure must be consistent with the Bank's or Project Entity's policies. Whereas for the APCF and FCF, which are both ADB funds, this disclosure must be consistent with any confidentiality agreement between the Trustee and Project Entity. For example, the PCF establishing instrument provides that to the extent consistent with the IBRD's, the IFC's or a Third Party Project sponsor's policies, as applicable, with respect to disclosure of information, the Trustee shall provide the Participants with (among other things) copies of all final documents prepared or received by the Trustee with respect to each Project (including, without limitation, project concept notes, project concept documents, project appraisal documents, validation reports, and verification reports).

6.2 Pros and cons of different approaches taken by different funds

Based on our consideration of the fund documents and interviews with SEA and personnel with experience at World Bank carbon funds and the APCF, this section considers pros and cons that have been identified of the different approaches taken by the Funds.

6.2.1 Fund design and governance structure

The experience of a number of fund participants and advisors is that different objectives and goals between fund participants in multi-participant funds sometimes create challenges for the decision-making process, and that for this reason, ensuring alignment of purpose and objectives up front is critical. We note the potential for differences of opinion among participants to delay project approvals, and therefore delivery of outcomes. A single-participant approach avoids these challenges but must be weighed up against other considerations (e.g. scale of investments and impact) which may be greater in a larger, more diverse fund.

Interviews with fund participants and advisors indicated that a simple governance structure is generally preferable, and that multiple decision-making layers can add unnecessary complexity. In the case of single-participant funds, an effective structure is commonly for the organization (Trustee) to manage all fund processes and make recommendations to the participant, who then makes the final decision through their own internal system of assessment and communicates this back to the organization (Trustee).

A complex governance structure can hinder pipeline development and disbursement of funds. For example, the FCPF governance structure consisted of a Trustee, Participants' Assembly, Participants' Committee, ad hoc technical advisory panels and a Facility Management Team. While an evaluation of the FCPF found that fund participants were satisfied with the level of participation that this governance structure provided, it found that the governance structure created a long approval and review process which negatively affected the disbursement pace of the fund.

Interviewees also noted, however, that more conservative investors may prefer funds which have an additional governance layer in the form of an advisory board (with final approval still resting with the participants). Further, sometimes including an advisory board in the structure can help the Fund Manager / Trustee organization to alleviate some of the legal risks associated with managing the fund by relying on third party inputs for matters such as project / activity evaluation. Where a fund has an advisory board, controversies can arise with respect to the selection of that board: for example, it can be difficult to locate personnel with appropriate expertise who are independent and not conflicted.

Our interviewee noted that multi-level governance structures (i.e. Fund Manager, Trustee and participants in the form of a Participants' Committee) generally adopted by World Bank funds and NEFCO can also present challenges: different tiers of governance may micro-manage the Trustee in relation to project selection and

strategy. The Trustee may face challenges accommodating the different views of multiple participants in different forums, who each have different interests.

With respect to the types of participants involved in fund governance, our interviews also highlighted that involvement of private-sector participants in funds (for example, the PCF), can be both positive in the sense that they can bring valuable perspectives to decision-making, but there may also be risks that the objectives of the participants are not aligned with the objectives of the fund (as a private participant may be more focused on a return on investment, rather than knowledge outcomes).

6.2.2 Splitting of responsibilities and decision-making

For participants who wish to be active participants in fund decision-making being on the Board of Directors is desirable. One advantage of the common structure of ADB funds is that it provides for participants to elect the Board of Directors (which has responsibility for providing advice to the Trustee on the operation of the fund, as well as to approve the terms and conditions of ERPAs). Interestingly, this model sometimes gives larger participants more influence over fund operations and project selection through allowing them greater input into the election of members for the Board of Directors (where that right extends beyond simply nominating its own member). By contrast, in certain World Bank funds, the Fund Management Committee (which has similar responsibilities to the Board of Directors in ADB funds) is selected by the Bank, not the participants (although this may be linked to prescribed participation levels).

Although some participants seek active participation, other participants may ideally wish to take a hands-off approach to fund participation. Where the fund is a single-participant fund, a risk arises that the Fund Manager will not have a deep enough understanding of the objectives and mandate of the participant organization. This proved to be an issue for NEFCO and highlights the importance of Fund Managers being aligned with participant objectives.

6.2.3 Process for selection and approval of projects

In the case of Trust Fund 1, interviews with SEA staff as the initial fund participant, indicated that SEA's opinion is that project selection criteria should be managed in the fund regulations and accordingly negotiated in advance rather than on a case-by-case basis after the fund is established. Enabling the project and portfolio criteria to be periodically reviewed by the participants (at Board of Directors and/ or committee level) to determine if changes are required, is important to enable the fund to be responsive to changing circumstances over the life of the fund and to respond to challenges (e.g., if insufficient activities meeting the section criteria are available).

Having a clear pipeline for projects / activities for the fund will assist in enabling investments to be made early in the funds' operation. As noted above, most funds rely on work being undertaken across other sectoral or country programs of the Trustee of the fund to supply the project pipeline. Whilst some challenges associated with coordination have been identified, overall, provided there are good relationships with the in-country implementing partners, this type of pipeline can be beneficial to source projects and activities.

An evaluation of the TCAF, however, indicated that where the Trustee or Fund Manager is solely responsible for the selection of projects to be proposed for inclusion, this can be a resource-intensive task for the Trustee / Fund Manager. The evaluation found that this was a contributing factor to slow pipeline development. This finding is supported by our interview discussions, which noted that the approach of the TCAF (whereby all projects must be sourced from an internal pipeline linked to different World Bank operational units and country offices) has proved challenging. This was primarily because the TCAF covers a wide range of sectors, and therefore, the TCAF Trustee needs to engage with different World Bank operational units, as each unit has different sectoral and thematic expertise, and this proved to be resource-intensive for the TCAF Trustee.

Allowing calls for projects may alleviate the Trustee's / Fund Manager's workload and also help expand the diversity of the fund's portfolio. NEFCO's experience with global calls for CDM projects for the NorCaP indicates that calls can be effective, however, this was in the context where the projects being sourced were pre-existing registered CDM projects. With respect to the utility of calls, our interviews with some fund participants and advisors indicated that calls should be avoided where possible. For example, one interview noted one criticism of NEFCO was that it allowed requests for proposals, but the rigid structure of the assessment process gave little flexibility with respect to project selection.

With respect to the types of projects invested in, one fund review noted the importance of risk assessing potential projects (particularly given the unstable nature of carbon costs, and the fact that return on investment is not guaranteed).

An opt-in/opt-out structure may mitigate problems with different views on project selection.

6.2.4 Communication with fund participants

The need for strong communication between the Trustee and/or Fund Manager and participants was highlighted in our interview with fund participants and advisors. One interviewee recalled an experience where a participant expressed frustration because they felt that they were not getting returns on investment from the fund they participated in as quickly as from other funds.

With respect to information about projects provided to participants, the United Kingdom's Department for Business, Energy and Industrial Strategy (a participant in the TCAF) noted in a 'Light Touch Review' that the pre-PINs presented by the Trustee to the participants for consideration provide only a broad overview of the country and sector in which the TCAF could operate, without detail of how the TCAF crediting mechanism could work or how the financing could be demonstrated as additional. This lack of detail created the risk that programs in the pipeline could ultimately turn out to be inappropriate once they reach PIN stage. The Review noted that length of development time expended in that process could lead to greater pressure from the World Bank for the Facility Board to approve the programs, which could in turn lead to lower quality TCAF programs that mean the Fund overall does not deliver in line with UK expectations. This observation indicates the importance of comprehensive information being provided to fund participants for the purposes of considering whether a particular project meets the selection criteria for the fund.

6.2.5 Application of operational policies

As mentioned above, all establishing instruments provide some level of incorporation of the administering bank's operational policies and procedures. While the review of the FCPF found that the application of the World Bank's operational policies and procedures provided a platform for risk management and quality assurance, it also found that there was both a general lack of understanding of these policies and procedures by host countries, as well as a lack of capacity to implement the policies and conform to them. This challenge in navigating and conforming to the World Bank's operational policies and procedures commonly led to delays in country-level disbursements. The review recommended the FCPF to facilitate the provision of technical assistance upon the request of REDD countries for the procurement of goods and services.

6.2.6 Process for participants to make contributions

Our interview with fund participants and advisors reinforced the benefit of allowing flexibility for participants to make contributions (for example, as in the TCAF), so as to accommodate different budgeting rules and procedures in different countries.

6.2.7 Contracting approaches for carbon credit transactions

Some of the Funds, including the BioCarbon Fund, provided for advance payments under the ERPA to assist projects meet their implementation costs. While advance payments can help sustain cash flow, maintain project activities, and ensure carbon credit delivery, a review of the BioCarbon Fund found that advance payments did not always result in successful carbon credit delivery. It was further found that advance payments have sometimes proven to be risky for the fund, as in some cases they led to overpayment when financially weak projects were unable to reimburse the investments made by the fund.

A review of the FCF noted that where CER price declined toward the end of the first Kyoto Protocol commitment period, the FCF continued to provide results-based carbon finance through pre-purchasing post-2012 CERs. This continued operation under adverse market conditions helped to protect its portfolio from the impacts of price fluctuations as a result of uncertainty about the future of CERs. Further, the FCF's ability to provide upfront payment helped project developers reduce their financial burden especially in the initial phase, but made a significant impact on the viability of their projects during the design phase. The upfront payments also helped sustain project operations and therefore ensured continuous delivery of the co-benefits.

A review of NEFCO funds also indicated the benefits of results-based finance.

A review of the CDCF noted that carbon finance can provide a stable source of revenues during the life of a project, but cannot bridge the capital investment financing gap (and access to capital has been a key barrier for projects in LDCs). The review noted that 'developing ways to front-load carbon revenues can increase the impact of carbon finance but requires innovative approaches and public support to mitigate the associated risks'.

