

Operationalization of Article 6

Hari Gadde

20 Oct 2023



Market

You'll hit the ground
in 12 to 15 seconds.

Countries

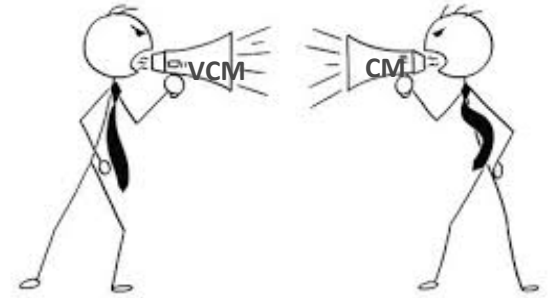
Get back to me when
you have more certainty!



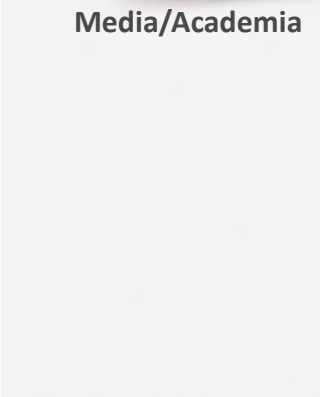
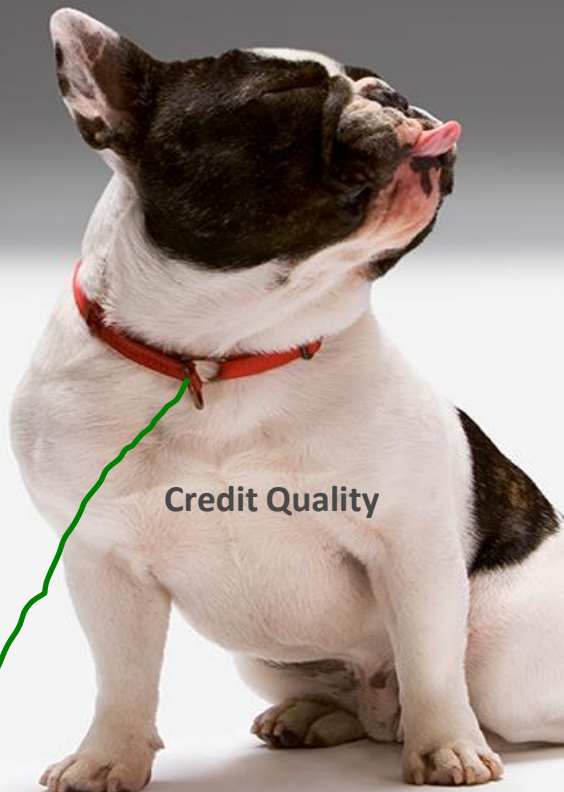
Voluntar
Markets



