

**Workshop on Financing Modalities of the Clean
Development Mechanism
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CDM: A Financier's Perspective and JBIC Operations

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**JAPAN BANK FOR
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UNEP Finance Initiative
Innovative financing for sustainability

The Clean Development Mechanism (CDM)—an overview

- The Kyoto Protocol's Clean Development Mechanism (CDM) is a unique instrument in international climate policy.
- The CDM
 - ✓ supports the implementation of sustainable and environmentally friendly technologies in developing countries; and
 - ✓ helps industrialized countries meet their emission reduction obligations in a cost-effective way.

Certified Emission Reductions (CERs)

- CERs represents greenhouse gas (GHG) mitigation contribution of a project, measured in metric tons of carbon dioxide equivalent.
- CERs are a second product (for example, after electricity) obtained by a CDM project.
- In other words, CDM is “**a mechanism to monetize environmental value**”.



Implications for the financial sector

- The financial sector is expected to play a key role in developing and promoting CDM projects.
- The global market for greenhouse gas emissions under the Kyoto Protocol could offer significant business opportunities for financial institutions.

Implications for the financial sector (continued)

- In reality, however, financial institutions' appetite for CDM projects is rather low, although the potential market for Certified Emission Reductions (CERs) exists, due to:
 - ✓ the specific risk structure of CDM projects;
 - ✓ various institutional barriers; and
 - ✓ the complexity in implementing a CDM project.

UNEP FI

- The United Nations Environment Programme Finance Initiative
- A unique global partnership between the UNEP and the financial sector
- About 180 member financial institutions worldwide
- Mission is “**to identify, promote, and realize the adoption of best environmental and sustainability practice at all levels of financial institution operations**”.

UNEP FI (continued)

UNEP FI CEO briefing on Finance for Carbon Solutions January 2005

Available online at

<http://www.unepfi.org/publications>



A summary of key findings and messages follows:

CDM: the fundamentals

- Registering a project under the CDM is a long and complex process with a number of additional steps compared to conventional projects.
- In addition,
 - ✓ costs for the additional CDM procedures are more or less between \$50,000 to 250,000;
 - ✓ it takes about one to three years before the registration of the project; and
 - ✓ the future of the CDM is unclear beyond 2012.

CDM: the fundamentals (continued)

Conventional projects

- Feasibility assessments
- Project structuring phase
- Implementation phase
- Operational phase

CDM projects

- Assessment of:
 - ✓ possible CER delivery
 - ✓ how to monitor emissions
 - ✓ CER market value
 - ✓ project methodology
- Drafting of project design document (PDD)
- Validation of baseline & monitoring plan
- Approval of host country
- Carbon reduction purchase agreement
- Registration of the project at the EB

CDM: a financier's perspective

- The sale of CERs can secure **an additional income stream** of the project.
- However, a CDM project entails three types of risks:
 - ✓ conventional project risks;
 - ✓ host country political risks; and
 - ✓ additional CDM process risks.
- For a financial institution, a question is **how to identify, allocate and assign those risks.**

CDM: a financier's perspective (continued)

- **Conventional project risks**—risks that are common to all the projects in developing and industrialized countries, for example:
 - ✓ cost overrun
 - ✓ market risks
 - ✓ counterparty credit risk
 - ✓ underperformance
 - ✓ currency risk
 - ✓ force majeure

CDM: a financier's perspective (continued)

- **Host country political risks**—the level of risk is higher in developing countries due to the often less developed legal and political infrastructure, for example:
 - ✓ confiscation, expropriation and nationalization
 - ✓ civil war
 - ✓ contract repudiation/frustration
 - ✓ host country sovereign risk
 - ✓ administrative barriers

CDM: a financier's perspective (continued)

- **CDM process risks**—specific to the generation and sale of CERs, for example:
 - ✓ CDM Executive Board non-approval
 - ✓ CDM risk, i.e., no CDM beyond 2012
 - ✓ monitoring/verification risk
 - ✓ institutional barriers
 - ✓ CER legal ownership

CDM: further barriers to project implementation and financing

- First, the CDM process, which is long and often perceived to be inefficient
- Second, the heavy and steadily increasing workload of the CDM Executive Board
- Third, a lack of institutional capacity both in host and buyer countries
- Fourth, a problematic issue of the project's additionality

Recommendations: how can the CDM process be improved?