6.2.8 How funds ensure 'value for money'

Whether funds ensure value for money for participants appears to depend on the pricing of carbon credits in ERPAs and also the types of outcomes considered by the fund (and its participants) to be considered 'valuable' (i.e., whether this is simply lowest cost carbon credit purchase, or whether broader sustainable development benefits of projects are also considered).

With respect to pricing, a review of the Sovereign Fund noted that the majority of ERPAs signed included some flexibility in the actual price paid for CERs in each individual project over time to allow for some price variation according to shifts in the market and other factors. These ERPAs also specified a minimum price, in order to ensure that the price would not sink too low in case, for example, of a market crash (which occurred for CERs in 2012). Following the crash in the global carbon market in 2012 (where prices of CERs fell dramatically), most ERPAs in the Swedish Program were signed with a fixed CER price to ensure that project-related costs could be reasonably covered over the course of the ERPA. The evaluation noted that SEA's reputation as a credible investor contributed to the Sovereign Fund's ability to sustain efforts through the 2012 market collapse.

The review indicated that this approach did contribute to cost-efficient emissions reductions, both when compared to short-term emissions reduction measures in Sweden and when compared with other carbon market options. The report also found that in general, the larger the project financed under the CDM or JI, the lower the cost per CER, indicating that purchasing CERs through small scale projects can be less cost-effective.

However, the report also noted that SEA's project financing decisions were not strictly based on cost-effectiveness and choosing projects that generated maximum CER volumes for lowest price: SEA's strategy was guided by government directives and climate policy. (We consider these directives in more detail at 4). In practice, this was exemplified by increased funding of LDC projects (where delay and delivery risk were higher than CERs, but which may have more potential co-benefits).

A review of NEFCO noted that NEFCO funds have provided cost effective compliance tools for governments and companies while also ensuring environmental integrity. Co-benefits achieved through financing included cost savings through improved energy efficiency, employment-related benefits, reduced groundwater pollution and capital investment, technology transfer and introduction of best practices through international cooperation (among other things).

The Baltic Sea Region Testing Ground Facility (TGF) generally was able to procure carbon credits at a price significantly below market price, and this offered a good return for investors, in exchange for the greater risk involved in developing primary contracts. However, a number of evaluations noted challenges associated with funds who offered a low price for emissions reductions. For example:

- An evaluation of TCAF noted that some countries had expressed lack of interest in participating in the TCAF due to the perceived over-selling risk, which was exacerbated by the request from the TCAF and the international community to raise NDC targets. According to the evaluation, the ERPA signaled a price to the market, and if the proposed price was considered too low by the host country, participation may be perceived as a risky operation.
- A review of the PCF noted that the issue of price was controversial. Host countries consistently regarded PCF transaction prices as being too low: PCF transactions were priced below those of the Dutch Government's 'ERUPT/CERUPT' program, and prices remained well below PCF participants' stated willingness to pay. The review noted the challenges of evaluating price, given both the project and country related risks and the values ascribed to them over time that enter into pricing, such as administration costs over the life of the fund, costs of dropped projects, allowance for under delivery of carbon across the portfolio, through failed or poor project performance, and dropped projects early in preparation. As an intermediary for these transactions, the Bank faced challenges in mediating the divergent interests of the buyer, whom it represents in a fiduciary capacity, and the seller, whom it represents as a development partner. The PCF managed the risk of an appearance of a conflict of interests by providing as much information as possible to all parties during pricing negotiations. Further challenges related to the nascent state of the carbon market for that fund included limited data on prices, and on supply and demand, which made it difficult to determine the true market price of emission reductions.

6.2.9 Ability for participants to opt out of receiving carbon credits from certain projects

Opt-out and opt-in provisions provided for in a number of the Funds have the benefit of providing flexibility for participants. In the case of the CACF, opt-in rights means that lack of interest from one participant does not impede the progress of the fund for another participant.

Our interviewee illustrated that while opt-out provisions are beneficial for participants by offering flexibility, one risk associated with allowing opt-out for all projects is that participants can stay in a fund for years without contributing to projects. This makes it more difficult for the Fund Manager and Trustee to prepare plans and programs for the fund, given that they have no certainty as to the amount of contributions they will be able to invest in projects.

Other interviewees noted that even where opt-in or opt-out provisions apply, participants may still be concerned that the fund does not take actions which reflect poorly on them as participants (for example, purchasing low integrity credits).

7 Implications for ITMO Fund establishment and ITMO procurement by GGGI

7.1 Fund design and governance structure

7.1.1 ITMO Fund as a dedicated trust fund

Based on the GGGI Financial Regulations, the Director-General may establish an ITMO Fund as a dedicated trust fund or earmarked fund to finance dedicated activities (ITMO procurement). The Director-General will be responsible for defining the purpose and limits of the ITMO Fund, and reporting on these to Council.

Based on our consideration of other carbon funds, structuring an ITMO Fund as a 'dedicated trust fund' under the Financial Regulations with GGGI as Trustee will best align with the purposes for which GGGI intends to establish the ITMO Fund. This structure also aligns with the approach taken by other carbon funds.

7.1.2 Single-participant or multiple-participant fund

The design and structure of an ITMO Fund will depend on whether GGGI takes a single-participant or multi-participant approach. As discussed at 6.1(a), the most common governance structure for a multi-participant fund typically consists of:

- a Trustee (being the administering bank);
- the participants themselves;
- a Board of Directors; and
- a Participants' Committee.

Different objectives and goals between the fund participants sometimes constitute a challenge in the decision-making process in multilateral funds and depending on the circumstances, a single-participant fund may be preferable. In that instance, the governance structure would most simply be effected by having a Trustee, Fund Manager and committee with representation from the participant and the Trustee.

If the ITMO Fund is a single-participant fund, the design and operation of the Fund will need to align with the participant's requirements for participation and contributions, and the Fund Regulations should be drafted accordingly.

Based on our analysis, the following aspects will be relevant considerations for GGGI's Director-General when establishing an ITMO Fund as a single-participant fund:

- It will be important for GGGI to have a deep understanding of the participant's mandate and objectives with respect to participating in the fund.
- Experiences with NEFCO and the Nordic governments indicate that where the fund has a strong identity and ownership by the Government participants (including Sweden), this can deliver benefits through the trust that is placed in the government brand (for example, Sweden)– particularly in the early phases of fund operation. This indicates that if the participant is willing for its involvement in the ITMO Fund to be publicized then this could help to encourage mitigation activity developers outside of the participant's country to engage with the Fund.

The following specific aspects will be relevant considerations for GGGI's Director-General if establishing Trust Fund 1 on behalf of the SEA as the initial single participant:

- Trust Fund 1 must be operated in compliance with the Appropriation Directives that apply to SEA. This will require that the Fund objectives align with the objectives described above. Relevantly, the objective of SEA directing resources to ‘preparatory and capacity-building for the implementation of pilot projects and concrete Article 6 collaborations’ likely aligns with establishing a fund that undertakes ITMO procurement with a component of capacity-building. Ideally, to align with SEA’s objectives as outlined in the Appropriation Directive, ITMOs will be sourced from mitigation activities that contribute to change at a sector level in low- and middle-income countries and from mitigation activities which reduce energy-related emissions.
- With respect to the budgeting arrangements for the Fund (which as noted above, will be provided for in the Fund Regulations), budgeting arrangements for the Fund should be consistent with the requirement for SEA’s contributions to align with the budget requirements of the ‘Appropriation directive for the budget year [2023] regarding grant 1:12 Contributions to international climate investments’. Although the budget is approved on a yearly basis, SEA has also been granted a long-term appropriation for commitments to facilitate long-term project engagement until 2032. We would expect that contributing to the Trust Fund 1 could fall under this long-term commitment, in which case, there would not necessarily be a need for the Trust Fund 1 to align with the annual budget approval processes.
- Although Swedish administrative (budget) laws typically do not allow for advance payments (i.e. payments should be made when the actual cost occurs), in practice, SEA has been willing to work with trust funds’ preferences for prepayment, and sometimes, prepayment is preferable for SEA. This signals that if Trust Fund 1 is established as a single-participant fund, the Fund should facilitate flexibility in regard to SEA’s payments and allow the ability to make advance payments.
- Trust Fund 1 reporting should align with SEA’s yearly reporting requirements. As noted above, SEA is required to on a yearly basis (no later than 14 March), report on how it is meeting its objectives and specifically report how it has contributed to sustainable development, with a particular focus on equality. Reporting on outcomes of the Fund would ideally enable reporting by SEA on these elements.

Conversely, if the ITMO Fund is a multi-participant fund, then any particular requirements that a participant has (different from or additional to other participants) can potentially be provided for in the Participation Agreement between the fund Trustee and the participant (as opposed to in the overarching Fund Regulations).

Interviews have emphasized the importance of the fund manager and fund management team having good communication with participants, and monitoring any issues that arise (for example, with respect to project selection and pricing).

7.1.3 Formulation of Fund Regulations

Under a trust fund structure, the Fund Regulations will prescribe the particular operational provisions of the fund, including the powers of the Trustee and rights and responsibilities of fund participants, a board (if established) and the fund manager / management unit (if separate to the Trustee). The Trustee typically has the power to manage and invest fund assets, incur and pay reasonable costs, as well as enter contracts to achieve the fund’s purposes and monitor the delivery of carbon credits to participants. The Fund Regulations can empower the Trustee to employ or contract others to conduct the business of the fund. Where a Fund Manager is appointed, the Trustee’s role may be more limited as some responsibilities are designated to the Fund Manager (such as the power to negotiate ERPA’s).

Under GGGI’s Financial Regulations, an ITMO Fund must operate in accordance with the requirements of the Financial Regulations unless the Director-General is otherwise authorized by the Council.

