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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
Sixty-eighth Meeting
Montreal, 3-7 December 2012

Addendum

STATUS REPORTS AND COMPLIANCE

This document is issued to **add**:

- Part V: Reports on resource mobilization activities;
- Part VI: Verification reports and methyl bromide project progress reports;
- Part VII: UNEP progress report on the implementation of the Executive Committee decision 66/15.

PART V: REPORTS ON RESOURCE MOBILIZATION ACTIVITIES

1. At its 63rd meeting the Executive Committee approved funding of US $680,000 for four individual global resource mobilization projects to be implemented by UNDP (US $200,000), UNEP (US $100,000), UNIDO (US $200,000) and the World Bank (US $180,000). These projects aim to mobilize resources to achieve climate benefits beyond those that could be secured through HCFC phase-out alone. Interim reports were submitted by UNDP, UNEP, UNIDO and the World Bank to the 66th meeting. In decision 66/15(m) and (o), the Executive Committee decided to request UNEP and the World Bank to provide a further report to the 68th meeting.

Global: Resource mobilization for climate co-benefits (UNEP)

Progress Report

2. Despite numerous reminders, UNEP had not provided a report on the progress of the implementation of the project for resource mobilization for climate co-benefits to the Secretariat.

Secretariat's recommendation

3. The Executive Committee may wish to urge UNEP to submit a final report of this project by the 69th meeting, or return the funds approved for this project if no progress had been made by then.

Global: Resource mobilization for HCFC phase-out and climate co-benefits (the World Bank)

Progress Report

4. The World Bank had provided information on the progress undertaken between the 66th and 67th meeting for resource mobilisation. In its report, the World Bank reiterated that the objective of the study currently in progress is to identify and highlight ways to finance from other sources energy-efficiency improvements that could be taken side by side with the transition to non-ODS technology being funded by the Multilateral Fund. This would address the financing gaps and potential missed opportunities during the implementation of ODS phase-out projects and would maximize synergies with climate finance in general, focusing on the World Bank's energy efficiency and climate portfolios in particular.

5. The report provided a more detailed outline of the proposed study, with annotated explanations for each specific section of the proposed report. This would look at financing elements for climate change mitigation, energy savings, conceptual models for upfront monetization, options for profit sharing as well as investment opportunities. The World Bank further indicated a change in the approach for this study which would now utilize internal expertise from the Bank on climate finance in place of the original proposal of having an independent consulting firm undertake it. In addition, due to the current weakness of the carbon market, the study will give lesser emphasis on the upfront monetization of credits from carbon finance but would instead focus on the broader opportunities for climate financing for energy savings.

6. The World Bank also provided information on what it called cross-cutting elements that need to be considered in pursuing options for broad financing packages such as additionality of the projects proposed; transparency and good governance; assurance that these projects would avoid perverse incentives for countries; exploring possibilities of profit-sharing, including return of funds to the Multilateral Fund; ensuring sustainability of the projects proposed; avoidance of duplication of similar projects; information on transaction costs, as required by decision 63/23(a)(ii). The report submitted by the World Bank is attached as Annex I to the present document (UNEP/OzL.Pro/ExCom/68/6/Add.1).

<u>Secretariat's comments</u>

7. The Secretariat provided comments and observations on the progress report submitted by the World Bank, and had a discussion on several issues, particularly those concerning the change in the approach to the study, linkages of current energy efficiency funding from other sources and how this is considered in this project, how the project output would lead to resource mobilization, among other things. The Secretariat also sought clarification on the current progress of the study and whether the timing of its completion had not changed, emphasizing the importance of having this information available for countries while preparing their stage II HPMPs.

8. In the discussion, the World Bank clarified that a team had already been formed for this purpose within the World Bank, and it has currently commenced an analysis of the portfolios available in the Bank, particularly those that relate to potential synergies and can be future sources of funding. It also explained that the change in approach to complete the study in-house rather than work with an outside consultant was made as this study provided an opportunity to link with existing World Bank activities on energy financing, climate finance and mainstream ozone activities. The Bank believed that this was an important prospect that would allow for identification of projects linking HCFC phase-out to other Bank priorities, as there are many untapped potential sources within the Bank itself. The World Bank clarified, however, that it would also at the same time explore opportunities outside the Bank and not just within.

9. In response to the Secretariat's concern that the output might just be a theoretical exercise, the World Bank confirmed that the report will include practical examples of how the financing gap could be addressed, using specific projects as cases. It also confirmed that the final output will be ready for the consideration of the Executive Committee by the 69th meeting as scheduled.

<u>Secretariat's recommendation</u>

10. The Executive Committee may wish to note the interim report on the resource mobilization for climate co-benefits submitted by the World Bank and urge the World Bank to submit a final report of the study by the 69th meeting.

PART VI: VERIFICATION REPORTS AND METHYL BROMIDE PROJECT PROGRESS REPORTS

11. Verification reports and methyl bromide reports that were submitted and were not part of tranche requests or project completion report are considered in the Status Reports and Compliance document pursuant to decision 66/16(b)(iv). Verification reports were submitted to the 68th meeting on the following multi-year agreements (MYAs): China: Process agent sector plan (phase II) status of CTC phase-out in PAII process agent applications; Nigeria: Progress report on final implementation (2010-2012) and consumption verification report for 2009 and 2010; and Tunisia: National ODS phase-out plan (2010 verification report on the consumptions of CFCs and halons). A methyl bromide report was submitted for Costa Rica.

China: Process agent sector plan (phase II): status of CTC phase-out in PAII process agent applications (World Bank)

12. The World Bank is submitting to the 68th meeting, on behalf of the Government of China, two documents related to production and consumption of ODS in process agent uses:

(a) A verification report on the 2010 CTC consumption for the process agent sector plan – phase II (PA II); and

(b) A verification report on the 2010 CTC production and consumption.

13. All of the funding tranches under PA II have been disbursed and the programme implemented.

14. A the 65th meeting, the Secretariat advised that in the 2010 verification already provided then, the World Bank had changed the format of the verification report regarding the process agent production and consumption of CTC in China as compared to earlier reports. The Secretariat pointed out that a number of enterprises where changes took place in 2010, such as closure of facilities or conversion had not been visited.

15. The Executive Committee took decision 65/10(i) to request the World Bank to provide an independent verification of consumption and production of CTC for controlled uses in 2010, which should, as a minimum, verify the set-up of the monitoring system and the quality of the information provided through the system; and to carry out site visits to the relevant enterprises not yet visited and revisit a sample of those already visited in order to gather the necessary data for the verification report.

16. The Secretariat reviewed the verification reports received and noted:

(a) that the verification had included now four additional enterprises included in PA II plan not visited previously by the verifiers, out of a list of nine enterprises where verification was outstanding, sent by the Secretariat to the World Bank prior to the 65th meeting; the remaining five enterprises being Changshu Xiangyang, Yancheng Runhua, Yixing Yonggu, Sanonda (Jinzhou); and Jiangsu Changlong (two lines dismantled); and

(b) that the verification of the set-up of the CTC monitoring and the quality of information provided through the system had not been carried out. The Secretariat requested from the World Bank an amendment of the verification report accordingly. The World Bank submitted a one-page explanation of the functioning of the on-line monitoring system, not integrated into the verification report, and not accompanied by an assessment of the quality of information.

17. The Secretariat recalls that in the documentation submitted to the 65th meeting, it had noted that the World Bank had provided excellent verification reports regarding PA I, PAII and CTC production for all the years up to and including 2009, ensuring that the agreed reductions in consumption and production had taken place and the relevant manufacturing capacities had been converted or dismantled.

18. The Secretariat would like to point to the completion of the implementation of the PA I and II plans in China, and that the Executive Committee had requested implementing agencies in its decision 66/16(b)(iv) to submit multi-year agreement project completion reports together with any available verification reports for, *inter alia*, CTC.

<u>Recommendation</u>

19. The Executive Committee may wish to consider requesting the World Bank, on behalf of the Government of China, to submit a project completion report for the process agent sector plan – phase II accompanied by a revised 2010 verification report for the sector as well as on CTC production and consumption, in line with decision 65/10(i), not later than the 70th meeting of the Executive Committee.

Nigeria: Progress report on final implementation (2010-2012) and consumption verification report for 2009 and 2010

20. On behalf of the Government of Nigeria, UNDP as the implementing agency has submitted to the 68th meeting of the Executive Committee a consumption verification report for 2009 and 2010 as well as a report on implementation of the National CFC phase-out plan (NPP). The NPP for Nigeria was approved by the Executive Committee at its 38th meeting to completely phase-out of CFC consumption in the

country by 31 December 2009. Funding of US $13,130,786 plus agency support costs has been approved in eight tranches, the last two tranches at the 59th meeting in 2009. The verification report confirms the Article 7 data submitted by Nigeria for 2009 and 2010, with a consumption level of 15.13 ODP tonnes for 2009 and 0 ODP tonnes for 2010. The report also provides an insight into the substantial improvement since 2003 of the data administration by the customs authority as well as of the relationship between customs and the National Ozone Unit, leading to the availability of reliable consumption data. The implementation report covers the time from January 2010 until today. In that period two more foaming enterprises have been converted, bringing the total to 112 enterprises. One hundred and seven more customs officers have been trained, leading to a total of 803 customs officers and 500 forwarders receiving training. The 1,400 refrigeration service technicians trained since 2010 bring the total number of technicians under the project to 10,813. UNDP informs that currently there is a remaining balance of US $38,785, some of which will be used for the publication “Implementation of the national CFC phase-out plan in Nigeria: right on target”, while the rest of the balance is intended to be returned to the Multilateral Fund or subtracted from future HPMP funding.

