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UK Voluntary  
Carbon Markets  
Forum

**C L I F F O R D  
C H A N C E**

# Enabling the voluntary carbon market in the context of the Paris Agreement



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# Foreword

I am pleased to introduce this paper on behalf of the UK Voluntary Carbon Markets Forum (**the Forum**) in collaboration with Clifford Chance LLP and the City of London Corporation.

The Sharm el-Sheikh Implementation Plan agreed at COP27, concluded that a global transformation to a low-carbon economy is expected to require investment of at least USD\$4-6 trillion a year. A high integrity scaled Voluntary Carbon Market (**VCM**) will be essential if we are to mobilise the capital required to achieve the Paris objectives. Investment in the Global South, in nature-based solutions, and in climate technology innovation is vital, and the VCM will facilitate and drive these capital flows

Earlier this year the Forum undertook a market mapping exercise which sought to identify market gaps and potential actions. A clear conclusion of this work was that uncertainty around Article 6 of the Paris Agreement and what it means for the VCM is holding back urgent investment. The idea for this paper arose – to consider the state of the Paris mechanisms and the VCM, examine actual and perceived barriers to its scaling and identify recommendations for the way forward.

Climate efforts must be both aspirational and practical. I am pleased to see the many initiatives underway to improve market infrastructure, and demand and supply-side integrity in the VCM; particularly through the work of the Integrity Council for the Voluntary Carbon Market and the Voluntary Carbon Markets Integrity Initiative. This paper seeks to make an important contribution by generating productive discussion on Article 6 and recommending solutions.

It is intended to provide thought leadership, but we hope that readers will also note the actions that can be taken now to clarify the role of the VCM. Most important, the paper shows how the VCM will continue to play a crucial role in mobilising capital into the future, even as its interaction with Paris and compliance markets evolves. We must act decisively, with a commitment to integrity and delivering real climate impact, if the ambition of the Sharm el-Sheikh Implementation Plan is to be realised.



**Dame Clara Furse DBE**

Chair of the UK Voluntary Carbon Markets Forum

# 1. Executive summary

Climate change is a global issue that requires a co-ordinated global response. The Paris Agreement set the target of *“holding the increase in the global average temperature to well below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit the temperature increase even further to 1.5 degrees Celsius above pre-industrial levels”*.

Decisive and coordinated actions of the Parties to the Paris Agreement (**Parties**) will be essential to achieving this target; however, there are limitations as to what can be achieved under the Paris Agreement in the short-term while the Article 6 mechanisms are still being operationalised. As António Guterres told world leaders at the opening of the recent COP27 summit *“the global climate fight will be won or lost in this crucial decade”*; climate action is required urgently, and private actors will need to play a principal role in this.

The Voluntary Carbon Market (**VCM**) presents an opportunity for immediate action. The past few years have demonstrated that the VCM can deliver significant private funding to climate positive investments. It also enables companies to support decarbonisation beyond their own carbon footprint and accelerate the broader transition to a lower carbon future. As the need for climate action becomes increasingly urgent, and the number of firms committing to net-zero continues to grow rapidly, the potential for this market is huge. Some commentators estimate this market could grow very rapidly, possibly reaching USD\$50 billion in value by 2030. However, uncertainties surrounding Article 6 of the Paris Agreement and its implications for the VCM are holding back activity in the VCM.

COP26 saw a breakthrough in agreeing the role of Article 6 market mechanisms in delivering on the Paris objective; but much of the detail on how these mechanisms will be implemented remains to be decided, with only incremental progress made at COP27. Countries are having to plan how to use these mechanisms to meet their Nationally Determined Contributions (**NDCs**) ahead of them being fully operational by developing detailed decarbonisation strategies. This important planning should not inhibit use of the VCM. Globally, we must use all means available to deliver positive climate action that is both aspirational and practical.

The ambition should be for a high-integrity, credible, scaled VCM, operating cohesively alongside Paris mechanisms. To achieve this, the uncertainties surrounding the interaction of the Paris mechanisms and the VCM need to be addressed.

The City of London Corporation, the UK VCM Forum and Clifford Chance LLP have collaborated on this paper to identify and address some of the most pertinent issues facing the Paris mechanisms and the VCM. It has been written by Nigel Howorth, Head of the Global Environment Group at Clifford Chance and Anneke Theelen, Senior Associate who both have extensive experience in carbon markets. It is intended to promote useful discussion on the topic globally and drive forward progress.





## Executive Summary

## In this paper, we:

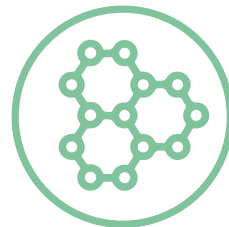
1. **Consider** the current state of the carbon markets;
2. **Describe** the key Paris mechanisms, focusing on Articles 6.2 and 6.4;
3. **Identify** key areas of uncertainty between the Paris mechanisms and the VCM; and
4. **Present** recommendations for what can be done, by countries and different market participants, to support both the Paris mechanisms and VCM initiatives; and
5. **Consider** what further work may need to be considered as the Paris mechanisms and the VCM continue to develop.

## Key themes

This paper identifies ten specific issues and uncertainties that exist between the Paris mechanisms and the VCM which, if not resolved, may hinder the opportunity presented by the VCM to deliver immediate climate action whilst the Paris mechanisms continue to develop.

These issues can be summarised into three key themes.

1. **Areas of uncertainty preventing engagement in the Paris mechanisms and the VCM**
2. **Concerns regarding the integrity of carbon credits**
3. **Lack of government support**



## 1. Areas of uncertainty preventing engagement in the Paris mechanisms and the VCM

- The practicalities surrounding domestic implementation of the Paris mechanisms.** The rules, modalities and procedures supporting the Paris mechanisms are complex. We expect that the Parties are now grappling with how best to give effect to these mechanisms in their own country. There is a risk of fragmentation as the Parties seek to interpret and internalise these rules, modalities and procedures within their existing legal and policy frameworks. There is also a risk that Parties inadvertently impede the VCM when implementing the Paris mechanisms. A high degree of harmonisation is needed amongst the Parties for the Paris mechanisms and the VCM to operate as effectively and efficiently as possible.
  - The impact that jurisdictional or sovereign based carbon initiatives may have on the Paris mechanisms and the VCM.** There have been a number of public announcements recently in the lead up to COP27 about jurisdictional based carbon initiatives that have the potential to generate huge quantities of voluntary carbon credits in a short amount of time. By way of example, the new African Carbon Markets Initiative (ACMI) announced at COP27 promises to deliver a further 300 million carbon credits annually by 2030. Whilst these initiatives can make a very significant contribution to achieving the Paris objectives, there is a risk that a huge influx of credits, over a relatively short period of time, may impose a significant downward pressure on the price of voluntary carbon credits and therefore have unintended consequences on the viability of other carbon projects in the near term. There is concern about the potential impact that this could have on both the VCM and the Paris mechanisms.
  - The role that avoidance emissions have in both the Paris mechanisms and the VCM.** Whilst recognising the importance of avoiding emissions, for example by preserving carbon sinks (and rewarding the countries that do), there are differing views as to whether avoidance-based credits are appropriate for recognition within the Paris mechanisms and the VCM.
- This uncertainty is not helped by the fact that the various carbon standards and carbon initiatives understand or use the terms “avoidance emissions” and “avoidance credits” differently. Where markets land on avoidance emissions may have ramifications for jurisdictional-based schemes such as REDD+ and the ACMI which rely heavily on forestry-based projects which, by their nature, are at least partially avoidance-based schemes.
- Difficulties in deciphering NDCs.** NDCs represent a country's climate action plan to cut emissions and adapt to climate impacts and are in essence the core of the Paris Agreement. At the same time, they help to inform the scope of VCM activities by indicating the types of mitigation scenarios a host country will or is likely to issue “use authorisations” for. However, NDCs tend to be drafted in broad, sweeping terms and can be difficult for project developers and prospective investors to understand. This lack of certainty may undermine participants’ confidence and prevent significant investments being made.
- These areas of uncertainty have led a number of countries to introduce moratoria on the issuance and/or international trading of carbon credits, spurred on by a desire amongst governments to exercise more control over the trading of carbon credits generated within their jurisdiction. The success of both the Paris mechanisms and the VCM rests on attracting sufficient investment in carbon activities that generate ITMOs, Paris registered carbon credits (i.e., A6.4ERs) and/or voluntary carbon credits. It is critical that these existing uncertainties are resolved so that project developers and prospective investors achieve a sufficient level of certainty to support investment of the scale needed to deliver on the Paris objectives, and countries are able to create domestic environments that fosters such investment.



## 2. Concerns regarding the integrity of carbon credits

Whilst the VCM has been growing rapidly in recent years, its growth has been marred somewhat by concerns surrounding the integrity of carbon credits available in the VCM. The emergence of internationally recognised carbon standards such as Verra and Gold Standard and the ongoing work of the Integrity Council for the Voluntary Carbon Markets (**Integrity Council**) to develop Core Carbon Principles and the Voluntary Carbon Markets Integrity Initiative (**VCMI**) a Claims Code of Practice have done a lot to address these concerns and we have confidence that the necessary motions are in place to create a high-integrity market.

However, one of the remaining concerns is around double counting and double claiming across the Paris mechanisms and the VCM which is causing hesitancy amongst many would-be participants. Double counting is when more than one country counts the same emission reduction or removal for the purposes of its NDC. The Paris Agreement expressly prohibits double counting and imposes requirements on countries to effect corresponding adjustments to

ensure this is avoided. A corresponding adjustment is when a transferring Party adds back the transferred emissions into its national account whilst the receiving Party subtracts them from its account. The Paris Agreement is less clear on the issue of double claiming. This is where a country and a private purchaser both claim the same emission reduction or removal.

It is important that double counting and double claiming are not conflated. Double counting is an accounting concept for the purposes of NDCs; it is not concerned with whether or how private entities may seek to claim the benefit of emission reductions or removals. Nevertheless, some argue that double claiming threatens the integrity of the VCM, and therefore, corresponding adjustments should also be applied to voluntary actions in the VCM. The decision at COP27 to define carbon credits that are not authorised for use towards NDCs as “mitigation contribution” credits appears to be an attempt to address the issue of double claiming. Exactly how this new concept of “mitigation contribution” credits is interpreted by

countries, and the VCM, remains to be seen, and there remains no clear market consensus as to whether carbon credits purchased by private actors for use as carbon offsets, should require a corresponding adjustment in all or some cases. We understand this remains a live issue for the VCM governing bodies and further work to address this issue is expected.

## 3. Lack of government support

To date, there has been limited engagement in, or express support for, the VCM by governments. The VCM is operating in a huge number of jurisdictions but this has largely been with little to no deliberate involvement from or engagement with host countries. This lack of involvement and clear governmental support for the VCM is causing hesitancy amongst many potential market participants, including project developers, investors and buyers.

To capitalise on the huge potential of the VCM, particularly for developing countries, governments need to begin engaging more strategically in the VCM. Part of this is so that governments can create domestic environments that are enabling of voluntary carbon activities to attract investment. Developed countries also need to send strong signals to buyers and investors that involvement in the VCM is a critical part of the climate action required to meet the Paris objectives. At the same time, however, countries will need to juggle the emerging Paris mechanisms and ensure that any action they take furthers both market mechanisms.

## Our recommendations

The international community needs to act with urgency on climate change. Negotiations on Article 6 are complex and contentious. It is becoming clear that the UN-developed Article 6.4 mechanism will take some time to become operational, meaning that capital flows to support climate action must be directed through other means. Fortunately, Article 6.2 is more established and the VCM is fully operational; and it is encouraging to see the momentum taking place in both of these markets as evidenced by the number of announcements made at COP27. There is clearly motivation to put these markets to work now, and the private sector has demonstrated clear ambition to do more.

However, to deliver this climate action at scale and within a timeframe necessary to deliver on the Paris objective, the issues identified in this paper will need resolving. At the heart of this, greater clarity and communication is needed from (and between) VCM governing bodies, the Conference of the Parties (**COP**) to the United Nations Framework Convention on Climate Change (**UNFCCC**), market participants and governments as to how the Paris mechanisms and the VCM should operate alongside each other.

The report recommends several key actions that these different stakeholders should consider taking which are aimed at delivering this certainty and unlocking the true potential of the Paris mechanisms and the VCM, some of which are highlighted below.

The full set of recommendations can be found in **Appendix 1** and are discussed in full in the body of this paper.



### FOR VCM GOVERNING BODIES TO:

- **Issue** a definitive position on corresponding adjustments and “double claiming” and the role of sovereign or jurisdictional based credits.
- **Highlight** the importance of the VCM in achieving the Paris objectives, and the important work being done to ensure the integrity and legitimacy of the VCM.
- **Work** closely with the UN Supervisory Body and other regulatory bodies to ensure that these markets remain complementary, and work done on integrity standards in the VCM can be adopted into compliance markets.



### FOR THE COP TO THE UNFCCC AND THE SUPERVISORY BODY TO:

- **Continue** to operationalise the Paris mechanism in a way that delivers sufficient clarity on how the Paris mechanisms are intended to work.
- **Clarify** the position on avoidance credits qualifying for the Article 6 Paris mechanisms.





## Executive Summary



## FOR GOVERNMENTS TO:

- **Demonstrate** clear support for and engagement with the VCM, including by using the VCM in their own climate action agendas.
- **Maintain** a clear and well-defined NDC.
- **Enter** into government-to-government or business-to-government arrangements to deliver certainty to project developers and investors.
- **Establish** the policy (and where necessary, the legal) framework to operationalise Article 6 mechanisms and develop clear parameters for use authorisations required by the Paris mechanisms.
- **Establish** a registry for the tracking of internationally traded mitigation outcomes (**ITMOs**) and possibly VCM activities.
- **Address** legal uncertainties that exist within the VCM such as formalising the legal nature of, and ownership rights over, carbon credits.



## FOR MARKET PARTICIPANTS TO:

- **Increase** transparency and information sharing within the market to improve integrity, credibility, and trust in the VCM.
- **Engage** with host governments to ensure a shared understanding of procedures and policy frameworks governing the use of the Paris mechanisms and the VCM.
- **Recognise** the importance of high-integrity carbon credits and ensure that offsetting remains secondary to emission reduction.

The issues and recommendations identified in this paper are by no means a perfect solution. Both the Paris mechanisms and the VCM remain evolving areas of climate action and new initiatives, understandings and developments are being reached every week. It is also expected that the role of the VCM will change over time and could eventually converge with compliance markets and the Paris mechanisms. It is important that the VCM is recognised as a separate and fully functioning market capable of delivering positive climate action now. The thinking in this paper is intended to demonstrate this and to act as a catalyst for further discussion on how the VCM and the Paris mechanisms can be used more effectively to support urgently needed climate action.



## 2. Introduction

Carbon credits and the development of high-quality, scaled carbon markets will be essential to promote the flow of capital required to achieve the global ambition of Net Zero by 2050 – as called for in the Paris Agreement. So far, three key market mechanisms exist to deliver this: (a) regulated or compliance carbon markets, which tend to operate as ‘cap and trade’ systems by placing limits on the amount of pollutants certain emitters are allowed to emit for a specified period of time; (b) voluntary carbon markets (**VCM**) which, unlike compliance carbon markets, are largely unregulated and provide for the sale and supply of carbon credits based on market drivers; and (c) the Clean Development Mechanism (**CDM**), which is essentially a hybrid market governed by international laws but participation is voluntary.

At the centre of the global net zero agenda is the Paris Agreement, which sets an overall objective to:

*“strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by: holding the increase in the global temperature to well below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels”.<sup>1</sup>*

The Paris Agreement establishes a number of methods by which Parties should aim to achieve this objective. Notably, Article 6 recognises the ability of Parties to pursue “voluntary co-operation”, or “co-operative approaches”, in the implementation of their nationally determined contributions (**NDCs**) under the Paris Agreement. The decisions on Article 6.2 and Article 6.4 at COP26 in Glasgow in 2021 finally set the rules for how these co-operative approaches should be applied. The recent decisions from COP27 in Sharm el-Sheikh, Egypt seek to build on these. However, none of the decisions expressly deal with the relationship between Paris Agreement mechanisms and the existing VCM. As a result, the extent to which the Paris Agreement arrangements and the existing VCM overlap, integrate or compete is not clear.

