

**DRAFT****Annex 2****COVER NOTE****DRAFT ANNUAL REPORT OF THE CDM EXECUTIVE BOARD TO THE CMP****I. Background**

1. In accordance with the modalities and procedures for a clean development mechanism (CDM), the CDM Executive Board is to report on its activities to each session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP). This annex is a draft of the Board's report to the CMP for 2012. It is based on the discussions on this issue at the sixty-eighth meeting of the Board.

II. Purpose

2. This annex is a draft of the Board's report to the CMP for 2012. It is foreseen that a revised draft of this report, to update it with information available after the Board's strategic planning session and the deliberations of the Board's sixty-ninth meeting, will be considered during the meeting. As was done last year, part II of the report, listing deliverables of the Executive Board to the CMP, regulatory documents and meetings of the Board, its regulatory bodies, its forums and other workshops in 2012, will be presented in table format.

III. Key issues and proposed solutions

3. The draft report includes three key messages: the first highlights progress made in improving the CDM, the second stresses the need to continue the process of improvement and evolution of the CDM, and the third points a way forward, to a future where markets play an increasingly important role and the CDM is further improved and well-positioned to meet the needs of Parties.

IV. Proposed work and timelines

4. The document is unedited and will go through the UN editorial process. Figures and data will be included in the report at the end of the reporting period. Space has been held in the document for matters that will be considered and decided by the Board at its sixty-ninth meeting. It is envisaged that the secretariat will finalize the report in cooperation with the Chair of the Board, taking into account the outcomes of the sixty-ninth meeting of the Board.

V. Impacts

5. The annual report, in addition to describing activities, achievements, challenges and the status of the mechanism, is an opportunity for the Board to focus the attention of Parties on matters of timely importance. The Board's report to CMP will be an important basis for Parties' negotiations on the CDM at the eighth session of the CMP.

VI. Recommendations to the Board

6. The secretariat recommends that the Board provide feedback to the secretariat on the contents of the report and agree on a subsequent version. It recommends also that the Board request the secretariat to finalize the report in cooperation with the Chair of the Board in order to include further outcomes of the sixty-ninth meeting.

**DRAFT****Appendix 1****DRAFT ANNUAL REPORT OF THE CDM TO THE CMP****(Version 01.0)****I. Introduction****A. Mandate**

1. In accordance with the modalities and procedures for a clean development mechanism (CDM), the CDM Executive Board (hereinafter referred to as the Board) is to report on its activities to each session of the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP). In exercising its authority over the CDM, the CMP is to review these annual reports, provide guidance and take decisions, as appropriate.

B. Scope of the report

2. This annual report of the Board provides information on progress made in implementing the CDM during its eleventh year of operation (2011–2012),¹ hereinafter referred to as the reporting period, and recommends decisions for adoption by the CMP at its eighth session. It refers to achievements, successes and challenges relating to the operation of the CDM, the governance of the mechanism, the quality, scale and applicability of the mechanism, and the resources available and required by the Board and its support structure during the reporting period. Further information is available on the UNFCCC CDM website, which is the central repository for all reports and other documentation relating to the Board.

3. The challenges and achievements during the eleventh year of operation of the CDM, as well as the challenges still lying ahead, will be highlighted further by the Chair of the Board, Mr. Duan Maosheng, in his oral presentation to the CMP at its eighth session.

C. Action to be taken by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol

4. The CMP, at its eighth session, taking note of the annual report of the Board, may wish:

- (a) To note the work of the Board in response to requests by the CMP at its seventh session;
- (b) To designate operational entities that have been accredited, and provisionally designated, by the Board (see chapter X below);
- (c) To provide guidance on matters arising from this report, in particular on:
 - (i) Recommendation on the withdrawal and suspension of letters of approval;
 - (ii) [PLACEHOLDER: significant deficiencies to be considered at EB69]

¹ The report covers the period from 27 October 2011 to 13 September 2012, in accordance with decision 1/CMP.2, paragraph 11, and decision 2/CMP.3, paragraph 7.

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(iii) [Any other issue arising from EB 69].