The Fund Regulations (or fund establishing instruments) of other carbon funds that we have reviewed typically provide for the following key matters (among other things):

- Objectives and principles of the fund;
- Application of organization's operational policies and procedures to fund operation;
- Contributions from participants, and distributions to participants;
- Meetings of participants and decision making / voting;
- Role of the governing body (for example, a fund management committee or board of directors);
- Role of the trustee in fund administration, including any powers to delegate to a fund manager;
- Processes upon participants defaulting in paying contributions, and processes for removing participants;
- Fund reporting requirements (for example, annual reporting to participants, and financial statements);
- Annual budgeting arrangements;
- Indemnification of the Trustee; and
- Project / mitigation activity selection criteria.

It will be necessary for the Director-General to obtain Council approval for ITMO Fund Regulations so that they can provide for the above matters, which go beyond what is in the Financial Regulations (and will necessarily differ from the requirements of the Financial Regulations, for example, in relation to contributions and financial reporting, and delegation of authority to a Trustee and Fund Manager).

Interviews indicated the importance of setting out the details of fund operation clearly in the Fund Regulations: particularly if an ITMO Fund is established as a multi-participant fund.

7.2 Application of EU and Swedish law to fund operation for Trust Fund 1

As discussed above at 4.1, in the case of Trust Fund 1, the Swedish and EU public procurement regulations will not apply to GGGI's acquisitions of supplies, services or works on behalf of SEA.

If Trust Fund 1 is established as a single-participant fund, then given the likelihood that SEA will be exerting influence over the operation of the Fund and its procurement decisions, SEA may risk criticism for trying to circumvent the public procurement regulations by using GGGI (or the Fund) as a middleman, should the transaction be challenged by a potential supplier of ITMOs. A similar result would be expected if the contributors in a multi-participant fund are other EU governments exerting influence over the operation of the ITMO Fund and its procurement decisions.

The panel's decision in the 'Sonar Mapping' decision outlined in 4.1.2, sets out various factors which, if present in the relationship between a participant entity and GGGI, may indicate that the participant is exerting a significant degree of control over GGGI's procurement decisions that will expose the participant to criticism (and, possibly a risk that GGGI itself will be considered legally required to apply public procurement regulations of the participant's jurisdiction).

In that light, drawing on the factors referred to in the Sonar Mapping panel decision, GGGI should design any ITMO Fund in a way that tempers the participant's control over fund decision-making processes and thereby minimizes risk to the participant of facing criticism in relation to its degree of control over the fund, including by:

- Making payments from the ITMO Fund from a designated account (rather than directly with participant funds).
- Conferring the fund manager with a degree of control over the process for procuring mitigation activities (in accordance with mitigation activity criteria clearly spelled out in the fund regulations) and negotiating MOPAs, so that the participant does not have full control over these processes (however, we consider that

it will still be appropriate for participants to provide final sign-off on procurement decisions, provided that this is based on recommendations from the fund manager).

- Conferring the fund manager or an independent party (rather than the participant) with responsibility for making final decisions about the pricing of ITMOs under MOPAs.
- Structuring MOPAs so that the ITMO Fund Trustee takes title to the ITMOs before these are disbursed and later transferred to the participant (at which point, the participant takes title).
- Considering including in fund regulations conditions on the participant's use of ITMOs (however, given that ITMOs can only be used for specific purposes, we do not consider this to be a high priority).

Risks of criticism to the participant can be further mitigated by:

- Setting out clear and transparent mitigation activity selection criteria in the Fund Regulations;
- Ensuring a fair approach to pricing of ITMOs in MOPAs; and
- Providing transparency to the public as much as possible around fund activities and evaluation.

We also note that an ITMO Fund itself (if established as a dedicated trust fund) will need to be operated in accordance with applicable trust laws. For multi-lateral funds, the establishing charter and contribution agreements are typically governed by and construed in accordance with English law: if GGGI takes this approach, then English trust law will apply. We have not undertaken a detailed analysis of the application of trust law that applies to other carbon funds, however, from our experience, a common approach is for the trust law of the country where the fund trustee is situated (rather than the country of participants) to apply to fund operation. For a single-participant fund, we expect that this could be negotiated between the participant and the trustee when establishing the fund.

7.3 Responsibilities and decision-making

7.3.1 Participation of participants in decision-making

Based on our interviews, we understand that program participants typically expect to be active fund participants and to be represented on the board of the fund. This would likely apply to an ITMO Fund and the structure of the ITMO Fund will need to enable this active participation. Based on our interviews with other fund participants, aside from board representation, active participation in funds may also be facilitated through greater access to project / activity level information and more frequent participant meetings. However, this level of engagement can also lead to micro-management, which is not ideal.

As discussed above at 6.1.2, the degree of input from participants varies between the carbon funds we have reviewed. Careful consideration of fund decision-making processes is important to ensure timely consideration of mitigation activities and pipeline development (in other words, striking a balance between enabling participation and timely delivery of outcomes). For this reason, a multi-level governance structure may not be appropriate for the ITMO Fund.

Interviews indicated the importance of the Trustee or Fund Manager making decisions in accordance with the fund regulations, and for the benefit of and consistent with the mandate given by the participants, rather than the priorities of the Trustee.

7.3.2 Frequency of meetings

In the case of Trust Fund 1, SEA considers that two board meetings and one meeting with all participants per year is sufficient. Meeting requirements in the ITMO Fund Regulations could provide for this (or similar).

7.4 Process for participants to make contributions

Typically, funds are flexible to accommodate participant preferences in relation to prepayments or calls for contributions (for example, the APCF Regulations allows participants to prepay required contributions in whole or part, as does the BioCarbon Fund).

In the case of Trust Fund 1, SEA prefers to regulate payments in SEK to eliminate currency risk. Under GGGI procurement policies, ITMO procurements will generally be in \$US. The Fund Regulations (or participation agreements) could specify the type of currency that contributions must be made in. SEA will need to deal with currency risk associated with the use of \$US.

7.5 Application of GGGI internal policies to fund operation

Based on our consideration of other carbon funds above at 6.1(p), all of the establishing charters reviewed provided some form of incorporation of the administering bank's operational policies and procedures. In this light, ITMO Fund Regulations may require fund operations to comply with certain GGGI policies and procedures.

A similar approach to that taken by the PCF and Biocarbon Fund will likely be preferable for the ITMO Fund, whereby the GGGI operational policies and procedures apply except to the extent inconsistent with the UNFCCC / Paris Agreement Article 6 Rules. While in practice, there are unlikely to be any immediate inconsistencies between GGGI's policies and the UNFCCC or Article 6 Rules, it is important that the Fund does not act inconsistently.

7.6 Scope for procurement / mitigation activity criteria and portfolio criteria

Consistent with the approaches taken by other carbon funds, the ITMO Fund Regulations should set out clear criteria for mitigation activity selection. Mitigation activity criteria should align with GGGI's objectives and activities noted above at 4.3. If a single-participant fund structure is for certain ITMO Funds, then mitigation activity criteria should align with the participant's objectives, including, for example, sustainable development criteria in the case of SEA.

We understand that GGGI's preference is for an ITMO Fund to invest in mitigation activities that already receive support from GGGI, particularly given that GGGI has a strong in-country presence with robust mitigation activities in a number of member countries. We consider that relying on a strong mitigation activity pipeline rather than relying on calls for mitigation activities will be an appropriate approach for an ITMO Fund. In that regard, we note that while NEFCO's experience with global calls for CDM mitigation activities for the NorCaP indicates that calls can be effective, this was in the context where the mitigation activities being sourced were pre-existing registered CDM mitigation activities: we expect that ITMO mitigation activities will not be well-established and registered in the same way for a number of years. For this reason, it would not be reasonable for an ITMO Fund to rely only on calls for established ITMO mitigation activities. Calls may, however, be used to supplement mitigation activity pipelines where needed, and the ITMO Fund Regulations should allow for this.

As discussed at 6.1.4, for the majority of the Funds reviewed, the scope for procurement of emission reductions generated by mitigation activities is governed by both 'mitigation activity criteria' and 'portfolio criteria'. Based on this, mitigation activity criteria for an ITMO Fund could include the following (for example):

- The mitigation activity is located in a country that is a Party to the Paris Agreement and meets the participation requirements under the Article 6.2 Guidance;⁷⁷
- The mitigation activity is consistent with UNFCCC / Paris Agreement Rules and any further guidance on Article 6.2 from the CMA (including the environmental integrity criteria outlined at 3.2.2);
- The host country for the mitigation activity has provided assurances that:
 - it authorizes the emissions reductions or removals generated by the activity that have been (or will be) issued as mitigation outcomes, for use as ITMOs under Article 6;
 - will not use the reductions or removals to achieve its NDC, and will account for these reductions and removals as ITMOs by applying corresponding adjustments in accordance with Article 6.2 Guidance; and
 - will report on the authorization and, where different, the first transfer of the project's emission reductions or removals as internationally transferred mitigation outcomes in a transparent manner in its biennial transparency report submitted under Article 13 of the Paris Agreement, and any relevant reports under Article 6 of the Paris Agreement.
- The mitigation activity is located in a GGGI member country and receives support from a GGGI program; and
- The mitigation activity complies with GGGI's operational policies. (By way of example, GGGI may wish to require compliance by mitigation activity developers with GGGI's 'Sustainability Safeguard Rules' and GGGI's procurement policies with respect to how those developers go about procuring goods, services and works for their mitigation activities.)

The criteria above are consistent with compliance with Article 6.2 requirements. Additional criteria related to sustainable development objectives, the ability to generate and disseminate knowledge outcomes etc. would also be relevant and could be determined in partnership with the anticipated fund participants.

We note that as an evaluation of the TCAF found, if GGGI as Trustee is solely responsible for the selection of mitigation activities to be proposed for inclusion, this is a resource-intensive task and can contribute to slow progress in pipeline development. Whereas, allowing calls for mitigation activities or enabling participants to refer activities for consideration can not only alleviate GGGI's task, but could also help expand the diversity of an ITMO Fund's portfolio.