Compliance
Markets

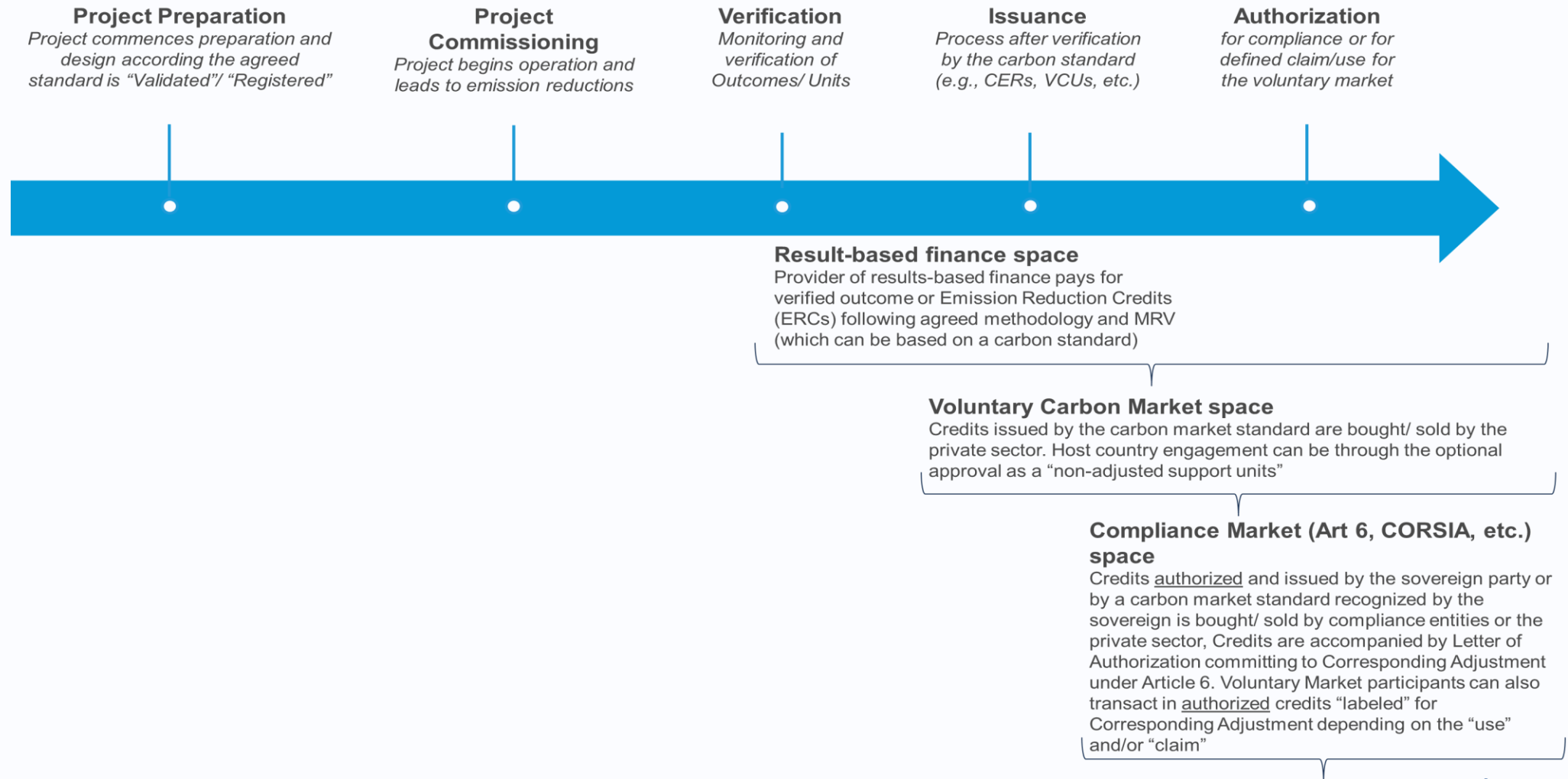


What.. I am not at fault

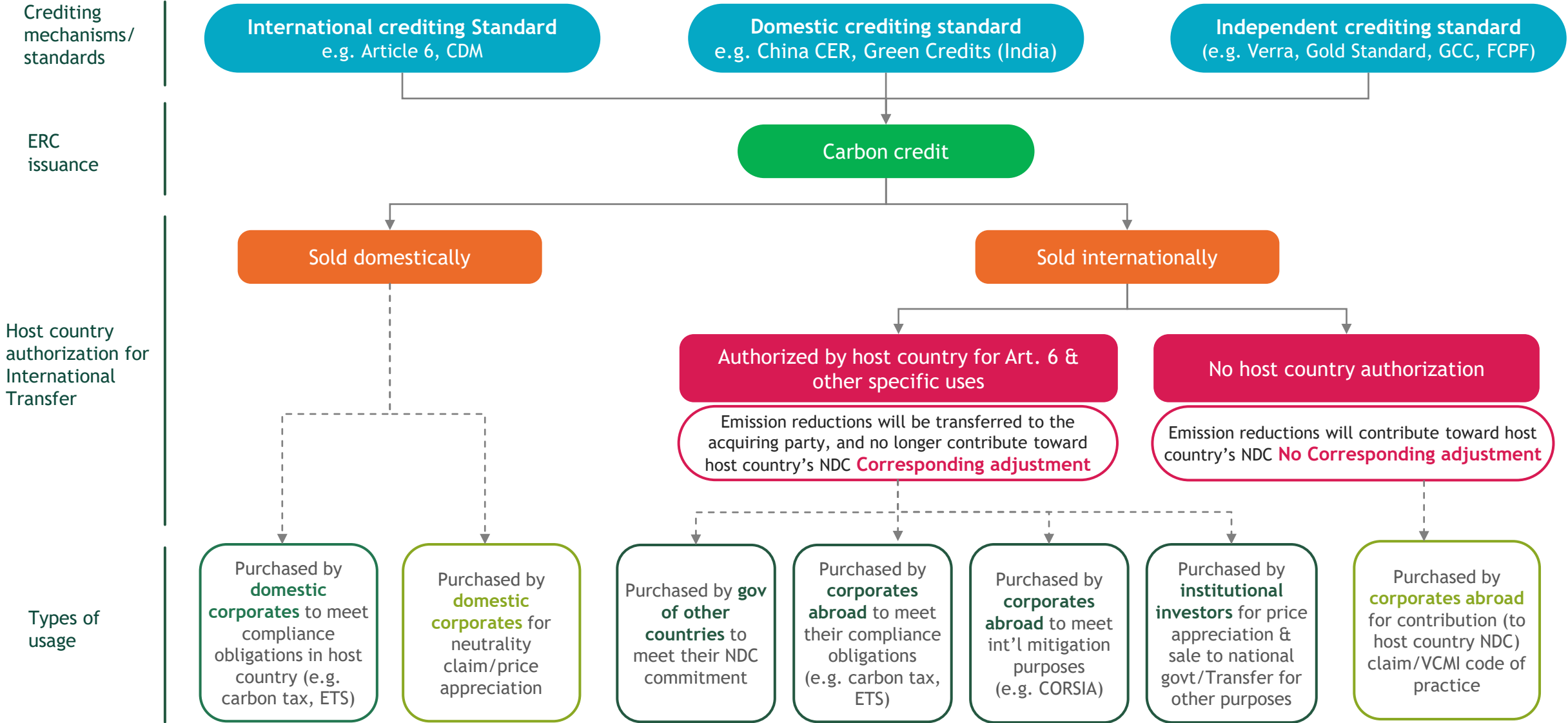


VCMi

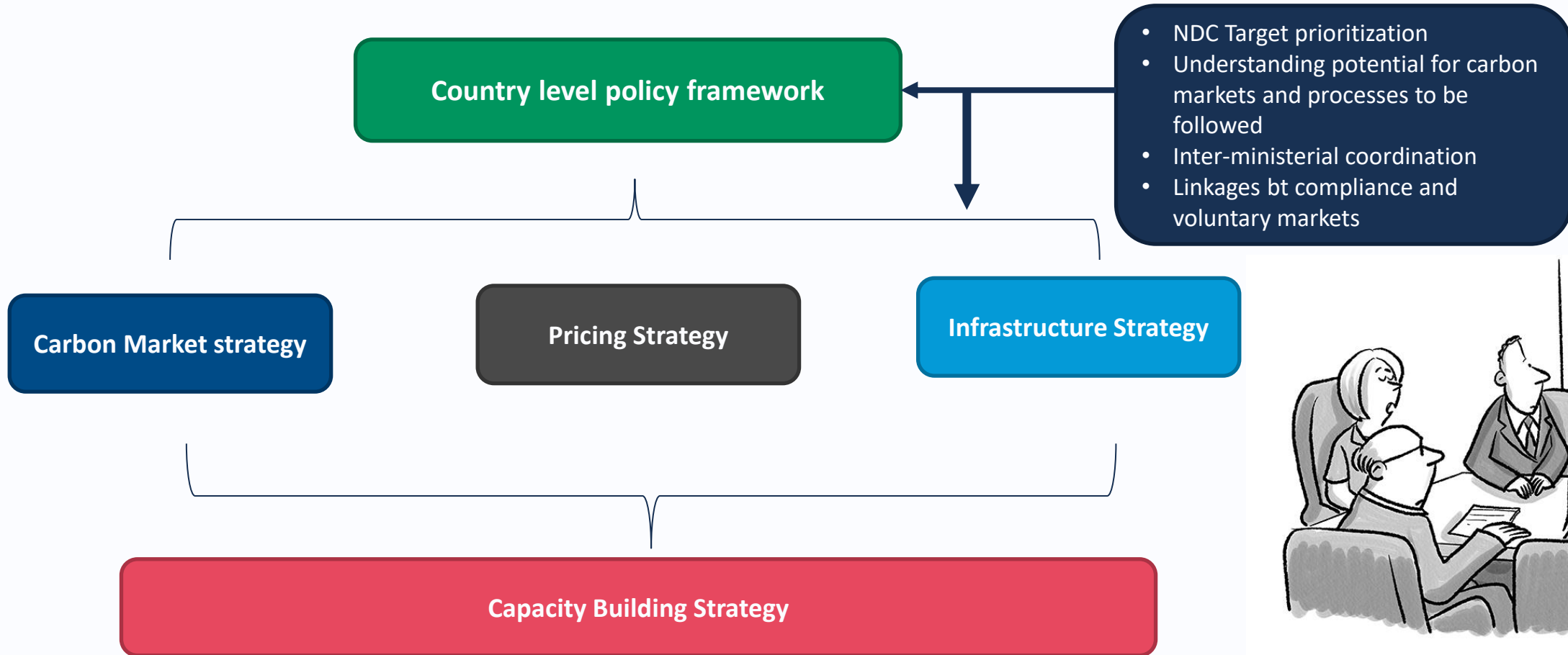
Results-Based Climate Finance, Voluntary Carbon Markets, and Compliance Carbon Markets



Carbon credits can be sold to various types of buyers for different uses



Country's participation in carbon markets depends on clear understanding of requirements and establishing clear strategies supported by a national framework



"They say that I need multiple strategies to prepare the carbon market recipe, so we invited an expert"

Appropriate institutional and governance arrangements should be in place to support execution of above

Institutional arrangements are also required to make strategic and tactical decisions to support carbon markets development in the country

Strategic

Tactical

Managing Risks

- Overselling risks and links to NDC
- Overselling risks and pricing considerations

Capturing opportunities

- Opportunities to support long term climate goals
- Opportunities for co-benefits
- Opportunities for market positioning – “branding”

- Decisions on which specific sectors, technologies and activities will form part of the country’s Article 6 portfolio
- How the national criteria, procedures and financing structures support implementation
- Eligibility criteria for A6
- A6 vs voluntary markets

Considerations for institutional and governance arrangements

- Build on **elements of existing international crediting programs**
 - Could be just methodologies, auditors, etc. or could be entire system (e.g. allow units issues by other crediting program in the transferring country to be used to ITMOs)
 - This will be most important determinant of capacity needs
- Combine governance with **existing climate policies and instruments**
 - If credits are used as offsets of other CPIs, potential synergies, but may not have capacity to address Article 6-specific requirements
- Build on **existing institutions** versus creating new institutions
 - Environmental regulators, climate policy governance, CDM DNA
- Include **non-government stakeholders** in rulemaking functions
 - Potential for added transparency as long as no conflict of interest
- Include **private sector stakeholders** in rulemaking functions
 - Would need to use industry associations, need to manage conflict of interest
- **Outsource** implementation functions versus in-house
 - Consider government burden, efficiency and possible trade-offs with credibility and transparency