The VCM enables companies to support decarbonisation beyond their own carbon footprint, thus accelerating the broader transition to a lower-carbon future, whilst also helping to finance carbon reduction and removal projects. Whilst the VCM is relatively small (compared with established compliance carbon markets), it has experienced rapid growth over the past few years as demand for carbon credits has increased. It is estimated that this demand could continue to increase by 15 times its current size by 2030 as an increasing number of companies pursue efforts to decarbonise.



<sup>1</sup> Article 2(1)(a) of the Paris Agreement.



## Introduction

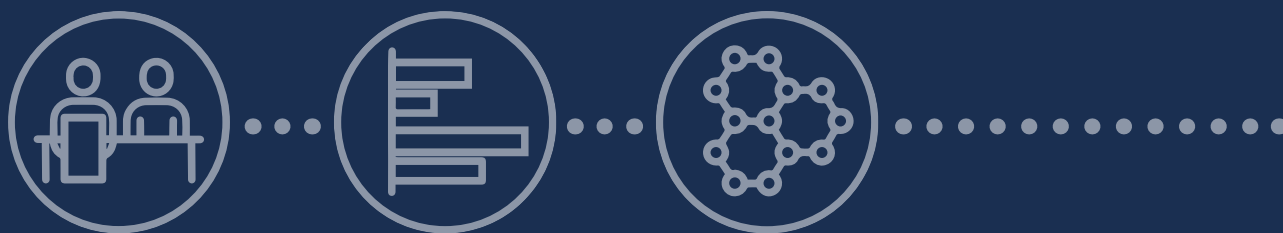
There is a risk that the emerging Paris mechanisms are seen to supplant the VCM. This uncertainty could undermine the considerable progress being made in the global efforts to decarbonise through the VCM and risks hampering ongoing investment in the VCM. It is important that this does not happen. The need for ongoing climate action is urgent. The VCM exists now and should continue to be utilised whilst operationalisation of the Paris mechanisms is ongoing. There may be opportunities for the Paris mechanisms and the VCM to converge in the years to come, but for now at least the global community should recognise the opportunity for the Paris mechanisms and the VCM to operate cohesively alongside each other and together drive decarbonisation as efficiently and equitably as possible.

The UK VCM Forum, the City of London and Clifford Chance LLP have collaborated in order to examine the relationship between the new Paris mechanisms and the existing VCM. The objective of this paper is to consider how the Paris Agreement mechanisms and the VCM can work alongside each other to support the Paris objectives and to set out recommendations for what could be done, by countries and different market participants, to support both. To this end, this paper considers:

- the current state of the carbon markets;
- the Paris mechanisms;
- identified areas of uncertainty between the Paris mechanisms and the VCM;
- recommendations for what can be done, by countries and different market participants, to support both the Paris mechanisms and VCM initiatives; and
- what further work may need to be considered as the Paris mechanisms and the VCM continue to develop.



### 3. Current state of the carbon markets



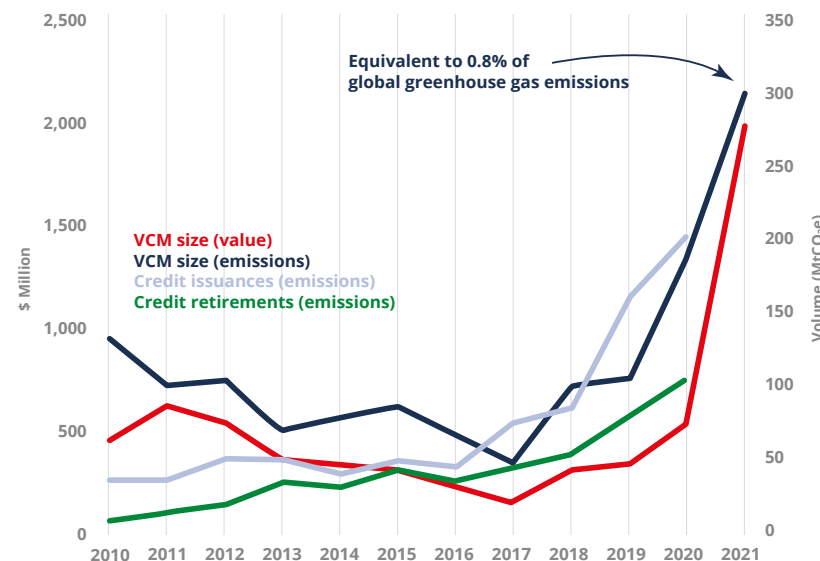


## Current state of the carbon markets

There are three types of carbon markets in existence today; those operating under mandatory (compliance) schemes, those operating under voluntary programmes, and the CDM, which is essentially a hybrid market.

Compliance markets are the largest and most mature of the three markets, with an estimated market value of over USD\$100 billion and an annual trading turnover of over USD\$250 billion.<sup>2</sup> In comparison, the VCM is relatively small. It had an estimated value of just USD\$300 million in 2020, although, the latest State of the VCM Briefing by non-profit Ecosystem Marketplace published in August 2022 suggests the market has reached USD\$2 billion in 2022 (an increase of 60% year on year).<sup>3</sup> It is estimated that the VCM has the potential to continue to scale rapidly, with estimates of its expected size in 2030 ranging from between USD\$5 billion and USD\$180 billion.<sup>4</sup> The CDM is smaller again with only USD\$151 million traded in 2021.<sup>5</sup>

**Figure 1: Estimated growth in size of global VCMs by value and volume**



**Source:** Ecosystem Marketplace (2022) State of the Voluntary Carbon markets; World Bank data (2022) Total greenhouse gas emissions.  
**Notes:** Figures are estimates, based on information from participants in a market survey managed by Ecosystem marketplace. VCM size (both value and emissions) shows volume of voluntary carbon credits traded in a given year. Issuances shows the number of projects that, having been verified, were issued with a unique serial number and can be purchased. retirements shows the number of issued credits that were 'used' or claimed by their owner. All figures are estimates. Market volume is weighted based on market data reported by Ecosystem Marketplace respondents. Proportion of greenhouse gas emissions is calculated using World Bank data for global emissions.

- 2 McKinsey & Company, October 2021, *Putting carbon markets to work on the path to net zero: How investors can help decarbonise the economy and manage risk-adjusted returns*. Available at: <https://www.mckinsey.com/capabilities/sustainability/our-insights/putting-carbon-markets-to-work-on-the-path-to-net-zero> (Accessed on 30 November 2022).
- 3 Ecosystem Marketplace, August 2022, *State of the Voluntary Carbon Markets 2022 Q3 briefing, "The Art of Integrity"*. Available at: <https://www.ecosystemmarketplace.com/publications/state-of-the-voluntary-carbon-markets-2022/> (Accessed on 30 November 2022).
- 4 McKinsey & Company, October 2021, *Putting carbon markets to work on the path to net zero: How investors can help decarbonise the economy and manage risk-adjusted returns*. Available at: <https://www.mckinsey.com/capabilities/sustainability/our-insights/putting-carbon-markets-to-work-on-the-path-to-net-zero> (Accessed on 30 November 2022).
- 5 Carbon market year in review, January 2022, Refinitiv.

## Current state of the carbon markets

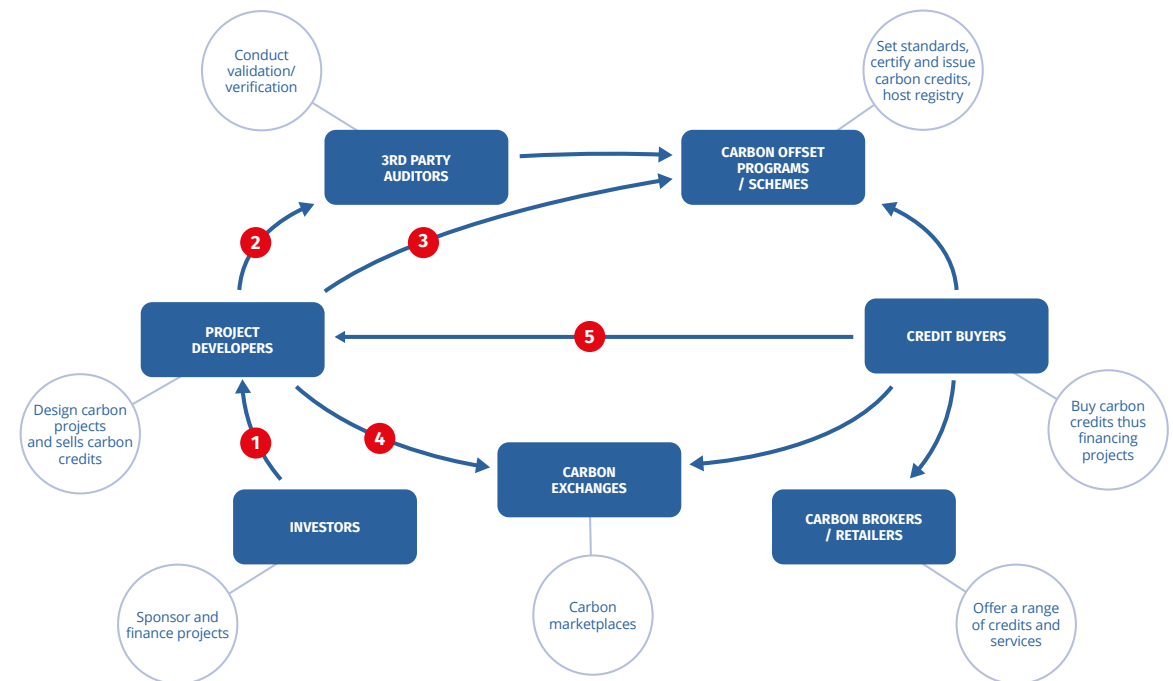
**VOLUNTARY CARBON MARKET**

The VCM is largely unregulated and was formed with the aim of driving finance to activities that reduce greenhouse gas (GHG) emissions. It has been operating without government intervention for decades and, over time, has evolved and matured into a robust and effective means of tackling climate change by mobilising and redirecting significant investment into projects which deliver independently verified and additional emissions reductions on a global scale. It is market driven making it both agile and available to all. The VCM also helps to deliver climate action more generally by helping to meet the broader sustainable development needs of emerging markets.

Within the VCM, carbon projects are developed by project proponents, often private and local actors, according to applicable local laws pertaining to the development of such projects (e.g., land use consents). There are two main categories of carbon projects within the VCM:

- **GHG emissions reduction projects**, which reduce emissions from current sources by replacing them with low-carbon alternatives. Reduction methodologies differ within the VCM, but a common methodology approved to date is improved cookstoves (which replace open cooking fires with energy efficient cookstoves giving communities access to sustainable energy technology); and
- **GHG removal and sequestration projects**, which remove and store GHG from the atmosphere, for example, through biological sequestration (e.g., reforestation), geological sequestration (e.g., carbon capture and storage) or other technology-based removals (e.g., direct air capture). GHG removal and sequestration methodologies most commonly approved in the VCM at present include afforestation and reforestation, coastal wetland creation, and tidal wetland and seagrass restoration.

**Figure 2: The carbon credit ecosystem<sup>6</sup>**



<sup>6</sup> This figure is based on a more detailed diagram produced by the Paia Team. Available at <https://paiaconsulting.com.sg/carbon-offsets-and-credits-explained/>

## Current state of the carbon markets

### Carbon standards

Carbon projects are registered with a private carbon offset-crediting organisation known as a “carbon standard”. Carbon standards are in essence the foundation of any high-quality carbon offset project. The carbon standards prescribe a set of rules and procedures for project design, project development, verification of, and accounting for, GHG emission reductions and/or removals, the issuance of verified carbon credits, and monitoring. Where a project satisfies the rules and requirements of the applicable carbon standard (e.g., in respect of project design, validation, monitoring, reporting and verification), the project will be eligible to receive carbon credits issued by that carbon standard for the verified GHG emission reductions achieved by the project. The carbon credits are issued into the electronic registry system maintained by the carbon standard; typically into a registry account in the name of the project proponent. Once issued, the owner of those carbon credits is free to deal with them as they wish (e.g. retire or sell/trade the carbon credits). All such retirements and/or sales and transfers of carbon credits are recorded in the registry.

Whilst early iterations of the VCM have been subject to criticism for failing to deliver quality carbon credits, the VCM as it exists today, through the emergence of internationally recognised carbon standards (such as Verra, Gold Standard, the American Carbon Registry Standard and, more recently, the Global Carbon Council), is recognised as delivering exactly this. To ensure high-quality carbon credits, the carbon standards prescribe core principles and requirements that carbon projects must satisfy which go beyond simply the old environmental adage of “do no harm”. Whilst the specifics will differ slightly amongst carbon standards, broadly speaking, to

be eligible for carbon credits under a carbon standard, carbon projects must achieve GHG emission removals or reductions that:

- are additional (i.e., the GHG emission reductions or removals are in excess of what would have been achieved under a “business as usual” scenario and the mitigation activity would not have occurred in the absence of the incentive created by carbon credit revenues);
- avoid double counting (i.e., they should only be counted once towards achieving mitigation targets or goals);
- are permanent (i.e., the GHG emission reduction or removal from the mitigation activity must be permanent, or where at risk of a reversal, adequate safeguards have been put in place to ensure that the risk of reversal is minimised and, should it occur, mechanisms are in place that guarantee the reductions or removals will be replaced or compensated);
- are independently and robustly validated and verified in accordance with the programme level requirements; and
- are recorded in a registry to uniquely identify, record and track mitigation activities and the carbon credits issued to ensure that those credits are identified securely and unambiguously.



## Current state of the carbon markets

### Global governing bodies

In recent years, a number of global governing bodies have emerged with the aim of scaling up the VCM with integrity. In September 2020, a global Taskforce for Scaling Voluntary Carbon Markets (**TSVCM**) was established with the aim of defining a blueprint for creating a large-scale, transparent carbon credit trading market that is capable of meeting expected demand driven by the Paris Agreement's goals.<sup>7</sup> The TSVCM brought together all parts of the value chain to provide recommended actions to address the most pressing pain points facing the VCM. To this end, the TSVCM published two reports (in January and July 2021, respectively); the first represented a blueprint for creating a large-scale, transparent carbon credit trading market, whilst the second represented the development and implementation phase of the TSVCM's project to scale-up the VCM.

Following this, in September 2021, the TSVCM announced the formation of a new, independent governance body for the VCM. This governance body, titled the Integrity Council for the Voluntary Carbon Market (**Integrity Council**), was to assume leadership of TSVCM's ambition to bring greater quality and integrity to the VCM. The work undertaken by the TSVCM and the ongoing work of the Integrity Council and the UK VCM forum is particularly focused on driving even greater integrity and legitimacy within the VCM.

The Integrity Council is currently consulting on a draft of the Core Carbon Principles (**CCPs**) and associated Assessment Framework and Assessment Procedure. The purpose of the CCPs and Assessment Framework is to provide a credible, rigorous and readily accessible means of identifying high-quality carbon credits. The aim is to drive alignment across the VCM programmes through greater consistency and standardisation, to enable the VCM to continue to support decarbonisation, at a speed and of a scale needed to deliver on the Paris Agreement objective.

Whereas the Integrity Council deals with the integrity of emissions reductions from the supply-side, the Voluntary Carbon Markets Integrity Initiative (**VCMI**), launched in June 2021, looks at integrity from the buy-side. The VCMI's aim is to build a VCM that delivers real and additional benefits to the atmosphere, helps protect nature, and accelerate the transition to ambitious, economy-wide climate policies and regulation.<sup>8</sup> The VCMI is developing guidance on how carbon credits can be voluntarily used and claimed by buyers as part of credible net zero strategies, in consultation with representatives of civil society, businesses, Indigenous Peoples and local communities, and governments.