21. The Secretariat, after review of the submission, recommends to the Executive Committee to:

(a) Note the verification report for CFC consumption in Nigeria for 2009 and 2010;

(b) Note the submission of a report on the implementation of the National CFC phase-out plan for Nigeria in 2010 to 2012; and

(c) Approve the use of part of the remaining funds for a publication and return of the balance to the Multilateral Fund, as proposed in the submission.

Tunisia: National ODS phase-out plan (2010 verification report on the consumptions of CFCs and halons)

22. On behalf of the Government of Tunisia, the World Bank as the implementing agency has submitted to the 68th meeting of the Executive Committee a consumption verification report for 2010, as requested in decision 65/10(f)(iii). A National ODS phase-out plan for Tunisia had been approved at the 49th meeting in 2006, to phase-out CFCs and halons. The verification report confirms that there were no imports of CFCs nor halons in 2010, and that the country’s consumption in 2010 for both groups of substances was zero ODP tonnes. The verification report also confirmed that the process of import control for ODS substances under Annex A, Groups I and II (i.e. CFCs and halons) is reliable, and that the ODS import controls are adequately applied at every step of the import process. However, the licensing process does not currently cover imports for enterprises exporting all of the goods manufactured.

23. The Secretariat, after review of the submission, recommends to the Executive Committee to note the verification report for CFCs and halons consumption in Tunisia for 2010.

Costa Rica: Progress report on the implementation of the total methyl bromide phase-out used as a fumigant in melons, cut flowers, bananas, tobacco seedbeds and nurseries, excluding QPS applications (UNDP)

Background

24. On behalf of the Government of Costa Rica UNDP has submitted to the 68th meeting the 2012 annual progress report on the implementation of the fifth tranche of the project for the total phase-out of methyl bromide (MB) used as a fumigant in melons, cut flowers, bananas, tobacco seedbeds and nurseries, excluding QPS applications.

25. The project was approved in principle by the Executive Committee at its 35th meeting, together with funding for the first tranche (US $1,211,321 plus agency support costs of US $143,245 for UNDP). The second and third tranches, at a total cost of US $1,938,114 plus agency support costs of US $145,359, were approved at the 43rd meeting and the fourth tranche, at a total cost of US $969,057 plus agency support costs of US $72,679, was approved at the 49th meeting. At the 59th meeting, the Executive Committee approved the fifth tranche of the project at a total cost of US $726,791 plus agency support costs of US $54,509 for UNDP, with the following disbursement schedule: US $363,400 in 2009; US $255,000 at the end of 2010; and US $108,391 at the end of 2012, on the understanding that disbursement of the funds for 2010 and 2012 would be subject to a report to be submitted by UNDP indicating that the phase out targets had been met (decision 59/36(c)). Decision 59/36(d) also requested UNDP to present annual progress reports on the implementation of the project, including financial reports, until the project was completed.

Annual progress report

26. Alternative technologies have been introduced in all farms, including solarization in combination with bio-fumigation and/or alternative chemical fumigants. After a number of missions and an exchange of experience with experts from Honduras and Costa Rica on the use of bio-fumigation, the surface area treated with this technology increased substantially and is currently among the preferred alternative technologies. The introduction of other crops, such as rice and/or maize, in the off-season for the production of melons has proven effective in controlling soil pests and reducing the dosage rates of fertilizers and fumigants. Technical assistance has been provided to enhance the productivity of the farms; research has also been conducted with regard to the use of beneficial native fungus and the application of biological controls. Of the total funding of US $4,845,283 approved, US $4,548,053 has been disbursed and the balance of US $297,230 will be disbursed in 2013 and 2014.

Further activities to be undertaken

27. The following activities are being proposed for 2013-2014 with a budget of US $297,300: procurement of additional equipment for enhancing the production of biological controls; increasing the storage capacity for beneficial microorganisms; technical assistance for the production of biological controls; training programmes for farmers to support farms converting to bio-control technology; maintaining open communication with the Government to ensure that the complete phase-out of MB is achieved by 1 January 2013; and monitoring.

Secretariat’s comments

28. The Government of Costa Rica has issued an import quota of 85.0 ODP tonnes of MB for 2012, which is similar to the level in the revised schedule agreed at the 59th meeting. UNDP also confirmed that the Government of Costa Rica will no longer issue quotas for controlled uses of MB.

29. Issues related to the long-term sustainability of the various alternative technologies being introduced, and the extent to which they have been accepted by the growers, were discussed and addressed. UNDP explained that no quotas for controlled uses of MB will be issued (as included in the current ODS legislation). Through the project, farmers have been provided with different tools and equipment that will allow them to address any soil infestation that may arise in the future. Rotation of crops and cultivated areas together with the alternative technologies introduced, namely biological controls, alternative chemical fumigants, alone or in combination with solarization are sufficient alternative approaches to the prosecution without MB. It is also expected that the cost of MB will increase when smaller amounts are imported thus favouring the use of alternatives. Furthermore, the requirements of the international market of food products with minimum or no chemical treatment would also contribute to the sustainability of the technologies.

Secretariat's recommendation

30. The Secretariat recommends that Executive Committee:

(a) Notes the 2011 annual progress report on the implementation of the fifth tranche of the project for the total phase-out of methyl bromide (MB) used as a fumigant in melons, cut flowers, bananas, tobacco seedbeds and nurseries, excluding QPS applications, in Costa Rica;

(b) Authorizes the disbursement of US $297,300 by UNDP to Costa Rica as part of the fifth tranche of the project; and

(c) Requests UNDP to submit the project completion report to the Executive Committee soon after completion of the fifth tranche of the project.

PART VII: UNEP PROGRESS REPORT ON THE IMPLEMENTATION OF THE EXECUTIVE COMMITTEE DECISION 66/15

Democratic People's Republic of Korea: UNEP progress report on the implementation of the Executive Committee decision 66/15

Background

31. At its 64th meeting the Executive Committee decided to defer consideration of the request for the renewal of the institutional strengthening (IS) project for the Democratic People's Republic of Korea to its 66th meeting and requested the Secretariat and UNEP, as implementing agency, to propose alternative methods of disbursement, organizational structures and monitoring procedures to the Executive Committee by its 66th meeting (decision 64/20). UNEP submitted a report to the 66th meeting where the Executive Committee decided in decision 66/16(k) to request UNEP and other interested agencies to further develop the proposed alternative methods of disbursement, organizational structures and monitoring procedures, taking into account the experience of other agencies working on the ground in the country, for further consideration by the Executive Committee at its 68th meeting (decision 66/15(k)). The IS renewal request was deferred until this new information was considered by the Executive Committee.

32. UNEP has submitted to the 68th meeting a progress report on the implementation of the Executive Committee decision 66/15 on the IS project in the Democratic People's Republic of Korea. This report is presented as Annex II to the present document (UNEP/OzL.Pro/ExCom/68/6/Add.1).

Secretariat's comments

33. The Secretariat noted that UNEP's report did not offer new alternative options for disbursement and monitoring than that presented to the 66th meeting. UNEP explained that after discussions with UNDP, UNIDO and other agencies, it concluded that this option "would be the best and most viable one in consideration of the constraints of UNEP's administrative framework".

34. In reviewing the report submitted, the Secretariat noted the following new information resulting from additional consultations held with UNDP and UNIDO:

(a) With regard to the transfer of the IS project to another agency, UNIDO, which is the lead agency for the HPMP for the Democratic People's Republic of Korea submitted to the 68th meeting, indicated that "following consultations with its Administration Department informed that it faces similar problems as that experienced by UNEP, and therefore

UNIDO would not be able to accommodate the requirement of the Executive Committee for the management of the ISP";

(b) UNDP had indicated that as there is no other Montreal Protocol related project in the Democratic People's Republic of Korea, any involvement of UNDP whether as the implementing agency of the Multilateral Fund (i.e., UNDP New York) and/or as the local agency for the execution of the project (UNDP Pyongyang), would require a workable arrangement between UNDP New York and UNDP Pyongyang with the endorsement by the Government;

(c) The Secretariat further noted that while UNEP is open to any alternatives decided by the Executive Committee, including transfer of the Democratic People's Republic of Korea's ISP to another implementing agency, this would require prior consultations and agreement between UNEP and the other implementing agency, and between the Government of the Democratic People's Republic of Korea and the related implementing agency.

35. The Secretariat also suggested that UNEP consult with its legal office in Nairobi on the implementation modality proposed and confirm it is in compliance with UN Security Council Resolutions 1695 (2006), 1718 (2006) and 1874 (2009). However, at the time of finalizing this document, UNEP was unable to conclude its consultation with its legal department.

