AFRICAN DEVELOPMENT BANK GROUP

Concept Note: Adaptation Benefit Mechanism

The purpose of the Adaptation Benefit Mechanism is to create a results-based finance business model to encourage private sector investment in adaptation. In the early 1990s there was no demand for mitigation units or emission reductions and private sector project developers were not incentivized to invest in low emission technologies. The creation of the Kyoto Protocol changed that and suddenly project developers could gain a new source of revenue if they could follow a set of procedures which culminated in the issuance of a unit into the CDM Registry. Demand for those units was then magnified by the linkage of the EU Emissions Trading Scheme to the CDM, ultimately triggering a CDM project pipeline worth in excess of USD 500 Bn.

The ABM seeks to use of the best parts of the CDM to do exactly the same thing for adaptation, but with several important differences:

1) The ABM uses the highly credible and transparent processes of validation/registration and verification/issuance against approved methodologies. These steps gave the CDM great credibility.

However, since there is no international compliance obligation for adaptation, the ABM does not seek to create compliance-based units for use in an international environmental treaty or an international Emission Trading Scheme (the Kyoto Protocol and the EU ETS), and hence the burden of proof for the ABM is considerably lower. In fact, ABUs from different projects are not designed to be exchangeable with one another which means that the methodologies are much simpler and the transaction costs are much lower.

Furthermore, since an ABU Offtake Agreement is formed between a willing buyer and a willing seller, the transaction is governed by commercial liability and failure to fulfil the contract by either party will not have a detrimental impact upon the global environment.

2) Under the CDM, CERs were a global commodity with a benchmark price. This encouraged project developers to find the cheapest sources of CERs in order to maximize profit and ultimately lead to the un-even distribution of mitigation finance.

The price for ABUs is determined by the cost of generation plus a risk premium for the project developer. The methodology will define what items can be included in the calculation of the cost and the values will be reported in the project design document and verified accordingly to ensure value for money. This means ABUs from different projects will cost different amounts of money, but since buyers are not trying to minimize the cost of compliance (which was one of the objectives of the CDM), they will buy the story behind the units, not necessarily the cheapest units they can find.

3) The CDM created units which were fungible under the Kyoto Protocol and the EU Emissions Trading Scheme, which were denominated in tonnes of CO_2e. This made methodologies highly complex and lead to very significant transaction costs.

Under the ABM, since ABUs are not fungible, they can be denominated in units which reflect simple outputs from the project. For example, ABUs may be denominated in a) Number of households using a clean cooking stove for a year; b) number of houses connected to a reliable source of electricity; c) number of farming households applying climate smart agricultural practices for a year; and d) number of houses protected from a 1 in 100 year flooding event. These outputs are cheaper and simpler to monitor and verify and they can be linked, for example through academic studies, to longer term outcomes.

4) The CDM was a market-based mechanism because the units which were created could be transferred away from the host country and into registries in other countries where they could be used to meet compliance obligations. The price for these units was also impacted by a global supply and demand curve and other external factors.

The ABM does not propose to make ABUs transferrable. They would be issued by the ABM Executive Board into the ABM registry. The sponsors of the ABM project would receive utilization codes for each ABU, for use when they wish to retire the ABUs. ABUs cannot be transferred out of the ABM registry. And as described above, the price for ABUs is not influenced by global supply and demand or other external factors. For these reasons, the ABM is consistent with the characteristics which many Parties have used to describe a non-market mechanism.

5) The CDM generated mitigation units with sustainable development co-benefits. Host countries could export these mitigation units because they did not need them for their own use.

The ABM generates adaptation units which have both mitigation and SDG co-benefits. Consequently, the ABM will help host countries meet their Paris Commitments by creating emission reductions which will ultimately be detected in national inventories. Thus the ABM will help host countries raise their ambition and accelerate their progress towards the long term goal of net zero emissions. By linking ABM methodologies to the Sustainable Development Goals, the ABM will also help host countries to meet their Sustainable Development Goals.

6) The CDM took off after the European Commission linked the EU Emissions Trading Scheme to the CDM and allowed compliance buyers to surrender CERs in place of EU Allowances. The CDM subsequently suffered a major fall in demand and price after this source of demand was saturated and the second commitment period of the Kyoto Protocol was not ratified.

The ABM lacks a source of compliance demand however, there are a number of other sources of demand which could prove more durable:

- Development Partners who seek to transparently and efficiently transfer funds to help developing economies adapt to the impacts of climate change. Adaptation is closely linked to development and if households and communities are not helped to adapt, decades of development gains could be lost.
- Multilateral Funds such as the Green Climate Fund have committed to allocating 50% of their climate finance to adaptation but so far lack scalable mechanisms to do so.
- Impact investors and philanthropists may use the ABM as a transparent and cost effective means of ensuring their funding achieves long term adaptation results.
- All forms of investors including Governments and MDBs could use the ABM to encourage private sector companies including local NGOs and SMEs to operate existing infrastructure to ensure that adaptation and development benefits are delivered and technologies are sustainably adopted.
- CSR buyers could buy ABUs in order to demonstrate their support to developing countries for both the Sustainable Development Goals and the Paris Agreement.

Furthermore, demand for ABUs will not be limited over time as countries will continue to renew their NDCs. Resources to purchase ABUs will also increase as Parties seek to increase climate finance in line with increased ambition.

Visit the ABM webpage for more information or contact Gareth Phillips, Chief Climate Change & Green Growth Officer, AfDB. G.Phillips@afdb.org