

**CDM-EB92-AA-A01**

## Concept note

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# Share of proceeds to cover administrative expenses

Version 01.0



**United Nations**  
Framework Convention on  
Climate Change

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## 1. Procedural background

1. With its decision 7/CMP.1, paragraph 37, the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol (CMP) provided guidance on accruing resources to cover the administrative expenses for operational functions of the clean development mechanism (CDM) as of 2008, also known as the share of proceeds (SOP) to cover administrative expenses.
2. With the decline in the CDM market conditions, the implementation of this CMP guidance allowed for the accumulation of a substantial amount of outstanding SOP for administrative expenses (i.e. SOP due but not paid by project participants (PPs)). This has implications for the CDM Trust Fund, and the CDM Executive Board (hereinafter referred to as the Board) needs to be aware of these implications. The Board should also be made aware of possible measures to address the situation.
3. Furthermore, the external auditors of the UNFCCC have noted in their report issued on 16 September 2016 on the UNFCCC financial statements for 2015 the high amount of accumulated SOP that has not been collected by the secretariat and recommended that the secretariat explore options to better disclose this information in the notes to the financial statements.<sup>1</sup>
4. This work relates to the activity “Finance” under cross-cutting activities as referred to in table 6 in the appendix of the CDM two-year business plan 2016–2017 and management plan 2016 (MAP 2016) (EB87 report, annex 1).

## 2. Purpose

5. This information note provides:
  - (a) The background to the practice established by the secretariat and the Board with respect to the collection of SOP for administrative expenses since its inception;
  - (b) Analysis of the status of the outstanding amount of SOP and implications for the CDM Trust Fund resources;
  - (c) Information on the likely impact of bringing forward the timing of SOP collection, namely before request for issuance assessment is commenced, in order to ensure that the cost of services rendered by the secretariat and the Board is recovered.

## 3. Analysis of key issues

### 3.1. Background information

6. The SOP to cover administrative expenses was established in paragraph 8, Article 12 of the Kyoto Protocol. Later, with its decision 3/CMP.1, paragraph 66, and appendix D,

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<sup>1</sup> Chapter II, recommendation (d) of the external audit report on the UNFCCC financial statements for 2015 refers. The report can be found under the following link:  
<<http://unfccc.int/resource/docs/2016/sbi/eng/inf12.pdf>>.

paragraph 6(b), the CMP determined that the SOP for administrative expenses is a proportion of the issued certified emission reductions (CERs) which, upon issuance, is to be forwarded by the CDM registry administrator to the appropriate account in the CDM registry for the management of SOP. Subsequently, decision 7/CMP.1, paragraph 37, established monetary terms for the SOP for administrative expenses, rather than using a proportion of issued CERs.<sup>2</sup>

7. More specifically, decision 7/CMP.1, paragraph 37, established a two-tier structure for the SOP for administrative expenses with two rates for issued CERs. The CMP also clarified that “the issuance of certified emissions reductions, in accordance with the distribution agreement, shall be effected only when the share of proceeds to cover administrative expenses has been received”.
8. The initial approach to implementation of the relevant provisions in decisions 3/CMP.1 and 7/CMP.1 underpins the current practice whereby PPs are requested to pay SOP upon issuance rather than prior to it. Only after the payment is received by the secretariat are the PPs granted access to their CERs (such that forwarding or voluntary cancellation may occur).<sup>3</sup>
9. This practice ensures that SOP is calculated and billed on the basis of issued CERs (i.e. the issued CERs become known upon approval of a request for issuance by the Board due to possible adjustments following the review of the Board) and has been consistently applied since the beginning of CDM operations.
10. Until 2012, the SOP collection rate (proportion of all SOP collected by the secretariat) was nearly 100 per cent. However, with the decline of the CDM market post-2012, the secretariat is maintaining and increasing record of SOP due but not paid by PPs (i.e. pending SOP). This situation had been noted by the external auditors of the UNFCCC who have recommended in their report on the UNFCCC financial statements for 2015 that the secretariat should explore options to better disclose this information in the notes to the financial statements.

### **3.2. Current situation**

11. As at 31 August 2016, the pending SOP stands at USD 38.98 million. Table 1 provides information on SOP due, pending SOP and the proportion of pending SOP of all SOP due on an annual non-cumulative basis. It also provides information on the corresponding number of requests for issuance submitted, number of requests for issuance with pending SOP, and the proportion of the requests for issuance with pending SOP of all requests for issuance.

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<sup>2</sup> The full text of the cited paragraphs is provided in section 8 of the present document.

<sup>3</sup> PPs are not allowed to submit a request for forwarding or voluntary cancellation of CERs without a security code, which they receive upon their payment of SOP.