36. In conclusion, while UNEP's current proposal does not differ substantially from that submitted to the 66th meeting, the Secretariat notes that UNEP had tried its best efforts to explore alternative methods of disbursement, organizational structures and monitoring procedures for the IS project. UNEP confirmed that it is limited in proposing approaches substantially different from that previously submitted due to its administrative constraints. It is therefore seeking guidance from the Executive Committee on how to proceed in view of these limitations, taking into account the urgency of providing assistance to the country for its IS. UNEP is ready to implement the IS project following the proposed option, and the IS renewal has been submitted to the 68th meeting accordingly.

<u>Secretariat's recommendation</u>

37. The Executive Committee may wish:

(a) To note the progress report, submitted by UNEP, on the implementation of the Executive Committee's decision 66/15 on the institutional strengthening project for the Democratic People's Republic of Korea; and

(b) To consider whether in view of the limitations expressed by UNEP, the proposed alternative methods of disbursement, organizational structures and monitoring procedures respond to the concerns expressed by the Executive Committee at its 66th meeting; or

(c) To consider whether to transfer the institutional strengthening project to another implementing agency where acceptable methods of disbursement for similar situations are already in place.

RECOMMENDATIONS

38. With regard to document UNEP/OzL.Pro/ExCom/68/6/Add.1, the Executive Committee may wish to consider:

(a) With respect to resource mobilization for climate co-benefits:

(i) Urging UNEP to submit a final report of this project by the 69th meeting, or return the funds approved for this project if no progress had been made by then;

(ii) Noting the interim report on the resource mobilization for climate co-benefits submitted by the World Bank and urge the World Bank to submit a final report of the study by the 69th meeting;

(b) With respect to the verification report in China: “Process agent sector plan (phase II): status of CTC phase-out in PAII process agent applications”, requesting the World Bank, on behalf of the Government of China, to submit a project completion report for the process agent sector plan – phase II accompanied by a revised 2010 verification report for the sector as well as on CTC production and consumption, in line with decision 65/10(i), not later than the 70th meeting of the Executive Committee;

(c) With respect to the verification report in Nigeria: “Progress report on final implementation (2010-2012) and consumption verification report for 2009 and 2010”:

(i) Noting the verification report for CFC consumption in Nigeria for 2009 and 2010;

(ii) Noting the submission of a report on the implementation of the National CFC phase-out plan for Nigeria in 2010 to 2012; and

(iii) Approving the use of part of the remaining funds for a publication and return of the balance to the Multilateral Fund, as proposed in the submission;

(d) With respect to the verification report in Tunisia: “National ODS phase-out plan (2010 verification report on the consumptions of CFCs and halons)”, noting the verification report for CFCs and halons consumption in Tunisia for 2010;

(e) With respect to the methyl bromide project in Costa Rica:

(i) Noting the 2011 annual progress report on the implementation of the fifth tranche of the project for the total phase-out of methyl bromide (MB) used as a fumigant in melons, cut flowers, bananas, tobacco seedbeds and nurseries, excluding QPS applications, in Costa Rica;

(ii) Authorizing the disbursement of US $297,300 by UNDP to Costa Rica as part of the fifth tranche of the project;

(iii) Requesting UNDP to submit the project completion report to the Executive Committee soon after completion of the fifth tranche of the project; and

(f) With respect to UNEP's progress report on the implementation of the Executive Committee decision 66/15 in the Democratic People's Republic of Korea:

   (i) Noting the progress report, submitted by UNEP, on the implementation of the Executive Committee's decision 66/15 on the institutional strengthening project for the Democratic People's Republic of Korea; and

   (ii) Considering whether in view of the limitations expressed by UNEP, the proposed alternative methods of disbursement, organizational structures and monitoring procedures respond to the concerns expressed by the Executive Committee at its 66th meeting; or

   (iii) Considering whether to transfer the institutional strengthening project to another implementing agency where acceptable methods of disbursement for similar situations are already in place.

Annex I

RESOURCE MOBILISATION FOR HCFC PHASE-OUT CO-BENEFITS STUDY

WORLD BANK PROGRESS REPORT TO THE 68TH MEETING OF THE EXECUTIVE COMMITTEE

Resource Mobilisation for HCFC Phase-out Co-benefits Study
World Bank Progress Report to the 68th Meeting of the Executive Committee
5 October 2012; rev. 2 Nov 2012

A. BACKGROUND

1. The ExCom by Decision 63/24 approved funding at the level of US$ 180,000, plus agency support costs of US$ 16,200, for resource mobilization activities related to the phase out of HCFCs.

2. The original proposal from the World Bank had envisaged addressing resource mobilization from two complementary approaches, harnessing market mechanisms to accelerate donor funding at the level of the replenishment and overall resources available to the Multilateral Fund, and using market mechanisms at the project level. The discussions within the Committee led to dropping the first approach related to donor's commitments, and decision 63/24 therefore requests the Bank to focus solely on the project-level approach.

3. Decision 63/24 also requested the World Bank to provide an interim report at the 66th meeting. Further to that interim report, the Committee requested "the World Bank to submit a more substantial report to the Executive Committee at its 68th meeting (Decision 66/15)".

B. STUDY OBJECTIVE

4. The objective of this study is to identify and highlight ways through which energy efficiency improvements taking place simultaneously with ODS-free transition supported by the Multilateral Fund of the Montreal Protocol (MLF), thereby addressing a financing gap and possible missed opportunities in ODS phase-out projects. It will also look at strategies to maximize synergies with climate financing in general in combination with the World Bank's energy efficiency and climate mitigation portfolios in particular.

5. This will be achieved through exploring options and mechanisms and offering concrete proposals as to how a project addressing the phase out of HCFC could benefit upfront from climate change financing mechanisms for energy savings, thereby increasing the level and/or lowering the cost of financing for these projects. Activities and outputs envisaged include an analysis of the various instruments available for financing energy efficiency measures related to HCFC phase-out, including promotion of low GWP alternatives; an outline of specific investment opportunities; analysis of options for "profit sharing" as requested by the ExCom and recommendations for successful blending.

C. APPROACH AND METHODOLOGY

6. The study will build on preliminary work undertaken in collaboration with the Carbon Finance Unit of the Bank and Treasury (see Annex), and will continue to pursue collaboration with these units and the climate policy team. The study will be undertaken through coordinating the input of these various groups, and others, with a view to harnessing the expertise that resides in the World Bank related climate financing and financial engineering. A draft final report will be submitted to the April 2013 meeting of the Executive Committee, and could be revised to take into account comments and recommendations of Committee at that time.

7. This approach is a departure from the interim report to the 66th meeting of the Executive Committee that envisaged working through a consulting firm. On further reflection it was felt that the study could more fruitfully be undertaken by relying on in-house expertise and understanding of climate finance.

8. A second departure from the original concept lies with a lesser emphasis in the study on the upfront monetization of credits from Carbon Finance / Clean Development Mechanism operation, taking into account the current weakness of the carbon markets, and the lack of visibility regarding their future, still. Instead, the paper emphasizes climate financing for energy savings more broadly. This is not to say that CDM-like market-based approaches will not be very relevant to the problem at hand however, but only that in the near term there is much uncertainty, and that whilst there is great hope in domestic carbon markets in developing countries for filling the gap, this is still some years away.

9. A related consideration is that the study aims to describing the climate finance architecture, and relies therefore on understanding and characterisation of the state of carbon markets and carbon finance in general, both of which are in a state of flux, and will likely remain so until at least 2015. Nevertheless, the approaches that will be developed are likely to apply independently of the exact configuration of climate related financing in the future. Furthermore, the team can tap on a large pool of wisdom and insights within the Bank on this subject.

10. It should be noted that an intrinsic risk to this type of study is that it might not lead to the uptake of new innovative approaches in future projects, in other words, that the study would have limited impact. Uptake (and therefore impact) will require that barriers can be broken down also between the energy and the "Montreal Protocol" sectors both in developing country clients and in Multilateral Fund agencies - something that goes beyond the scope of this study (although the study will make recommendations in this respect. Moreover, tapping into the large resources related to energy efficiency might require some flexibility on the part of the Montreal Protocol community. Again, the study is designed to address this aspect also, but can only hope to be one small element to facilitate the dialogue between sectors.

11. Taking into account the risks and considerations outlined above, it should be recognized that the study takes a fairly long-term view and seeks to outline ways forward in the midst of a still; ill-defined and changing landscape for climate financing.

D. AUDIENCE AND DISSEMINATION

12. In the broadest sense, this study can be expected to contribute to educating the Montreal Protocol community about opportunities for financing under the climate agenda, whilst conversely it aims at educating the climate mitigation community about opportunities and challenges under the Montreal Protocol and the HCFC phase out agenda. In facilitating the dialogue between the two communities, the study responds directly to the letter and the spirit of Decision XIX/6 of the Meeting of the Parties to the Montreal Protocol that links HCFC phase out with the minimization of climate impact.

13. Formally, the primary audience for this work is the Executive Committee of the Multilateral Fund that has approved funding for this work and towards the study report is addressed. Other stakeholders that can benefit from the study are the parties to the Montreal Protocol, in particular developing countries. Indirect audiences are the stakeholders involved in ODS phase out, in particular the private sector in the refrigeration and refrigeration-using sectors in Bank client countries.