5. The CMP is to elect the following to the Board for a term of two years upon nominations being received from Parties:

- (a) One member and one alternate member from the African regional group;
- (b) One member and one alternate member from the Asian regional group;
- (c) One member and one alternate member from the Latin America and Caribbean regional group;
- (d) One member and one alternate member from the Western Europe and Other regional group;
- (e) One member and one alternate member from Parties included in Annex I to the Convention (Annex I Parties).

II. The CDM at the end of the commitment period**A. State of the CDM**

6. The CDM continued to grow over the reporting period. The number of registered projects passed a milestone 4,000 projects in April 2012. At the time of reporting there were X,XXX registered projects in 7X countries and more than 9XX million certified emission reductions (CERs) had been issued to X,XXX projects (see figure X). About a further X,XXX projects are being validated, a step prior to submission to the Board for registration.

7. The year also saw continued growth in the number of programmes of activities (PoAs). There are now XX registered PoAs in XX countries, with a total of X,XXX component project activities. Under PoA, an unlimited number of component project activities across a country or region can be registered under a single administrative umbrella. The use of PoAs is seen as a way to scale up and extend the reach of the CDM, especially in underrepresented regions.

8. A change to rules to exclude use of CERs for compliance in the European Union Emissions Trading System (EU ETS) where the CERs come from CDM projects registered after 2012 and hosted in countries other (a) than least developed countries (LDCs) or (b) countries with bilateral agreements with the EU and particular types of projects was the most likely cause of a rise in projects entering validation in the first half of 2012. The number of projects entering validation hit a high of XXX in April, ahead of the end-of-year deadline.

9. The considerable work done to date by the Board to increase regional distribution, together with the decision taken by the EU ETS, can be expected to affect the geographical distribution of projects, as more projects in development reach the registration phase (see figure X).

10. Transactions involving CERs were valued at approximately USD XX billion in 2011. Despite the fall from a peak in market value in 2008 of around USD 33 billion, largely as a result of declining CER prices under domestically legislated emissions trading systems, most significantly in Europe, the CDM remains today the world's largest generator of carbon offset credits.

11. All of this said, the drop in the number of new projects entering pre-validation development, noted by market participants in 2011, continued in 2012, largely due to uncertainty regarding the level, timing and

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nature of new emission targets, despite a decision at the international level to agree a second commitment period of the Kyoto Protocol and to negotiate a new, comprehensive climate change agreement by 2015.

12. The CDM continues to attract strong interest, and strong and growing interest in underrepresented countries. It remains to be seen how the current depressed market price for CERs and uncertainty regarding the demand for CERs, in terms of volume and timing of that demand from existing and emerging emissions trading systems, will affect project development.

B. The path so far

13. The CDM grew out of a page and a half adopted in the Kyoto Protocol. Within a few years, Parties had adopted modalities and procedures, written to be as comprehensive as possible but with the recognition that a unique, first-of-its kind mechanism like the CDM would have to follow a “learning-by-doing” approach.

14. Today, at the end of the first commitment period of the Kyoto Protocol, the CDM is a mature, well-functioning mechanism that has undergone substantial improvement at the urging of Parties and committed stakeholders.

15. Perhaps the first lesson learned in implementing the CDM was that demand for projects would be much higher than most people had predicted – the mechanism would incentivize thousands of projects, not hundreds, and in the process create an industry producing and trading the world’s first international environmental currency.

16. With this success came challenges, foremost was meeting the quality imperative – each CER must represent a true emission reduction – while ensuring that regulatory processes moved at a reasonable pace. To do this, the Board increased its scrutiny of registration and issuance cases. At the same time, it endorsed and encouraged the scaling up of its principal support structure, the UNFCCC secretariat, and pursued refinements to increase the clarity, simplicity and objectivity of the CDM’s methodologies, rules and processes.

17. The approach is enabling the Board to take on a more executive role, focused on improving its rules, processes and governance, leaving the secretariat and the Board’s panels and working groups to take on the technical work associated with implementing the mechanism.

18. The CDM has at times been the subject of intense criticism – with some stakeholders pressuring for swifter processes and others pressuring for more stringent processes or for the doing away with the mechanism altogether on the grounds that Parties with commitments under the Protocol should achieve those commitments solely at home, not in developing countries.

19. From the beginning, Parties and the Board have worked to correct a geographical imbalance that saw the majority of projects established in a limited number of fast-growing economies, mainly China and India, and most other countries underrepresented by comparison.