**Table 1. Table 1. Status of share of proceeds for administrative expenses on an annual (non-cumulative) basis**

Year	SOP <sup>4</sup> due	Pending SOP	% of pending SOP	Submitted Rfls	Pending Rfls	% of pending Rfls
	(USD)					
1	2	3	4=3/2 (%)	5	6	7=6/5 (%)
2005	43 205	-	0%	4	0	0%
2006	3 920 721	-	0%	126	0	0%
2007	15 073 907	-	0%	312	0	0%
2008	27 476 653	-	0%	472	0	0%
2009	26 264 164	500 317	2%	522	5	1%
2010	26 990 734	-	0%	616	0	0%
2011	63 925 739	73 330	0%	1529	23	2%
2012	64 709 806	1 706 069	3%	1972	106	5%
2013	48 718 566	11 975 679	25%	2010	294	15%
2014	16 987 656	8 119 881	48%	562	182	32%
2015	20 704 734	9 636 490	47%	455	100	22%
2016*	11 311 268	6 976 950	62%	274	125	46%
<b>Total:</b>	<b>326 127 154</b>	<b>38 988 716</b>	<b>12%</b>	<b>8854</b>	<b>835</b>	<b>9%</b>

\* Data as at 31 August 2016. It should be noted that a time lag exists between billing SOP and receiving SOP, which varies between projects/PoAs and is currently several months on average. The end results for 2016 are generally expected to align with the previous two years.

12. The data show that pending SOP started to accumulate post-2012. Furthermore, proportion of pending SOP from the total SOP due for the respective year has a growing trend, rising from 25 per cent in 2013 to close to 50 per cent for the years that follow. In short, in the post-2012 period, PPs are often willing to incur the verification costs and have CERs issued without necessarily having guaranteed the sale of their units, therefore delaying the payment of SOP.
13. The trend in the proportion of requests for issuance with pending SOP out of the total submitted requests for issuance for the same period<sup>5</sup> fluctuates (table 1, column 7). Its average value for the three complete years in the post-2012 period<sup>6</sup> is 23 per cent. A comparison with the proportion of pending SOP for the same period of 40 per cent (table 1, column 4) indicates that SOP is pending for requests for issuance with a higher SOP value (PPs would not pay a high amount of SOP per issuance request unless its recovery is certain).
14. Both trends are important to consider as the pending SOP in USD indicates the revenue the secretariat is expected to forego, while the proportion of requests for issuance with pending SOP indicates the service level<sup>7</sup> for which the secretariat is not paid.

<sup>4</sup> Share of proceeds for administrative expenses

<sup>5</sup> Post-2012 period to date.

<sup>6</sup> 2016 is not included to avoid distortion from the time lag between billing and payment of SOP.

<sup>7</sup> On average, Rfls require comparable effort for processing irrespective of the size of the emission reductions or removals requested.

15. Further insight into the pending SOP can be derived from analysing the split of pending SOP according to the Kyoto commitment periods 1 (CP1) and 2 (CP2) (CP1 for 2008–2012 and CP2 for 2013–2020). It would be useful to consider how pending SOP relates to each commitment period and the expectations for the future as requests for issuance for CP1 rapidly decrease. The challenge here is that a number of requests for issuance have monitoring periods that straddle the commitment periods. For such requests, it is difficult to ascertain the SOP due for CP1 and CP2 separately because the SOP is due on the total CERs for the request. With this in mind, table 2 represents the pending SOP in USD and the proportion of pending SOP split by commitment periods and provided separately for requests for issuance with monitoring periods that straddle the commitment periods. The data in table 2 is on a cumulative basis and it accumulates only the results for the post-2012 period (i.e. from 1 January 2013 until 31 August 2016).

**Table 2. Pending share of proceeds split per commitment period (cumulative)**

Cut-off date	Pending SOP in USD (million)				Proportion of pending SOP of the total SOP due			
	CP1	CP2	CP1/CP2*	Total	CP1	CP2	CP1/CP2*	Total
31 Aug 2016	9.54	21.03	6.14	<b>36.71</b>	18%	62%	49%	<b>38%</b>

\* CP1/CP2 correspond to requests for issuance with monitoring periods that straddle the commitment periods.