14. Internally from a World Bank perspective, the study aims at, and is a means to, intensifying the dialogue between staff working on the Montreal Protocol, on climate finance, and on energy efficiency operations, and can help therefore mainstream the objectives of the Montreal Protocol in broader World Bank operations. Internal dissemination is envisaged through Brown Bag Lunch and through the Climate Financing Thematic Group.

15. The study is to be submitted for discussion at the Executive Committee of the Multilateral Fund. It will also be available for information of all countries at the Meeting of the Parties to the Montreal Protocol, and will be shared with UNEP for dissemination through the OzonAction network. Internally, a BBL can be organised, while externally, the study could be presented at a side-event of the Open-Ended Working Group, or during a "Stockholm Group" meeting on the margins of the same.

16. The issues will also be considered for presentation to a climate audience through a combination of outreach towards the UNFCCC – presentations to the Subsidiary Body for Implementation can be envisaged from the GEF and/or carbon finance perspectives, and outreach towards the GEF can inform and help shape the GEF-6 strategy for climate mitigation. Finally, the study is relevant also to the work of the Climate and Clean Air Coalition to address Short Lived Climate Pollutants, including HFCs, and will be shared with partners in that coalition.

17. The document will be available for download on the Bank's external website. Translation of an executive summary is also expected, while translation of the main text can be envisaged based on demand.

E. Study Report Outline

Executive Summary

18. This will be prepared after the final version has been received by the Executive Committee, and would be translated into Spanish and French.

Background and Sector Setting

19. This section confirms the rationale and TORs of the study and sets common language and parameters between ozone layer depletion and climate change for the purpose of the study.

20. Sector setting discusses the HCFCs scheduled for reduction under the Montreal Protocol (MP), and relationship with Kyoto Protocol and UNFCCC, including relationship with HFCs (in terms of “avoided phase in”). Key characteristics of volumes, growth, and estimated financing needs to achieve targets are described. Related potential energy savings are estimated as well.

Financing Instruments for Climate Change Mitigation

21. This section is an analysis of the “landscape” of climate financing with focus on linkages with the Montreal Protocol agenda that builds on the work of the Climate Policy Initiative. This will take the form of a matrix that will indicate the amounts that are practically available, address experience with implementation, and pass judgement therefore on whether specific instruments should be pursued or not.

22. The review will take a broad definition of climate financing, and will consider other possible sources of financing such as related to green growth or cleaner production.

23. The review will provide estimates for the evolution of climate financing over a 3 - 10 year horizon, and provide pointers to the Montreal Protocol to tap into new financing instruments at country or global level.

Climate Change Financing for Energy Savings

24. New equipment or industrial processes have two benefits which make them eligible to earn carbon credits: they can be more energy efficient, or the new equipment may contain low ODP/ low GHG refrigerant (taking into account also associated production processes). This section will discuss the state and possible evolution over a

3 - 10 year horizon of the carbon markets with focus on linkages with the Montreal Protocol, and implications for carbon markets as one of the instruments to speed up the phase out of HCFCs as complement to Multilateral Fund funding, as well as supporting development and implementation of recovery and destruction of used ODS "banks".

25. The section will provide an overall assessment on extent to which carbon markets at global level and emerging domestic levels can: (i) generate real market demand for carbon credits from HCFC phase out; (ii) destruction of ODS banks; and (iii) support energy efficiency improvements with co benefits – including examining the actual financial contribution that is possible, and therefore the extent to which these can be relied upon as a financial mechanism to support these activities. The section will entail:

- Review the current status of the CDM market post 2012 including European position related to purchase of carbon credits from middle income countries and from HFC23 projects and likely implications for financing HCFC phase out activities from carbon finance;
- Review status of the voluntary carbon market, as well as emerging domestic markets in largest HCFC countries (China, India) and implications for financing HCFC phase out activities from carbon finance;
- Review trends in prices of carbon assets in different carbon markets and including discussion of likely pricing for assets associated with HCFC. Review implication of carbon prices on typical projects and what it does for IRR.
- Review existing baseline technologies and their replacement alternatives, taking into account sector prioritization, energy savings potential, and existence of low GWP alternatives;
- Review existing methodology (voluntary market and CDM) and any operational complications caused by requirements from these methodologies. Assess the need to develop new methodologies or revise existing methodologies.
- Briefly review and evaluate the experience for the sector with carbon finance, including at project level (description and lessons learnt) and for the global chillers program.

26. Typical case studies will be analysed to provide a handle on whether co-benefits from energy efficiency could help bridge the financing gaps of for HCFC phase out projects, or simply whether carbon revenues from energy efficiency might represent sufficient incentives to accelerate the phase-out of HCFC without dedicated Montreal Protocol financing.

Conceptual Models for Upfront Monetization

27. This section will build on the scheme described in the original concept note (see Annex), and provide concrete proposals for the nuts and bolts of a "monetization" scheme related to a project. It will give a detailed description of how a project could be set up in practice with an upfront monetization scheme and new carbon market instruments, for a number of model scenarios. In addressing the recommendations from

the ExCom at time of approval, this will seek to include estimates of the range of transaction costs that would typically be associated with the services and financial engineering required to support and operate such a scheme.

28. The “scenarios” or project types that are envisaged include:

- Appliance replacement or manufacturing. For CDM-type support this would require the definition of a dynamic baseline to allow for growth of equipment;
- City-wide approaches that target several sources of emissions in a programmatic manner;
- The topic of chillers replacement, including whether different approaches to financing might have mitigated some of the implementation challenges faced by some of these projects at present; and
- Revisiting the issue of financing for the destruction of ODS banks, building on the existing studies and work already supported by the Multilateral Fund.

Options for Profit Sharing

29. The Executive Committee requested with its approval that the study “explore possibilities of profit-sharing, including return of funds to the Multilateral Fund”. This involves legal issues related to, amongst other things, ownership of carbon credits; it is largely a legal issue of how the proceeds can be distributed, and will be reviewed under the various models explored in the previous chapter.

30. This matter is difficult to analyse in the absence of a specific concrete case. Conceptually, this would appear to be difficult since the shared “profits” would involve private sector actors, and would typically derive from energy savings and reduced CO_2 emissions, and not be directly linked to the ODS reduction that might be supported by the Multilateral Fund. Moreover, a known barrier to multiple-strand financing is that generally this comes with an increase in transaction cost which decreases the attraction of any such scheme for investors.

31. Nevertheless, the problem will be briefly and tentatively explored, taking into account both legal aspects and financial/economic feasibility aspects, so as to provide elements of response to the Executive Committee.

Investment Opportunities

32. World Bank investments for clean energy are growing at rapid pace. World Bank Group commitments for energy efficiency have been around $1.5 billion per year for the past five years. This section seeks to establish the possible linkages between these operations and the Montreal Protocol agenda. Ultimately, this should serve both to educate the energy community about the agenda and opportunities that lie with the Montreal Protocol, as we well as educating the Montreal Protocol community about the potential scope and scale of activities that could be tapped into if incentives can be aligned and transaction costs kept to a minimum.

33. This section is both backward looking – based on analysis of lending and possible missed opportunities in the past years, as well as forward looking. It aims at identifying potential mid-term investment opportunities – in other words World Bank operations in the pipeline that could lead themselves to enhanced Montreal Protocol synergetic work.

34. The Bank pipeline review and analysis will make concrete recommendations regarding energy efficiency and "cities" investments across the Bank that would offer potential for co-financing, going forward. The extent to which the IFC portfolio can also contribute will be analysed.

35. By way of guide and example, a preliminary outline of the typology of tradition World Bank investments in energy efficiency gives a flavour for the potential for synergies. These investments typically take the form of:

- Investments through "Financial Intermediaries" that then on-lend to others. These Financial Intermediaries can be Banks, Energy Service Companies, or dedicated investment funds. They can establish credit lines or offer guarantees. This is the most common type of intervention that can support energy efficiency with building owners, small industries etc. Unfortunately there is limited information at the central level regarding the exact composition of the portfolio.
- Working directly with Electric Utilities as implementing agencies in demand side management approaches – addressing lighting or energy efficient appliances. This is for example the case of the Mexico Efficient Lighting and Appliances Project.
- More recently, supporting green procurement for municipalities, schools, hospitals – where an incentive is provided to base purchase decisions not only on least cost considerations, but also take into account life cycle considerations.
- And finally, projects still under preparation are developing approaches to provide incentives directly to manufacturers.

Conclusions and Recommendations

36. The section will start by revisiting the opportunities and challenges of successful blending in light of the above, building on existing work on "Financing instruments for climate change", but addressed more directly to the MP community. It will also take a broad view of the challenges with effecting ozone-climate synergies and would make tentative recommendations or options that stakeholders could consider in the process of shaping the various elements of the future climate financing architecture.

37. Conclusions will be informed by organizing broad discussions outside and within the Bank. As noted above, the climate change community will be engaged through a combination of the SBI, the GEF and the CCAC. Input from various units in the Bank will be sought through the climate financing thematic group when the work has advanced, but early enough to inform directions, and towards the end, to validate findings.