<sup>7</sup> The Taskforce was initiated by Mark Carney, UN Special Envoy for Climate Action and Finance; is chaired by Bill Winters, Group Chief Executive, Standard Chartered; and is sponsored by the Institute of International Finance (**IIF**) under the leadership of IIF President and CEO, Tim Adams. Annette Nazareth, senior counsel at Davis Polk and former Commissioner of the US Securities and Exchange Commission, serves as the Operating Lead for the Taskforce. McKinsey & Company provides knowledge and advisory support. The Taskforce's over 250 member institutions represent buyers and sellers of carbon credits, standard setters, the financial sector, market infrastructure providers, civil society, international organisations and academics. An advisory board of 20 environmental NGOs, investor alliances, academics and international organisations provides guidance on TSVCM recommendations. <https://www.iif.com/>.

<sup>8</sup> VCMI is an independent non-profit organisation housed in Rockefeller Philanthropy Advisors. VCMI was announced by COP26 President-Designate Alok Sharma at the Climate and Development Ministerial on 31 March 2021 and has received co-funding from the Children's Investment Fund Foundation, Google.org, the Packard Foundation and the UK Department for Business, Energy and Industrial Strategy (BEIS). VCMI is co-chaired by Rachel Kyte and Tariye Gbadegesin and led by Mark Kenber as Executive Director.

## Current state of the carbon markets

### The VCM has further potential

The true advantage of the VCM, in this post-Paris era, is that it is operational. Whilst there is opportunity for improvement (as evidenced by the work of the Integrity Council and VCMI), it is an established market which, with a few changes, can be scaled up significantly and at speed to deliver on the Paris objectives whilst the Paris-specific mechanisms find their footing. This growth potential has been recognised by the Institute of International Finance (IIF), a founding member of the TSVCM, which estimates that markets to buy and sell carbon are expanding rapidly around the world and have the potential to address more than half of all GHG emissions by 2030. The report by the IIF, *Getting to Net Zero – The Vital Role of Global Markets*, shows<sup>9</sup>:

- Projected expansion of both compliance (government-mandated) and voluntary carbon markets could see their GHG coverage more than double, from 24% of global emissions today, up to 52% of global emissions in 2030.
- Compliance market coverage could expand from 21% of global emissions today to 47% in 2030.
- Voluntary market commitments could grow from covering 9% of corporate emissions today to 23% of emissions by 2030.

### COMPLIANCE MARKETS

Compliance markets are created and regulated by mandatory national, regional or international carbon reduction regimes. These types of emissions trading regimes typically involve the establishment of a 'cap and trade' system. Under a 'cap and trade' system, a regulatory body establishes a limit, or cap, on GHGs emitted by a group of regulated facilities, also referred to as 'installations' for a special period of time (i.e., a compliance period). Typically, this cap reduces over time. The regulatory body allocates or auctions emissions allowances to the 'installations'. The total amount of allowances allocated or auctioned to installations cannot exceed the cap.

At the end of the compliance period, each installation is required to surrender an equivalent number of emission allowances to cover its emissions during the compliance period. Some entities may need to buy extra emission allowances to cover emissions from their operations, whilst others may have surplus allowances (e.g., through more efficient running or a reduction in operations meaning lower emissions). An installation with excess allowances may keep those surplus allowances to cover its future needs or else sell them to another installation that is short of allowances. This element of trading brings flexibility, enabling emissions to be cut overall in a cost-effective way. The EU Emissions Trading System and the recently spun-off UK Emissions Trading Scheme are two examples of traditional 'cap and trade' compliance markets.

**Compliance markets are created and regulated by mandatory national, regional or international carbon reduction regimes.**

<sup>9</sup> IIF, October 2021, *Getting to Net Zero – The Vital Role of Global Markets*. Available at: <https://www.iif.com/Publications/ID/4629/Getting-to-Net-Zero-The-Vital-Role-of-Global-Carbon-Markets> (Accessed on 30 November 2022).

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## Current state of the carbon markets

### CLEAN DEVELOPMENT MECHANISM

The CDM is essentially a hybrid market. It operates in a similar manner to a 'cap and trade' compliance market; however, unlike a traditional mandatory 'cap and trade' scheme, participation in the CDM is voluntary.

The CDM was born out of the UNFCCC, which entered into force on March 1994. At the third meeting of the COP to the UNFCCC held in Kyoto, Japan in December 1997, the COP agreed the Protocol to the United Nations Framework Convention on Climate Change (**Kyoto Protocol**), albeit the Kyoto Protocol only came into force in February 2005. The Kyoto Protocol operationalised the UNFCCC by committing industrialised countries and economies in transition to limit and reduce GHG emissions in accordance with agreed individual targets. An important element of the Kyoto Protocol was the establishment of three flexible market mechanisms to achieve the agreed individual targets, each based on the trading of emission permits. The CDM was one of those market mechanisms (the other two being the joint implementation mechanism and the international emissions trading mechanism).

The CDM was established under Article 12 of the Kyoto Protocol and is considered the first global environmental investment and credit scheme recognising a standardised emissions offset instrument, Certified Emission Reductions (**CERs**) (each equivalent to one tonne of CO<sub>2</sub>). Under the CDM, Countries listed in Annex I of the Kyoto Protocol could engage in projects in developing countries to reduce GHG emissions. The purpose of the CDM was to benefit both Annex I countries (acting as "investors") and developing host countries by contributing to sustainable development in developing countries whilst allowing investor countries to meet their GHG reduction targets in a cost-effective manner. Participation in the CDM was open

to public and private entities belonging to Annex I countries. The CDM operated by allowing emission-reduction projects in developing countries to earn CERs. These CERs could be traded and sold (including by non-State actors), and used by industrialised countries (i.e., Annex I countries) to meet a part of their emission reduction targets under Annex B of the Kyoto Protocol. CERs could also be retired.

The end of the final commitment period of the Kyoto Protocol caused some uncertainty about the future of the CDM, given the emergence of the Paris Agreement mechanisms and that, as some considered, the primary legal basis for CERs, being to satisfy Kyoto targets, was ending. A decision by the Executive Board of the CDM temporarily extended CDM operations past the end of 2020 until a decision could be taken on the future of the CDM at COP26. Following COP26, a decision was issued providing that requests for registration, renewal of crediting periods and issuance of CERs for project activities relating to emission reductions occurring after 31 December 2020 may not be submitted under the CDM. Instead, it provided that such requests and submissions must be made under the mechanism established by Article 6.4 of the Paris Agreement, which we consider further below.

A focus of the recent COP27 in Sharm el-Sheikh, Egypt was on establishing processes for implementing the transition of registered project activities under the CDM to the Article 6.4 mechanism (subject to certain conditions, including requirements regarding activity design and crediting periods).

## 4. The Paris Agreement

At the 21st meeting of the COP in Paris in December 2015, the COP reached agreement on a new, internationally binding treaty to further the climate change objective of the UNFCCC, the Paris Agreement.





## The Paris Agreement

The Paris Agreement, which was adopted in December 2015 and came into force in November 2016, has been ratified by 193 Parties. It commits all countries to reduce their GHG emissions and work together to adapt to the impacts of climate change. Article 2 states that in enhancing the implementation of the UNFCCC, the Agreement aims to:

*strengthen the response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty including by:*

*(a) **holding the increase in the global average temperature to well below 2 degrees Celsius above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels**, recognising that this would significantly reduce the risks and impacts of climate change...*

**[Emphasis added]**

Article 3 further provides that:

*As nationally determined contributions to the global response to climate change, all Parties are to undertake and communicate ambitious efforts as defined in Articles 4, 7, 9, 10, 11 and 13 with the view to achieving the purpose of this Agreement as set out in Article 2. The efforts of all Parties will represent a progression over time, while recognising the need to support developing country Parties for the effective implementation of this Agreement.*

### THE PARIS AGREEMENT AND THE VCM

The Paris Agreement is rightly seen as a significant step forward in the fight against climate change. However, the development of further detail at the 26th meeting of the COP in Glasgow in 2021

(**COP26**) in respect of Article 6 of the Paris Agreement caused some to question the role of the VCM for future climate action and whether, and if so how, the Paris Agreement and the VCM should, or are intended to, work alongside each other. This is particularly so given the parallels that exist between the emerging Article 6.4 mechanism, and the established practices and procedures of the VCM in respect of project registration, issuance of carbon credits and trading of carbon credits.

We believe the Paris Agreement and the VCM are, and should remain, two related but distinct tools for driving climate action; both have an important role to play in delivering on the Paris objectives. The Paris Agreement presents new international carbon mechanisms that have been designed with a particular focus on driving State-level action and accountability. As with any new market mechanism, however, they will take time to develop and be adopted by Parties and market participants. We have seen this already with the time it took for detailed rules for how the Paris mechanisms were to operate to be negotiated, agreed and ultimately published.

The VCM, on the other hand, is an established, operating market available to anyone which is capable of scaling up significantly and at speed to support the Paris objectives. The VCM presents a real opportunity to drive significant climate action and climate finance in the short term and beyond. It also offers the additional benefit of being agile.

**The VCM presents a real opportunity to drive significant climate action and climate finance in the short term and beyond.**

## The Paris Agreement

Many in the market recognise the possibility of the existing VCM and Paris mechanisms converging in the future. However, the nimbleness of the VCM means that, even if this is the case, it is still likely to have a valuable role to play as an incubator for new climate action (for example, as a testing ground for new emissions reduction or removal methods) before such methods are accepted into the established compliance markets. It is critical that the opportunities presented by the VCM are not inadvertently lost in the wake of the Paris mechanisms and the global community should act to ensure that both can operate alongside each other in a cohesive manner. We set out some recommendations later in this paper as to how this could be achieved.

To understand how the Paris mechanisms and the VCM overlap and could work alongside each other, it is useful to consider in more detail the defining features of the Paris Agreement.

### NATIONALLY DETERMINED CONTRIBUTIONS

As recognised by Article 3 above, at the heart of the Paris Agreement are Parties' NDCs. NDCs are described by the UNFCCC as embodying the "efforts by each country to reduce national emissions and adapt to the impacts of climate change".<sup>10</sup> Pursuant to Article 4(2) of the Paris Agreement, *"each Party shall prepare, communicate and maintain successive NDCs that it intends to achieve. Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions"*. Article 4(2) provides that Parties shall pursue domestic mitigation measures with the aim of achieving the objectives of their NDCs. Article 4(3) recognises that each Party's successive NDC will represent

a progression against the current NDC and reflect *"its highest possible ambition"*. More particularly, Article 4(4) recognises that developed country Parties should continue taking the lead by undertaking economy-wide absolute emission reduction targets, whilst developing country Parties should continue enhancing their mitigation efforts and are encouraged to move over time towards economy-wide emission reduction or limitation targets in the light of different national circumstances. Parties are required to communicate their NDCs every five years to the UNFCCC secretariat and the NDCs are recorded in the publicly available NDC registry maintained by the secretariat (Articles 4(9) and 4(12)).

The synthesis report prepared by the UNFCCC secretariat in September 2021, and updated in October 2022<sup>11</sup>, provides a useful summary of what NDCs typically cover. The report considered the latest 165 NDCs communicated by the 192 Parties as at 12 October 2021 and published key findings about and/or observations on them. Of particular interest, the report recognises that:

- all Parties provided information on mitigation targets or mitigation co-benefits resulting from adaptation actions and/or economic diversification plans;
- most Parties provided quantified mitigation targets, expressed as clear numerical targets;
- most Parties communicated economy-wide targets, covering all, or almost all, sectors defined in the 2016 IPCC Guidelines, with an increasing number of Parties moving towards absolute emission reduction targets;
- almost all Parties communicated an NDC implementation period leading to 2030 (while some specified periods to 2025,

**NDCs are described by the UNFCCC as embodying the "efforts by each country to reduce national emissions and adapt to the impacts of climate change".**

<sup>10</sup> United Nations Framework Convention on Climate Change, Nationally Determined Contributions (NDCs). Available at: <https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs/nationally-determined-contributions-ndcs> (Accessed on 24 August 2022).

<sup>11</sup> UNFCCC Secretariat, October 2022, Nationally determined contributions under the Paris Agreement. Available at: <https://unfccc.int/ndc-synthesis-report-2022> (accessed on 29 November 2022).

## The Paris Agreement

2035, 2040 or 2050); and

- of particular relevance, most Parties provided information on voluntary cooperation under Article 6 of the Paris Agreement, with almost all stating they will, or plan to, use at least one type of voluntary co-operation. Some have set qualitative limits on such uses. The report went on to state that almost all communicated that they had a plan, or would possibly use voluntary co-operation, in at least one of the scopes within their NDCs. The share of Parties that indicated that they would use voluntary cooperation increased from 46% to 85% in the new or updated NDCs compared with those Parties' previous NDCs.<sup>12</sup>

The report sets out common priority areas of national importance identified by Parties when achieving mitigation targets of their NDCs by domestic means. These are energy supply, transport, buildings, industry, agriculture, land use, land-use change and forestry (**LULUCF**), and waste. Within those sectors, many Parties identify particular sub-areas of focus. For example, within energy supply, 80% of Parties are targeting renewable energy generation, transmission and storage, and improvements in energy efficiency; within transport, 60% are targeting green road infrastructure; and within LULUCF, 55% are targeting forestry and 21% wetland ecosystems. It is evident from this that large-scale, technology-driven development programmes are seen as key drivers for NDC implementation. In contrast, the VCM has been dominated by LULUCF projects in recent years with 46% of the traded volume in 2021 being sourced from such projects. Renewable energy projects accounted for the second largest source of volume traded.<sup>13</sup>

## CO-OPERATIVE APPROACHES

Article 6 of the Paris Agreement establishes “co-operative approaches” which Parties can use in their pursuit of achieving the Paris Agreement’s overall objective and in implementing their NDCs. Three key co-operative approaches are specifically provided for:

- **Article 6.2:** allows Parties to trade “mitigation outcomes” (referred to as “internationally traded mitigation outcomes” or “ITMOs”) with each other through bilateral or multilateral agreements for use towards NDCs and provides for an accounting framework for international co-operation;
- **Article 6.4:** establishes the foundation for a UN-led global carbon crediting mechanism to provide for the trading of emissions reductions on a voluntary basis (**Article 6.4 mechanism**) (similar in nature to the CDM established under the Kyoto Protocol); and
- **Article 6.8:** develops a framework for co-operation between countries to reduce emissions outside market mechanisms through non-market initiatives such as aid.

Following COP26, the COP adopted three decisions relating to Article 6 and its co-operative approaches. Of these three decisions, the key decisions for the purposes of this paper are:<sup>14</sup>

- Decision 2/CMA.3 Guidance on co-operative approaches referred to in Article 6, paragraph 2, of the Paris Agreement (**Art. 6.2 Decision**); and

Carbon Markets 2022 Q3 Available at <https://app.hubspot.com/documents/3298623/view/433338095?accessId=3abc8b> (Accessed on 29 November 2022).

14 The third decision adopted at COP26 relating to Article 6 was Decision 4/CMA.3 Work programme under the framework for non-market approaches referred to in Article 6, paragraph 8, of the Paris Agreement.

12 UNFCCC Secretariat, October 2021, nationally determined contributions under the Paris Agreement – Revised synthesis report by the secretariat, paragraph 96. Available at: [https://unfccc.int/sites/default/files/resource/cma2021\\_08rev01\\_adv.pdf](https://unfccc.int/sites/default/files/resource/cma2021_08rev01_adv.pdf) (Accessed on 30 November)

13 Ecosystem Marketplace, August 2022, Markets in Motion: State of the Voluntary

## The Paris Agreement

- Decision 3/CMA.3 Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4, of the Paris Agreement ((**Art 6.4 Decision**) also referred to as the **RMP**).