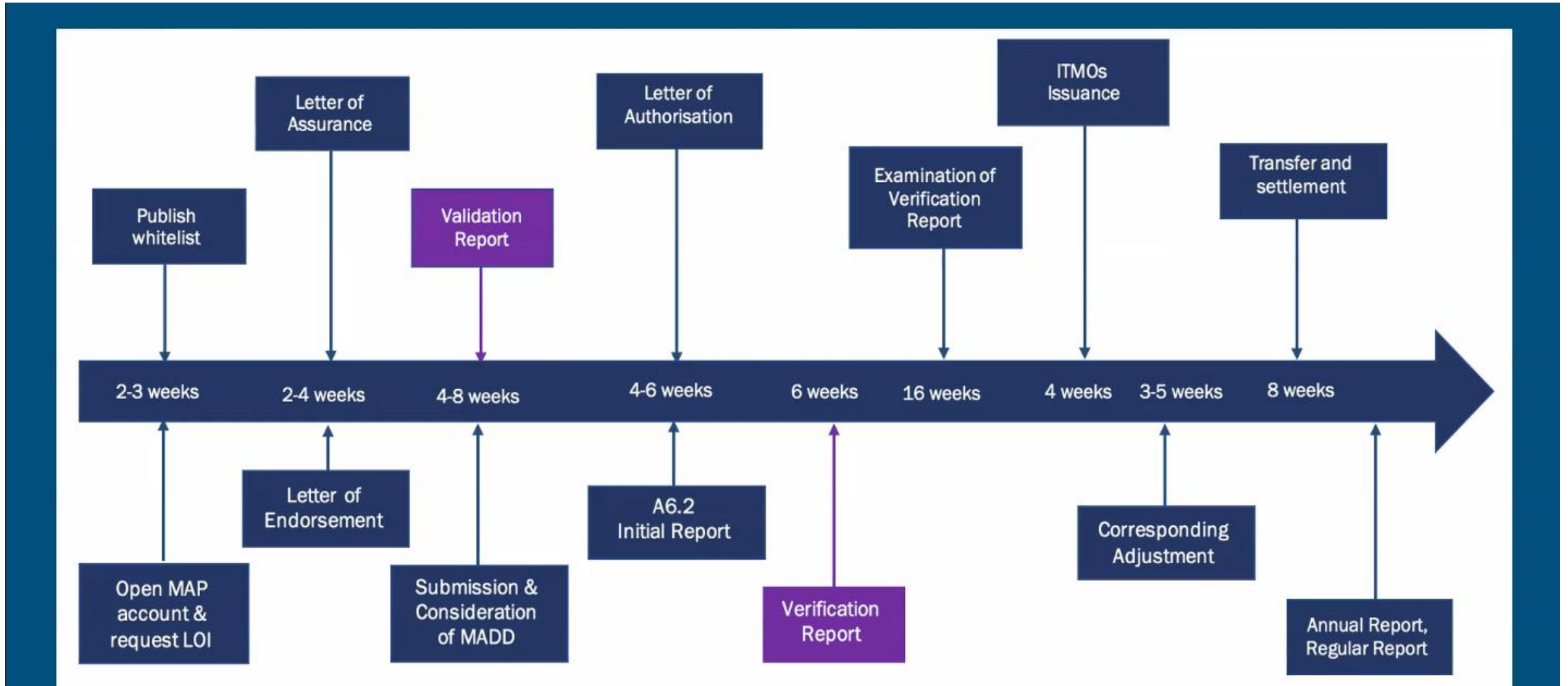
The institutional setup should reflect the country capacity and priorities and build on existing structures

What countries need to do for Authorization?

- Establish domestic arrangements for authorizing the use of ITMOs
- Application of corresponding adjustment (CAs)
- Development of a registry system for ITMOs recording and tracking
- Reporting under Article 6.2 (Initial Report, Annual Information and Regular information as a part of Biennial Transparency Report)
- The review by Article 6 technical experts

Domestic arrangements: a copy of the authorization by the participating Party, a description of the approach, its duration, the expected mitigation for each year of its duration, and the participating Parties involved and authorized entities; (in the Initial report)

What countries need to do for Authorization?