38. The section will highlight the key findings and recommendations and highlight “next steps” as appropriate – reminding readers of the role which broader financing for climate mitigation and energy efficiency as well as market based instruments/carbon finance can play in HCFC phase out.

Annex - Resource Mobilisation for HCFC Phase-out Co-benefits Study - Concept submitted to ExCom; revised in line with approval decision

Summary

The experience to date with developing strategies for the phase out of hydrochlorofluorocarbons (HCFCs) is that there is a need for additional funding to complement the amount traditionally provided under the Multilateral Fund of the Montreal Protocol (MLF), in particular to leverage financing for energy efficiency-related improvements. Therefore the Executive Committee of the Multilateral Fund at its 63rd meeting has approved a study to explore possibilities and mechanisms to increase leverage of climate financing, including upfront monetization of carbon credits.

The study will be submitted to the Executive Committee of the Multilateral Fund and shared with parties to the Montreal Protocol (MP). It will serve as a guide to develop projects funded by the MLF that can bank on, and therefore maximise, climate co-benefits. It will also familiarize the carbon market with the Montreal Protocol and the opportunities for generating carbon credits from the ozone depleting substances (which are not covered by Kyoto).

The study aims to generate model scenarios and provide concrete examples and "how-to" guides as to how a project addressing the phase out of HCFC could benefit upfront from the generation of future carbon credits expected from energy savings, thereby increasing the level and/or lowering the cost of financing for these projects. The study will build on preliminary work undertaken in collaboration with the Carbon Finance Unit and Treasury, and will continue to pursue collaboration with these units.

The main project output is a report to be submitted to the Executive Committee at its 69th meeting in April 2013 for further dissemination to Parties to the Montreal Protocol. The expected impact on operations is to provide developing countries with concrete options for maximising climate co-benefits from operations aimed at phasing out HCFCs.

Introduction

The decision of the Parties to the Montreal Protocol to accelerate HCFC phase-out in 2007 held much promise for the environment; not only in terms of moving an impressive record of ozone protection measures to an earlier completion but also by recognizing the relationship of these measures to the climate. Part of Decision XIX/6 also assured countries operating under Article 5 that full incremental costs for accelerated HCFC phase-out would be covered. It is only now, four years later, as Article 5 countries are submitting their HCFC Phase-out Management Plans under the Multilateral Fund (MLF) and the Executive Committee’s HCFC policies evolve, that the actual funding requirements are better understood.

One of the most prominent aspects of Article 5 country consumption of HCFC is the rate of growth in a relatively short period. This rate of growth is directly related to economic development in emerging economies which are rapidly building a consumer-base. Another critical aspect directly related to HCFC is the pattern of growth with China representing over 60% of Article 5 consumption and 90% of its production.

These trends may impact the level of MLF funding available as a whole for meeting incremental costs over a number of replenishment periods. This is further affected by a present mismatch between available funding and the Montreal Protocol reduction schedule on the one hand and the realities on the ground where a changeover to HCFC alternatives will in some cases lead to an unavoidable technology upgrade (linked to energy efficiency) or where HCFC phase-out can only be done on a sector basis, on the other hand. There is a risk therefore that opportunities for energy efficiency related improvements will be missed because of lack of funding. As a consequence, there is ongoing discussion in the MP community on possibilities and options for leveraging additional support to the MLF – if it becomes necessary for ensuring that countries can first and foremost meet their MP obligations and to assist countries that wish to include climate co-benefit considerations into their HCFC phase-out programs.

Bridging the Financing Gap

There are two broad steps that could be pursued to leverage additional funding to complement the amount traditionally provided under the MLF. The first step is to circumspectly review and increase current donor commitment/replenishment estimates. The second step is to utilize market and other mechanisms to raise funding as required for project implementation. These two steps are not mutually exclusive. The World Bank had proposed to develop approaches addressing both: upfront monetization of future donor commitments similar to what was done under the Internal Finance Facility for Immunization (IFFIm); and project level activities including upfront monetization of carbon credits.

The ExCom by Decision 63/24 approved funding at the level of US$ 180,000, plus agency support costs of US$ 16,200, for resource mobilization activities related to the phase out of HCFCs. The discussions within the Committee led to dropping the first approach related to donor's commitments, and decision 63/24 therefore requests the Bank to focus solely on the project-level approach. Therefore the reminder of this note will focus on that aspect. Nevertheless it remains a possibility that the option to frontload future donor commitments can be explored at a later stage in time for future replenishments of the MLF.

Facilitating financing of HCFC co-benefits

MP projects that aim to reduce Ozone Depleting Substances, in particular those dealing with refrigeration applications, will also generate energy saving benefits, given the very nature of replacing old CFC and HFCF cooling units with more modern and efficient technology.   If these projects are also registered under one of the various Carbon

Finance mechanisms, then the energy savings could be turned into Carbon Assets. The problem is that whilst the Carbon market can provide a greater return on investment, it does not help address the upfront investment costs and address the financing barrier at the time a project is put together. Monetizing future carbon assets to finance the costs of climate-ozone benefits would seek to achieve that. Preliminary estimates show that cumulative CO_2 reductions generated by MP projects from years 2010 to 2040 will be about 19 million t/CO_2 from energy efficiency and 11,000 million t/CO_2 from energy substitution[1]. As an illustration of the potential (nominal) value of the carbon assets, assuming Certified Emission Reduction (CER) prices held constant at $10 per t/$CO_2$, the carbon assets[2] would be worth $190Million from efficiency, and $110 billion from substitution. Monetizing these assets would require discounting of the nominal value, but would nonetheless appear significant.

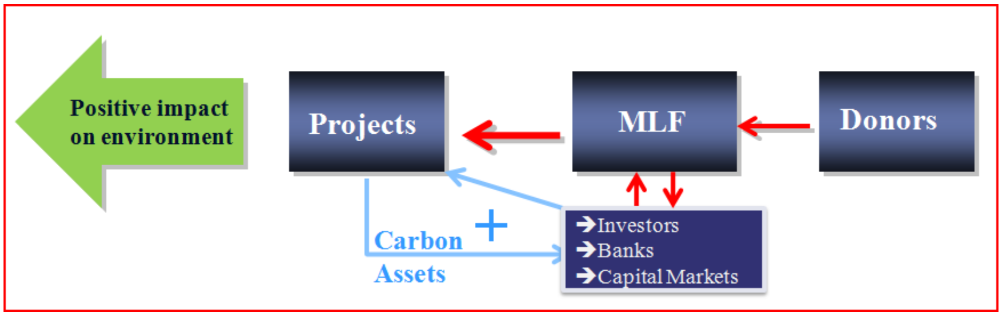
Once verified, carbon assets become entitlements to the project entity, and are redeemable in the future. Various mechanisms exist today to monetize these assets, such as primary market carbon funds and secondary market exchanges. However, these mechanisms do not directly address the need for increased project finance capital at an early stage of the project.

Carbon assets redeemable in the future could be used by the project entity to increase the financing available at an early stage of the project. It may be possible to advance financing (e.g.: commercial loans, bonds) against these future carbon assets to fund projects before the assets are generated, using the future stream of carbon revenues to repay the financing, over time.

Furthermore, it may be possible to use carbon assets to enhance the creditworthiness of projects, which would enable financial entities (banks, investors or multilaterals) to improve the terms of financing (such as increased financing amounts, decreased cost of financing, increased loan maturity, etc.). As a credit enhancing instrument, carbon assets would be transferred or posted as collateral to the benefit of financiers, to reduce the potential loss in case of a default by the borrowing project entity.

[1] These figures will be reviewed.
[2] These figures only for indicative purposes, and not valid as of October 2012

Figure : Financing HCFC Phase Out Co-Benefits



The above cannot be considered without looking at what sources of funding could be available broadly. There are a number of sources for grant financing and concessional or commercial lending as well that should be sought to complement MLF funding particularly where MP projects intersect with the climate agenda, in order to maximize ozone and climate benefits. These include the Global Environment Facility, bilateral, the Climate Investment Funds including the Clean Technology Fund, IBRD/IDA lending and the Green Climate Fund in the making, or even instruments such as green bonds.

However, while these sources of finance can in principle be pulled together[3], in practice there are considerable barriers in doing so. These barriers that stem from different project cycles and information requirement include: (i) timing issues; (ii) transaction costs in general; (iii) and multiple decision makers in various sectors, at the country, agency, and funder level, with different short-term priorities.

Finally, a broad financing package should also take into account incentives to ensure that the potential climate change mitigation benefits from HCFC phase out are not diluted because of high GWP alternatives. In some limited instances, HCFC phase-out is leading to HFC phase-in where there are no other cost effective and available alternatives. The study would explore ways to leverage financing to effect a transition that would promote low GWP alternatives altogether.

Crosscutting elements

When approving funding for this work, the Executive Committee in its decision highlighted a number of elements which are key principles that will be taken into account in pursuing all three avenues outlined above:

(i) Additionality of the projects proposed
In this context, "additionality" is understood as assurance that the set of activities that is promoted will bring environmental benefits beyond the baseline of Multilateral Fund supported interventions, and would not happen without additional push.