More recently, during the 27th meeting of the COP which took place between 6 and 18 November 2022 in Sharm el-Sheikh, Egypt (**COP27**), the COP has been negotiating additional decisions relating to Article 6 which build on the Art. 6.2 Decision and the Art. 6.4 Decision. As at the time of writing, final draft decisions have been agreed between the Parties and are publicly available. These draft decisions are yet to go through the formal United Nations approval process but their substance is not expected to change. The key texts for the purposes of this paper are:

- Draft decision on CMA.4 Agenda Item 13: Guidance on co-operative approaches referred to in Article 6, paragraph 2, of the Paris Agreement and in decision 2/CMA.3 (19.11.2022) (**Art. 6.2 Decision (COP27)**); and
- Draft decision on CMA.4 Agenda Item 14: Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4, of the Paris Agreement (19.11.2022) (**Art. 6.4 Decision (COP27)**).

In this paper, '**Decisions**' refers to the Art. 6.2 Decision, the Art. 6.2 Decision (COP 27), the Art. 6.4 Decision and the Art. 6.4 Decision (COP 27).

### ARTICLE 6.2 – ITMOS

The Art. 6.2 Decision provides guidance on the co-operative approaches referred to in Article 6.2. It provides that ITMOs from a co-operative approach are: (a) real, verifiable and additional; (b) emissions reductions and removals (including mitigation co-benefits resulting from adaptation actions and/or economic diversification plans or the means to achieve them) when internationally transferred; (c) generated in respect of or representing mitigation from 2021 onward; (d) measured in metric tonnes of carbon dioxide equivalent or in other non-greenhouse gas metrics determined by the countries which are consistent with the NDCs of those countries; and (e) which fall within one of the following categories:

- are from a cooperative approach referred to in Article 6.2 that involves the international transfer of mitigation outcomes authorised for use towards an NDC pursuant to Article 6.3;<sup>15</sup>
- are mitigation outcomes authorised by a country for international mitigation purposes other than achieving an NDC (such as for CORSIA) (**International Mitigation Purposes**) or authorised for other purposes as determined by the first transferring country (which is widely interpreted as including voluntary offset purposes) (**Other Purposes**), together referred to as "**Other International Mitigation Purposes**"; or
- are Article 6.4 emission reductions under the Article 6.4 mechanism (**A6.4ERs**) when they are authorised for use towards achievement of NDCs and/or authorised for use for Other International Mitigation Purposes.

<sup>15</sup> Article 6.3 of the Paris Agreement provides that the "use of internationally transferred mitigation outcomes to achieve nationally determined contributions under this Agreement shall be voluntary and authorised by participating Parties".



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We refer to the above authorised uses as “**Paris Uses**” in the remainder of this paper.

In each case, to be categorised as ITMOs, the relevant emissions reductions and removals must be authorised for use by the relevant country. In the case of A6.4ERs, they become ITMOs if they are authorised for Paris Uses (and meet the other parts of the definition). Whether or not they are so authorised depends on how the host country treats them. The Art. 6.4 Decision (COP27) has clarified that A6.4ERs not authorised for Paris Uses shall be deemed “mitigation contribution A6.4ERs”. We consider authorisations and these mitigation contribution A6.4ERs further below.

It is widely thought that Article 6.2 sets the guidelines for ITMOs between Parties. Article 6.2 refers to “*Parties... engaging on a voluntary basis in co-operative approaches that will involve the use of internationally transferred mitigation outcomes towards nationally determined contributions...*”. The Art. 6.2 Decision and Art. 6.2 Decision (COP 27) only refer to Parties, not public or private entities. However, some stakeholders and industry groups believe it is a misconception to consider Article 6.2 as concerning only Party-to-Party transfers. They believe Article 6.2 is intended to have broader application and can be used to facilitate ITMOs with private entities as well. Whether this develops in practice remains to be seen.

For all ITMOs, each participating Party is required to apply corresponding adjustments consistent with the Art. 6.2 Decision.

### ARTICLE 6.2 – REGISTRIES

Each Party is required to have, or have access to, a registry for the purpose of tracking. The registry is required to record authorisation, first transfer (which gives rise to specific obligations under the Paris mechanisms), all subsequent transfers, use towards NDCs, authorisation for use towards Other International Mitigation Purposes and voluntary cancellation.

The Art. 6.2 Decision (COP27) describes a registry for the purpose of tracking as comprising an electronic database and other technical and administrative arrangements that:

- has accounts for ITMOs as necessary;
- supports the actions relating to ITMOs, including authorisation, first transfer, transfer, acquisition, use towards NDCs, authorisation for use towards other international mitigation purposes, and voluntary cancellation (including for overall mitigation in global emissions (**OMGE**), if applicable) ([see p25](#));
- tracks, maintains, records and accounts for ITMOs, including through unique identifiers;
- provides access to operations by the Party and other entities for which access is authorised by the Party; and
- produces, maintains and compiles records, information and data consistent with the agreed electronic format.

The Art. 6.2 Decision (COP27) provides that Parties should, for the purpose of transferring ITMOs, either connect their registries or establish processes under which transfers are recorded independently in each registry.

**The Art. 6.4 Decision (COP27) has clarified that A6.4ERs not authorised for Paris Uses shall be deemed “mitigation contribution A6.4ERs”.**

## The Paris Agreement

An international registry will also be set up for participating Parties that do not have, or do not have access to, a registry, and any Party may request an account. The international registry will be part of a centralised accounting and reporting platform required by the Art. 6.2 Decision which will record corresponding adjustments and emissions balances, and information on ITMOs transferred acquired, held or cancelled. The Art. 6.2 Decision (COP27) provides that the international registry accounts shall enable the tracking and recording of information in relation to the ITMO actions they record.

The international registry will connect to the Article 6.4 mechanism registry (discussed further below). The international registry will also provide interoperability arrangements to enable participating Parties to connect their registries to it, should they choose to do so.

### ARTICLE 6.4 – A.6.4ERS

The Art. 6.4 Decision established the rulebook for how the Article 6.4 mechanism should operate. The rules laid out in the RMP are similar to those established under the CDM. According to the RMP, the Article 6.4 mechanism will operate as follows:

- A carbon project must first be registered under the Article 6.4 mechanism to be eligible for what have been termed “Article 6.4 emission reductions” (**A6.4ERS**) (i.e., essentially carbon credits). The public or private entities participating in the carbon project that wish to register a project as an Article 6.4 activity must design the activity according to the requirements of the RMP and any other relevant requirements adopted by the COP or the dedicated Article 6.4 Supervisory Body.<sup>16</sup>

- The carbon project must satisfy certain prescribed criteria with respect to permanence, additionality, measurability, and absence of negative environmental and social impacts. The carbon project must also apply a mechanism methodology approved by the Supervisory Body (to ensure the additionality, appropriate monitoring and calculate the emissions reduction achieved).
- Where a carbon project satisfies these requirements, the host Party (being the country where the carbon project is located) will supply the Supervisory Body with an approval of the carbon project, prior to a request for registration. The host Party's approval must include:
  - confirmation of how the activities foster sustainable development;
  - an explanation of how the activity relates to the implementation of its NDC; and
  - how the expected emission reductions contribute to the host Party's NDC.
- The host Party must also provide a statement to the Supervisory Body specifying whether it authorises A6.4ERS issued for the activity for use towards achievement of NDCs and/or Other International Mitigation Purposes (i.e., for Paris Uses). We consider this authorisation further (below).
- The carbon project is then independently assessed by a designated operational entity (**DoE**). If the DoE is satisfied that the project meets the rules, modalities and procedures set out in the RMP, the carbon project will be validated and submitted to the Supervisory Body for registration. If the Supervisory Body concurs, it must register the carbon project as an Article 6.4 activity.

**The carbon project must satisfy certain prescribed criteria with respect to permanence, additionality, measurability, and absence of negative environmental and social impacts.**

<sup>16</sup> The Supervisory Body is the body designated as such by the COP that will be responsible for supervising the Article 6.4 mechanism.

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- The carbon project is required to go through a monitoring phase, undertaken by the activity participants, whereby the activity participants monitor the emissions reductions achieved by the activity, in accordance with the relevant requirements adopted by the Supervisory Body. The DoE must then independently review and determine the implementation of, and the emissions reductions achieved by, the activity during that monitoring period (referred to as “verification”). If the carbon project is found to be compliant with the applicable rules, modalities and procedures, the DoE will provide written assurance of the verified emissions reductions (referred to as “certification”) and submit a request for issuance to the Supervisory Body.
- If the Supervisory Body decides the verification, certification and outcomes meet the relevant requirements, it will approve the issuance of A6.4ERs. The mechanism registry is required to distinguish A6.4ERs that are authorised for use towards the achievement of NDCs and/or for use for Other International Mitigation Purposes from those that are not (i.e., “mitigation contribution A6.4ERs”).
- At issuance, the mechanism registry administrator will be required to effect a first transfer of 5% of the issued A6.4ERs to an account held by the Adaptation Fund for assisting developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation.<sup>17</sup> The administrator must also effect a cancellation of a minimum of 2% of the issued A6.4ERs to the account for

delivering OMGE. Thereafter, the administrator will forward or effect a first transfer of the remaining issued A6.4ERs in accordance with the instructions of the activity participants and with any further modalities adopted.

- Importantly, where a host Party has authorised A6.4ERs for use towards Paris Uses, the RMP provides that the host Party must apply a corresponding adjustment (**see p26**) for the first transfer of all authorised A6.4ERs.

### AUTHORISATION

Use authorisations are fundamental to the Paris mechanisms. They determine whether a co-operative approach under Article 6.2 or an A6.4ER issued under Article 6.4 constitutes an ITMO (assuming all other requirements are satisfied).

In the context of Article 6.2, each Party participating in a co-operative approach that involves the use of ITMOs is required to have arrangements in place for authorising the use of ITMOs towards achievement of NDCs pursuant to Article 6.3. Authorisations and information on authorisations of use of ITMOs for Paris Uses must be included in a participating Party’s biennial transparency reports and recorded and tracked in a registry maintained under Article 6.2. However, the form and content of authorisation is, as yet, not prescribed.

**Use authorisations  
are fundamental to the  
Paris mechanisms**

<sup>17</sup> The Adaptation Fund was established in 2001 to finance concrete adaptation projects and programmes in developing country Parties to the Kyoto Protocol that are particularly vulnerable to the adverse effects of climate change. The Adaptation Fund was originally financed with a share of proceeds from the CDM project activities (amounting to 2% of CERs issued for those activities) and, from the second commitment period of the Kyoto Protocol, a 2% share of proceed levied on the first international transfer of Assigned Amount Units (**AAUs**) (each AAU being an individual unit representing an allowance to emit one metric tonne of carbon dioxide equivalent) and the issuance of ERUs for Article 6 activities. However, through decisions by the COP serving both the

Kyoto Protocol and the Paris Agreement, it was decided that the Adaptation Fund would serve the Paris Agreement with respect to all Paris Agreement matters from 1 January 2019, and exclusively the Paris Agreement once the share of proceeds under Article 6.4 of the Paris Agreement becomes available. (Additional financing is sourced from a variety of voluntary public and private sources.) According to an announcement by the Adaptation Fund prior to COP26 (available at <https://www.adaptation-fund.org/cop26/>) the Adaptation Fund had grown into a USD\$1 billion fund since 2010 and had committed approximately USD\$850 million for adaptation projects and programmes to date, including more than 123 committed projects in over 100 developing countries.

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In the context of the Article 6.4 mechanism, the host country is required to provide a statement to the Supervisory Body as part of the process leading to registration of a project specifying whether it “authorises” A6.4ERs issued for a particular activity for Paris Uses. The authorisation process is specified in the Art. 6.4 Decision<sup>18</sup>:

*The host Party shall provide a statement to the Supervisory Body specifying whether it authorizes A6.4ERs issued for the activity for use towards achievement of NDCs and/or for other international mitigation purposes as defined in decision 2/CMA.3. If the host Party authorizes any such uses, the Party may provide relevant information on the authorization, such as any applicable terms and provisions. If the host Party authorizes A6.4ERs for use for other international mitigation purposes, it shall specify how it defines “first transfer” consistently with paragraph 2(b) of the annex to decision 2/CMA.3.*

If the host country authorises A6.4ERs for Paris Uses, it has the option to provide information on the authorisation such as any applicable terms and conditions. It must also specify how it defines “first transfer” in the case of Other International Mitigation Purposes, as per the Art. 6.2 Decision (see below).

It is within the host country’s discretion whether to authorise all or some A6.4ERs issued for an activity for Paris Uses. This means that A6.4ERs can also be issued for non-Paris Uses. The Art. 6.4 Decision (COP27) describes these unauthorised A6.4ERs as “mitigation contribution A6.4ERs” which may be used “inter alia, for results-based climate finance, domestic mitigation pricing schemes, or domestic price-based measures, for the

purpose of contributing to the reduction of emission levels in the host Party”. While this new text emphasises use of these mitigation contribution A6.4ERs for domestic purposes, it does not expressly prevent or prohibit them being traded internationally meaning this remains a possibility. Rather, we understand that this new text has been introduced to address the issue of double claiming and is designed to send a signal to the VCM that these mitigation contribution A6.4ERs should be used towards host country targets only and not by private companies claiming offsets against their own targets. We return to the issue of double claiming later in this paper.

In any event, it remains that it is the “use authorisation” given to a co-operative approach under Article 6.2 or an A6.4ER under the Article 6.4 mechanism that determines whether corresponding adjustments are required.

### CORRESPONDING ADJUSTMENTS

Corresponding adjustments are a type of accounting tool used by parties to the Paris Agreement to avoid the double counting of GHG emissions. Corresponding adjustments are effected by the host Party adding the transferred emissions back into its national account whilst the receiving Party subtracts the transferred emissions from its own account. This ensures that the host Party no longer counts the emission reduction or removal as its own. In other words, if ITMOs are traded between countries pursuant to Article 6.2 or A6.4ERs which are authorised for use towards the achievement of NDCs are traded internationally, those ITMOs and A6.4ERs cannot be used by both Parties to satisfy their emission reduction targets under their NDCs as this would amount to double counting. The source of the obligation to make

**Corresponding adjustments are a type of accounting tool used by parties to the Paris Agreement to avoid the double counting of GHG emissions.**

<sup>18</sup> Chapter V.C, paragraph 42 of the Annex.



## The Paris Agreement

corresponding adjustments is Article 6.2 (mirrored in Article 4.13), which provides:

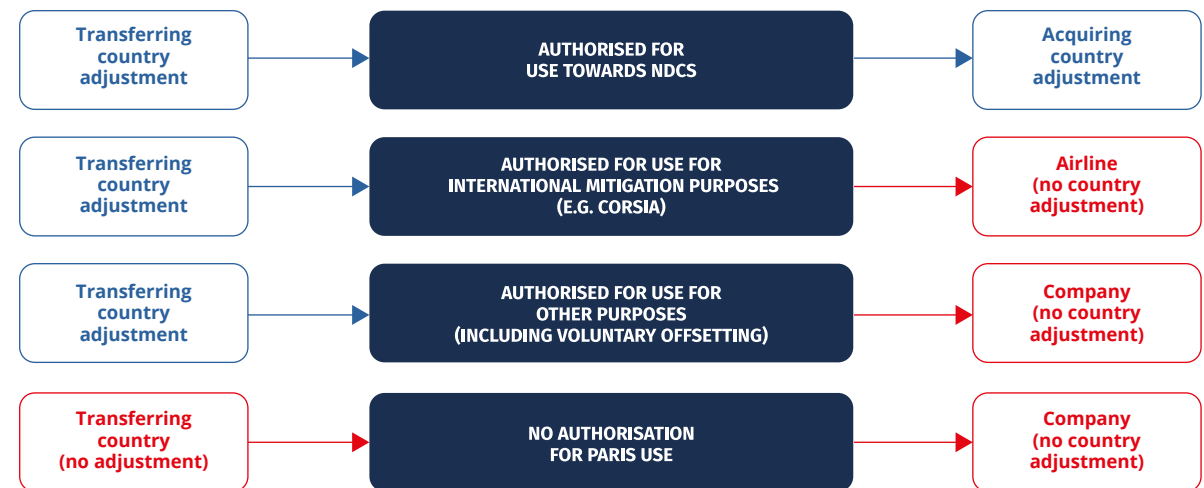
*Parties shall, **where engaging on a voluntary basis in co-operative approaches that involve the use of internationally transferred mitigation outcomes towards nationally determined contributions**, promote sustainable development and ensure environmental integrity and transparency, including in governance, **and shall apply robust accounting to ensure, inter alia, the avoidance of double counting**, consistent with guidance adopted by the Conference of the Parties serving as the meeting of the Parties to this Agreement.*

**[Emphasis added]**

Where Parties employ co-operative approaches pursuant to Article 6.2, corresponding adjustments must be applied as follows:

- a participating Party that first transfers ITMOs from emission reductions and removals covered by its NDC shall apply corresponding adjustments;
- a participating Party that first transfers ITMOs from emission reductions and removals that are not covered by its NDC shall apply corresponding adjustments; and
- where a participating Party authorises the use of mitigation outcomes for Other International Mitigation Purposes, it shall apply a corresponding adjustment for the first transfer of such mitigation outcomes.