7.7 Contracting approaches for ITMO transactions

7.7.1 MOPAs for ITMO transactions

As discussed at 6.1.9, most of the Funds reviewed utilize ERPAs to procure carbon credits, but take different approaches.

The likely mechanism for contracting ITMOs through an ITMO Fund will be MOPAs. The approach for formulating MOPAs is different to ERPAs in the following important respects:

- as discussed in our consideration of the Article 6.2 Guidance, specific additional participation requirements will need to be met by participants (for example, for the host Party or its authorized entity to develop the cooperative approach in accordance with the Article 6.2 Guidance; and for the participating Parties to meet and continue to meet the participation requirements under the Article 6.2 Guidance);⁷⁸
- while we understand that GGGI is focused on procuring ITMOs (or mitigation activities that generate ITMOs) in CO₂e metrics, additional complexities will apply when procuring ITMOs in non-GHG metrics;

⁷⁷ Decision 2/CMA.3, Annex, Chapters II.

⁷⁸ Decision 2/CMA.3, Annex, Chapters II.

- there will need to be oversight and management of ongoing compliance requirements (for example ensuring that there has been no overselling of ITMOs);
- procedures will need to be implemented to ensure that corresponding adjustments are made which must also reflect how corresponding adjustments are achieved if the Trustee of the ITMO Fund is the purchaser of ITMOs as it is the participant who is required to make corresponding adjustments where the ITMO will be used toward that participant's NDC; and
- there will need to be management of authorization processes in accordance with Article 6 requirements.

For the Sovereign Fund, SEA has the power to enter and negotiate ERPAs. If an ITMO Fund is established as a single-participant fund, then if the Fund Regulations provided, the participant could potentially be a party to MOPAs making some of the aspects related to ITMO transfer more streamlined.

Noting the World Bank's experiences with integrating benefit sharing into ERPAs, if an ITMO Fund were to include a benefit sharing objective, incorporating the requirement to provide details of benefit sharing arrangements into the MOPA, and reporting on the implementation of such benefit sharing following carbon credit payments will help ensure the equitable sharing of both mitigation outcomes and benefits.

We consider that appropriate benefit sharing arrangements with host countries of mitigation activities will be important to build trust and support for ITMO Funds and the CTP and for broader cooperative approaches under Article 6.2 of the Paris Agreement, particularly given the nascent state of the ITMO market. Whilst the primary issue for benefit sharing will be how mitigation outcomes from supported activities are shared are allocated to the host country for its own uses and to transferee countries for use towards an NDC or for other international purposes, it is also important to consider other types of benefits that may flow to the host country as a result of the MOPA. A study by the World Bank identified a number of best practices which we consider could apply to the operation of the ITMO Fund and structuring of MOPAs to facilitate appropriate benefit sharing, including:

- the utility of up-front cover costs associated with designing and initiating programs (including conducting stakeholder input and implementing activities) before mitigation outcome payments can be made;
- transparency of financial management and a simple approach to calculating, monitoring and delivering mitigation outcomes and benefits;
- transaction costs should be assessed to reduce them where possible and to adequately budget for them so as to preserve the effectiveness of projects / mitigation activities; and
- benefit sharing mechanisms should have clear, accessible, impartial, culturally appropriate and easy to understand grievance mechanisms.

7.7.2 Managing legal uncertainty and market uncertainty

GGGI will need to have regard to the fact that the legal characterization of ITMOs under, for example, EU and Swedish law, and other jurisdictions, is currently unclear.

Relevantly, the information memorandums for the Apcf and Cacf discuss how (at the point in time the fund was being established) the international institutions, and international regulations that related to the carbon credits are still being developed and even once agreed, they are subject to change which may impact the eligibility of projects to generate carbon credits that can be used by participants towards their international commitments. The information memorandum for the Apcf also includes a discussion on how at the end of the fund's term, the assets to be distributed amongst financing may include rights related to carbon credits that have not yet been created and since national and international regulatory regimes do not specify how such rights are treated, the assets to be distributed by the trustee may not be liquid.

Similar risks will need to be managed by the ITMO Fund Trustee.

7.8 Opt-out and opt-in provisions

As described at 6.1(o), a number of the Funds reviewed include opt-out provisions. We consider that these types of provisions could be important for participant entities, particularly where participant entities are party to a multi-participant fund, to allow the entities to avoid investing in specific mitigation activities that are not aligned with its own requirements. This will be less relevant in the case of a single-participant fund.

As noted at 6.1.15, one model is the CACF which provides significant flexibility by providing participants with 'opt-in' rights, whereby participants have autonomy in deciding whether to opt-in, to any transaction proposed, and this would likely be an approach that would provide the participant entity with maximum flexibility. In the case of Trust Fund 1 as an example, given SEA's interest in ensuring timely delivery of ITMOs, opt-in provisions can mitigate the risk that the lack of interest from one participant does not impede the progress of the Fund.

That said, we understand from interviews that even where SEA has the ability to opt-out (or opt-in), it will still be concerned about being associated with a fund which invests in controversial projects: for this reason, we understand that SEA's preference is for the ITMO Fund Regulations to clearly spell out the criteria for mitigation activity selection to ensure that the fund only invests in high integrity mitigation activities (as opposed to providing for opt-out). While mitigation activities must meet the environmental integrity requirements in the Article 6.2 Guidance⁷⁹ and this should be made clear in the Fund Regulations and MOPAs, there is scope for selection criteria to set out more stringent criteria that go beyond the requirements of the Article 6.2 Guidance.

As noted at 6.2.9, one risk for GGGI associated with opt-out provisions is added uncertainty around investment planning, because GGGI has less visibility of how much funding it will receive. This would also likely be a concern for SEA in the case of Trust Fund 1, who is concerned about 'deal certainty' or ensuring that its committed funds will be invested in a timely and effective manner. This will be something to borne in mind by GGGI when determining whether (and when) to provide opt-out provisions.

7.9 Value for money and gender equality considerations

Based on experiences with the Sovereign Fund, GGGI may wish to focus on funding large-scale mitigation activities through the ITMO Funds, given that these are more likely to deliver cost-effective emissions reductions.

However, broader sustainable development factors outside of ITMO price are likely to also be important to have regard to when determining mitigation activity selection criteria (particularly where the ITMO Fund is a single-participant fund with SEA). For example, SEA has a mandate under the Appropriation Directive to support gender equality, and we understand from our interview with SEA that SEA is developing its own sustainable development policy. This has potential to create challenges for ITMO procurement (for example, where ITMOs are proposed to be procured from a host country with poor gender equality laws). This risk may be mitigated by the requirement under Article 6.2 for cooperative approaches to reflect the eleventh preambular paragraph of the Paris Agreement, in relation to respecting, promoting and considering their respective obligations on gender equality (among other things). In this way, it would be expected that all mitigation activities should consider sustainable development objectives, including gender equality considerations.

⁷⁹ Decision 2/CMA.3, Annex, Chapter IV.

We consider that clear mitigation activity selection criteria will help to ensure value for money both from a mitigation activity scale and sustainable development perspective. Further, if the ITMO Fund is a multi-participant fund, allowing opt-out provisions can further enable each participant to safeguard, for example, its own sustainable development and gender equality criteria by opting out of supporting mitigation activities that it does not support. Lack of projects has historically been a larger challenge for participants we interviewed, than safeguarding their sustainable development criteria. For this reason, selection criteria will need to strike a balance between robust environmental and sustainable development criteria and not unnecessarily restricting the types of activities that are eligible for investment. Given GGGI's robust pipeline, we suggest that this balance will be able to be well managed.

We note that the BioCarbon Fund is an example of a fund that considers broader benefits of mitigation activities aside from their carbon credit return, and a review of the BioCarbon Fund relevantly considered the effectiveness of funded mitigation activities which incorporated gender development objectives in their design. This is illustrative of the potential for the ITMO Fund Regulations to provide for broader sustainable development objectives (which could specifically include gender equality requirements) and to measure benefits broader than ITMO returns.

7.10 Reporting

If established as a multi-participant fund, the ITMO Fund Trustee would typically base reporting on its own internal requirements which would be set out in the Fund Regulations. In regard to participant's additional reporting requirements, these could be provided for in the Participation Agreement (or a side letter). However, we understand that, for example, SEA has historically been satisfied with reporting practices of other funds it has participated in, so accommodating SEA's reporting requirements is unlikely to be an issue for ITMO Fund operation.

7.11 Transparency requirements

GGGI is required under its Establishment Agreement to act in a transparent manner, and GGGI's Disclosure Policy provides that it is GGGI's policy to publicly disclose information concerning its governance organs and their decisions as well as operational activities in the absence of a compelling reason to consider such information as proprietary, privileged or confidential. Based on the examples of the Funds we have reviewed, the ITMO Fund Regulations could specify that, subject to compliance with the Disclosure Policy, it will facilitate public access to fund documents relating to, for example, information on selection of mitigation activities, reports of any participants' meetings, lessons learned through operation of the ITMO Fund, and other information deemed appropriate by GGGI.

7.12 Practical considerations relevant to fund operation

Based on our review of the Funds and interviews, we have set out below practical considerations that will be important for effective operation of the ITMO Fund.

7.12.1 Importance of strong host-country engagement and capacity-building

Experiences from the other Funds indicate that effective ITMO procurement by an ITMO Fund in practice will require that decisions can be made in a timely manner, that there is strong engagement and support in the countries where mitigation activities are hosted, and that there are efficient processes for translating early-phase mitigation activities into MOPAs. This will likely require GGGI to have a strong presence in host countries.