20. The Board has increased the simplicity and objectivity of its rules, encouraged capacity-building, particularly of designated national authorities (DNAs) through the DNA Forum, and established a loan scheme to assist with project development. These and other initiatives were aimed at removing barriers to participation. The work was encouraged by Parties and benefited from cooperation with many stakeholders and partner agencies, for example under the banner of the Nairobi Framework.

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21. Today, the number of projects in underrepresented countries is on the rise. What's more, the groundwork has been laid for a significant scaling up of the CDM, through for example the establishment of the programme-of-activities approach and the adoption of rules governing standardized baselines.
22. This process of improvement and evolution, despite success, needs to continue to ensure that the potential of the CDM is fully realized in underrepresented countries, particularly in Africa (which has lately seen a blossoming of interest in the CDM) but also in the several emerging market systems around the world.
23. The CDM was established to assist countries to achieve their emission reduction obligations under the Kyoto Protocol, and to assist host countries in achieving their sustainable development objectives. The CDM, in a very short period, has grown into a mechanism that can do just that: it is incentivizing investment well beyond what was anticipated – approaching 1 billion certified emission reductions at the time of reporting, each equivalent to one tonne of carbon dioxide – it is stimulating sustainable development and spurring technology transfer. Parties should also not overlook the contribution the CDM has made to adaptation, through the regular deposits of CERs in the Adaptation Fund, the contribution that the CDM has made to fostering formal economies and rules-based processes, and the important role that the CDM has played in raising awareness about, and inspiring action against, climate change.
24. As they meet to discuss the evolving international response to climate change, Parties and stakeholders need to take a “fresh look” at the current, much strengthened, much improved CDM.

C. Future challenges and priorities of the CDM

25. Support remains strong for market-based approaches. Parties have agreed to develop a new market mechanism and a mechanism's framework to help them achieve their mitigation objectives. At the same time, several countries and jurisdictions have either launched or have announced their intention to launch emissions trading systems. While this could suggest a bright future for mechanisms like the CDM, it is clear that in the future the CDM will be of one tool among many, and will have to adjust to maintain its relevance and effectiveness. One could imagine, for example, CERs being used to bridge emerging market mechanisms and ameliorate the inefficiencies of fragmented international carbon markets.
26. The Board's role, within the guidance set by the CMP, is to ensure that the CDM remains a viable and effective instrument for use by Parties and the private sector to combat climate change and achieve the objectives of the Convention. Part of its response to that role was the launch of a high level policy dialogue on the CDM in 2011.
27. It is in this context that Parties have affirmed, in their international negotiations, that the CDM has an important, continuing role to play in incentivizing investment to combat climate change and contribute to sustainable development.
28. However, the CDM's ability to fulfil that role is threatened by the current weak demand for CERs, which is ultimately the result of continuing uncertainty surrounding the level and timing of emission reduction commitments.
29. The Board sees this as a significant challenge that requires an active response from Parties. Now is the time to shape the CDM to ensure that is ready to meet future demand, from whatever sources this demand might come, and satisfy the preferences of customers, including in emerging market systems.
30. The Board sees a need for further simplicity and objectivity in the rules that govern the mechanism. This work will build on the considerable work done to date – e.g. programmes of activities, standardized baselines, region-specific methodologies, and streamlining and consolidating rules.

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31. Success in efforts to increase simplicity and objectivity will go a long way to achieving success in addressing two other key challenges, that of ensuring the continuing usefulness and attractiveness of the CDM in an evolving carbon market, and ensuring accessibility to the CDM for all. In this respect, the CDM has been a pioneer creator of universal standards for the carbon market. The Board sees this as an important continuing role for the mechanism.

32. While Parties see a role for markets and market mechanisms in virtually any scenario to address climate change, the current low demand for CERs, and the resulting low prices, threatens the gains painstakingly made by Parties to develop the CDM. It is necessary for Parties to consider this when they are taking decisions that affect the price of units and the applicability of the CDM in established and emerging markets systems. For its part, the Board will continue to develop the CDM to make it useful in any scenario that Parties bring to fruition.