**Figure 3: Country control via authorisation**



**Note:** Verra, November 2021, COP26 Outcomes and Implications. Available at: <https://verra.org/wp-content/uploads/2021/11/Verra-PPT-COP26-Debrief-22-NOV-2021-final-2.pdf> (Accessed on 25 October 2022).

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Corresponding adjustments must also be applied in certain scenarios within the Article 6.4 mechanism. Specifically, if A6.4ERs are authorised for Paris Uses, the host country is required to apply a corresponding adjustment when they are “first transferred”. “First transfer” is defined as:

- for a mitigation outcome authorised for use towards the achievement of an NDC, the first international transfer of the mitigation outcome; or
- for a mitigation outcome authorised for use for Other International Mitigation Purposes: (i) the authorisation; (ii) the issuance; or (iii) the use or cancellation of the mitigation outcome, as specified by the authorising country.

A6.4ERs that are not authorised for Paris Uses can be traded internationally without the host country having to make corresponding adjustments. This means that the host Party may account for those carbon credits within its NDC whilst enabling the carbon credits to be traded in the VCM (provided that buyers are happy to purchase on those terms). This does not constitute double counting; an issue we return to later in this paper. Hence, in the case of A6.4ERs, the type of authorisation a host Party applies to an A6.4ER determines whether corresponding adjustments are required. A summary of the different authorisations and whether they require a corresponding adjustment to be made is summarised in Figure 3.

### APPLICATION OF CORRESPONDING ADJUSTMENTS

There is some overlap between the Art. 6.2 Decision and the Art. 6.4 Decision in respect of when corresponding adjustments are required but the position can be summarised as follows:

- corresponding adjustments must be applied when a country authorises mitigation outcomes, A6.4ERs or other ITMOs for Paris Uses; and
- more specifically, corresponding adjustments must be applied:
  - where a host country authorises the use of mitigation outcomes for Other International Mitigation Purposes, in which case the corresponding adjustment must be applied for the first transfer of such mitigation outcomes<sup>19</sup>;
  - where a host country has authorised A6.4ERs for use towards NDCs or International Mitigation Purposes, in which case the corresponding adjustment must be applied for the first transfer of all authorised A6.4ERs<sup>20</sup>;
  - where a host country has authorised A6.4ERs for use towards achieving Other Purposes, in which case the corresponding adjustment must be applied for the first transfer of all authorised A6.4ERs<sup>21</sup>; and
  - where a country first transfers any other ITMOs from emissions reductions and removals (whether or not covered by its NDC).<sup>22</sup>

What constitutes “first transfer” and therefore exactly when a corresponding adjustment must be made will depend on the circumstances.

All corresponding adjustments must be applied consistently with the guidance in the Art. 6.2 Decision and in relevant future decisions of the COP.

<sup>19</sup> Annex of the Art. 6(2) Decision, III.C.

<sup>20</sup> Annex of the Art. 6(4) Decision, V.C(43).

<sup>21</sup> Annex of the Art. 6(4) Decision, V.C(44).

<sup>22</sup> Annex of the Art. 6(2) Decision, III.A and III.B(13-14).

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The Paris Agreement
**ARTICLE 6.4 MECHANISM REGISTRY**

A dedicated Art 6.4 mechanism registry will be established and connected to the international registry and other registries established under Article 6.2.

The Art. 6.4 Decision (COP27) details the form and functions of the mechanism registry. It specifies that the mechanism registry shall be made up of at least:

- a pending account to which all A6.4ERs are issued;
- a holding account which may acquire A6.4ERs or CERs tracked in the mechanism registry;
- a share of proceeds for the adaptation account, which receives A6.4ERs;
- an account for mandatory cancellation of A6.4ERs for OMGE;
- an account for voluntary cancellation of A6.4ERs for OMGE;
- a retirement account for A6.4ERs and CERs;
- an account for cancellation of A6.4ERs for Other International Mitigation Purposes; and
- a holding account or each Party and each public or private entity authorised per Article 6.4(b) by a Party that requests an account.

The mechanism registry will track:

- A6.4ERs authorised for use towards achievement of NDCs and/or for Other International Mitigation Purposes; and
- A6.4ERs not specified as authorised for use towards achievement of NDCs and/or for Other International Mitigation Purposes (i.e., mitigation contribution A6.4ERs), which may be used, inter alia, for results-based mitigation finance, domestic mitigation pricing schemes, or domestic price-based measures, for the purpose of contributing to the reduction of emission levels in the host Party.

The secretariat will serve as the mechanism registry administrator and maintain and operate the mechanism registry under the supervision of the Supervisory Body.

## 5. Identified areas of uncertainty between the VCM and the Paris Agreement

As with any developing international initiative, whilst the text of the Paris Agreement and the Decisions may clearly set out the framework there is a lot of detail that is still required.





## Identified areas of uncertainty between the VCM and the Paris Agreement

The Supervisory Body's approved workplan for 2022-2023 aims to operationalise the Article 6.4 mechanism by the end of 2023.<sup>23</sup> However, the workplan, and the associated Article 6.4 Mechanism Resource Allocation Plan 2023, demonstrate the large body of work that remains to be undertaken to do so including the development of standards and methodologies. Key areas of development for the Supervisory Body with respect to the Article 6.4 mechanism include:

- developing an operational procedure for the Article 6.4 mechanism registry;
- reviewing CDM accreditation standards and procedures and revise them as appropriate to apply to the Article 6.4 mechanism;
- developing a methodology development procedure and a standardised baseline development procedure; and
- designing and implementing a capacity building programme (expediting the implementation of Article 6.4).

The Art. 6.4 Decision (COP27) takes note of the agreed Article 6.4 Mechanism Resource Allocation Plan 2023 and other activities deemed essential for operationalising the Article 6.4 mechanism.

Even then, however, the detail of the Paris mechanisms will take the international community some time to understand and implement. This is complicated by the existence of the VCM and the uncertainties as to how the two will interact, and the opportunities the VCM continues to present in the wake of the Paris Agreement. Teething problems are to be expected. We identify below some of the key issues that we believe need to be addressed upon implementation of the Paris mechanisms and in terms of their relationship with the VCM.

### INCONSISTENCIES IN APPROACHES TO IMPLEMENTATION

As demonstrated by the above, the rules, modalities and procedures set out in the Decisions for the Paris mechanisms are complex. We expect that each Party is now grappling with how best to give effect to these mechanisms in their own country. Of course, at the heart of the Paris Agreement is each Party's obligation to develop and implement an NDC. Whether and to what extent implementation of an NDC is achieved using ITMOs will be determined by the "use authorisation" for ITMOs that host Parties are required to issue. For example, where an A6.4ER is "authorised for Paris Uses", the host Party is agreeing to apply a corresponding adjustment for that A6.4ER to enable another Party to claim it for use towards its NDC. However, the RMP recognises that an A6.4ER may also be issued without this authorisation, in which case the host Party may report that mitigation outcome under Article 4 of the Paris Agreement but not apply a corresponding adjustment. No other Party may then claim that A6.4ER for use towards its NDC. However, exactly how an unauthorised A6.4ER (i.e., a "mitigation contribution A6.4ER") may then be used remains unclear. The Art. 6.4 Decision (COP27) states mitigation contribution A6.4ERs may be used for certain domestic purposes. As explained above, this is not an exhaustive list and we are of the view this does not prevent them being traded internationally. How Parties will interpret this text is however unclear. It could lead to Parties imposing controls on the use of mitigation contribution A6.4ERs through the authorisation process. Such uncertainty could disincentivise market participants away from the Paris mechanisms in favour of the VCM.

Similarly, the Decisions do not prescribe procedures for, or the form of, use authorisations expected for the Paris mechanisms. A technical paper prepared by the secretariat on options for operationalising the guidance on co-operative approaches, for consideration by the SBSTA at SBSTA 57, detailed possible requisites

<sup>23</sup> United Nations Framework Convention on Climate Change, September 2022, Workplan of the Supervisory Body 2022-2023. Available at: <https://unfccc.int/sites/default/files/resource/a64-sb002-a02.pdf> (Accessed on 30 November 2022).

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for use authorisations in the hope of driving standardisation.<sup>24</sup> These included:

- core details such as date, number of authorisation, party, issuing authority, including contact information and elements for authentication;
- details of the co-operative approach from which the mitigation outcome or ITMOs are authorised;
- the amount and details of mitigation outcomes or ITMOs authorised toward NDCs;
- the amount and details of mitigation outcomes or ITMOs authorised toward other international mitigation purposes and authorised entities;
- NDC implementation period; and
- details of the mitigation activity, including, but not limited to, methodology/sector, type, crediting period and monitoring.

Various industry bodies, including the World Bank Group and the Global Carbon Council, have already published template “Letters of Authorisation/Endorsements” which they suggest satisfy the requirements of the Paris mechanisms.<sup>25</sup> However, practical implementation remains an issue as Parties seek to internalise the use authorisation requirements within their jurisdictions and existing legal frameworks. There is a risk of fragmentation of both approaches and the standards applied in and between different jurisdictions.

### DOUBLE COUNTING / DOUBLE CLAIMING

Depending on how such credits acquired under the Paris mechanisms or the VCM are used by credit buyers, there may be perceptions of double counting if a buyer counts a credit towards achievement of its own carbon reduction target where no corresponding adjustment has been made in respect of that credit. This stems from differing opinions within the market as to how international private (non-government) users of voluntary carbon credits without corresponding adjustments should count or claim those credits and what is meant by “double counting” of emissions reductions.

Under the Paris Agreement, “double counting” refers to a situation where more than one country claims an emission reduction or removal for the purposes of its NDC. However, issues arise when “double counting” is conflated with “double claiming”. “Double claiming” concerns a scenario where both the host Party (i.e., where the carbon credit was generated) and the purchasing entity (e.g., a company) make use of, or claim in respect of, the emission reduction or removal represented by the carbon credit, and is due to the disconnect between country and corporate accounting systems. For example, the host Party may claim the emission reduction or removal as government action, whilst the purchasing company uses that same emission reduction or removal to make claims about its climate performance. A distinction can be drawn here between those private buyers who do so to “offset” their own climate impacts (i.e., to balance out GHG emissions associated with its activities) and those seeking to “contribute” towards climate mitigation (e.g., those simply seeking to contribute to emission reductions without supporting a claim to balance out any of the buyer’s emissions). Carbon credits that are used to “offset” emissions are seen as more likely to serve as a substitute to directly reducing the emissions of the carbon credit buyer

**There may be perceptions of double counting if a buyer counts a credit towards achievement of its own carbon reduction target where no corresponding adjustment has been made .**

<sup>24</sup> UNFCCC. September 2022. Technical Paper on options for operationalizing the guidance on co-operative approaches referred to in Article 6, paragraph 2 of the Paris Agreement and in decision 2/CMA.3. Available at: [https://ercst.org/wp-content/uploads/2022/10/20220920-SBSTA57\\_Article-6.2\\_Technical-paper.pdf](https://ercst.org/wp-content/uploads/2022/10/20220920-SBSTA57_Article-6.2_Technical-paper.pdf) (Accessed on 18 November 2022)

<sup>25</sup> World Bank. 2021. Carbon Asset Development Process. Article 6 Approach Paper Series; No. 3. Available at <https://openknowledge.worldbank.org/handle/10986/36246> (Accessed on 24 October 2022), and Global Carbon Council, Program Forms & Templates. Available at: <https://www.globalcarboncouncil.com/framework/program-forms-templates/> (Accessed on 24 October 2022)

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than carbon credits which represent a “contribution” to supporting emissions reductions. Historically, in the VCM, carbon credits have mostly been used to offset GHG emissions associated with the buyer’s activities.

The RMP deals with the need for corresponding adjustments when ITMOs, including A6.4ERs, are authorised for Paris Uses. This has led to a debate on whether corresponding adjustments should be required for A6.4ERs not authorised for Paris Uses (e.g., in the context of the VCM) and whether this would increase overall mitigation efforts. There are some that are of the view that “double claiming” threatens the integrity of the VCM. They argue that corresponding adjustments should be applied within the VCM and would increase the credibility of VCM transactions by managing real or perceived risks of double claiming. They argue that the VCM will only drive additional climate change mitigation if double claiming is eliminated. However, others argue that corresponding adjustments are not relevant to the VCM and will create additional and unnecessary burdens on Parties. They are concerned that demands for corresponding adjustments in the VCM would limit VCM purchases and private finance flows. Ultimately, this difference of opinion has created significant uncertainty amongst governments and market participants. Climate Focus summarised the issue neatly when it said:

*A polarized debate on whether voluntary market transactions need to be complemented by corresponding adjustments has unfolded, monopolizing the attention and blocking the view for a broader appreciation of the potential of the VCM to attract investments into climate and development priorities. The exclusive focus on accounting is unhelpful and arguably not the first step in promoting climate action.*<sup>26</sup>

### Carbon standards

Adding to this uncertainty, carbon standards (such as Verra, Gold Standard and Global Carbon Council) have all adopted slightly different interpretations on the matter.<sup>27</sup> Verra welcomed publication of the RMP following COP26. Verra considers that the rules for both co-operative approaches and the Article 6.4 mechanism contain provisions to allow host countries to incorporate voluntary market transactions in their Article 6 accounting if they wish. To do so, countries would first give their “authorisation” in relation to using voluntary market credits for “other purposes”, and would then include these transactions when calculating the “corresponding adjustments” that they communicate in their reporting under the Paris Agreement. Verra acknowledges the many debates about whether corresponding adjustments are necessary for voluntary market transactions. It has always been its view, however, that such adjustments should not be mandated across the voluntary market by the Article 6 rules. Verra believes that “the fact that emissions – and emission reductions – are recorded at both company and country levels is both normal and widespread, and should not be considered double counting”.<sup>28</sup> It acknowledges, however, that such practice

<sup>27</sup> Verra was founded in 2007 and is one of the leading global standards for certifying carbon emission reductions. One of its key programmes, the Verified Carbon Standard (VCS) Programme, is the world’s largest voluntary GHG programme and allows certified projects to turn their GHG emission reductions and removals into tradable carbon credits (i.e., Verified Carbon Units or “VCUs”). Similarly, Gold Standard was established in 2003 by WWF and other international NGOs to ensure that projects that reduced carbon emissions featured the highest levels of environmental integrity and contributed to sustainable development. Gold Standard maintains the Gold Standard for the Global Goals which, like the VCS Programme, allows qualifying projects to be certified as Gold Standard compliant. Once certified, projects are entitled to be issued tradable carbon credits (called Gold Standard Verified Emission Reductions or “VERs”). Finally, the Global Carbon Council (GCC) Programme, also founded in 2007, is the Middle East and North Africa’s (MENA) first voluntary carbon offsetting programme and is an initiative of the Gulf Organisation for Research and Development. The voluntary GHG offsetting programme developed by the GCC accredits GHG emission reduction projects from around the world but with special emphasis on low-carbon development in the MENA region. Projects that are registered with the GCC programme are issued carbon credits, called Approved Carbon Credits or “ACCs”.