Identifying projects and their approvals to support their participation in the carbon market requires careful thinking and their impacts

Existing CDM projects

- Could be used towards achievement of first NDC
- Could be used in the VM if buyers exist
- Registered on or after 1 Jan 2013
- Pre 2021 issued credits
- No need for application of CA
- Can be transitioned to Article 6; no later than 31 Dec 2025

Projects that are not part of unconditional targets of country NDC

- Should not put burden on meeting the Govt NDC target
- Should qualify the criteria on eligibility of projects and quality of credits
- Requires corresponding adjustment; based on its usage
- Country should have the needed policy framework and infrastructure to meet the requirements

Projects that are outside the NDC

- Should support the Govt enhancing its NDC ambition
- Should qualify the criteria on quality of credits; stricter
- Requires corresponding adjustment if is an ITMO; based on its usage
- Country should have the needed policy framework and infrastructure to meet the requirements

Eligibility, additionality demonstration and demonstrating high quality of credits will be more stringent under the Paris Agreement

Clarity on cost of meeting NDC target helps countries to avoid overselling risks and meeting its NDC target with potentially expensive mitigation measures

MOs: Cost Pricing

- Stay in host countries, applied toward host country NDC compliance;

Payment for MOs:

- Concessional climate finance (RBCF);
- Private climate donations.

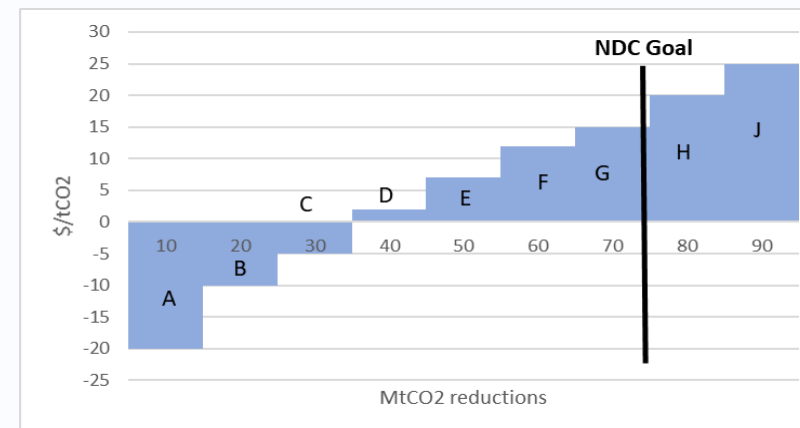
Minimum payment principle:

- Minimum payment to enable program implementation;
- Financial analysis to determine cost gap;
- Breakdown of cost gap to MO unit.

$$\text{ITMO cost} = c(\text{ITMO}) = c(\text{MO}) + \text{OC}$$

ITMOs: Opportunity cost pricing

- Transferred out of host country;
- No longer available for host country NDC compliance: corresponding adjustments;
- Host country has opportunity cost of transferring ITMOs.