An evaluation of the TCAF identified a number of factors contributing to slow progress on translation from ‘preliminary program information notes’ (Pre-PINs) for projects to ERPAs, including:

- lengthy processes involved in translating projects from early phase to ERPAs (for example, the process of developing PINs between host country, the TCAF trustee and the World Bank teams took a long time);
- reliance on World Bank teams to source programs and engage host countries;
- wide sector coverage of the fund, which created challenges with engagement as this approach was resource-intensive and not streamlined; and
- lack of engagement in host countries hindering pipeline development. This element was considered to be influenced by a number of factors, including:
 - the TCAF has been perceived by some potential host countries as too high-risk (for example, in relation to over-selling risk). If the proposed price in an ERPA was considered too low by the host country, this discouraged engagement. In addition, host countries are requested to comply with certain rules (TCAF’s operational approach as per the Core parameters note), which may or may not be in line with the future Paris Agreement Rules;
 - host countries were only involved in the TCAF only once the pre-PIN was approved by the Facility Board;
 - the Trustee faced difficulties involving the right point of contact in host countries, given that climate policies frequently involve several ministries/departments;
 - host countries were less prepared than initially expected to implement the TCAF. This included a lack of relevant infrastructure (such as monitoring, reporting and verification systems), and a lack of understanding of the Article 6 Rules, including corresponding adjustments; and
 - capacity-building under the TCAF was only provided to programs where an ERPA has been signed. However, the review noted that capacity-building at earlier stages could have helped progress PINs more efficiently;

We note that since this evaluation of the TCAF, the Article 6.2 Guidance (as discussed above at 3.2) has provided further certainty regarding the nature of ITMOs. Despite this, readiness continues to be a significant issue for many countries’ participation in Article 6.

Design of the ITMO Fund should seek to mitigate these challenges faced by TCAF, through:

- taking a targeted approach to sector priorities for mitigation activities, through thorough strategic planning;
- ensuring that fund mitigation activity criteria align with the requirements of ITMOs under Article 6.2 (including participation requirements);
- maintaining strong in-country engagement with host country teams, including good contact with relevant government contact points;
- providing capacity-building support for early-stage mitigation activities (i.e., investing in mitigation activities up-front to support large-scale mitigation activities); and
- streamlining mitigation activity approval processes as much as possible.

As discussed earlier, calls for mitigation activities (where implemented appropriately) offer another avenue to alleviate risks associated with relying on an internal mitigation activity pipeline. That said, given that GGGI currently has a strong in-country presence, we consider that it may be feasible for GGGI to rely on its own pipeline of mitigation activities.

7.12.2 Managing ITMO delivery risks

Information memorandums for the APCF and CACF identified risks relating to mitigation activities, including the risk of underperformance and cancellation. We would expect that similar risks will need to be managed for ITMO activities. One way to mitigate this risk would be through providing up-front payments to mitigation activity developers to assist activity development.

In light of the nascent state of the market for ITMOs, there are likely to be numerous risks involved with the delivery of ITMOs which will need to be adequately disclosed to fund participants. In addition to standard project / activity performance and delivery risks, these risks include:

- host countries will likely undertake a conservative approach to avoid the overselling of ITMOs and domestic use of ITMOs;
- ITMOs will be in high demand, and the ITMO Fund will have to compete for ITMOs with other market participants which may impact the ability to generate a sufficient pipeline of ITMOs that can meet the requirements of the participants, as well as the ability to acquire ITMOs at an attractive price; and
- there may be a mismatch of timing in the ability to deploy funds and meeting participants' mitigation requirement.



Annex 5

GGGI CARBON TRUST FUND

Information Memorandum

DRAFT

Dated September 2023

Disclaimer: This Information Memorandum is intended to provide background information and a summary of the terms of the first Carbon Trust Fund managed by GGGI. It is a draft version, and its contents are subject to change. The Fund Rules and the Contribution Agreement shall prevail in the event of any inconsistency with this Information Memorandum.

Participants should seek their own professional advice regarding the suitability of this Fund for their investment purposes.

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INFORMATION MEMORANDUM FOR THE CARBON TRUST FUND

The Global Green Growth Institute (“**GGGI**”) desires to establish the Carbon Trust Fund (the “**Fund**”), through which Participants will provide resources to Mitigation Activities that are intended to generate GHG Reductions recognized under Article 6 of the Paris Agreement.

The Internationally Transferred Mitigation Outcomes (“**ITMOs**”) generated by a Mitigation Activity will be acquired by the Fund through Mitigation Outcome Purchase Agreements (“**MOPAs**”) and distributed to Participants, thereby assisting Participants in meeting their nationally determined contributions (“**NDCs**”) or otherwise enhancing their climate mitigation ambition.

The GGGI Council has authorized the Director-General of GGGI to establish the Fund pursuant to decision C/2022/DC/5.¹

This Information Memorandum is intended to provide background information and a summary of the terms and key design elements of the first Carbon Trust Fund managed by GGGI. In the event of any inconsistency between this Information Memorandum and the Fund Rules and/or the Contribution Agreement, the Fund Rules and/or the Contribution Agreement shall prevail.

1 BACKGROUND AND RATIONALE

1.1 Background

International carbon trading under Article 6 of the Paris Agreement stands to play a crucial role in achieving the long-term temperature goal adopted by Parties at COP21 in 2015. The use of Article 6 market mechanisms has the potential to reduce the cost of implementing NDCs by more than half – equivalent to approximately USD 250 billion per year by 2030 – and accelerate the implementation of global mitigation action.²

Countries are increasingly indicating that they intend to utilize Article 6 market mechanisms. A 2021 analysis found that 77% of countries who submitted updated NDCs anticipate the use of Article 6, with almost half of these being countries in Sub-Saharan Africa or Latin America.³ For host countries, Article 6 provides an opportunity to unlock international flows of carbon finance that can be used to increase the ambition of climate targets while delivering sustainable development co-benefits.

1.2 Rationale

Despite increasing interest to utilize Article 6 market mechanisms, potential sellers of ITMOs are not confident that they will get equitable treatment and payment in their transactions. GGGI’s 2022 survey of its Members and partners revealed that in 86% of countries (21 out of 29 surveyed), respondents concluded that they did not believe that buyers and sellers had equal opportunity to benefit from the Article 6 market under current conditions. Nearly 50% of surveyed countries felt

¹ <https://gggi.org/wp-content/uploads/2022/11/C2022DC5-Decision-on-Establishment-of-the-Carbon-Transaction-Platform.pdf>.

² IETA, University of Maryland, and CPLC (2019). The Economic Potential of Article 6 of the Paris Agreement and Implementation Challenges.

³ Michaelowa et al. (2021). Article 6 readiness in updated and second NDCs. Perspectives Climate Group and Climate Focus.

they were not able to equitably participate in the market, and that they may be at risk of being taken advantage of by buyers.⁴

At the same time, potential buyers of ITMOs face difficulties in engaging with potential sellers, capacity constraints, and long lead times and high transaction costs in completing ITMO transactions. GGGI is seeking to address such barriers by setting up ITMO purchasing carbon trust funds, managed by GGGI as the trustee.

GGGI's role as an embedded, trusted advisor to host countries facilitates an equitable basis for trading between developed and developing nations. GGGI intends to build a strong pipeline of Mitigation Activities through its existing activities in green investment services. GGGI will then be able to increase the pace and volume of trading by taking on the burden of administration for initial trade completion, as well as ongoing trade management over the transaction period. GGGI's permanent presence in countries allows for oversight of transactions for the whole crediting period. Being embedded in Member and partner countries also allows GGGI to provide Member governments ongoing guidance and support as they develop, execute, and monitor Article 6 transactions.

2 OBJECTIVES AND PRINCIPLES OF THE FUND

2.1 Objectives

The Fund will mobilize carbon finance for eligible Mitigation Activities through the purchase of ITMOs.

The principal objectives of the Fund are to:

- a) Reduce GHG emissions;
- b) Raise NDC ambition;
- c) Contribute to sustainable development progress globally; and
- d) Enhance the confidence of seller countries to participate in Article 6 markets on an equitable basis.

2.2 Governance Principles

A set of overarching governance principles ("**Governance Principles**") will guide GGGI's operation of the Fund. The overarching Governance Principles for the Fund are as follows:

- a) Promoting achievement of the Paris Agreement;
- b) Respecting national circumstances;
- c) Fostering predictability and stability;
- d) Upholding fairness and impartiality;
- e) Empowering stakeholders;
- f) Promoting transparency; and
- g) Ensuring integrity and accountability.

⁴ GGGI (2022). Global Survey on Article 6 Readiness Report. <https://gggi.org/wp-content/uploads/2022/11/GGGI-Global-Survey-on-Article-6-Readiness-Report.pdf>.

3 FUND SETUP AND GOVERNANCE

3.1 Fund Establishment

The Fund will be established through Fund Rules, outlining the specific terms and conditions for the Fund. The Director-General of GGGI is authorized to establish this Fund, as per decision C/2022/DC/5 of the GGGI Council. The Fund will be subject to ultimate governance oversight by the GGGI Assembly and Council.

3.2 Participants

The Fund will enable participation from one or multiple contributing parties (“**Participants**”).

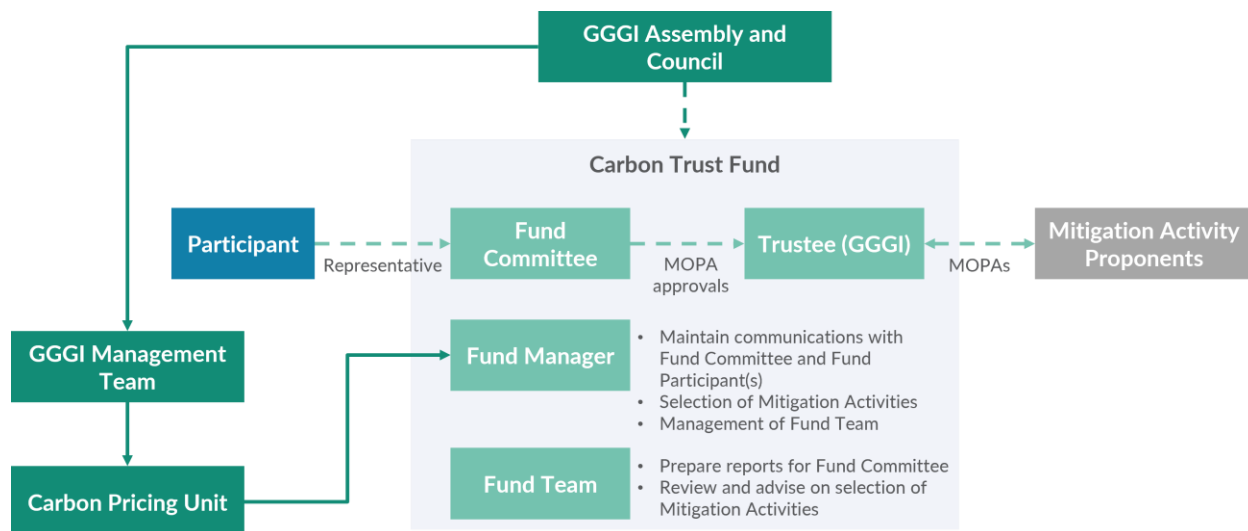
A Contribution Agreement will be signed between each Participant and GGGI to register the specific contribution of Participants to the Fund. The Contribution Agreement will refer to the Fund Rules established by GGGI.