33. The present uncertainty, although serious, need not be a barrier to action. On the contrary: now is the time to shape the CDM to make sure it is ready to meet future demand, from whatever sources this demand might come, including in emerging market systems.

D. The CDM Policy Dialogue**1. Process**

34. It is time to build on the CDM to maximize its usefulness as a tool to combat climate change and contribute to sustainable development. The CDM is incentivizing investment in climate change mitigation, spurring technology transfer, assisting countries to achieve their sustainable development goals, generating funds for adaption, inspiring public-private partnerships, and raising the level of engagement and capacity developing countries. Not least it is reducing the cost of compliance for countries taking on commitments.

35. It was against this background that the Board, at its sixty-fourth meeting, launched the CDM Policy Dialogue to review the functions and lessons learned from the CDM and make recommendations regarding how to best position the CDM to respond to future challenges and opportunities and ensure the effectiveness of the mechanism in contributing to future global climate action, for its consideration in preparing its annual report and recommendations to the eighth session of the CMP.

36. The Board established a high-level Panel to conduct the dialogue in an independent manner under its own responsibility. The Panel was composed of 11 members drawn from a range of constituencies (private and public sectors, and civil society) and geographical regions (Africa (2), Asia (3), Australia-Pacific (1), Europe (2), Latin America (2) and North America (1)). Members were invited by the UNFCCC Executive Secretary and the Board chair jointly, based on input provided by members of the Board.

37. The Panel conducted a wide-ranging assessment of experience, benefits and shortcomings of the CDM and engagement with civil society, policymakers and market participants.

2. Outcomes

38. [PLACEHOLDER: to be considered at EB69]

III. Work undertaken in the reporting period

39. [PLACEHOLDER: to be incorporated at EB69]

**DRAFT****B. Governance and management matters**

40. The Board and its panels and working groups met on a regular basis during the reporting period. In addition, the secretariat organized various meetings of the DNA Forum and DOE Forum and workshops with stakeholders. Part II of this annual report provides information on these meetings and workshops.

1. Membership issues

41. At CMP 7, new members and alternate members of the Board were elected to fill vacancies arising from the expiration of terms of tenure. During the reporting period, the Board comprised the members and alternate members listed in table 1.

Table 1

Members and alternate members of the Executive Board of the clean development mechanism

<i>Members</i>	<i>Alternate members</i>	<i>Nominated by</i>
Mr. Martin Cames ^a	Ms. Pauline Kennedy ^a	Annex I Parties
Mr. Maosheng Duan ^a	Mr. Qazi Kholiquzzaman Ahmad ^a	Non-Annex I Parties
Mr. José Domingos Miguez ^a	Mr. Washington Zhakata ^a	Non-Annex I Parties
Mr. Victor Kabengele ^{b, c}	Ms. Fatou Gaye ^b	African regional group
Ms. Diana Harutyunyan ^a	Ms. Natalie Kushko ^a	Eastern European regional group
Mr. Martin Hession ^b	Mr. Thomas Bernheim ^b	Western European and other States regional group
Mr. Shafqat Kakhakel ^b	Mr. Hussein Badarin ^b	Asian regional group
Mr. Hugh Sealy ^a	Mr. Amjad Abdulla ^a	Small island developing States
Mr. Antonio Huerta-Goldman ^{b, d}	Mr. Eduardo Calvo ^{b, d}	Latin America and the Caribbean regional group
Mr. Kazunari Kainou ^{b, e}	Mr. Peer Stiansen ^b	Annex I Parties

^a Term: two years ending at the first meeting in 2014.

^b Term: two years ending at the first meeting in 2013.

^c Mr. Tosi Mpanu Mpanu resigned effective 10 February 2011.

^d Mr. Antonio Huerta-Goldman and Mr. Eduardo Calvo took over the seats of members/alternate member based on GRULAC decision.

^e Mr. Akihiro Kuroki resigned effective 21 September 2011.

42. The Board reiterates its concern that neither the Conference of the Parties nor the CMP has established an international legal framework for privileges and immunities for Board members performing their functions relating to the CDM. Members are entitled to privileges and immunities only in Germany, in accordance with the Headquarters Agreement of the secretariat, and in countries where Board meetings are convened pursuant to an agreement with the host country that contains provisions on privileges and

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immunities. The Board urges the CMP to take further action as a matter of urgency to ensure that Board members are fully protected when taking decisions for which they have been mandated. The Board notes the progress of deliberations on this matter and requests the CMP to find an interim solution at CMP 7, pending the conclusion of a long-term solution.