[3] See "Beyond the Sum of its Part Blending Financial Instruments to Support Low-Carbon Development", Hosier et al, 2010, The World Bank

(ii) Transparency and good governance, as well as covering the cash flow
Transparency and good governance are key principles that underlie all World Bank operations and as such will be reflected in the Study as appropriate.

(iii) Assurance that these projects would avoid perverse incentives for countries
"Perverse incentives" in this context is understood at its most basic as a scheme that would be set up in such a way that the main beneficiary could have an incentive – monetary or otherwise – that would not be aligned with maximizing environmental benefits. To the extent that such perverse incentives can be difficult to uncover, the Study will proactively envisage possible misalignment of incentives.

(iv) Exploring possibilities of profit-sharing, including return of funds to the Multilateral Fund
This will be explored in the development of the Study, taking into account both legal aspects and financial/economic feasibility aspects.

(v) Ensuring sustainability of the projects proposed
This is fully in line with operational principles of the World Bank which would apply, and as such will be reflected in the Study as appropriate. In principle, the financial schemes considered that would involve the Bank's Treasury would have to be intrinsically sustainable as that operation would transfer some of the medium to long term risks and uncertainty from the Project Entity to the Bank.

(vi) Avoidance of duplication of similar projects
In principle, priority efforts will be directed to developing different product lines or addressing different sectors or regions rather than duplicating similar projects.

(vii) Information on transaction costs.
This point relates to point number (ii) on transparency. The Study will provide Information on any fees for financial services that would be levied by the World Bank or by commercial enterprises as appropriate.

Outputs

(i) A detailed description of a scheme to monetize upfront Carbon Credits so as to address the barrier to initial capital investments costs;
(ii) An analysis of options for "profit sharing", including the feasibility of return of funds to the MLF;
(iii) An analysis of the various concessional and commercial instruments available within the next five years for financing of energy efficiency measure related to HCFC phase-out, as well as an outline of approaches to promote low GWP alternatives;
(iv) An description of specific mid-term investment opportunities, to the extent possible;

(v) An analysis and recommendations to effect successful blending, including stakeholders and decision makers to involve and timing.

Appendix - Using Carbon Assets to enhance investments in Montreal Protocol Projects

This appendix explores the possibility of using future Carbon Assets, which are being generated by Montreal Protocol (MP) projects, to increase the level and/or lower the cost of financing for these projects. MP Projects that aim to reduce ODS in refrigeration applications will also generate energy saving benefits, given the very nature of replacing old CFC and HFCF cooling units with more modern and efficient technology. If these projects are also registered under one of the various Carbon Finance mechanisms, then the energy savings could be turned into Carbon Assets.

Monetization of future Carbons Assets would offer two main benefits. From an environmental perspective, it would accelerate the implementation of HCFC and CFC reducing projects. From a financial stance, providing more capital and/or lowering its cost at the onset of the project would improve their financial viability and enable quicker ramp up of ODS reducing projects.

Carbon Assets as a credit enhancement tool for lending

Carbon Assets generated by MP projects could potentially be used as collateral against lending[4]. For most sponsors, the collateral would be used to reduce the risk profile of the borrower, and would then enable the lender to decrease the cost of funding for these collateralized operations. Alternatively, for borrowers facing limitations with credit exposure headroom, the credit enhancing effect of the collateral could be used to increase the exposure limits, releasing additional funding sources. This proposal could utilize a range of carbon assets, such as CERs and VERs.

MP projects generating energy efficiency gains would need to register under the CDM or JI schemes. After registration, carbon assets would be transferred by means of an Emissions Reduction Purchase Agreement (ERPA) or other arrangement, into the custody of a third party, which could use these assets as collateral to extend a loan to the country/project originating the assets, at the project construction phase. The collateral could be held on the balance sheets of the lender or in a separate facility that could be set up as a debt service facility with irrevocable payment instructions to pay off pre-determined debts.

The introduction of carbon assets to the MLF financial structure will induce the management of additional risks. Determining which parties bear what risks, and how these risks can be mitigated will become crucial elements of this proposal.

[4] The lending could be done by multilateral agencies, banks or other financial institutions.

Project Company: it would keep delivery risk, the risk of generating fewer carbon assets than expected.

Carbon Credit Trustee: it would take carbon asset price risk if an ERPA is signed. Otherwise, it would stay with the Project Entity.

Lender: it would take the Borrower's Credit Risk in case of default by the project companies, though this risk would be reduced by the collateral. The Lender would also take Carbon Asset Delivery Risk indirectly, as the quality of the collateral is linked to the ability of the project company to deliver as planned. Of all risks, Delivery Risk remains the most difficult one to mitigate or transfer.

Figure 1. Project's Process Flow

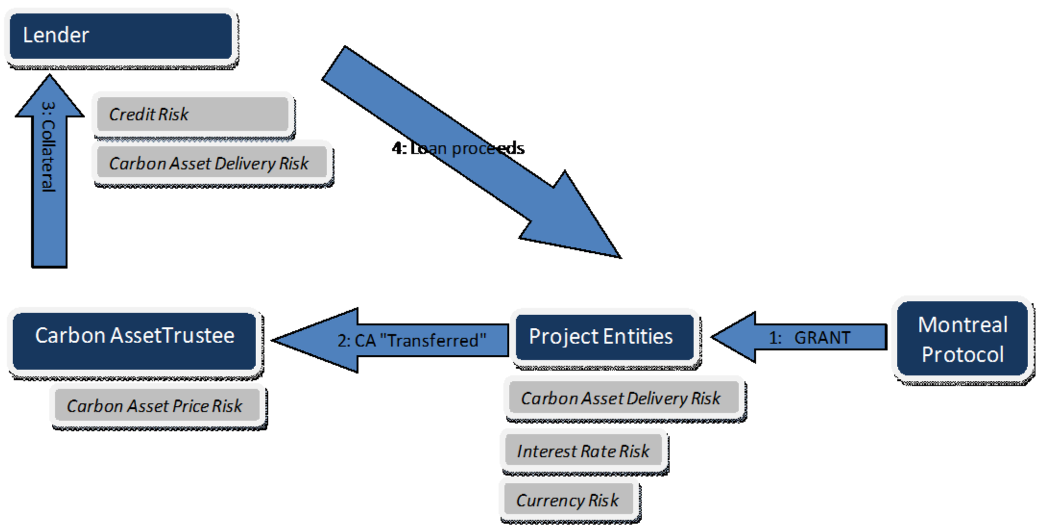
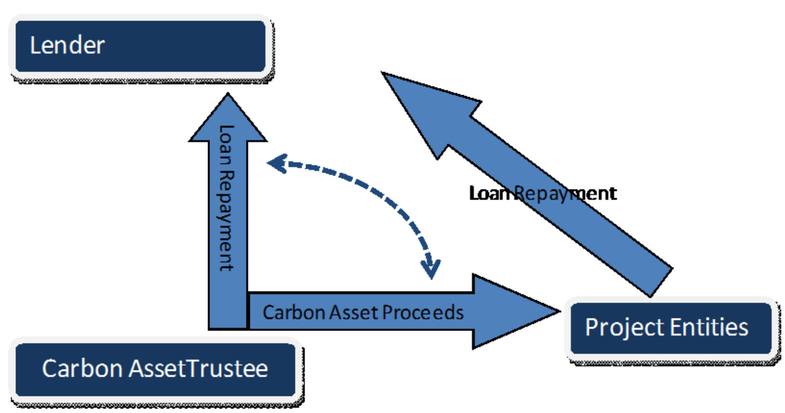


Figure 2. Illustration of flows as carbon assets are verified



As the Carbon Assets are verified, they can be sold at spot market prices or settled through the ERPA at the pre-agreed price. Depending on the arrangements, the proceeds can be paid back to the lender as debt service, or to the project entity. The host government could stand as a guarantor and / or consolidator.

To enhance the collateralized lending concept, guarantee mechanisms could be used to mitigate certain risks. For instance, it may be possible to strip out the credit risk and delivery risk components out of the Carbon Assets, using new or existing mechanisms (IFC's Carbon Delivery Guarantee Mechanism is one such illustration), thereby enhancing the monetization potential of the Assets[5].

[5] See IFC Carbon Finance information page: http://ifcnet.ifc.org/intranet/carbonfinance.nsf/.

Annex II

PROGRESS REPORT ON THE IMPLEMENTATION OF THE EXECUTIVE COMMITTEE DECISION 66/15 ON THE INSTITUTIONAL STRENGTHENING PROJECT OF DPR KOREA

22 October 2012

Background

The 64th meeting of Executive Committee (25-29 July 2011) discussed the submission of DPR Korea's Institutional Strengthening project (ISP) renewal. In the margins of that meeting, UNEP met with the Committee member that expressed interest in this topic to provide additional clarifications. During that informal side meeting, the member raised the following specific issues:

- The salary level of the Ozone Officer and the modalities of salary payment under the ISP: It was noted that the cost of the salary is high and not in line with local salaries and the payment to the Ozone Officer through the Government needs more transparency. As an alternative, it was suggested whether it was possible for UNDP Pyongyang to pay the Ozone Officer with a reduced salary level.
- The UNEP delegation was provided with a document that had details about UNDP's new Internal Control Framework for implementation of projects in DPR Korea. UNEP was asked to explore to which extent the ISP project could be implemented in light of such a framework.
- Possibility for the Ozone Officer to be located in UNDP's Pyongyang office.