<sup>28</sup> Ibid.

<sup>26</sup> Climate focus, August 2021, Governments can exploit the untapped potential of the VCM to scale-up emissions reductions. Available at: <https://climatefocus.com/governments-can-exploit-untapped-potential-vcm-scale-emission-reductions/>. (Accessed on 28 September 2022).

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could risk lowering country and corporate climate change mitigation ambitions. It considers that greater understanding is still needed, among voluntary market participants and stakeholders, on where such adjustments may be appropriate.

By contrast, Gold Standard has generally taken the view that a corresponding adjustment should be applied in cases where carbon credits will be used for offsetting claims in the voluntary market to avoid “double claiming”.<sup>29</sup> Gold Standard distinguishes between a scenario where companies claim to have offset their emissions and a scenario where a company claims simply to have “financed” emission reductions; the latter not requiring a corresponding adjustment. Gold Standard is therefore of the view that carbon standards will need to actively differentiate – for post-2020 vintages – between units that do and those that do not have a corresponding adjustment. They have suggested that the Gold Standard registry’s functionality will be enhanced to:

- indicate whether the host country has issued a letter of assurance and authorisation for the project associated with the carbon credit;
- indicate whether a corresponding adjustment has been applied by the host country;
- indicate whether the project’s mitigation activities, emission reductions and/or removals are covered by any targets (including targets expressed in non-GHG metrics) communicated in a country’s NDC; and

- in cases where the project activity and corresponding emission reductions and/or removals are covered by NDC targets in GHG metrics and the credits are to be used for offsetting purposes, provide access to the letter of assurance and authorisation from the country or countries where a project’s emissions reductions or removals occurred.

That said, Gold Standard has confirmed that it will continue to issue credits to projects regardless of whether the host country has authorised them for use by other entities under Article 6 and agreed to apply a corresponding adjustment (except where credits will be used towards NDCs or CORSIA compliance, in which case a corresponding adjustment will be required).

The Global Carbon Council has sought to address the risks of double counting by applying market eligibility flags to their carbon credits. For example, a CA+ market eligibility flag denotes a carbon credit generated by a project where the host country of that project has officially communicated that the issued carbon credit will be included in the corresponding adjustments towards its NDC target. New requirements introduced by the GCC (to conform to the requirements of the RMP and good practice established under guidelines on avoiding double counting under CORSIA adopted by the International Civil Aviation Organisation) provide that for all GCC projects that voluntarily seek CA+ market eligibility flags, project owners must obtain and provide to the GCC a written host country attestation (i.e., a Host Country Letter of Authorisation (**HCLOA**)), noting that the emission units, once CA+ approved, can be used by voluntary carbon credit buyers. The GCC emphasises that it is the host country’s responsibility to ensure that no double claiming occurs in respect of projects registered with the GCC, for which there has been an issued HCLOA. The number of credits for each project per host country will be reported to relevant authorities and registries to ensure compliance.

<sup>29</sup> Gold Standard, February 2021, *Treatment of Double Counting and Corresponding Adjustments in Voluntary Carbon Markets*. Available at: [https://www.goldstandard.org/sites/default/files/documents/gs\\_guidance\\_correspondingadjustments\\_feb2021.pdf](https://www.goldstandard.org/sites/default/files/documents/gs_guidance_correspondingadjustments_feb2021.pdf) (Accessed on 30 November 2022).

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### Emerging governing bodies of the VCM

This question about corresponding adjustments is also being considered by the Integrity Council and the VCMI, taking forward the early work by the TSVCM. Both the Integrity Council and the VCMI have grappled with the question of whether a corresponding adjustment should be made for any carbon credits transferred internationally and used for voluntary purposes.

“Part 3: Summary for Decision Makers” of the Integrity Council’s CCPs public consultation draft provides a helpful articulation of the so-called double counting issue and its status:

*It is broadly understood that double counting must not occur where international transfers are used to comply with mandatory climate targets or Nationally Determined Contributions under the Paris Agreement. This understanding is also reflected in Article 6 rules agreed at COP26 in Glasgow. There is, however, an active debate whether double claiming should be avoided on the basis of a corresponding adjustment in the context of companies using carbon credits towards voluntary climate commitments, particularly as it relates to carbon credits that are internationally transferred. The issue sits at the intersection between the Paris Agreement and voluntary climate action. The Article 6 rules leave this issue unresolved. Some view the Paris Agreement and company accounting systems as operating in parallel while others consider these systems inherently connected. If one views these systems as working in parallel, double claiming by both companies (for example when purchasing carbon credits to compensate [for] their carbon footprint), and by host countries (as emission reductions under their Paris commitments) is not an integrity issue and no adjustment would be required. If instead one views these*

*accounting systems as connected, the claim by a company to be compensating [for] its emissions with credits would need to be adjusted by the host country itself, as the view would prevail that the reduction achieved would have been unduly counted twice.<sup>30</sup>*

The Integrity Council goes on to state that more analysis is required on the topic and that it has not taken a position on the issue but will be guided by the results of the consultation. Publication of the official CCPs, Assessment Framework and Assessment Procedure is expected in the coming months..

The VCMI recently consulted on its provisional Claims Code of Practice, which is guidance on the credible voluntary use of carbon credits by companies and other non-State actors, and the associated public claims<sup>31</sup>. The VCMI’s intention is to issue a final Claims Code of Practice in the coming months and to carry out a full review of it in 2025. The VCMI is clear in the provisional Claims Code of Practice that corresponding adjustments “are an accounting tool used to avoid double counting between countries and international compliance mechanisms”, but notes that Article 6 guidance does not specify whether corresponding adjustments should be applied when companies use carbon credits for voluntary purposes. The provisional Claims Code of Practice does not require carbon credits underpinning VCMI claims to be associated with corresponding adjustments, but does require transparent reporting on whether or not carbon credits are associated with corresponding adjustments. The VCMI notes that “the reality on the ground is that few countries have decided whether to make corresponding adjustments for voluntary

30 The Integrity Council for the Voluntary Carbon Market, July 2022, *Part 3: Summary for Decision Makers*. Available at: <https://icvcm.org/wp-content/uploads/2022/07/ICVCM-Public-Consultation-FINAL-Part-3.pdf> (Accessed on 30 November 2022).

31 Voluntary Carbon Markets Integrity Initiative, June 2022, *Provisional Claims Code of Practice*. Available at: <https://vcmin integrity.org/wp-content/uploads/2022/06/VCMI-Provisional-Claims-Code-of-Practice.pdf> (Accessed on 30 November 2022).



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carbon transactions, and fewer still have put the necessary legal and institutional frameworks in place". It also observes that "many countries have predicated achievement of their NDCs on the availability of external finance, including that generated through carbon markets". The VCM is working on refining the approach to this issue by commissioning analysis to assess the potential impacts of including carbon credits associated with corresponding adjustments within the VCM, in collaboration with the Integrity Council. This analysis will look at the impacts on the availability of credits, credit prices, purchasing decisions, and achievement and enhancement of countries' NDCs.

### The Art. 6.4 decision (COP27)

More recently, the UNFCCC has sought to weigh in on the issue. In a last-minute amendment to the Art. 6.4 Decision (COP27), the Parties agreed to recognise A6.4ERs not authorised for Paris Uses as "mitigation contribution A6.4ERs". The Art. 6.4 Decision (COP27) describes these mitigation contribution A6.4ERs as capable of being used "inter alia, for results-based climate finance, domestic mitigation pricing schemes, or domestic price-based measures, for the purpose of contributing to the reduction of emission levels in the host Party". Commentary coming out of COP27 suggests that this new text was introduced to address this issue of double claiming. The Parties hope that calling these units "mitigation contribution A6.4ERs" gives a clear indication that they should only be used towards a host country's NDC target. It is intended to send a strong message to the VCM that mitigation contribution A6.4ERs should not be claimed by private companies for offsetting purposes. Rather, they should only be used to fund climate action.

### ARTICLE 6.4 V ARTICLE 6.2

The Article 6.4 mechanism has been designed with the aim of creating a regulated, global international trading mechanism. However, many have raised concerns that the strict and detailed requirements of the Article 6.4 mechanism may disincentivise, rather than encourage, use of it, and the uptake of the Article 6.4 mechanism is therefore uncertain. Of particular concern are the following two requirements which essentially act as levies on the use of the Article 6.4 mechanism:

- at issuance of A6.4ERs, the administrator must effect a first transfer of 5% of the issued A6.4ERs of a carbon project into the Adaptation Fund account for assisting developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation; and
- at issuance, the administrator must effect a first transfer, for cancellation, of a minimum of 2% of the issued A6.4ERs to the account for cancellation for delivering overall mitigation in global emissions.

There has been some uncertainty as to how to interpret reference to "a first transfer" in these requirements and whether it is intended to capture all A6.4ERs issued in respect of a project, whether or not authorised for Paris Uses. The Art. 6.4 Decision seeks to address this by describing the transaction procedure for these two requirements as follows. The mechanism registry administrator shall:

- forward 5% of issued authorised A6.4ERs *and* mitigation contribution A6.4ERs in the pending account immediately to the share of proceeds for the adaptation account held by the Adaptation Fund and, if the issued A6.4ERs are authorised, shall distinguish that forwarding as effecting a first transfer.

**It is intended to send a strong message to the VCM that mitigation contribution A6.4ERs should not be claimed by private companies for offsetting purposes.**

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This first transfer shall be subject to a corresponding adjustment;

- cancel a minimum of 2% of issued authorised A6.4ERs and mitigation contribution A6.4ERs in the pending account immediately to the mandatory cancellation for OMGE account, and if the issued A6.4ERs are authorised, shall distinguish the cancellation as a first transfer. This first transfer shall be subject to a corresponding adjustment.

Thereafter the administrator must forward or effect a first transfer, as applicable, of the remaining A6.4ERs to the holding accounts of activity participants and participating Parties involved, in accordance with the instructions of the activity participants.

These requirements do not exist in respect of the other co-operative approaches such as ITMOs traded between Parties pursuant to an Article 6.2 bilateral agreement, or in the VCM. Some have suggested that these levies, as well as the bureaucracy around the Article 6.4 mechanism, will drive Parties to utilise these other mechanisms, rather than the Article 6.4 mechanism.

### MORATORIA ON THE ISSUANCE AND/OR TRADING OF CARBON CREDITS INTERNATIONALLY

Following COP26 and publication of the RMP, a number of jurisdictions have introduced moratoria on the issuance and/or trading of carbon credits internationally. This action seems to stem from a general uncertainty by some Parties as to what impact VCM trading has on NDC implementation and the concerns about double counting / double claiming. For example:

- in March 2022, Papua New Guinea introduced a moratorium on any new or intended REDD+ Voluntary Carbon Market Projects looking to use voluntary carbon standards to trade carbon credits. The press statement issued by the Minister for Environment and Conservation and Climate Change explained that the country will *“now take advantage of the COP26 outcomes and pursue Article 6 of the Paris Agreement by negotiating with Private Sector-based companies to buy into Papua New Guinea’s soon to be established emission trading scheme”*<sup>32</sup>;
- in June 2022, the Honduran Government imposed a moratorium on the sale of voluntary carbon credits that are not duly recognised by the UNFCCC or the Paris Agreement. According to a report by the Coalition for Rainforest Nations, *“once the Honduran Government has completed a new forest carbon inventory, updated its REDD+ safeguards and strategy, consolidated its institutional arrangements, updated its regulatory framework, implemented the carbon accounting system (which allows for non-duplication) and the crediting process, the moratorium will be lifted”*<sup>33</sup>
- in August 2022, India announced that it too would ban firms from exporting carbon credits until the nation meets its climate goals, in favour of establishing a national carbon market. In a speech to lawmakers, India’s Climate Targets, Power and Renewable Energy Minister Raj Kumar Singh is quoted as saying *“Carbon credits are not going to be exported.*

32 REDD-monitor, March 2022, *Papua New Guinea declares moratorium on voluntary REDD projects*, REDD-monitor.org. Available at <https://redd-monitor.org/2022/03/19/papua-new-guinea-declares-a-moratorium-on-voluntary-redd-projects/> (Accessed on 29 September 2022.)

33 Coalition for Rainforest Nations, June 2022, *Honduras imposes moratorium on voluntary credits*, rainforestcoalition.org. Available at <https://www.rainforestcoalition.org/country-news/honduras-imposes-moratorium-on-voluntary-credits/#:~:text=On%20June%2024%2C%20the%20government,data%20reporting%20expertise%20under%20REDD%2B> (Accessed on 14 October 2022).

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*No question*". On the development of a national carbon market, Mr Singh stated *"These credits will have to be generated by domestic companies, [and] bought by domestic companies"*. However, in subsequent public comments made by the Minister on 8 October 2022, the Minister clarified that India did not intend to impose a full ban on the trading of carbon credits internationally, only a ban up to the extent required for India's own NDC, and that *"other countries can look forward to huge quantities of carbon credits being available in India"*<sup>34</sup>; and

- in October 2022, (following a moratorium announced in April on the issuance of carbon credits), the Indonesian government passed a regulation regarding Implementation of Carbon Economic Value (*Peraturan Menteri Lingkungan Hidup No. 21 Tahun 2022 tentang Nilai Ekonomi Karbon*).<sup>35</sup> The regulation requires those seeking to trade carbon credits internationally to apply for a ministerial licence, and imposes an indirect tax on credits sold internationally.

Of course, how these moratoria and bans on the international trading of carbon credits operate in practice depends on the domestic laws giving effect to them and what is deemed by a host country to constitute an international trade (sometimes also referred to as the "export" of carbon credits). It is arguable that whilst the emission reductions or removals are generated in the host country, the actual credits are generated in the jurisdiction of the carbon standard registry and so are not capable of being "exported" from the host country. A host country may therefore look to ban the export of the benefit of the reductions or removals and any associated credits. It could also determine that ownership

by international entities of carbon credits issued in respect of GHG reductions or removals generated in their host country constitutes export and is therefore prohibited. Irrespective of specifics, it is likely that the carbon standards will refuse to issue credits if the host country has passed a legally binding ban. These moratoria and bans risk stifling the VCM in developing countries which arguably have the most to gain from it, by:

- potentially delaying carbon offsetting projects and the issuance of carbon credits, where urgency is needed. For example, market commentators have suggested that the new Indonesian regulation is likely to delay the issuance of carbon credits by several months, if not years, as it requires project developers to have plans that are aligned with Indonesia's NDC before credits can be exported<sup>36</sup>;
- restricting capital flows to developing countries which is critical for achieving net zero; and
- hindering efforts to scale-up supply of carbon credits and grow capacity whilst creating significant uncertainty on the demand side,

and risk ultimately destroying the carbon market in those countries.

### UNCERTAINTIES AROUND BENEFIT SHARING

Another issue seemingly concerning developing countries is that of the opportunities, or lack thereof, for benefit sharing from carbon projects that progress under the VCM and the impact this will have on a country's ability to monetise carbon projects through the Paris mechanisms.

<sup>34</sup> Carbon Pulse, October 2022, India won't ban carbon credit exports – Minister,. Available at: <https://carbon-pulse.com/175017/> (Accessed on 28 November 2022).

<sup>35</sup> Quantum Commodity Intelligence, October 2022, *Indonesian regulation imposes restrictions on carbon exports*. Available at <https://www.qcintel.com/carbon/article/indonesian-regulation-imposes-restrictions-on-carbon-exports-9363.html> (Accessed on 31 October 2022).

<sup>36</sup> Quantum Commodity Intelligence, October 2022, *Indonesian carbon export laws subject to major changes – sources*. Available at <https://www.qcintel.com/carbon/article/indonesian-carbon-export-laws-subject-to-major-changes-sources-9395.html> (Accessed on 31 October 2022).

