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FACTSHEET

Pilot Auction Facility (PAF)

Limiting the average global temperature rise to under 2°C is a prerequisite to avoiding dangerous climate change.

Urgent action is needed to not only reduce greenhouse gas emissions, but to help countries build resilience and prepare for a world of dramatic climate and weather extremes.

Rationale

The Pilot Auction Facility for Methane and Climate Change Mitigation (PAF) is an innovative mechanism that pioneers the use of auctions to allocate public finance for climate action efficiently. The PAF was - with inputs from a report from the Methane Finance Study Group, an international group of experts - convened at the request of the G8. The facility demonstrates a new pay-for-performance mechanism that takes advantage of existing tools and experience developed at the multilateral level under the Clean Development Mechanism and related carbon markets to deliver financing, in the form of a price guarantee, to projects that combat climate change.

Objectives and activities

The key objective of the PAF is to demonstrate a new, cost-effective climate finance mechanism that incentivizes private sector investment and action in climate change in developing countries by providing a guaranteed floor price on carbon reduction credits. The guaranteed floor price is delivered through the auctioning of put options supported by donor funding.

The nature of the put option means that the facility's resources will only be disbursed after the emission reductions have been independently verified, making the PAF a "pay for performance" facility. The put options are embedded into puttable bonds issued by the World Bank. The World Bank's obligation under the bonds is backed by the PAF. Under the terms of the bond, the bond-holders have the right, but not the obligation, to sell the emission reductions achieved by the underlying projects to the PAF at a pre-agreed price, the put option "strike" price.

The optionality allows put option owners to benefit if carbon prices in international markets rise above the strike price. In this case, the PAF will have achieved its objective (to stimulate private sector investment in mitigation) without paying for the carbon credits. If prices fall, the put option owner has the right to sell the carbon credits to PAF at the strike price. Either way, the price guarantee has provided the private investors the financial incentive to fund projects.

SECO country/region
Global

Main funding partners
Germany, Sweden, Switzerland (SECO and Climate Cent Foundation), United States

Implementing partner
World Bank

Duration
2014-2022

Total budget
USD 55,000,000

SECO contribution
USD 2,500,000

PILOT AUCTION FACILITY

The competitive nature of the auction used to allocate the put options reveals the incremental price required by the private sector to make such investments, therefore optimizing the impact of public funds and achieving the highest volume of climate benefits per dollar.

Governance structure

The PAF is established as a financial intermediary fund ministered by The World Bank as Trustee. The participation and governance structure of the PAF include a Participants Committee, a Secretariat, a Trustee, an Auction Manager and an Issuer of the PAF Bond:

- The Participants Committee, comprising of contributors provides strategic guidance and oversees the operations of the PAF and meets once a year.
- The trustee's role is performed by the International Bank for Reconstruction and Development (IBRD)and its Development Finance unit and includes establishing the PAF trust funds and administer contributions and financial flows of the Fund.
- The Secretariat and the auction manager roles are performed by IBRD's Climate Change unit, which provides secretariat services and technical support for day-to-day operations of the PAF, including the delivery of auctions.
- The Issuer of the PAF Bond (IBRD's Treasury) is responsible for issuing and administering financial flows related to the issuance and redemption of the PAF Bond.

Results so far

The PAF's pilot auction phase is complete, with three successful auctions that addressed methane and nitrous oxide emissions. For put options allocated in the first and second auctions, methane emission reductions must occur in the waste, wastewater, and agricultural waste sectors, and they must be verified under the Clean Development Mechanism (CDM) (for the first auction), or CDM, Gold Standard, or Verified Carbon Standard (VCS) methodologies (for the second auction). For the third auction, nitrous oxide emission reductions must occur in the industrial sector relating to nitric acid and fertilizer production, and they must be verified under CDM or VCS. The facility pays for emission reductions in Methane (Auction 1 &2) and Nitric Acid (Auction 3) on the basis of the CO_2 equivalent of these two gases. Emission reductions must also occur within a set of eligible countries. Finally, emission reductions must be generated and issued within a specified time frame.

Further information and contact details

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