A Participant or additional Participant’s participation in the Fund will take effect from the date on which the Trustee countersigns the relevant Contribution Agreement. Additional Participants will not be entitled to receive distributions of ITMOs delivered under a MOPA which has been executed on or before the effective date of the relevant Contribution Agreement. Additional Participants may be required to contribute a catch-up payment.

3.3 Governance

The governance structure of the Fund comprises the Trustee, Fund Manager, Fund Team and Fund Committee. Fund operations will be subject to regular GGGI governance and management oversight. The Fund governance structure is illustrated in Figure 1.

Figure 1. Carbon Trust Fund governance structure.



Trustee

The Fund will be established as a dedicated trust fund with GGGI as the Trustee. The role of the Trustee shall include:

- a) managing Fund property;

- b) facilitating the interaction between Participants, the Fund Committee, and GGGI;
- c) identifying, assessing and selecting Mitigation Activities in accordance with the Portfolio Guidance and in compliance with applicable Selection Criteria and Portfolio Restrictions;
- d) undertaking legal, technical and any other due diligence in order to determine whether ITMOs may be produced by a Mitigation Activity;
- e) presenting MOPAs to the Fund Committee for approval;
- f) managing the disbursement of the Fund's payments to Mitigation Activity Proponents for ITMOs;
- g) receiving delivery of ITMOs on behalf of the Fund and generally enforcing the terms of any MOPA;
- h) managing the receipt of contributions from Participants and timely distribution by the Fund of ITMOs to Participants;
- i) preparing the Annual Budget for the Fund; and
- j) reporting to and communicating with Participants regarding the Fund portfolio and operations, Mitigation Activity status, timing of contributions and the realization and transfer of ITMOs.

Fund Manager

The Trustee will appoint a Fund Manager, who will be located within GGGI's Carbon Pricing Unit. Such appointment will be in accordance with GGGI Operational Policies and Procedures.

The Fund Manager will have overall responsibility for the day-to-day operations of the Fund, including:

- a) the selection and management of staff;
- b) representing the Fund's interests at international fora and maintaining contact with Participants;
- c) overseeing the selection of Mitigation Activities, reviewing Mitigation Activities during their appraisal, implementation and operation, and assisting the Trustee with negotiating MOPAs;
- d) ensuring compliance with Selection Criteria and Portfolio Restrictions;
- e) seeking to ensure consistency, to the extent possible, of the Fund's operations with the Paris Agreement and Article 6 Rules, GGGI's Operational Policies and Procedures, and the Governance Principles; and
- f) collecting, organizing, managing and disseminating the knowledge and information obtained by the Trustee in the course of its operation of the Fund.

Fund Team

The Fund Team will manage the day-to-day operations of the Fund. It shall be headed by the Fund Manager, and is comprised of staff designated from GGGI's Carbon Pricing Unit. The Fund Team will provide advice to the Trustee on:

- a) the implementation of the Fund;
- b) proposed Annual Budgets and business plans for the forthcoming Fiscal Year for the Fund, prior to submission to the Fund Committee at their annual Fund Committee Meeting; and
- c) existing and proposed Selection Criteria and Portfolio Restrictions, including suggesting methods to enhance the effectiveness of the Fund.

The Fund Team will also be responsible for independently reviewing and advising on Mitigation Activities proposed for support by the Fund, including advising the Trustee on whether to approve each Mitigation Activity Idea Note, and where appropriate, prior to the review by the Fund Committee.

Fund Committee

The Fund Committee shall be comprised of one representative of each Participant, as nominated by the Participant and notified to the Trustee in writing within thirty (30) calendar days of executing a Contribution Agreement. Nominated representatives of each Participant for the Fund Committee shall be officers, directors, employees or officials of that Participant. Elected members of the Fund Committee who cease to be officers, directors, employees or officials of the Participant who elected them, will no longer be eligible for membership of the Fund Committee.

The Fund Committee will be responsible for:

- a) providing advice to the Trustee on issues regarding the operation of the Fund, including where relevant, proposing changes to the Selection Criteria or Portfolio Restrictions;
- b) reviewing and approving the terms and conditions of MOPAs;
- c) reviewing the operations of the Fund;
- d) reviewing and approving the proposed Annual Budget prepared by the Trustee for the forthcoming Fiscal Year;
- e) reviewing and where relevant, approving changes to the Expense Cap;
- f) reviewing and approving the financial statements for the Fund for the preceding Fiscal Year; and
- g) determining the scope and frequency of evaluations.

The administration of the Fund will be governed by the Fund Rules. The Fund Rules may be amended from time to time. Amendments to Fund Rules must be unanimously approved by the Fund Committee, and approved by GGGI's Director-General.

The Fund Committee will meet, at a minimum, once per year. Meetings of the Fund Committee shall be called by the chairperson of the Fund Committee or the Trustee, provided that at least fourteen (14) calendar days' written notice is given to each member of the Fund Committee stating the matters to be considered and the place, date and time of the meeting. Fund Committee members represented at a Fund Committee Meeting holding a majority of all the votes of the Fund Committee shall constitute a quorum for the transaction of business at that meeting.

Each member of the Fund Committee shall be entitled to one vote for every USD 1 million of the Commitment of its nominating Participant on each matter submitted to a vote at a Fund Committee Meeting. The members of the Fund Committee shall make every effort to make decisions by consensus at Fund Committee Meetings. If all efforts at consensus have been exhausted and no agreement has been reached, every matter submitted to a Fund Committee Meeting shall be decided by the majority of the votes cast by the members of the Fund Committee at that meeting.

Subject to compliance with the Governance Principle of ensuring integrity and accountability, the Trustee may attend Fund Committee Meetings as an observer and may express its views on issues under discussion at such meetings, but without voting rights to any decision by the Fund Committee.

3.4 Fund structure

The Fund will operate within the overall structure of GGGI's Carbon Transaction Facility (CTF)⁵.

The Fund's activities will be restricted to support for ITMO generation and transactions. If necessary, the Fund may provide technical assistance to support Mitigation Activity development, and the establishment of an Article 6 agreement between the relevant host country and Fund Participant(s), if required.

Readiness and capacity building activities will be supported through GGGI's Article 6 Readiness Facility.

3.5 Contribution arrangements

GGGI will accept contributions to the Fund from Participants. Contributions will be held and administered by GGGI in its capacity as Trustee.

Each Participant shall be required to make Fund Contributions in accordance with the terms of the relevant Contribution Agreement and the Fund Rules. Following the execution of a Contribution Agreement, the Trustee shall provide the respective Participant with a written notice which contains the aggregate sum of the Commitments of all Participants in the Fund under their respective Contribution Agreements and the number of voting rights held by the Participant's nominated member of the Fund Committee.

Fund Participants will be issued a Fund Contribution Request from time to time in accordance with the relevant Contribution Agreement, having regard to the financial requirements of the Fund. Participants will be given at least sixty (60) days' notice of any demands for the payment of a Fund Contribution.

Contributions shall be administered in accordance with the Governance Principles and GGGI's applicable policies and procedures, which may be amended from time to time, including its financial management, disbursement and safeguard policies, its framework to prevent and combat fraud and corruption, and its due diligence procedures.⁶ GGGI shall administer the contributions through its own organization, services, officers, staff and consultants engaged by GGGI, and the reporting lines of such staff and consultants shall be in accordance with GGGI's regulations, rules, policies and guidelines.

GGGI shall open and maintain a separate interest-bearing account ("**Account**") denominated in US dollars in which contributions from Fund Participants shall be held. If the contribution received is in a currency other than US dollars, GGGI will convert the contribution into US dollars and transfer it to the Account. GGGI shall have no liability to the Participant from which contributions have been received for any exchange or other losses in connection therewith.

If Participants fail to pay their contributions when due ("**Defaulting Participants**"), their right to receive ITMOs will be suspended. Following a notice period of 45 days, Defaulting Participants will cease to be a Fund Participant and their interest in the Fund will be offered to other Participants.

⁵ Previously referred to as the Carbon Transaction Platform. The overall design of the CTF was described in the Proposed GGGI Carbon Transaction Platform: For Council Approval, and attached to the Council document Carbon Transaction Platform: Draft Recommendations [[A/2022/2-C/2022/2](#)].

⁶ All policy documents are available at <https://gggi.org/policy-documents/>.

Participants to the Fund will also provide a contribution to GGGI's Article 6 Readiness Facility, recognizing that the Readiness Facility will support the origination of Mitigation Activities, knowledge sharing, capacity building and wider readiness activities for GGGI Member and partner Governments to prepare for participation in Article 6 related carbon trading.

3.6 Fund duration

The Fund is proposed to be established for a set duration. It is proposed to operate from the Fund operational date, through to 31 December 2035.

Key milestones:

Fund Commencement Date: [1 November 2023].

Fund Operational Date: the date that the Fund commences operation, which is the date that the Trustee receives the initial Contribution from a Participant that has executed a Contribution Agreement.