In the deliberations at the 64th meeting of Executive Committee, "*concern was expressed about the lack of transparency and difficulties in monitoring the exact use of any institutional strengthening funding in the Democratic People's Republic of Korea" (*UNEP/OzL.Pro/ExCom/64/53, *para 86).* The Committee then took the following decision:

"The Executive Committee decided:

(a) To defer consideration of the request for phase VI of the institutional strengthening project for the Democratic People's Republic of Korea to its 66th meeting; and

(b) To request the Secretariat and UNEP, as implementing agency, to propose alternative methods of disbursement, organizational structures and monitoring procedures to the Executive Committee by its 66th meeting"

(Decision 64/20)

Following that decision and the informal discussions, UNEP's Compliance Assistance Programme (CAP) informed DPR Korea's National Coordinating Committee for Environment (NCCE) about the Executive Committee Decision 64/20, and sent a formal letter to the UNDP Representative in Pyongyang through the Director of UNEP's Regional Office for Asia and the Pacific (ROAP) to initiate the consultation. It was later agreed that the consultation would be conducted in Pyongyang during a joint UNIDO/UNEP mission for the country's HPMP preparation from 28 November to 1 December 2011.

UNEP prepared a draft report based on the consultations with DPR Korea and UNDP in Pyongyang and circulated it to the Multilateral Fund Secretariat for review and comment. UNEP also kept relevant Executive Committee delegations informed of these consultations. Based on the comments received, UNEP finalized the report and submitted it to the 66th meeting of the Executive Committee for consideration.

The Executive Committee reviewed the progress report, and a number of members applauded the work done to improve transparency and suggested that, as a next step, UNEP should provide additional information to increase transparency even further, consult with other implementing agencies that might have suggestions, and resubmit the report. Accordingly, The Executive Committee decided:

"(k) With regard to Democratic People's Republic of Korea:

> *(i) To take note of the report submitted by UNEP on the implementation of Executive Committee decision 64/20 on the institutional strengthening project for the Democratic People's Republic of Korea; and*
>
> *(ii) To request UNEP and other interested implementing agencies to further develop proposed alternative methods of disbursement, organizational structures and monitoring procedures, taking into account the experience of other agencies working on the ground in the country, for consideration by the Executive Committee at its 68th meeting."*

(Decision 66/15)

As a follow up, UNEP discussed the matter with NCCE, DPR Korea in the margin of the joint network meeting of the Joint South Asia and South-East Asia Regional Network Meeting in Bhutan during 15-19 May 2012. UNEP then consulted UNDP and UNIDO, the only other implementing agencies that have on-going programmes in DPR Korea, for their views and advice in further developing alternative methods of disbursement, organizational structures and monitoring procedures. UNEP updated the present report with the results of those additional consultations, for the consideration of the 68th meeting of the Executive Committee.

The following three parts describe (a) the current implementation modality of the ISP in DPR Korea, (b) the consultation process in Pyongyang and Bhutan, and (c) the proposed alternative methods for disbursement, organizational structure and monitoring procedures as requested by Executive Committee Decisions 64/20 and 66/15.

A. Current methods of disbursement, organizational structures and monitoring procedures for the implementation of the ISP

Disbursement

Under the current financial system, UNEP has been transferring the approved funds under the ISP to DPR Korea through Small Scale Fund Agreements (SSFAs). Following the signature of an SSFA between DPR Korea and UNEP with the agreed work plan, the first payment is made as a cash advance to support the NOU to conduct the agreed planned activities. Upon receipt of a satisfactory interim progress report and financial reports and confirming that 80% of first payment has been spent, UNEP proceeds with making the second payment. UNEP uses this same modality for all ISPs for which UNEP is the responsible Multilateral Fund Implementing Agency.

The cash advance and the later reimbursement will be diverted to the National Ozone Unit, NCCE through UNDP Pyongyang in local currency.

Organizational structure

The National Ozone Unit (NOU) of DPR Korea was established in December 1996 as part of the Institutional Strengthening project funded by the Multilateral Fund under the authority of the NCCE.

NCCE is coordinating all the policies and compliance activities for environmental protection with regard to the cooperation with International Organizations in the field of environment including the implementation of the Montreal Protocol.

NCCE is chaired by the Vice-Minister in charge of international organizations in the Ministry of Foreign Affairs, vice-chaired by the Vice-Minister of the Ministry of Land and Environment Protection and composed of the representatives from relevant line Ministries and Organizations such as State Planning Commission, State Commission of Science and Technology, Ministry of Chemical Industry, Nature Conservation Union, etc.

The NOU, being supported by project officers and coordinators who oversee the activities relating to the Montreal Protocol, coordinates the daily implementation of the Montreal Protocol, prepares and supervises the implementation of the Multilateral Fund projects including RMP and NPP, and fulfils reporting requirement to the Ozone Secretariat and the Multilateral Fund. All staff working in the NOU are appointed by their respective organs and approved by NCCE.

Monitoring procedures

As specified in the SSFA, the NOU needs to submit regular progress reports on the implementation of the agreed work plan, as well as interim and final financial reports, for UNEP's review. The NOU also provides UNEP with copies of final information and outreach products such as newsletters, posters, etc. that were produced under the ISP. UNEP maintains regular contact with the NOU through UNDP Pyongyang for any queries and/or clarifications. Furthermore, from time to time UNEP, in most cases jointly with UNIDO undertakes supervision and inspection missions to visit Pyongyang, in combination with the implementation of other approved activities under the Multilateral Fund. UNEP has also participated in some major awareness activities organized by the NOU under the ISP, such as celebrations of the International Day for the Preservation of the Ozone Layer (Ozone Day) in Pyongyang.

B. Consultation process in Pyongyang and Bhutan

Meeting with NCCE/NOU

UNEP and the DPR Korea NCCE jointly reviewed the Decision 64/20 in Pyongyang from 28 November to 1 December 2011, and identified possible alternative methods of disbursement, organizational structures and monitoring procedures that the Government could consider. During the further consultations between UNEP and the NCCE representative at the Network meeting in Bhutan, the following issues were highlighted:

General issues

- The NCCE first raised concerns about the impact of the delayed approval of the ISP for the country's compliance with Montreal Protocol obligations, and NCCE requested UNEP to convey a similar message that was recorded in the final report of the Joint Meeting of the South Asia-South East Asia Regional Network of ODS Officers in Pokhara during 17-19 October 2011, i.e." Network countries felt that the IS funding is essential for successful implementation of the Montreal Protocol and Executive Committee should be informed of countries concerns of difficulties that may face if any disruption or delay in funding of IS projects".
- The NCCE further stated that it would fully cooperate with UNEP and the Multilateral Fund Secretariat to explore any possible alternatives as requested by the Executive Committee, even though it was not convinced that it should be singled out for such a treatment.
- The possibility of transferring DPR Korea's ISP to another Implementing Agency was discussed. Although the NOU prefers that UNEP continues implementing the ISP considering its long-term cooperation with UNEP for more than 20 years, and national stakeholders' familiarity with UNEP's reporting requirements and procedures, the NCCE is open to work with any other Implementing Agency if the Executive Committee so decides.

- The NCCE requested UNEP to convey to the Executive Committee the message that the continuous deferral of the ISP renewal for DPR Korea is negatively affecting the normal operation of the NOU, including the preparation of the country's HCFC Phase out Management Plan (HPMP).
- For the proposed alternative methods of disbursement, organizational structure and monitoring procedures, following carefully review of each of all the earlier proposals to the 66th meeting of Executive Committee, it is jointly concluded by NCCE and UNEP that the proposed options to the 66th meeting of Executive Committee would be the best and viable ones in consideration of the constraints of UNEP's administrative framework.
- There are three full-time Ozone Officers among the staff of NOU that have been paid under the IS project directly. If Executive Committee is not in a position to approve the IS project, NCCE would have to convert them to work on the Montreal Protocol matter on a half-time basis, therefore, it can be justified for the Government to pay their salary. The similar arrangement will also be made for the other NOU staff. The NCCE has done its best to keep the NOU operating, but it may still affect the smooth implementation of the Montreal Protocol as well as the HPMP if approved.

Disbursement

- The option to stop advance payments under the current system was discussed. This means that following the signing of the SSFA, the NOU would need to organize the planned activities by using funding from other internal Government resources outside of the Multilateral Fund support, and upon the submission of the progress report, the financial report and the receipts UNEP would reimburse the cost accordingly through UNDP Pyongyang. The NCCE expressed concern about that without advance payments under the ISP, the planned activities may not be organized as originally planned, as they will depend on the availability of the funding in the other resources, which might most likely delay the project implementation. The NCCE advised it would be more efficient to continue the current advance payment system, but instead strengthen the management and monitoring on the use of the advance payments.

Organizational structure

- Concerning staff recruitment in the NOU, the NCCE was flexible for local people to be contracted by a UN organization following the established procedures of UNDP, and to make payments to those staff directly.