16. The pending SOP for CP1, expressed as an absolute amount in USD, is lower than the absolute amount of pending SOP for CP2 (column 2 of table 2 compared to column 3 of the same table). This can be attributed to the slowing submission rate of requests for issuance for CP1. The low proportion of pending SOP for “pure” CP1 requests in the post-2012 period (column 6 of table 2), indicates that CP1 CERs were typically requested if sale was guaranteed. This suggests a higher probability that SOP will be collected for any future CP1 issuances.<sup>8</sup>
17. Considering that CP1 requests for issuance rapidly decreased after the end of the CP1 true-up period<sup>9</sup> the trend relevant for the future is the trend in pending SOP for CP2. Under current CDM market conditions, pending SOP for CP2 is expected to continue to accumulate. Pending SOP for CP2 would be recovered if PPs can find buyers willing to pay a price that covers the cost of SOP due<sup>10</sup>. Such likelihood is difficult to estimate as it would require making assumptions on the future state of the CDM market.
18. The growing trend in providing assessment services for which the administrative cost may not be recovered is evaluated against an alternative method of collecting SOP prior to commencing assessment services.

<sup>8</sup> The secretariat currently continues to process requests for issuance for CP1.

<sup>9</sup> The additional period of 100 days for fulfilling commitments for the respective commitment period. For CP1, the true-up period ended on 15 November 2015.

<sup>10</sup> There is currently no rule to enforce payment of SOP other than not allowing PPs access to their CERs until SOP is paid.

### 3.3. Collecting share of proceed prior to commencing the assessment of requests for issuance

19. To address the issue of growing amount of pending SOP, the Board may wish to consider bringing forward SOP collection by billing SOP upon the submission of a request for issuance and scheduling the request for assessment after the SOP is received by the secretariat, similar to the process for requests for registration. Implementing such a change is administratively feasible with a number of possible implications. The following is a list of implications, which are categorized as positive and potentially negative for one or more stakeholders in the process.
20. Expected positive implications include:
  - (a) There would be more prudent management of resources and reduced financial risk by ensuring that the secretariat and the Board provide services for issuance only if the SOP is paid. If we assume that an average of 150 requests for issuance for which SOP may not be recovered are processed annually,<sup>11</sup> the unrecovered costs would be equivalent to USD 150,000. This would be reduced by the additional operational cost that would be required if the change is implemented (see paragraph 22 (h) below);
  - (b) The practice would be better aligned with the processing of requests for registration, for which fees (calculated as an advance payment of SOP) are payable prior to commencing the assessment of requests for registration;<sup>12</sup>
  - (c) All other conditions remaining the same, PPs who pay SOP would benefit from an improved level of service because the pipeline of submissions would not be loaded with submissions for which SOP may never be recovered;<sup>13</sup>
  - (d) PPs who pay SOP would not de-facto “subsidize” the costs for assessment of requests for issuance that do not then pay the SOP;
  - (e) The financial reporting on SOP would be more straightforward and transparent. The current practice of not disclosing pending SOP have led United Nations auditors to make recommendations about how to better reflect the pending SOP;
  - (f) The change would better align the practice with the requirements in decision 7/CMP.1, paragraph 37.

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<sup>11</sup> The assumed average 150 requests for issuance per year for which SOP may not be collected are calculated as an approximation to the average number of requests for issuance with pending SOP for the period 2012–2016 as per table 1.

<sup>12</sup> A registration fee payment is part of a submission of a request for registration. The processing of a request for registration cannot commence prior to receipt of the registration fee. The registration fee is an advance payment to the SOP and is calculated on the basis of the estimated annual emission reductions or removals to be achieved by the CDM activity. The registration fee is deducted from the SOP for subsequent requests for issuance until it is fully absorbed.

<sup>13</sup> The number of submissions of requests for issuance is expected to decline with approximately 100 to 150 per year in the short run based on the average number of submissions for which SOP is not paid in the last years.

## 21. Negative and other implications include:

- (a) Some PPs may see the change as disadvantageous for them, arguing that it is easier to market issued CERs. From the high amount of CERs currently in the pending account of the CDM registry, it appears that PPs are willing to incur the verification costs, particularly for large issuances, in order to have the CERs issued, possibly hoping to attract buyers and/or better prices in the absence of “issuance risk”;<sup>14</sup>
- (b) The change in procedure may have mixed effects; it may postpone some submissions (until PPs are ready to incur the SOP costs) and completely deter other submissions;
- (c) Fewer CERs may be available for voluntary cancellation through the United Nations platform for voluntary cancellation, as PPs may not be willing to pay SOP upfront;
- (d) The issuance process timeline would not be shortened for PPs because the billing of the SOP could only happen after a request for issuance is submitted. After a DOE uploads a request for issuance in the secretariat’s information system, the SOP can be calculated and billed. The scheduling will take place only after the SOP is received;<sup>15</sup>
- (e) The change will have no effect on already accumulated pending SOP;
- (f) Procedural changes are sometimes perceived as adding to regulatory unpredictability/uncertainty;
- (g) Costs for modifying the CDM information system workflow (one-off cost equivalent to two person-months of effort);
- (h) Additional administrative costs of handling changes to SOP billed. Approximately 5 per cent of all requests for issuance are approved with adjustments to the requested emission reductions or removals. Additional administrative support would be required for reimbursing or recovering differences in SOP, including reimbursing rejected submissions and handling errors. At the current submission level, the effort of carrying out additional accounting services would be in the range of USD 30,000 per year.