Fund Operating Period: the period between the Fund Operational Date and 31 December 2035, the latter being the date by which the Trustee shall have received all contracted ITMOs, completed all financial transactions.

Fund Closing Date: 31 December 2035.

One year before the end of the Fund Operating Period, Participants may decide to extend the Fund Operating Period and the Fund Closing Date. Any such extension is also contingent upon GGGI consenting in writing to continue to serve as Trustee, as per the Fund Rules.

3.7 Assignment of participants' interests

A Participant may assign all, but not part, of any of its rights under the relevant Contribution Agreement to an eligible participant with the prior written consent of the Trustee. Such consent is not to be unreasonably withheld, provided that such assignee agrees, in form and substance acceptable to the Trustee, to be bound by:

- a) the terms of the Fund Rules;
- b) the Contribution Agreement entered into between the Trustee and the assignor Participant; and
- c) to pay the Trustee's reasonable costs in respect of the transactions.

3.8 Termination

The Fund will be terminated on the earliest of the Termination Date and the occurrence of one or more of the following:

- a) failure of the Fund to, within eighteen (18) months of the Commencement Date to have signed Contribution Agreements for participation in the Fund representing a sum deemed viable for the operation of the Fund by the Trustee (as determined by the Trustee in its absolute discretion);
- b) the unanimous written consent of all Participants; or
- c) resignation of GGGI as Trustee.

Following the termination of the Fund, after paying or adequately providing for the payment of all liabilities, and upon receipt of such releases, indemnities and refunding agreements as it may

deem necessary for its own protection, the Trustee shall distribute the remaining Fund Property in cash or in kind, or a combination of both, among the Participants according to their respective rights (and such distribution shall include the repayment to a Participant of any prepaid Contributions that have not been applied by the Trustee to the operations of the Fund).

4 SCOPE

4.1 Selection Criteria

Country Selection Criteria

Mitigation Activities must be located in developing and emerging economy countries that are Parties to the Paris Agreement. The host country in which the Mitigation Activity is implemented must have provided assurances that it:

- a) Intends to meet the participation requirements under the Article 6.2 Guidance⁷;
- b) Intends to authorize the mitigation outcomes that will be generated by the Mitigation Activity for use as ITMOs under Article 6;
- c) Will not use authorized mitigation outcomes generated by the Mitigation Activity towards the achievement of its own NDC, and will account for ITMOs by applying corresponding adjustments in accordance with the Article 6.2 Guidance; and
- d) Will submit all relevant reports (initial report, annual information, and regular information) to the UNFCCC in accordance with the Article 6.2 Guidance.

Mitigation Activity Criteria

Mitigation Activities must meet certain criteria (“**Mitigation Activity Criteria**”) to be eligible to contract with the Fund. The Mitigation Activity shall:

- a) be located in a country that meets the Country Selection Criteria;
- b) be either project or program-based activities, policy-based activities, or sectoral-based activities. However, [*activities specified by Fund Participants*] will be excluded from the Fund;
- c) comply with the requirements of the Article 6.2 Guidance, including but not limited to environmental integrity requirements and sustainable development-related requirements;
- d) contribute to transformational change towards decarbonization in the Host Country; and
- e) in respect of the Mitigation Activity Proponent, comply with the GGGI Operational Policies and Procedures, including but not limited to the GGGI Sustainability and Safeguards Rules and GGGI Rules on Child Protection.

Mitigation outcomes generated from an eligible Mitigation Activity must be correctly attributed to the underlying source of concessional finance, where relevant.

4.2 Portfolio Restrictions

The Fund’s portfolio will be subject to a number of specific restrictions (“**Portfolio Restrictions**”). The Trustee shall ensure that the Fund shall only enter into MOPAs that:

⁷ The Article 6.2 Guidance refers to the rules adopted by the Conference of the Parties to the Paris Agreement (CMA) at COP26 in Glasgow in 2021 (Decision 2/CMA.3), and all further relevant guidance from the CMA, including but not limited to Decision 6/CMA.4.

- a) Do not result in the Fund's aggregate payments to Mitigation Activities in GGGI non-Member and partner seller countries exceeding 40% of the aggregate amount of the commitments of all Participants;
- b) Do not result in the Fund's aggregate payments to a single Mitigation Activity exceeding [% specified by Fund Participants] of the aggregate amount of the commitments of all Participants; and
- c) [relevant sectoral restrictions, if specified by Fund Participants].

4.3 Portfolio Guidance

The Fund shall enter into MOPAs during the Operating Period in accordance with the Portfolio Guidance. The Trustee, in contracting MOPAs on behalf of the Fund, shall endeavor:

- a) to target Mitigation Activities that already receive support from GGGI;
- b) to target Mitigation Activities that are located in GGGI Member and partner developing and emerging economy countries;⁸
- d) to target [sectors/technologies, if specified by Fund Participants];
- c) to preference Host Countries that have established an Article 6 agreement with Fund Participants. Where such an agreement does not exist, the Trustee may facilitate the establishment of Article 6 agreement(s) with Fund Participants in consultation with Participants, using Fund resources; and
- d) to select high-quality Mitigation Activities and negotiate MOPAs with a view to full and timely allocation of the Fund's Commitments at a reasonable cost.

5 ITMO PROCUREMENT

5.1 Approach to ITMO procurement

The Trustee will seek to identify and select Mitigation Activities for the Fund:

- a) which meet the Selection Criteria, Portfolio Restrictions and Portfolio Guidelines; and
- b) where supporting those Mitigation Activities through the Fund is consistent with the Governance Principles.

When considering whether supporting a Mitigation Activity through the Fund is consistent with the Governance Principles, the factors that the Trustee shall consider include (but are not limited to):

- a) whether supporting the Mitigation Activity through the Fund is consistent with respecting national circumstances, recognizing and respecting the autonomy of the participating countries who would be involved in the potential transaction; and
- b) whether supporting the Mitigation Activity through the Fund is consistent with empowering stakeholders involved in the potential transaction.

Participants may also present potential transactions to the Trustee. The Trustee shall have sole discretion in determining that such potential transactions are aligned with the Selection Criteria, Portfolio Restrictions, Portfolio Guidelines, and Governance Principles.

⁸ Developing and emerging economy countries are defined as those on the OECD's DAC list of ODA recipients: <https://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/daclist.htm>.

The Trustee shall present to Participants Mitigation Activities as potential Fund transactions in the form of Mitigation Activity Idea Notes (“**MAINs**”). MAINs shall include the following information:

- a) the extent to which and how the activity aligns with the Selection Criteria, including how the Mitigation Activity will contribute to transformational change in the Host Country and compliance with the environmental integrity and sustainable development requirements set out in the Article 6.2 Guidance;
- b) how the Fund’s support for the Mitigation Activity is consistent with each of the Governance Principles;
- c) the estimated volume of Mitigation Outcomes that the Mitigation Activity will generate;
- d) the transaction terms of the Mitigation Activity Proponent and the relevant Host Country; and
- e) the estimated technical assistance needs related to the Mitigation Activity.

Following a thirty-day opt-out period (see Opt-out provision), the Trustee shall commence negotiations with the Mitigation Activity Proponent for the potential transaction to enter a MOPA. When negotiating the price paid for ITMOs under a MOPA, the Trustee will act in accordance with the Governance Principles, and will endeavour to negotiate a price for ITMOs that:

- a) strikes an appropriate balance between providing a sound investment for Participants whilst appropriately incentivizing and supporting Host Countries and Mitigation Activity Proponents to engage in Article 6 markets; and
- b) has regard to any relevant information on prices for Mitigation Outcomes in the Host Country where available.

The Trustee will present a recommended MOPA to Participants for their review and approval. Participants that have exercised their opt-out rights (see Opt-out provision) will not be entitled to a vote in respect of the recommended MOPA, nor will they be entitled to ITMOs delivered in respect of that potential transaction.

When presenting a recommended MOPA to Participants, the Mitigation Activity’s Mitigation Activity Design Document (MADD) will be attached as an annex to the MOPA. The MADD is expected to cover, but is not limited to, the following information:

- a) how the Mitigation Activity contributes to transformational change towards decarbonization in the seller country;
- b) the financial, policy/regulatory, and/or technological additionality of the Mitigation Activity;
- c) how the Mitigation Activity fosters sustainable development and how it enhances positive impacts and avoids negative impacts;
- d) how the Mitigation Activity ensures environmental integrity, including the procedures for monitoring, reporting and verification (MRV) of both emission reductions or removals and sustainable development impacts; and
- e) estimated volume of mitigation outcomes to be generated by the Mitigation Activity within the specified authorization period.

5.2 Opt-out provision

A Participant may (through its nominated Fund Committee member), within thirty (30) calendar days of being issued a MAIN for a potential transaction, notify the Trustee in writing if it wishes to be excluded from the potential transaction, in which case, the Participant will not be required to

provide any Contribution, and will not be entitled to ITMOs delivered in respect of that potential transaction.

5.3 ITMO collection and distribution

The Fund will undertake the following proposed approach to ITMO collection and distribution:

- a) The Trustee shall open and maintain such Registry Accounts as are required for the purposes of holding ITMOs delivered to the Fund pursuant to MOPAs.
- b) The Trustee shall maintain a record of all ITMOs held by the Trustee on behalf of the Participants and transfers of ITMOs in and out of the Trustee's Registry Accounts.
- c) Upon issuance of ITMOs from the Mitigation Activity, the Trustee will provide to all Participants a notice of the number of ITMOs that are available for distribution and will initiate the transfer of such ITMOs to the designated accounts of Participants, as notified by the Participants.⁹
- d) In the case that multiple Participants make contributions to the Fund, Participants will be entitled to a pro-rata share of ITMOs based on their contributions.

The Trustee shall issue Fund Participants with a Fund Contribution Request, in accordance with the relevant Contribution Agreement, as and when required with regard to making payments to Mitigation Activity Proponents under MOPAs.