- Simplify, standardize and streamline **the CDM process**
- Provide prompt and clear guidance on the CDM regulations **beyond 2012**
- Foster the development of **institutional CDM capacities** in host and investor countries
- Rethink the interpretation of **additionality**

JBIC

JBIC is an official financial institution providing policy-based financing to implement the Japanese Government's external economic policy.

International Financial Operations

Export Loans

Import Loans

Overseas Investment Loans

Untied Loans

Guarantees

Equity participation

Overseas Economic Cooperation Operations

ODA Loans

Private-Sector Investment Finance

JBIC (continued)

**JBIC is a UNEP FI signatory,
and serves as Chair
of the UNEP FI Asia Pacific Task Force
Outreach Group since April 2005.**



JBIC (continued)

JBIC's activities are guided by six priorities:

- Contributing to the stability of the international financial order
- Supporting economic and social development in developing countries
- Securing Japan's stable access to natural resources
- Supporting capital- and technology-intensive exports from Japan
- Supporting the development and expansion of Japanese industries' international operations
- **Supporting developing countries in addressing global issues**



JBIC operations

JBIC supports projects to alleviate greenhouse gas (GHG) effects through various operational instruments.

JBIC operations (continued)

Renewable energy

- Export loan for geothermal power plant in Mexico, June 2000
- Guarantee for private placement bonds to finance geothermal projects in the Philippines, June 2000
- ODA loan to Zafarana wind power generation project in Egypt, December 2003



JBIC operations (continued)

Renewable energy (continued)

- ODA loan to Lahendong geothermal power plant project in Indonesia, March 2004
- ODA loan to Ulubelu geothermal power plant project in Indonesia, March 2005

JBIC operations (continued)

On top of supporting renewable energy projects,

- Investment to Prototype Carbon Fund, May 2000
- Participating in investment fund for ESCO, May 2004
- Contributing funds to Japan GHG Reduction Fund (JGRF) and establishing Japan Carbon Finance, Ltd. (JCF), December 2004

JBIC operations (continued)

On top of supporting renewable energy projects, furthermore,

- ODA loan to afforestation projects in China and India among others
- Untied loan to support a coal gasification project in Anhui Province, China, February 2005
- Untied loan to support a methane gas recovery project in Shanxi Province, China, March 2005

CDM and JBIC operations

CDM candidate projects

- Wind power generation project in Zafarana, Egypt, December 2003, supported by ODA loan
- Geothermal power plant project in Lahendong, Indonesia, March 2004, supported by ODA loan
- Geothermal power plant project in Ulubelu, Indonesia, March 2005, supported by ODA loan
- Methane gas recovery project in Shanxi Province, China, March 2005, supported by untied loan

JBIC's strength to support CDM projects

- Capacity to provide **underlying finance** to CDM candidate projects
- Accumulated **knowledge and experience** in dealing with environmental projects and the Prototype Carbon Fund (PCF)
- **A strong tie with host countries** (government, government agencies, and private sector entities) based on decades' of operational experience and the global network with 26 representative offices

JBIC's strength (continued)

- A close tie with **Japanese industries** with technological advantages
- **Partnership** with:
 - ✓ financial institutions
 - ✓ international organizations
 - ✓ other government agencies
 - ✓ local governments
 - ✓ research institutions
 - ✓ NGOs

UNEP FI Asia Pacific Task Force

The Asia Pacific Task Force was launched in January 2005 with its activities focusing on:

- setting of “sustainability” priorities for the Asia Pacific financial sector;
- **creating a critical mass of Asia Pacific signatories** that are able to exchange ideas and best practice facilitated by a UNEP FI network; and
- integrating a triple bottom line approach to the operations of the Asia Pacific financial sector.

UNEP FI Asia Pacific Task Force Outreach Group Activities

The Outreach Group

under the umbrella of the Asia Pacific Task Force

- The aim is **to lead and coordinate various cross-boundary outreach activities in the Asia Pacific region.**
- Members: 8 signatories
- Associate members: 6 UNEP FI partners
- Chair: JBIC
- Co-chair: Association of Development Financing Institutions in Asia and the Pacific (ADFIAP)

Innovative financing for sustainability

“The financial sector has a key role to play in delivering market solutions to climate change.”

(2002 Study, UNEP FI Climate Change Working Group)

Thanks.

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