22. It would be relevant to note that the secretariat regularly receives inquiries related to different aspects of the SOP. Some inquiries are about the possibility for staged or partial payment, particularly for requests for issuance that combine CP1 and CP2 CERs.<sup>16</sup>

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<sup>14</sup> The risk of part or all emission reductions or removals requested not being approved.

<sup>15</sup> The waiting period until the SOP is received would be equivalent to the waiting period for SOP payment after issuance and before forwarding is permitted.

<sup>16</sup> PPs may have not considered the full implications of opting for monitoring periods that straddle the commitment periods. The difficulties in marketing CP1 CERs seems to lead at times to CP2 CERs being held back by CP1 CERs after issuance and before forwarding/cancellation because the SOP is due on the total amount of units issued for a given request for issuance.



Introducing staged/partial payments could potentially improve the proportion of collected SOP, however, the current analysis does not take this into account.<sup>17</sup>

23. There is a chance that not all implications from changing the practice for SOP collection have been fully taken into account in this analysis. However, while it is important to note that the absolute value of pending SOP in USD is a considerable amount, the real issue is the effort spent on processing requests for issuance for which the SOP would not be received. This effort is estimated to be equivalent to approximately nine person-months per year if current trends continue. The costs associated with nine person-months per year should be compared to potential SOP foregone, that is SOP that PPs would have paid if allowed the possibility to issue and market CERs before having to pay the SOP. Although the latter may be highly speculative with regard to quantity, it may be worth considering.

## **4. Impacts**

24. Implementing SOP collection in advance of commencing the assessment of requests for issuance would discontinue the practice of accumulating pending SOP and will ensure that the secretariat and the Board provide paid services. It is possible that the change may act as a deterrent to the issuance of CERs and make it more difficult for projects with financial difficulties to continue to operate under the CDM.

## **5. Subsequent work and timelines**

25. From scheduling a start date to commencing work, the secretariat would require three months to implement the change to the timing of SOP payment. The secretariat expects to be able to schedule the work with four to six-months' notice.

## **6. Budget and costs**

26. The effort for implementing the change in the timing of SOP collection would be a one-time effort of three person-months and an ongoing effort of one person-month per year at the current submission rate. It is expected that the total effort can be absorbed by the MAP 2017.

## **7. Recommendations to the Board**

27. The secretariat recommends including a requirement in the "CDM project cycle procedure" for SOP to be paid prior to the commencement of the assessment of a request for issuance, including a grace period of six months for implementation, and adjusting the relevant practices and workflows accordingly.
28. The Board may wish to provide any other guidance as it deems appropriate.

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<sup>17</sup> Payment in more than one stage/instalment, allowing PPs to only access the proportion of CERs for which the SOP is paid.

## 8. Reference

29. The following decision texts are provided for reference purposes:

### **Decision 3/CMP.1, paragraph 66:**

Upon being instructed by the Executive Board to issue CERs for a CDM project activity, the CDM registry administrator, working under the authority of the Executive Board, shall, promptly, issue the specified quantity of CERs into the pending account of the Executive Board in the CDM registry, in accordance with appendix D of this decision. Upon such issuance, the CDM registry administrator shall promptly:

- (a) Forward the quantity of CERs corresponding to the share of proceeds to cover administrative expenses and to assist in meeting costs of adaptation, respectively, in accordance with Article 12, paragraph 8, to the appropriate accounts in the CDM registry for the management of the share of proceeds;
- (b) Forward the remaining CERs to the registry accounts of Parties and project participants involved, in accordance with their request.

### **Decision 7/CMP.1, paragraph 37:**

The Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol decides, with a view to accruing resources to cover administrative expenses for operational functions as of 2008, and with the understanding that the issuance of certified emissions reductions, in accordance with the distribution agreement, shall be effected only when the share of proceeds to cover administrative expenses has been received, that the share of proceeds to cover administrative expenses of the clean development mechanism as referred to in Article 12, paragraph 8, of the Kyoto Protocol shall be:

- (a) USD 0.10 per certified emission reduction issued for the first 15,000 tonnes of CO<sub>2</sub> equivalent for which issuance is requested in a given calendar year;
- (b) USD 0.20 per certified emission reduction issued for any amount in excess of 15,000 tonnes of CO<sub>2</sub> equivalent for which issuance is requested in a given calendar year.

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### **Document information**

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