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Many of the carbon standards require project proponents to demonstrate some form of benefit sharing, but this is generally limited to benefit sharing with landowners and/or local communities, and the extent of it very much depends on the nature of the certification being sought. For example, Verra's VCS Standard requires project proponents to develop a grievance redress procedure to address disputes with local stakeholders that may arise during project planning and implementation, including with regard to benefit sharing. The Verra Climate, Community and Biodiversity Standards go slightly beyond requiring project proponents to design and implement a benefit-sharing mechanism, demonstrating that smallholders/community members have fully and effectively participated in defining the decision-making process and the distribution mechanism for benefit sharing; and to demonstrate transparency, including on project funding and costs as well as on benefit distribution.<sup>37</sup> There is no provision for benefit sharing with the host country specifically.

In certain countries, host governments may seek to secure some form of State or regional benefit sharing via the regulated development framework, if one exists and is applicable to carbon projects. However, these are often lacking in developing countries and/or are limited in scope.

The absence of benefit-sharing obligations with host countries in the VCM carbon standards has led to a concern amongst developing countries that this will impede their ability to monetise the Paris mechanisms, as doing so may discourage developers from the Paris mechanisms in favour of the VCM. Developing countries argue that such arrangements risk directing foreign investment to large-scale NGOs / project proponents and landowners only.

### SIGNIFICANT QUANTITIES OF JURISDICTIONAL-BASED CREDITS EXPECTED WITHIN THE VCM

There has been considerable media coverage recently about the role of "sovereign credits" issued under the REDD+ mechanism in the Paris mechanisms. This is largely due to the potential volumes to be offered and potential impacts on the carbon markets. Of particular note, the UNFCCC announced that Gabon will be eligible for 90.6 million sovereign credits under the REDD+ mechanism following validation of the Gabon jurisdictional scheme. The scheme is said to have achieved a reduction in GHG emissions by approximately 90 million tonnes through forest protection between the years 2010 and 2018. It is understood that these credits will be marketed by Gabon's sovereign wealth fund and sold on the VCM. Honduras, Belize and Papua New Guinea are expected to follow Gabon.

In a similar vein, a new Africa Carbon Markets Initiative (**ACMI**) was announced on 8 November 2022 at COP27, with numerous African nations showing their support for it including Kenya, Malawi, Gabon, Nigeria and Togo. The ACMI has published a Roadmap Report detailing practical steps for how the potential of the VCM in Africa (**African VCM**) could be realised.<sup>38</sup> It describes an ambition to grow the African VCM to:

- produce 300 million carbon credits annually by 2030, and 1.5 billion credits annually by 2050;
- unlock USD\$6 billion in revenue by 2030 and over USD\$130 billion by 2050; and
- support 30 million jobs by 2030 and over 110 million jobs by 2050.

<sup>37</sup> Verra Carbon Standard, June 2017, *Climate, Community & Biodiversity Standards*, Available at: [https://verra.org/wp-content/uploads/2017/12/CCB-Standards-v3.1\\_ENG.pdf](https://verra.org/wp-content/uploads/2017/12/CCB-Standards-v3.1_ENG.pdf) (Accessed on 30 November 2022).

<sup>38</sup> Africa Carbon Markets Initiative (ACMI), November 2022. *Roadmap Report – Harnessing carbon markets for Africa*. Available at [https://www.seforall.org/system/files/2022-11/ACMI\\_Roadmap\\_Report\\_Nov\\_16.pdf](https://www.seforall.org/system/files/2022-11/ACMI_Roadmap_Report_Nov_16.pdf) (Accessed on 16 November 2022).

## Identified areas of uncertainty between the VCM and the Paris Agreement

Both sovereign credits under the REDD+ mechanisms and the ACMI promise huge volumes of carbon credits over the coming years. Whilst REDD+ and ACMI can make a very significant contribution to achieving the Paris objectives, there is a concern that the quantum of credits coming into the market could impose a significant downward pressure on the price for voluntary carbon credits. Cheaper carbon credits may benefit buyers, but it would ultimately mean significantly reduced capital flows going to carbon projects and may render some carbon projects, particularly in developing countries, unfinanceable or unviable. Market mechanisms mean that if prices fall too far such that fewer projects are financed, prices will inevitably increase and the ability to finance supply will slowly recover. However, the reduction in climate action in the intervening period may be considerable. Significant price fluctuations also risk undermining the stability of, and trust in, the VCM, which does not support the scaling up of the VCM.

### UNCERTAINTIES SURROUNDING AVOIDANCE EMISSIONS

There is considerable uncertainty about the role that avoidance emissions and avoidance credits should play in the Paris mechanisms and the VCM. Unhelpfully, there is no universally accepted definition for “avoidance emissions” or “avoidance credits”, and the various carbon initiatives understand and use these terms differently. However, at a very basic level, avoidance emissions are generally understood to refer to scenarios where the release of GHG emissions that would otherwise have been emitted has been avoided.

There is a concern that avoidance credits do not represent the actual additional sequestration of GHG from the atmosphere but rather the preservation of something, e.g., a carbon sink in the form of a forest. Whilst recognising the importance of preserving

these carbon sinks (and rewarding the countries that do), some feel bringing in credits from them is not appropriate for the Paris mechanisms or the VCM which are designed on the basis of funding additional reductions or removals. However, others argue that avoided emissions are just as important in the global efforts to achieve net zero as reducing or removing emissions and should be recognised. This is a particularly live issue for the Paris mechanisms. The Art. 6.2 Decision requested the SBSTA to develop recommendations on consideration of whether ITMOs could include “emission avoidance”; a request that has been repeated in the Art. 6.2 Decision (COP27) and Art. 6.4 Decision (COP27) following little progress on this issue at COP27. A decision on avoidance emissions may have ramifications for jurisdictional-based schemes such as REDD+ and the African ACMI which rely heavily on forestry-based projects which, by their nature, are at least partially avoidance-based schemes.

**There is no universally accepted definition for “avoidance emissions” or “avoidance credits”, and the various carbon initiatives understand and use these terms differently.**

### DIFFICULTIES IN DECIPHERING NDCs

NDCs form the basis for countries to achieve the objectives of the Paris Agreement. Put simply, they represent a country's climate action plan to cut emissions and adapt to climate impacts, and the co-operative approaches of the Paris Agreement have been specifically geared to help Parties achieve their NDCs. As recognised by the UN Development Programme in its paper *Designing and Preparing Intended Nationally Determined Contributions*<sup>39</sup>, NDCs help to:

- demonstrate a political commitment to limit warming;
- enable policy integration by linking climate change to other

<sup>39</sup> World Resources Institute, *Designing and Preparing Intended Nationally Determined Contributions (INDCs)*. Available at: <https://www.undp.org/sites/g/files/zskgke326/files/publications/designing-preparing-indcs.pdf> (Accessed on 30 November 2022).



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## Identified areas of uncertainty between the VCM and the Paris Agreement

national priorities such as sustainable development and poverty reduction;

- advance the understanding of key stakeholders, as well as the international community, regarding future policymaking, implementation strategies and expected emissions reductions and non-climate benefits that may result from the NDC; and
- communicate support needs for completion and implementation of low emissions development strategies and national adaptation plans and/or activities. This may enhance Parties' abilities to mobilise public and private, and national and international, investments.

At the same time, they help to inform the scope of VCM activities. Whilst there is an expectation that developed countries will prepare and maintain whole-economy NDCs, there is a general recognition that it may take developing countries some time to expand their NDCs to cover their whole economy. Where this is the case, the scope of an NDC is likely to inform whether or not a particular mitigation outcome may be authorised for Paris Uses. A host Party with a broad NDC may be less willing to authorise mitigation outcomes for Paris Uses if it is relying on those mitigation outcomes for achievement of the objectives of its own NDC. A host Party with a narrow NDC may be more willing to authorise mitigation outcomes for Paris Uses if not relying on such mitigation outcomes for its own NDC. Mitigation outcomes not authorised for Paris Uses may still form part of the VCM. An understanding of when a host Party is or is not likely to authorise mitigation outcomes for Paris Uses will help market participants assess what opportunities exist within that country for VCM activities.

However, as they currently stand, NDCs tend to be drafted in broad, sweeping terms and can be difficult for market participants

to decipher. It is not always clear on the face of them what sectors and/or activities fall within or outside an NDC. This may create uncertainties for those seeking use authorisations and/or those wishing to develop voluntary carbon projects.

### **ACHIEVING SUFFICIENT CERTAINTY TO ATTRACT LARGE-SCALE INVESTMENT**

The success of both the Paris mechanisms and the VCM rests on attracting sufficient investment in carbon activities that generate ITMOs under Article 6.2, A6.4ERs and/or voluntary carbon credits. Investors seeking to support Paris activities will be looking for certainty that the projects they invest in will secure the necessary use authorisations and, by extension, corresponding adjustments, to enable the trading of A6.4ERs. Similarly, investors seeking to support VCM activities will want comfort that their voluntary carbon projects will be left for the VCM and not used for Paris Uses. There are two ways in which this level of clarity and certainty could be achieved; through government-to-government (**G2G**) arrangements, or through business-to-government (**B2G**) arrangements.

#### **Government-to-government arrangements**

G2G arrangements would enable Parties to communicate and agree their roles in operationalising the Paris Agreement mechanisms, their intentions to support Paris activities, and their intentions to utilise the VCM. Reaching agreement on such matters at a government level will provide considerable certainty to investors who are interested in those countries and help to generate investment activity.

## Identified areas of uncertainty between the VCM and the Paris Agreement

Article 6.2 already envisages the trading of “mitigation outcomes” through bilateral or multilateral agreements between countries. Switzerland, for example, has entered into bilateral agreements with a number of countries, including, by way of example, Peru, Ghana, Georgia and the Kingdom of Thailand. Whilst the specifics differ, the general objective of these agreements is described as establishing the legal framework for the transfers of mitigation outcomes for use towards NDC achievement or for mitigation purposes other than achievement of the NDC. These agreements are fairly high-level but provide the basis for how each Party will: recognise authorised transfers of mitigation outcomes; define and use a registry; apply corresponding adjustments (in some cases this is prescriptive; in others, the agreement simply recognises this shall be done in accordance with the Art. 6.2 Decision); and report.

To deliver even greater certainty, G2G arrangements could go beyond simply establishing a framework for future co-operation and record, in detail, how the Parties will deliver on the Paris mechanisms and the VCM together. Of course, where the arrangements are to provide for the trading of A6.4ERs for Paris Uses, fundamental to these arrangements will need to be an understanding that both the host country and the recipient country will make the necessary corresponding adjustment(s) to their national GHG emissions inventory (See Figure 3 on p27) and reflect this in the implementation and achievement of their NDCs. At the same time, these G2G arrangements could also record both Parties’ intention to support and/or utilise the VCM within their jurisdictions. This might include recognition between the Parties as to what sectors are in or outside the scope of either NDCs and what opportunities this presents for the trading of voluntary carbon credits within the VCM (i.e., between the Parties or individual actors from within their respective jurisdictions) and reflect this in the implementation and achievement of their NDCs.

At the same time, these G2G arrangements could also record both Parties’ intention to support and/or utilise the VCM within their jurisdictions. This might include recognition between the Parties as to what sectors are in or outside of the scope of either NDCs and what opportunities this presents for the trading of voluntary carbon credits within the VCM (i.e. between the Parties or individual actors from within their respective jurisdictions).

There are two main ways in which governments could seek to formalise these arrangements: either by way of a Memorandum of Understanding (**MoU**) between governments; or a treaty. A treaty is an international agreement concluded in writing between Parties which creates rights and obligations in international law<sup>40</sup>. Treaties are known by a variety of names, for example agreement, convention, protocol, treaty, etc. They may be in the form of a single instrument with numbered articles or in the form of an exchange of notes. An MoU records international commitments, but in a form and with wording which expresses an intention that it is not to be binding as a matter of international law. An MoU can have a variety of names (e.g., arrangement) and can also be either in the form of an exchange of notes or a single document.

On the whole, we consider that MoUs present a more realistic and achievable route for governments to provide further detail on the mechanics of international carbon trading between countries pursuant to the Paris mechanisms, for the following reasons:

- **Timing:** Compared to treaties (which can take years to negotiate and conclude), MoUs can be prepared, agreed and formalised at speed, and they become effective immediately upon signing.
- **Minimal formalities:** MoUs do not require the same level of

**These G2G arrangements could also record both Parties’ intention to support and/or utilise the VCM within their jurisdictions.**

<sup>40</sup> Article 2(1) of the Vienna Convention on the Law of Treaties 1969 defines a treaty as “an international agreement concluded between Parties in written form and governed by international law, whether embodied in a single instrument or two or more related instruments and whatever its particular designation”.

## Identified areas of uncertainty between the VCM and the Paris Agreement

formalities in terms of domestic process and authorisation as entry into a treaty requires. With few exceptions, most written constitutions stipulate that parliamentary approval of treaties is required before ratification. Domestic legislation may also be required to enable a State to give effect to its obligations under a treaty. These formal processes inevitably increase the time, cost and effort required to implement an arrangement, as well as carrying the risk that necessary approvals will not be provided.

- **Legal status:** Treaties are governed by international law, whereas MoUs are not. While MoUs are generally designed so as not to be legally binding, the commitments they contain are usually taken very seriously by Parties and are not readily departed from. MoUs usually specify that any differences as to their interpretation or application will be resolved through discussion and negotiation. Whilst this may mean that there are no legal dispute resolution mechanisms available to the Parties in the event of a disagreement beyond private negotiation, this is unlikely to be a problem given that the Parties are primarily looking to achieve credibility of a system that can be relied upon to ensure that there is no double counting of GHG emission reductions and giving effect to the requirements of the RMP.
- **Flexibility:** MoUs are easily amended (by mutual written consent) in the event of changing circumstances; for example, if the nature or quantum of carbon credits available for exporting were to change. They are also generally considered a more suitable vehicle than treaties for recording arrangements which are technical in nature. A treaty may be amended by agreement between the parties, but the process may be likely to be more cumbersome than amending an MOU.
- **Non-state parties:** Unlike treaties, which must be between States, MoUs have the flexibility of also allowing non-State actors

(such as project developers or financial investors) to be parties, should circumstances require this.

- **Publication requirements:** Typically, MoUs are not formally published, whereas treaties are required, after their entry into force, to be transmitted to the secretariat of the United Nations for registration or filing and recording, and for publication.<sup>41</sup> There may be sensitive elements of such arrangements for which confidentiality is preferred (albeit in order to deliver the certainty that market participants are likely to expect in terms of achieving corresponding adjustments, key details of the arrangements will need to be publicised).

### Business-to-government arrangements

An alternative method of delivering the type of certainty investors are likely to require is B2G arrangements. Governments could enter into B2G arrangements direct with market participants, such as project proponents or large financial investors, to record the parties' intentions with respect to international carbon trading.<sup>42</sup> These B2G arrangements may be similar in nature to the use authorisations required under the Paris mechanisms if supportive of such mechanisms, or take the form of an exemption from authorisation if the parties wish to avoid Paris mechanisms and instead rely on the VCM.<sup>43</sup> The scope of these B2G arrangements could be as broad or as narrow as the parties prefer.

<sup>41</sup> Article 80(1) of the Vienna Convention on the Law of Treaties ("Registration and publication of treaties") provides: "Treaties shall, after their entry into force, be transmitted to the Secretariat of the United Nations for registration or filing and recording, as the case may be, and for publication."

<sup>42</sup> There may be a scenario where private actors seek to approach governments of countries of any ultimate recipients to their anticipated carbon trades but expect such arrangements to be more difficult to arrange and may in any event require the support of the private actor's own government.

<sup>43</sup> Gold Standard has recommended to project developers that wish to obtain agreement on Article 6 authorisation and/or corresponding adjustment to get in touch with the relevant government entity of the host Party. They have offered support to project developers and other stakeholders in engagement with host governments, recognising that many may not yet have in place formal processes for managing such requests.