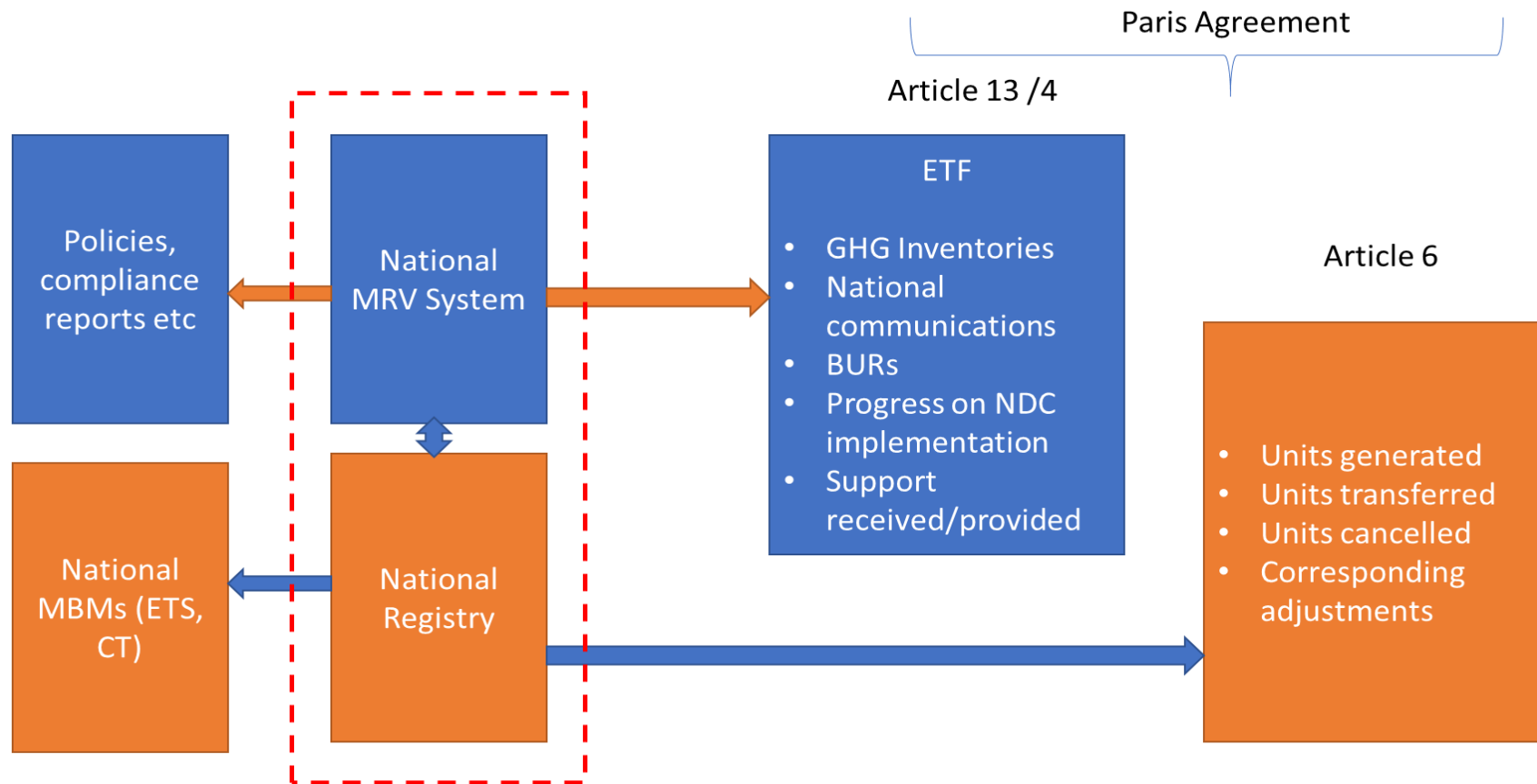


Countries need an infrastructure that satisfy multiple requirements and to support market players to participate in carbon markets

DOMESTIC REQUIREMENTS

INTERNATIONAL REQUIREMENTS

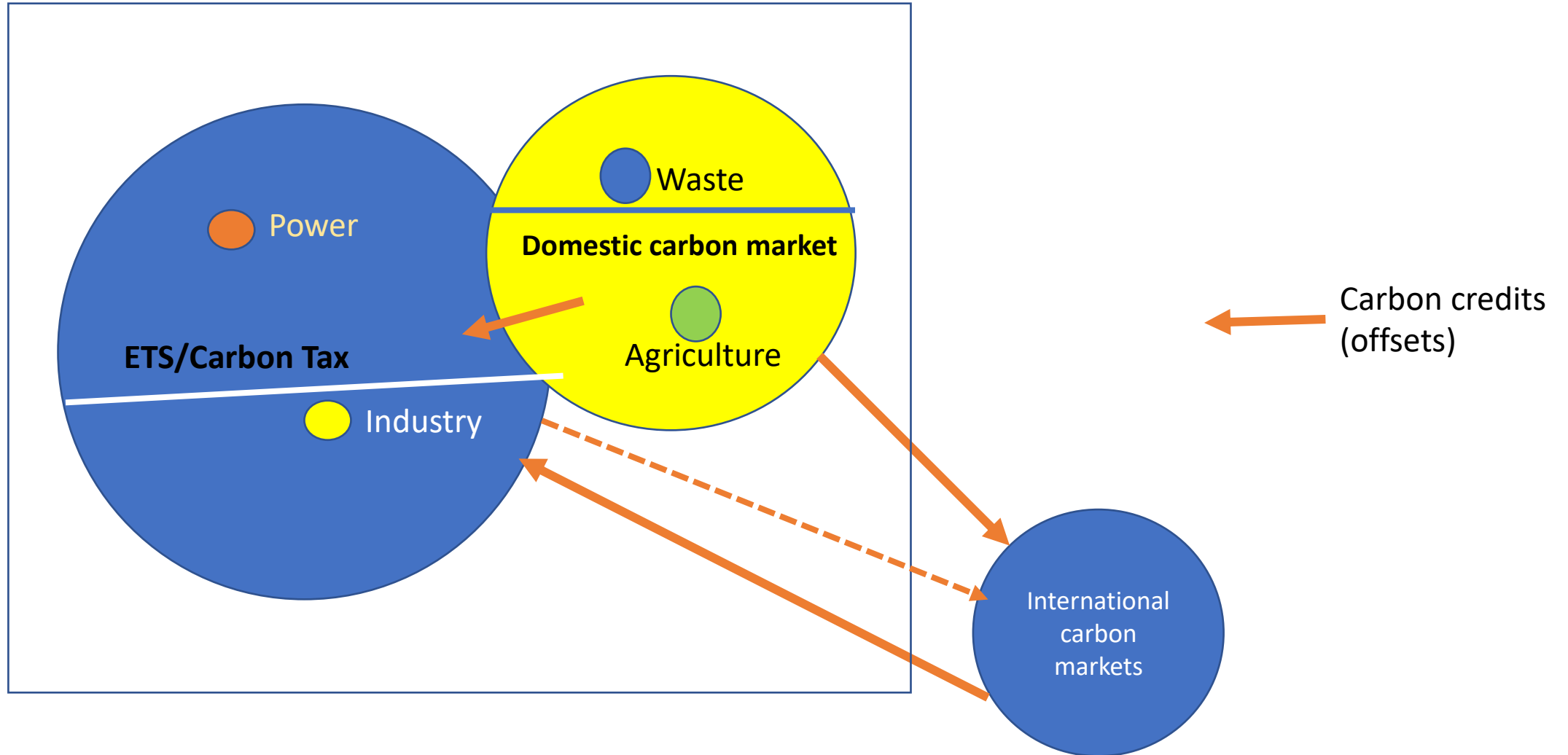
*Need a **Market infrastructure** based on a **robust monitoring, reporting and verification system** that relies on a **national registry system** that is configured to issue, track and transfer credits, both within and outside the country*



However,

the sophistication of the system ranges significantly; and some countries may choose to link with existing regional/centralized registries rather than building their own

Understanding the role of carbon credits (offsets) in different market segments helps to manage the incentive structures for different stakeholders



What govts should know/have?