5.4 Procurement rules

Purchases of ITMOs by the Fund will not be subject to GGGI's Procurement Regulations or Rules for Procurement, as payments contracted under MOPAs will be for verified MOs achieved by the Mitigation Activity Proponent, which will then be distributed to Participants. Such procurement is outside the scope of procurement of goods, works and services for GGGI.

6 ADMINISTRATION ARRANGEMENTS

6.1 Expenses

The Trustee may use Fund Property to pay or reimburse it or any other person, including GGGI, for all Administrative Costs attributable to the Fund. The Fund shall not incur, or reimburse GGGI for, costs and expenses exceeding the 15% expense cap, except for costs and expenses relating to any fees charged by the Host Country to cover the administration expenses associated with Mitigation Outcome issuance.

6.2 Monitoring and reporting

The Fund Manager will submit the following two reports to Participants:

- 1) Annual Report on the Fund's performance; and
- 2) Annual Financial Statements.

The scope of the Annual Report on the Fund's performance will be determined in consultation with Participants and set out in the Fund Rules but is expected to include information on the host

⁹ 'Transfer' may also refer to the cancellation of the relevant ITMOs from the Trustee's registry account and re-issuance into an account specified by the Participant(s). The Trustee will provide proof of cancellation of the relevant ITMOs prior to such re-issuance.

countries from which ITMOs are procured, including information related to NDC compliance and potential overselling risks.

The Fund Manager will maintain the records and accounts, in accordance with its standard procedures that identify the contributions made, the commitments to be financed out of the available funds, the eligible activities, and all related administrative costs of the Fund. The Fund Manager will provide Participants with audited financial statements on these records and accounts by the end of June following each fiscal year. An external financial audit will be undertaken annually by GGGI's external auditor in US Dollars with the cost of the audits to be borne by the Fund as administrative costs.

Consistent with the Governance Principle of promoting transparency and ensuring integrity and accountability, the Fund shall be subject to periodic evaluation on the effectiveness of its operation.

6.3 Indemnification

The Trustee, GGGI, and any person who is, or has been, an officer, employee or agent of the Trustee, GGGI or the Fund shall be indemnified out of Fund Property against any loss, liability, cost, claim action, demand or expense (including, but not limited to, all reasonable costs, charges and expenses paid or incurred in disputing or defending any of the foregoing) that any Indemnified Party may incur or which may be made against any of them arising out of or in connection with the Fund's activities, except as may result from the Trustee's gross negligence or willful misconduct.

The status, immunities, exemptions and privileges accorded to GGGI pursuant to the GGGI Establishment Agreement and the GGGI Privileges and Immunities Agreement shall apply to the Trustee and its officers, employees and consultants engaged by it, the Fund Property, and the archives, operations and transactions of the Fund.

6.4 Accountability mechanisms

Operations of the Fund will be subject to regular oversight by GGGI's governance organs.

GGGI is required under its Establishment Agreement to act in a transparent manner, and GGGI's Disclosure Policy provides that it is GGGI's policy to publicly disclose information concerning its governance organs and their decisions as well as operational activities in the absence of a compelling reason to consider such information as proprietary, privileged, or confidential.

Subject to compliance with GGGI's Disclosure Policy, the Fund will facilitate public access to Fund documents where appropriate, including documents with information relating to the selection of Mitigation Activities, reports of any Participants' meetings, and lessons learned through operation of the Fund.

GGGI's Compliance Review Mechanism is available to any person or group of persons that believes that GGGI has failed to comply with any of its regulations, rules, policies and procedures and that this failure has or threatens to adversely affect such person(s).

7 RISK FACTORS

7.1 Risks from structure and nature of fund

Risks from fund performance

The overall Fund performance will be determined by the Fund's success in contracting and collecting ITMOs under MOPAs. No guarantees can be given to Participants on the number of ITMOs they will receive, or price of ITMOs.

Competition

There is no guarantee that Fund will be able to acquire ITMOs at attractive prices (or at all).

Risk of participants' losing interest

If Participants lose interest in the Fund, or the Fund cannot attract a sufficient number of participants to scale, this will limit the efficacy of the Fund to support Mitigation Activities and deliver on its objectives. To mitigate against this risk, the following non-exhaustive list of actions may be taken:

- a) providing in the Fund Rules that Participants who exit the Fund may transfer their interest to other Participants; and
- b) strong advertisement of the Fund and the outcomes of its work, including through publicly available evaluation reports.

7.2 Legal and reputational risks

Legal risks

As Trustee, GGGI will act in a fiduciary capacity for, and on behalf of, Participants. If Participants believe that GGGI has breached its duties, GGGI may be subjected to potential claims or have implications on its reputation. The Fund is structured to ensure a robust legal and governance framework that will minimize any legal and reputational risk to GGGI. In addition, both the Fund Rules and the Contribution Agreement will contain a hold harmless clause that absolves GGGI of any legal liability for any injury or damage that Participants may suffer. The liabilities of the Fund are separate from the liabilities of GGGI and GGGI Member and partner governments. In addition, every MOPA with Mitigation Activity Proponents will limit recourse of such counterparties to the Fund Property only.

Reputational risks

The contracted Mitigation Activities may be perceived by external observers to be from host countries with less ambitious NDCs. This risk will be mitigated by applying the Selection Criteria, Portfolio Restrictions, and Portfolio Guidance to the selection of Mitigation Activities.

Conflict of interest risks

There is a potential risk of perceived or actual conflict between GGGI's role as Fund Trustee, and as a technical advisor to GGGI Member and partner Host Countries. To mitigate against this risk, the following non-exhaustive list of actions may be taken:

- a) provide in the Fund Rules that the Trustee, Fund Manager, Fund Committee, and Participants shall perform their roles consistence with the Governance Principles;
- b) include conflict of interest disclosure provisions in the Fund Rules;
- c) include other provisions in the Fund Rules to ensure transparency in Fund management, for example providing for the disclosure of Fund documents in line with GGGI's Disclosure Policy;
- d) providing as much information as possible to all parties during MOPA negotiations; and

- e) providing access to MOPA training for all parties to MOPA negotiations, particularly Host Country stakeholders.

7.3 Mitigation Activity-specific risks

General risks associated with underlying Mitigation Activities

There are general risks, such as force majeure risk, delays and cost overruns, associated with Mitigation Activities contracted by the Fund. Similarly, there are risks of harms or damages caused to people or property connected with the implementation of the Mitigation Activity to which the Fund is a contracted Party. To mitigate this potential risk, the following non-exhaustive list of actions may be taken:

- a) requiring adherence with the Article 6 rules, and compliance with relevant GGGI policies, including GGGI's Sustainability and Safeguard Rules and GGGI Rules on Child Protection; and
- b) building into MOPAs clear requirements around respecting communities, Free, Prior and Informed Consent, compliance with the Article 6 rules, and compliance with relevant GGGI policies, including GGGI's Sustainability and Safeguard Rules and GGGI Rules on Child Protection.

Identified projects may ultimately not be registered

There is a risk that validated Mitigation Activities are not registered, where applicable, with a crediting mechanism. To mitigate this risk, the Fund may provide technical assistance support to Mitigation Activity development, including support for the validation and registration of Mitigation Activities.

Mitigation Activity underperformance

There is a risk that a Mitigation Activity contracted by the Fund may not generate the anticipated volume of ITMOs. To mitigate this potential risk, the following non-exhaustive list of actions may be taken:

- a) draft clear project selection criteria in the Fund Rules that help the Fund to identify high quality activities that are less likely to fail on ITMO delivery;
- b) providing appropriate conditions precedent in MOPAs which may include, for example, that GGGI has completed due diligence on the Mitigation Activity Proponent and has confirmed that there are no third-party step-in rights in relation to the Mitigation Activity;
- c) requiring the Mitigation Activity Proponent to provide regular reports to the Fund on the Mitigation Activity and its compliance with the Article 6 rules; and
- d) contractual protections for non-performance.

Insufficient pipeline of Mitigation Activities

There is a risk that the Fund will not be able to generate a sufficient pipeline of Mitigation Activities that can meet the requirements of the Fund. To mitigate this risk, the Fund may allow calls for Mitigation Activities from time to time. The Fund may also allow Participants to refer Mitigation Activities to the Trustee for consideration. In addition, GGGI will target readiness resources through the Article 6 Readiness Facility toward developing Mitigation Activities that will meet the Fund selection criteria.

7.4 Regulatory and market risks

Host country regulatory risks

There may be changes in the national regulatory environment of each host country, which could impact the feasibility of the projects. Examples include changes to carbon credit ownership rights or a revocation of ITMO authorization. GGGI will monitor regulatory developments at both the international level, and with respect to relevant Host Countries. The Fund Rules may be updated with further information about the legal nature of ITMOs, should this be further developed.

International regulatory risks

There are international regulatory risks associated with a new, emerging market such as the ITMO market. It is difficult to predict the contours of such market development. Failure to apply corresponding adjustments poses a particular risk, because this would result in the double counting of emissions reductions between Host Countries and Fund Participants. To mitigate this potential risk, the following non-exhaustive list of actions may be taken:

- a) closely monitoring Article 6 negotiations for further guidance from the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA);
- b) building into MOPAs a requirement for Participants and Mitigation Activity Proponents to adhere to the Article 6 rules (including any future relevant decisions of the CMA); and
- c) strong engagement in-country to strengthen knowledge of Host Countries and Mitigation Activity Proponents of the Article 6 rules and requirements.

Pricing and market risks

Given the nascent market for ITMOs, there is a risk of price fluctuations. To mitigate this risk, the Trustee shall endeavour to negotiate a price for ITMOs that:

- a) strikes an appropriate balance between providing a sound investment for Participants whilst appropriately incentivizing and supporting Host Countries and Mitigation Activity Proponents to engage in Article 6 markets; and
- b) has regard to any relevant information on prices for Mitigation Outcomes in the Host Country where available.