Annex 1

SUMMARY OF THE PUBLIC COMMENTS TO THE "GUIDELINES ON THE ASSESSMENT OF INVESTMENT ANALYSIS"

(Version 01)

I. Background

1. The Clean Development Mechanism (CDM) Executive Board (hereinafter referred to as the Board), at its fifty-eighth meeting, agreed to open a call for public inputs from 1 December 2010 to 12 January 2011 on the draft revised "Guidelines on the assessment of investment analysis". The revised guidelines were recommended to the Board by the forty-sixth meeting of Methodologies Panel.

2. In total, the UNFCCC secretariat received 22 inputs from stakeholders.

II. Summary of comments

3. Most comments were made with regard to the use of default values. The use of default values for financial benchmarks was welcomed in many submissions. However, many submissions highlighted different problems that project participants could face in the application of the revised guidelines. These include that:

(a) The number of sectors is considered as too low;

(b) The default values may be too conservative;

(c) A more detailed country specific information may be available and could be used and;

(d) The assumptions and rationales for the default values should be better reassessed or better explained.

In addition, many submissions suggested that the use of the default values should be optional.

III. Main issues raised

4. Many public inputs point out that the application of default benchmarks is not sufficiently flexible and practical. The main reasons raised in the comments are:

(a) The number of sectors is too low. The risk of different types of projects is not reflected by introducing only three sectors. For example, with the proposed approach, a wind farm project activity has the same risk as an energy efficiency project activity, while in practice these types of projects have different risk profiles;

(b) The default values provided are overly conservative. The proposed values in appendix A are in general lower than the values obtained by already registered CDM project activities (source of information: Institute for Global Environmental Strategies - IGES). Several inputs explained with examples that the default values in appendix A were lower than the values obtained in projects from the application of models that are used in financial analysis (e.g. an extended Capital Asset Pricing Model). Furthermore, it is common that CDM projects are subjected to higher risks than the sectoral scope average, a renewable

energy project has a higher risk than a fossil fuel power plant. Therefore, the use of average sectors tends to penalize the CDM project activities;

(c) The approach proposed in the draft revised guidelines does not take into consideration specific information of the economy of the country. Specific country information should be preferred over default values:

(i) There are countries with reliable and well documented financial information, e.g. in Indonesia, the risk free rate is 10%;

(ii) The use of values provided officially by governments and other regulating bodies, taking into account national circumstances when possible, is more appropriate;

(iii) The use of 3% as risk free rate based on the United States government bond rates is overly conservative. It is necessary to use country specific information or information from countries with similar Gross National Product (GNP) when country specific information is not available;

(iv) The government in some countries has already established a default value taking into consideration the country specific information (e.g. in Israel, the public authority fixes a return on equity return of 15% for Independent Power Producers (IPPs) using renewable energies because of the market risk);

(v) The country risk premium is lower than other independent estimates of default spreads for sovereign debt. For example, the World Bank and other multilateral development banks use a standard discount rate of 10-12%. Higher country risk spreads for investment are considered in a work stream paper prepared by a sub-group of the UN Secretary-General's High Level Advisory Group on Climate Finance.

(d) Some of the assumptions or references used to determine the default values are not appropriate:

(i) Moody's rating is not appropriate because it measures the country risk from the point of view of debt service capacity and offers a guide for debt instruments investors;

(ii) It is not possible to use a single default factor for every project even if they are in the same sector. Each project faces different risks that are determined by the country and the industry. Therefore, it is necessary to use expert subjective judgement to determine the specific risk of different sectors.

(e) There is a need to improve the consideration of a company internal benchmark:

(i) It is required to provide evidence from the company internal benchmark, by their historic application, while subjective profitability expectations or the risk profile of a particular project should not be included. In many cases internal benchmarks are based on both subjective profitability and risk profiles of individuals/companies;

(ii) It could be difficult to have information on previous historical company internal benchmarks, e.g. for landfill project activities;

(iii) It is not relevant to know how the company internal benchmark has been calculated but if the benchmark has been used consistently in the past.

IV. Other issues

5. The remaining comments to the guidelines are oriented on improving the clarity of it and increasing transparency and removing ambiguity. The guidelines should clarify:

(a) How to introduce the term “inflation rate” in the calculations;

(b) Whether the consumer price index (CPI) or the wholesale price index (WPI) should be used to determine the standard inflation rate;

(c) Which period of time should be used to determine the inflation rate;

(d) How frequently the default values should be updated, or which data vintage should be used;

(e) Whether the local commercial lending rate is a pre or post-tax benchmark;

(f) Whether the use of appendix A is compulsory or not;

(g) What is the difference between entity and project participant;

(h) How the term "parameters standard to the market" is defined. Markets are changing very fast in different regions, thus it is not easy to define standard parameters;

(i) Which point of time the data for investment shall be taken.

(j) How to differentiate between “expenditure” and “expended amount”;

6. The guidelines should also provide a clear definition and guidance of:

(a) The company internal benchmark;

(b) The registration issuance in the financial system;

(c) The set up in the market;

(d) The rationale used to choose the default values in order to ensure the credibility of the values, with a clear explanation on:

(e) What was the approach used when Moody’s rating was not available?

(f) How were the adjustment factors set among the three industrial groups?

(g) The debt equity ratios.

7. Some inputs also stated that these guidelines still requiring a large amount of documentation, specially for least developed countries (LDCs), and that all the guidance on it needs to be reflected in the "Validation and verification manual" (VVM), in particular with regard to which extent designated operational entities (DOEs) can rely on statements from third parties.

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