Adaptation Benefit Mechanism

A BUSINESS MODEL TO ENCOURAGE PRIVATE SECTOR INVESTMENT IN ADAPTATION

Q&A

What activities or efforts qualify as adaptation benefits?

Traditionally, multilateral development banks and donors have focused on adapting assets to withstand increasingly extreme climate events. However, if we think about what a community needs to be able to bounce back from a climate-induced shock such as flood or a drought, then there are many things can be considered as adaptation: Anything which makes a household economically stronger increases their ability to survive extreme events. This goal translates into electricity connection; clean cooking; access to potable water; waste management; climate smart agriculture; reforestation and avoided deforestation; biodiversity protection. A better understanding of adaptation will allow many activities to be identified and supported using climate finance, and furthermore, many of these activities have mitigation co-benefits.

How is the ABM different from the Clean Development Mechanism?

There is one fundamental difference between the two mechanisms: the CDM produced a commodity which was fungible, could be traded and could be surrendered against an obligation (Kyoto targets by Annex 1 countries, or EU ETS targets by EU emitters). As a result, CERs became the subject of intense market based activities including re-sale and speculation. The ABM produces Adaptation Benefit Units which are unique, non-fungible and once issued into the ABM registry, can only be cancelled. The ABUs cannot be transferred to other registries, there are no obligations or commitments to be met. They are used by donors and voluntary consumers to demonstrate support for adaptation. The redemption codes (or cancellation codes) which are used to cancel the units, can be traded but there is no financial incentive to do so. There is no supply and demand curve and no arbitrage opportunity. As a result, buyers of ABUs buy the story behind the project, not a compliance unit. What matters I how much money they spend, not the number of units they buy.

How does a project become part of the ABM?

This part is similar to the CDM. A project needs to follow an approved methodology which ensures that the units which the project produces are accurately and transparently produced and that they deliver adaptation benefits. The project needs to undergo validation by an independent third party and receive a host country letter of approval (indicating that the host country recognizes the benefits as contributing to adaptation). The validation includes stakeholder consultation and an assessment to ensure that the projects were not going to happen anyway. However, since the units we produce are for voluntary consumption and are not the subject of international announced targets, the level of assurance required is considerably lower. So, the process brings the good things from the CDM (the transparency, the credibility) but not the increasingly complex methodologies and additionality assessment. Existing CDM projects can also apply to become ABM projects by following a "change or purpose" procedure.

Must a government be involved in order for a project to qualify for the ABM?

Yes, Government approval is required for two reasons. 1) the mechanism exists under the Paris Agreement and therefore Parties to the agreement must signify their consent to the project, and in doing so, acknowledge that the project contributes to adaptation in their country and 2) to ensure that the projects are recognized and correctly counted in national reports. For example, a donor government will want to declare their funding as a contribution to adaptation in the host country and the host country will want to recognize it as such.

What is the role of the UN in the ABM?

The UNFCCC can provide the ABM Secretariat to host and support the ABM Executive Board, ABM Methodologies Panel, Accreditation Panel and the registry, just as they did for CDM.

Why is the ABM a non-market mechanism?

The ABM is a non-market mechanism because the primary instrument, the ABU, is non-tradable. It is generated as an output or outcome from a project activity, verified by an independent third party, and then issued by the ABM Executive Board into a Registry. It then sits in the registry until such time as it is cancelled and reported by the entity who owned the cancellation code. Thus, the primary instrument in the ABM is not a market instrument. It cannot be transferred out of the registry, it cannot be sold on or used as a source of collateral. There is a market element for project developers who may compete to produce higher quality or better value ABUs for a given technology and investors may also complete for financing opportunities - for example a US-based institutional investor might want to take a share of the electricity market in an African country and so they be prepared to put equity into an off-grid renewable energy project which has underlying revenues. These aspects are subject to market forces, but they are independent of the primary instrument.

How does the ABM facilitate private sector investment in adaptation?

ABM facilitates private sector investment in adaptation by providing a mechanism to pay a project developer for delivering an adaptation benefit. Without this mechanism, project developers must rely on the underlying business model to make a profit or simply cover their cost. ABM enables a project developer to transparently and fairly declare the incremental cash flows which they need to make a project attractive and if there is a donor or CSR actor willing to pay that price, then the two parties can sign a contract. The project developer can use that contract in a variety of ways to raise debt and / or equity to develop the project. For investors, ABM offers a source of additional cash flow (in hard currency) to offset some of the risks of investing in developing countries and or in new technologies. The same approach was used in the CDM, although it was spiced-up by the prospects of booming demand for emission reductions and higher prices. ABM can also be used by governments and NGOs to access funds to undertake adaptation projects.

How do you distinguish between new projects and projects that would have happened anyway?

This is the challenge of additionality. First and foremost, for ABM the stakes are much lower. If the project is not 100% additional, then the buyer is not getting the full value of what they are paying for - which is an issue - but it does not come with the same consequences of non-additional emission reductions which undermine the achievements of the Kyoto Protocol or Paris Agreement. For non-revenue generating projects the key test is whether a donor, NGO or Government has budgeted to undertake the actions within the next [5] years. If there is no budget then we may assume it won't happen and therefore the project would be additional. Yes, that might discourage Governments from doing these things however, it would also be possible to look at where that money is being allocated (for example health, education) and, at the end of the day, if donors or CSR buyers feel the Government is deliberately under-funding adaptation actions, they can support projects in other countries instead. For revenue generating projects, it will be necessary to prove that there are financial or other barriers. This was also the process in the CDM, and it came under sustained criticism however for ABM, the stakes are lower. The methodology will specify the allowed costs which will be subject to verification. The project document will show the expected revenues and calculate the shortfall. If these figures are verified and if no other developers are doing similar projects without some form of additional support, then the project may be considered additional. Since the ABM does not deal directly with the accounting instruments of the Paris Agreement (i.e. emissions) ABM projects will not interfere with host country policies and measures which mandate reductions in emissions, and in the event that a project is subsequently proven to be non-additional for fraudulent reasons, they buyer can sue the project developer under commercial law. The result of a non-additional project is lower value for money for the buyer, not damage to the global atmosphere.