Election of the Chair and the Vice-Chair of the Board

43. The Board, at its sixty-sixth meeting, elected Mr. Duan Maosheng, a member from a non-Annex I Party, and Mr. Martin Hession, from an Annex I Party, as Chair and Vice-Chair, respectively. Their tenures as Chair and Vice Chair will end at the first meeting of the Board in 2013.²

44. The Board expressed its appreciation to the Chair, Mr. Maosheng, and Vice-Chair, Mr. Hession, for their excellent leadership of the Board during its eleventh year of operation.

IV. Report on the status of financial resources for work on the clean development mechanism

45. This chapter presents information on income and expenditure up to ##.

46. Table # shows a total of operating income of USD # as at #. The table indicates a carry-over balance from ## of # and 2011 revenue from fees and shares of proceeds by type.

Table 2
Status of Income 2011–2012
(United States dollars)

<i>CDM Trust Fund fees and carry-over</i>	<i>2011</i>	<i>2012^a</i>
Carry-over from previous year		
Fee income during the year		
<i>Methodology fees^b</i>		
<i>Registration fees^c</i>		
<i>Shares of proceeds^d</i>		
<i>Accreditation fee</i>		
<i>Accreditation process-related fees</i>		
Reallocation of prompt start		
Interest		
Total operating income for the year		

^a 1 January to 30 September 2012.

^b This fee is based on the average annual issuance of certified emission reductions (CERs) over the first crediting period and is calculated as a share of proceeds to cover administrative expenses, as defined in decision 7/CMP.1, paragraph 37. Projects with annual average emission reductions of less than 15,000 tonnes of carbon dioxide equivalent are exempt from the registration fee, and the maximum fee applicable is USD 350,000. This fee is considered to be a prepayment of the share of proceeds to cover administrative expenses.

²Rule 12 of the rules of procedure of the Board. See
<<https://cdm.unfccc.int/Reference/COPMOP/08a01.pdf#page=31>>.

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- ^c A non-refundable submission fee of USD 1,000 is payable at the time a new methodology is proposed. If the proposal leads to an approved methodology, the project participants receive a credit of USD 1,000 against payment of the registration fee or a prepayment of share of proceeds.
- ^d The share of proceeds, payable at the time of issuance of CERs, is USD 0.10 per CER issued for the first 15,000 CERs for which issuance is requested in a given calendar year, and USD 0.20 per CER issued for any amount in excess of these per year.

47. Table 2 above shows a total operating income of USD # for 2012. The table indicates a carry-over balance from 2011 of USD # and 2012 revenue from fees and shares of proceeds by type amounting to USD #. Fees and shares of proceeds were estimated in the 2012 management plan at USD #.

48. At its sixty-sixth session the Board approved the management plan and related budget amounting to USD # to cover the CDM activities for the calendar year 2012, which represented a USD # or a # per cent increase above the prior year's budget. As shown in table 3, an expenditure of USD # has been incurred during the reporting period against the approved budget. On the basis of projected expenditure, it is expected that the budget utilization rate will approach nearly #%.

Table 3
Comparative status of expenditure against budget
(United States dollars)

<i>Budget and Expenditure</i>	<i>2011</i>	<i>2012^a</i>
Budget		
Expenditure		
Expenditure as percentage of budget		

^a 1 January to 30 September 2012.

**DRAFT****Appendix 2**

Recommendations for consideration by the Conference of the Parties serving as the meeting of the Parties at its eighth session

Appendix 3 (Part II)

Deliverables of the CDM Executive Board to the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol at its eighth session

List of regulatory documents approved and/or revised by the Executive Board of the clean development mechanism

Meetings of the Executive Board of the clean development mechanism, its regulatory bodies, its forums and other workshops in 2011

History of the document

Version	Date	Nature of revision(s)
01.0	27 August 2012	Initial publication as an annex to the annotated agenda of EB69.
Decision Class: Operational Document Type: Annual report to CMP Business Function: Governance		