- Clarity on its NDC targets and what it takes to meet it and through what activities and financing needs
- Understanding the costs of meeting its NDC (\$/tCO₂)
- Full knowledge on the requirements under the compliance and voluntary markets, mainly on the authorization/approvals needed and the need for the corresponding adjustment and its implications
 - Restrictions from independent standards on types of activities
 - Countries moratorium on transfer of credits until the clarity is reached
- Providing clarity to the market through a needed policy framework that defines the process flow, eligibility, approvals/authorizations required, any levies/taxes, what data/info should be provided etc.

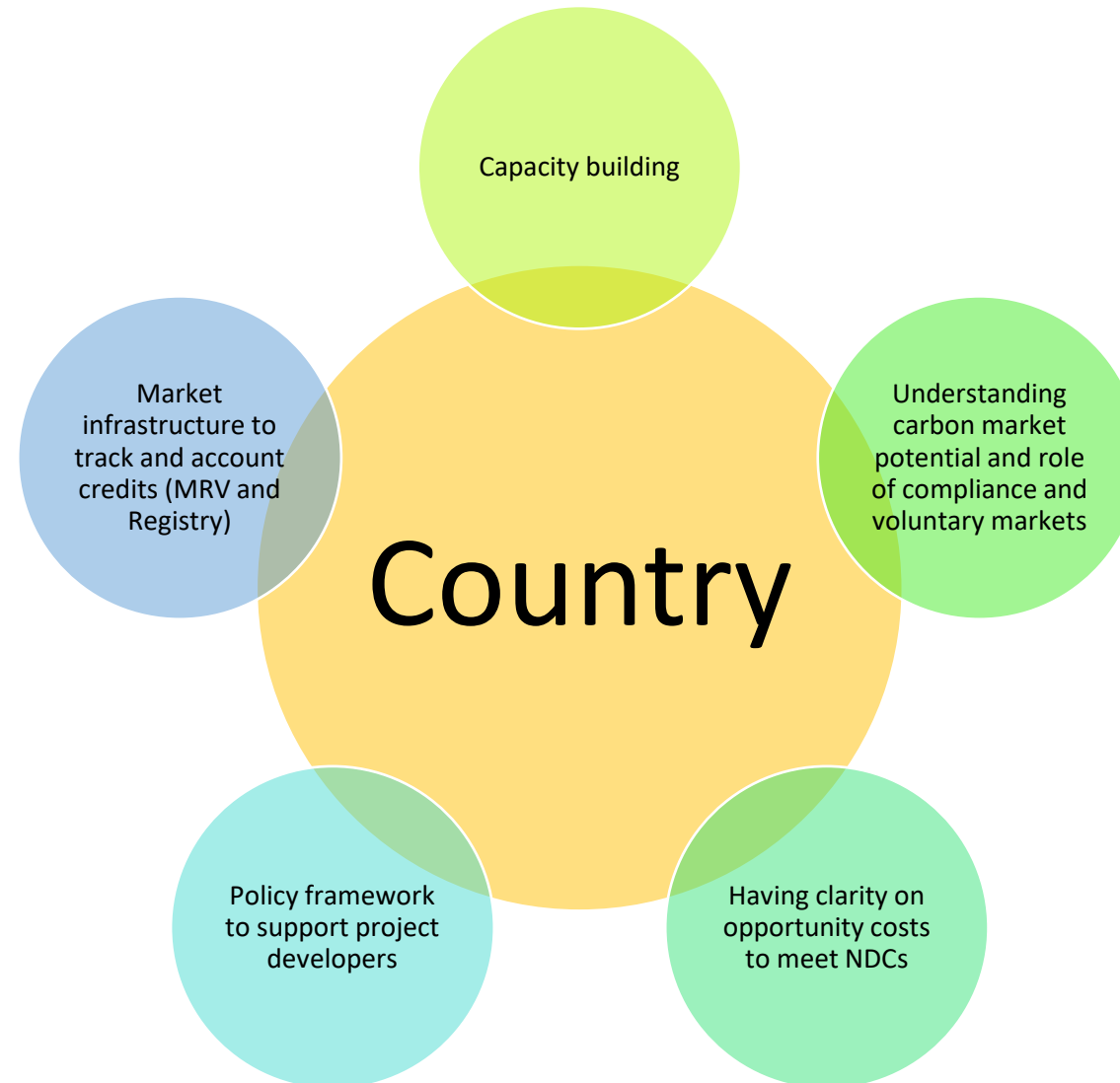
A host country choice – Article 6, voluntary markets or both?