Monitoring procedures

- Regarding the monitoring of the activities under the ISP, the NCCE agreed to coordinate with UNEP more closely, to enable UNEP staffs who are visiting DPR Korea for other activities to participate in these activities. The NOU further agreed to provide UNEP with a separate report for each event they organized under the ISP within two weeks of completing the activity.

<u>Meeting with UNDP, Pyongyang Office</u>

UNEP has engaged in discussions with the UNDP DPRK Country Office ("UNDP Pyongyang"), in the latter's capacity as a common office serving the entire UN system. It is important to draw the distinction between the role of that Country Office, with its broader support role for UN operations in DPRK, and that of UNDP as an Implementing Agency of the Multilateral Fund. UNEP limited its discussion with UNDP Pyongyang with issues related to the Country Office role.

UNDP Pyongyang has been extremely cooperative, and further showed its support to the work UNEP is carrying out in DPRK under the Multilateral Fund and expressed its readiness to further extend its support, if the working environment permits.

UNDP in DPRK has a special Internal Control Framework and signed a Memorandum of Understanding (MoU) with the DPR Korea Government, specifying those special operating arrangements under finances, banking, human resources, procurement and reporting.

UNDP is directly implementing its projects under the Direct Implementation Modality (DIM). For an example, no advance payments are allowed under DIM, and UNDP should implement all the activities and make payments directly to the vendors for the goods and services and pay in local currency to their local bank accounts of the vendors. UNDP national personnel should be hired under UNDP contracts and are considered UNDP staff. The procurement of goods and services follow the same strict regime and controls, UNDP verify each requisition for goods and services against the lists of Items Prohibited for Export to and Import from DPRK pursuant to UN Security Council Resolutions (UNSCR) 1695 (2006), 1718 (2006) and 1874 (2009) including checking the items against the category "double use items" and accordingly UNDP requests vendors to provide export licenses for goods containing at least 10% of United States- or Japanese-made components or technology.

As the Implementing Agency responsible for DPRK's IS project, UNEP could engage UNDP Pyongyang to execute the project under UNDP DIM. For the purposes of the Multilateral Fund UNEP would remain the responsible Agency, however the project will be completely managed under UNDP rules and regulations, and the complete budget should be transferred to UNDP Pyongyang to execute the project and not only part of it, this includes managing the staff and resources, activities and payments. UNDP Pyongyang for that will charge its fixed General Administration fee of 7% as well as the Implementation Support Services for DIM projects, which should be added to the total budget of the project.

UNEP is open to any alternatives decided by the Executive Committee, including transfer of DPR Korea's ISP to another Implementing Agency. Any such arrangement would require prior consultations and agreement between UNEP and the other Implementing Agency, and between the DPR Korea government and the related Implementing Agencies. However, UNEP also recognized that the country's preference of continuing with UNEP should be respected. In addition, if the ISP is to be transferred, the financial implications to the Multilateral Fund due to the charging structure for programme support cost (PSC) for the ISP, also needs to be considered (note: as per Decision 26/41(d) UNEP receives 0% PSC for ISPs it implements).

UNEP noted that as per the salary level determined by International Civil Service Commission (ICSC), the current salary level of the NOU staff under the ISP is considered reasonable. Currently, the proposed salary level for the 3 staff of the NOU is about USD 520/month per person on average. For comparison, the salary level of local professional working on other projects for UNDP is about USD 900-1,000/month as per the established salary level by ICSC. If UNEP needs to hire the local staff directly, as per UNDP's procedure the salary level for the NOU staff would need to be increased.

For the physical location of the NOU staff, UNDP Pyongyang informed UNEP that it currently has space constraints and in fact one of its project offices is located outside of UNDP compound in Pyongyang. Therefore, to house the 3 staff of NOU in UNDP Pyongyang's office would be difficult. Also it recognized that due to the nature of the work of NOU, it might not be efficient for NOU to be located in UNDP compound.

UNDP Pyongyang also advised UNEP to contact other agencies which are operating in DPR Korea to understand their execution modalities. UNEP did so and later the United Nations Children's Fund

(UNICEF) confirmed that "UNICEF has a full fledged office here in Pyongyang, DPR Korea and manages its activities like any other country office does."

UNEP's consultation with UNDP and UNIDO

Following Executive Decision 66/15 as well as the consultation with NCCE representative in the margins of the Bhutan Regional Network meeting, UNEP contacted both UNDP and UNIDO that have on-going programmes in DPR Korea to seek their advice about how to manage the implementation of DPR Korea's ISP in light of the specific consideration of the Executive Committee on the fund disbursement, organizational structures and monitoring procedures. Further, in recognition that due to UNEP's constraints and administrative structure, it would be practically difficult for UNEP and DPR Korea to find any viable alternative methods within UNEP that would satisfy the Executive Committee's expectations, UNEP also proposed to introduce to both UNDP and UNIDO the possibility that one of their agencies could better serve DPR Korea for its ISP needs.

Both UNDP and UNIDO provided the following responses to UNEP's request for advice:

- UNDP: Although it has a country office in Pyongyang, UNDP has no Montreal Protocol-related portfolio in DPR Korea therefore with only one small ISP project the quality of implementation would be impacted negatively unless they would be able to strengthen the local capacity at the country office level. However, this would be difficult due to the limited level of fees available in one single project. In conclusion, UNDP recommends that an Implementing Agency with more than one project should be selected to implement the ISP. The operational arrangements in UNDP involve the coordination of the entire Montreal Protocol programme by UNDP's Montreal Protocol Unit in New York (MPU) with all country offices through delegated authority from the Administrator of UNDP and the head of the Bureau. It is therefore not possible to transfer the IS project to UNDP CO without discussion and a workable arrangement between UNDP MPU and UNDP DPRK. Having consulted with the head of UNDP MPU, additional discussions would be needed between UNDP/MPU and UNDP DPRK regarding capacities and cost recovery as well as UNDP MPU coordination role, before any decision could be reached regarding whether the project can be transferred.

- UNIDO: Following consultations with its Administration Department, UNIDO informed that it faces similar problems as that experienced by UNEP, therefore UNIDO would not be able to accommodate the requirement of the Executive Committee for the management of the ISP.

For the proposed alternative methods of disbursement, organizational structures and monitoring procedures, both UNDP and UNIDO reviewed reports; however, they acknowledged that it would be difficult for them to offer any advice due to the different administration and management systems.

UNEP's internal consultations

UNEP consulted UN Economic and Social Commission for Asia and the Pacific (ESCAP) that is providing administrative service to UNEP ROAP to determine whether it would be administratively possible for UNEP to directly contract the local staff working for DPR Korea's NOU. ESCAP advised that it would not be able to contract the Ozone Officer without daily supervision in Pyongyang. Therefore, UNEP would not be a position to recruit the local staff.

UNEP is also in consultation with its legal office in Nairobi on the implementation modality taking into account the UNSCR 1695 (2006), 1718 (2006) and 1874 (2009).

C. Proposed alternative methods of disbursement, organizational structures and monitoring procedures

Fund disbursement approach under the ISP

All activities under the ISP would be undertaken locally, such as public awareness events, UNEP and NCCE would sign a financial agreement (SSFA) to clearly define all activities and the respective costs. UNEP, as per the financial agreement, would make advance payments in the local currency (Korean Won) through UNDP Pyongyang after a detailed workplan for the year has been submitted listing the activities that will be conducted. However, the advance payment would not be spent for any of these activities unless the NOU submits a separate further detailed Terms of Reference (TOR) for each of the planned activities at least one month before the activity, for endorsement by UNEP. It was also agreed that within two weeks following the completion of the activity, the NOU would submit to UNEP a detailed report of the activity undertaken against the endorsed TOR with expenditure reports as well as original receipts for UNEP's review and monitoring. For any activities that are organized without UNEP's pre-endorsement, UNEP would not agree to cover the cost under the ISP.

Organization structure

The NOU staff would be recruited by the Government, and would be physically based in NOU office located at the Environment and Development Centre. UNEP, UNIDO and their consultants could easily visit the NOU office during their missions, and the NOU staff would be invited to the meetings of the Regional Networks of Ozone Officers as well as other relevant meetings concerning the implementation of the Montreal Protocol.

Monitoring procedures

As agreed with NCCE, in addition to the semi-annual progress report that is required for any country as per UNEP procedures, the NOU of DPR Korea would conduct each planned activity as per pre-endorsed TOR following the above-mentioned procedure and submit the activity report within two weeks after completion of the activity. In addition, UNEP would coordinate with the NOU on the timing of the organization of any activity to maximize UNEP staff's physical participation in ISP activities. UNEP is responsible for implementing other projects with DPR Korea beyond those of the Multilateral Fund, therefore frequent visits of other UNEP ROAP staff (i.e. they do not work in UNEP's Compliance Assistance Programme) to Pyongyang will also be utilized for such monitoring. UNEP CAP will also try its best to organize visits to the NOU twice a year for coordination, advice and review of ongoing ODS phaseout activities implemented by UNEP in DPR Korea.

The NCCE would like to invite UNEP to major events and activities under IS project and also agrees that UNEP will have unhindered access to project sites, as necessary for the implementation, monitoring and oversight of the UNEP-implemented projects.