- Choice is not binary
- Credibility of VMs: increased market scrutiny, potential voluntary oversight by the ICVCM and VCMI
- Defining ‘beyond compliance’ in respect of a host country NDC: additionality/environmental integrity and the need for CA; NDC stringency key
- CORSIA, while allowing credits from voluntary markets, requires CA
- Countries like Singapore require all credits be correspondingly adjusted, in order for them to use in its carbon tax scheme
- Accordingly, countries may choose to:
 - Create ITMOs under A6.2 and A6.4 ERs under A6.4
 - Create voluntary credits using standards such as GS, Verra and choose not to do CA
 - Adopt a hybrid approach: create credits under ind. Standards and unilaterally decide to do CS
- The accounting and economic cost of carrying out a CA is the same whether the unit in question is an A6.4 ER, an ITMO or a voluntary market credit.
- The choice therefore depends on: a) speed by which A6.4 market becomes operational; b) the ease of use or convenience of the new A6.4 markets vs the VCM; c) the market price of an ITMO or A6.4ER compared to a CA VCM credit or a non-CA VCM credit.
- Given the experience of CDM when host countries lost their ability to finance project due to collapse of demand, host countries may wish to hedge their bets between Article 6 markets and VCM
- This will be likely reflected in the relevant legislation they pass and the manner in which their A6 authorization frameworks to be introduced

How different countries are hedging the risks - case of India, Indonesia, Malaysia and Ghana

	Indonesia	India	Malaysia	Ghana
Status of regulatory framework	Exist (Presidential regulation no. 98 of 2021 requires prior approval of project from MoEF; Regulation no 21 of 2022 sets detailed rules for authorization framework)	Exist (Energy Conservation Bill 2022); detailed framework for approvals/authorizations is still needed	Under finalization; Sarawak introduced the legislation requires verification under the global standard	Exist
Is there carbon tax/ETS?	Yes	Not at present	Planning to introduce	Not at present
Projects subject to prior govt approval?	Yes	Not clear; none mentioned in the Bill	Expecting the approval requirement; Sarawak requires	Yes; for VCM, the choice is by the project developer
Units issued by national authorities or Ind. Standards?	MoEF will issue domestic offset units; by others depends on the terms of the mutual agreement bt MoEF and the relevant standard	Looks BEE would administer the issuance and trading	Bursa Malaysia Berhad entered an MOU with VERRA;	Ghana issues the MOs and record in their registry; recognizes all VCM projects; all projects need to be registered with the Carbon Market Office
Any restrictions on exports?	Yes; expected to develop the conditions; may require buffer quantity	Bill does not contain any such and need to be seen if any will be introduced	The final bill may have some restrictions	
Positive/Negative lists	Not yet	Not yet	Not yet	Yes

Country needs increased significantly to support their participation in carbon markets



What countries need: Key conclusions and lessons from the country experience so far

- Countries' comprehension of Article 6 rules and governmental role in implementation is rapidly evolving but **there are still major gaps** in understanding on what is needed to be put in place at domestic level. Facilitating exchange of experience from the initial pilots will be important to fill the gaps.
- **Domestic level infrastructure** (mainly registry) and **capacity building** are top priorities for many countries, even for those with Kyoto markets experience given the evolved nature of Article 6 framework. Coordinated efforts among development partners and initiatives will be helpful in providing concerted support. Use of new tools such as digital MRV can help in creating necessary infrastructure at much less cost and effort compared to the past.
- Support is needed for countries in **prioritizing identification of sectors and mitigation activities** eligible for international market transaction (without jeopardizing meeting the NDC targets) at a faster rate since uncertainty over these is making any cooperation and involvement in Article 6 pilots slow. This info can help to estimate the potential size of the carbon market in the country.

What countries need: Key conclusions and lessons from the country experience so far

- Rapid **assessment of initial needs** through available tools (e.g., WB's Mitigation Action Assessment Protocol – international market readiness (MAAP-ITR) can be useful in the preliminary decision making without investing too much time and resource. However, availability of data and information for such assessment remains a challenge and should be specifically addressed.
- Establishing a **policy framework with legislative/regulatory support** is very important to facilitate countries' participation in international markets
- Design of enabling policies/frameworks and institutional arrangements for various functions (authorization, inter-ministerial coordination, accounting, reporting, etc.) needs to take into account the specific country context including level of political buy-in, policy-making approach and institutional culture.

Options for mapping functions to key institutions

- Consider roles of main institutions that can perform the below:
 - high-level “decision body” with overall authority to design and oversee the cooperation – including impacts on NDC
 - “executive body” to approve rules based on the overall regulatory environment and mandate
 - “administrator” to execute the rules and guidance
 - “technical committee” to advise other bodies
- In many voluntary market standards, administrator covers almost all rulemaking functions versus CDM where CDM EB covers these
- Potential trade-offs between efficiency and credibility, depending on capacity of administrator and political environment

Functions	Decision Body	Exec Body	Admini- strator	Tech Comm
Policy coordination and oversight	●	●	●	●
Rulemaking	●	●	●	●
Technical advisory	●	●	●	●
Implementation	●	●	●	●

The institutional setup should reflect the country capacity and priorities and build on existing structures ²³