**Governments could enter into B2G arrangements direct with market participants, such as project proponents or large financial investors, to record the parties' intentions with respect to international carbon trading.**

## Identified areas of uncertainty between the VCM and the Paris Agreement

Assuming the parties wish to enable trading within the Article 6.4 mechanism, the B2G arrangements are likely to require:

- **From the host party:** confirmation that it will nominate the counterparty's carbon project(s) to the Supervisory Body under Article 6 and, in doing so, authorise A6.4ERs issued for that particular activity(ies) for Paris Uses. The arrangements should record a commitment on behalf of the host Party to apply the necessary corresponding adjustments for the first transfer of all authorised A6.4ERs from that project, as well as a general commitment otherwise to comply with the requirements of Article 6.4 and the RMP.
- **From the private actor:** a commitment to ensure that their carbon project (or projects) satisfies the requirements of the Paris Agreement and the RMP such that it is eligible for registration under Article 6.4 (recognising that it is the DoE that will assess a project's compliance with the Article 6.4 requirements); confirmation of the private actor's intended use of A6.4ERs issued for that particular activity and, as with the host Party, a general commitment to otherwise comply with the requirements of Article 6.4 and the RMP.

If the intention is to further carbon projects and carbon trading within the VCM, the B2G arrangements could record a shared understanding that the carbon projects and carbon credits in question will not be registered under Article 6 and will not be authorised for Paris Uses. These arrangements should clarify that the right to account for the GHG emissions within the Paris accounting framework stays with the host country. B2G arrangements also provide a forum for the parties to negotiate and agree any benefit-sharing arrangements that the host country may require in respect of carbon projects located within its country. The host country may seek a commitment from the counterparty that it

will not permit, authorise, offer, encourage, etc. a receiving country of those carbon credits to account for those credits within its NDC (if it were particularly concerned about the risks of double counting). Whether or not this is reasonable will depend on the counterparty but, in any event, we do not consider the receiving country would be able to do so legitimately.

B2G arrangements could be implemented via an MoU or a private B2G agreement. In this scenario, an MoU would offer all the same benefits as a G2G MoU (e.g., in respect of speed and flexibility, etc.); however, whether they were appropriate in the circumstances would need to be considered. A private actor may value a legally binding B2G contract over a traditionally non-binding MoU, given that it will be relying on it to bring forward its carbon projects. The biggest consideration is likely to be one of enforceability. Due consideration would need to be given to the practicalities of enforcement, such as the forum within which disputes may be brought and the governing law. It is likely that private actors would insist on internally recognised legal systems, such as English law and the English courts, in place of the governing laws of the host Parties, which may be less developed in these areas. This may be resisted by some host Parties.

### LEGAL UNCERTAINTIES WITHIN THE VCM

Whilst the VCM has grown rapidly over the past few years and looks likely to continue on this path, some legal uncertainties remain because of its largely unregulated nature.

#### Legal nature of carbon credits

Broadly speaking, a carbon credit is generally accepted in the VCM to be a unit of account representing one tonne of GHG reduction,

## Identified areas of uncertainty between the VCM and the Paris Agreement

removal, sequestration or mitigation relative to a baseline scenario that has been independently verified as having been achieved by a carbon standard and which conforms to that carbon standard. However, the exact legal nature of carbon credits is unclear. Such uncertainty as to the legal nature and treatment of carbon credits has hampered, to an extent, major investment in the VCM to date and has prevented the development of any real secondary market. The International Swaps and Derivatives Association (ISDA) paper titled “Legal Implications of Voluntary Carbon Credits” dated December 2021<sup>44</sup> considered this issue in detail, recognising that a robust VCM must be grounded in a strong legal foundation.<sup>45</sup> The paper explains that, across jurisdictions, two main legal treatments have emerged:

- Many jurisdictions, including England, treat carbon credits as a form of intangible property on the basis that they are definable, identifiable by third parties, capable of being assumed by third parties, and have some degree of permanence or stability. Carbon credits are viewed as an intangible asset, established in accordance with the applicable carbon standard and evidenced by that carbon standard’s register entries.
- The alternative treatment is as a bundle of contractual rights between the project developer, verifier, carbon standard and register. The issue with this treatment is that it risks a greater degree of fragmentation within the VCM due to variances that are likely to exist between the different contractual arrangements. It also complicates the trading of carbon credits

because in certain jurisdictions, including English law, contracts can only be transferred by assignment or novation, provided certain formalities are complied with. Such issues do not arise when dealing in intangible assets.

### Ownership rights over carbon credits

Similarly, uncertainty as to ownership rights over carbon credits has also stifled the VCM’s development somewhat. Within the VCM, most market participants have operated on the assumption that rights over carbon (i.e., the rights to claim credit for emission reductions) are akin to property rights from which ownership rights directly flow. This is true for many of the carbon standards which equate ownership of an offset project with ownership over the carbon credits generated by that project. Verra, for example, will only issue carbon credits to the “project proponent” or its authorised representative. A project proponent is the individual or organisation (or group thereof) that has overall control and responsibility for the project and can demonstrate project ownership in respect of the project. Similarly, Gold Standard, as part of its general eligibility criteria, requires all project developers seeking Gold Standard certification to demonstrate full and uncontested legal ownership of any products that are generated under Gold Standard certification (for example, carbon credits). It recognises that, for certain projects, this may require full and uncontested legal land title/tenure to be demonstrated. Having satisfied ownership, the project developer becomes the registry account holder and authorised owner of the carbon credits.

However, there is a separate school of thought which equates carbon to a State asset (e.g., like oil). This idea has found further support following the emergence of the Paris mechanisms with more Parties now seeking to treat carbon as effectively national.<sup>46</sup>

<sup>44</sup> ISDA, December 2021, Legal Implications of Voluntary Carbon Credits. Available at: <https://www.isda.org/a/38ngE/Legal-Implications-of-Voluntary-Carbon-Credits.pdf> (Accessed on 1 December 2022).

<sup>45</sup> ISDA has just released a supplemental paper looking specifically at the legal nature of carbon credits under the laws of France, Japan and Singapore. ISDA, November 2022, *The Legal Nature of Voluntary Carbon Credits: France, Japan and Singapore*. Available at: <https://www.isda.org/a/PlcgE/Legal-Nature-of-Voluntary-Carbon-Credits-France-Japan-and-Singapore.pdf> (Accessed on 1 December 2022).

<sup>46</sup> Bloomberg UK, July 2022, *World’s Biggest Carbon Credit Load Pits Firms Against Ministers*, Available at:



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## Identified areas of uncertainty between the VCM and the Paris Agreement

Essentially, publication of the Art. 6.4 Decision has caused more governments to consider carbon offsets as a national asset by, in effect, crystallising their value. This position seems to have developed from the concept of “carbon rights” which framed the rights to carbon as somewhat inherent rather than recognising the value comes from the recognition, through the issuance of carbon credits, of the service of carbon sequestration. This idea of nationalising carbon is further supported by the fact that many NDCs capture all (or almost all) GHG emissions within scope and, by consequence, carbon offsets. If this were the case, this would have significant implications for how carbon credits issued in respect of those emission reductions could be used and who could claim ownership rights over those credits. We do not believe it was the intention of the Art. 6.4 Decision to affect such a fundamental change. However, any uncertainty about ownership of carbon credits will be a significant concern to potential investors and international buyers and could prevent or hamper investment.

will require corresponding adjustments, and (b) carbon credits that are not authorised for Paris Uses and will not require corresponding adjustments (i.e., either because they are issued under the Paris mechanism but not “authorised” or because they are truly voluntary carbon credits). Such a clear distinction in the market is likely to lead to a price premium being attributed to carbon credits that have a corresponding adjustment associated with them over those that do not, if the market comes to view them as being more desirable for certain uses because of the avoided risk of double claiming.

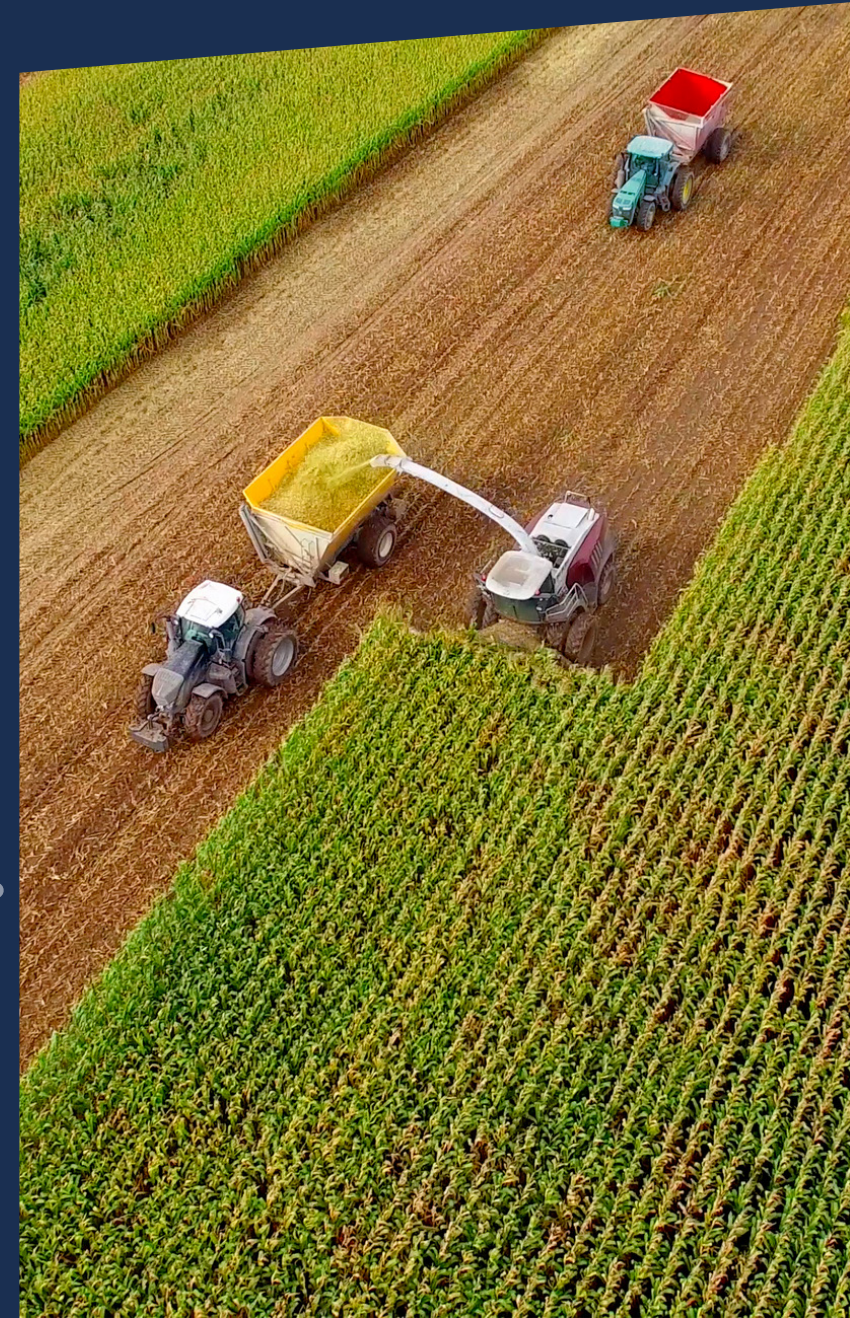
### CARBON PRICING

One of the issues in scaling the carbon markets (particularly a secondary market) is the lack of certainty over carbon pricing. There are significant differences and fluctuations between different types of projects, different jurisdictions and different vintages. The likely outcome of the implementation of the Paris mechanisms is that there will be more diversity on pricing, not less. A distinction will be drawn between (a) carbon credits issued under the Paris mechanisms and authorised for Paris Uses which

<https://www.bloomberg.com/news/articles/2022-07-07/world-s-biggest-carbon-credit-load-pits-firms-against-ministers> (Accessed 30 November 2022). In the article, Mr Sebastian Cross, co-founder of carbon ratings agency BeZero, commented that until now, the VCM had operated in a policy vacuum. Mr Cross said that while the general assumption has been that carbon rights are part of property rights, and that credits can be issued accordingly, this is changing. His view was that, since COP26 “all carbon is now effectively national”.

## 6. Recommendations

The Paris Agreement marks a paradigm shift in international efforts to address and adapt to climate change. However, it is critically important that climate action is not slowed or held back while the establishing work for the Paris mechanisms is carried out. The international community needs to act with urgency and the VCM, which exists now, remains a very valuable tool for delivering on such action. However, to achieve this with scale, governing bodies, market participants and host governments need to provide greater clarity on how the Paris mechanisms and the VCM can best operate alongside each other.



## Recommendations



### 1. New governing bodies

We set out below recommendations aimed at unlocking the true potential of the Paris mechanisms and the VCM. The UNFCCC secretariat has published a list of assessment criteria for defining options for operationalising the co-operative approaches, such as the need to promote transparency, accuracy, completeness, consistency and comparability, and ensuring effectiveness and efficiency.<sup>47</sup> In developing these recommendations, we have sought to reflect these assessment criteria. We have divided the recommendations amongst key market participants as follows:

We have divided the recommendations amongst key market participants as follows:

1. NEW GOVERNING BODIES OF THE VCM;
2. COP TO THE UNFCCC AND THE SUPERVISORY BODY;
3. PROJECT PROPONENTS;
4. BUYERS OF CARBON CREDITS; AND
5. GOVERNMENT-LED ACTION.

As recognised above, the Integrity Council and the VCMI are undertaking huge amounts of work and making significant progress in building a high-quality VCM through the development of the CCPs and Claims Code of Practice. We think there is opportunity to build on this work further in a way that draws positive attention to the VCM and dispels some of the uncertainties that have arisen in the post-Paris era.

#### *Increased communications about the success and benefits of the VCM*

**Implement a communications strategy to promote the benefits of the VCM with the aim of dispelling the rising criticisms.** There is a common fear held in respect of the VCM that offsets give the illusion of a “fix” but, in fact, lead to complacency in addressing climate change, or are simply a tool to help companies “greenwash” their public image. This negative perception is exacerbated by the existing concerns surrounding the risks of double counting and double claiming. These concerns weaken the trust in the VCM. In the short term, the new governing bodies should look for opportunities to promote the benefits of the VCM with the aim of dispelling these concerns and generally improving attitudes and behaviours towards the VCM by building a more positive narrative. The focus of these communications should be on promoting the benefits of the VCM, in particular its key role of directing very significant levels of capital flows to climate projects in the developing countries. These projects often bring significant economic, social and environmental benefits and help support a just transition. The VCM can deliver high-quality carbon credits and scale-up at a speed urgently needed to deliver on the Paris Agreement

<sup>47</sup> UNFCCC. September 2022. *Technical Paper on options for operationalizing the guidance on co-operative approaches referred to in Article 6, paragraph 2 of the Paris Agreement and in decision 2/CMA.3*. Available at: [https://ercst.org/wp-content/uploads/2022/10/20220920-SBSTA57\\_Article-6.2\\_Technical-paper.pdf](https://ercst.org/wp-content/uploads/2022/10/20220920-SBSTA57_Article-6.2_Technical-paper.pdf) (Accessed on 18 November 2022). The list of assessment criteria published by the secretariat for defining options for operationalising the co-operative approaches includes: (i) promoting transparency, accuracy, completeness, consistency and comparability (TACCC); (ii) effectiveness and efficiency; (iii) robustness and secure operations; (iv) minimising reporting obligations on Parties; (v) eliminating undue burden on the secretariat; (vi) building on existing solutions and continuous improvement; (vii) impact on stakeholders, including maximising participation; and (viii) high-level assessment of implementation effort as a measure of future cost.



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## Recommendations

commitments. The VCM also has a critical role in engaging the private sector which is seeking to strive for net zero whilst delivering climate action in developing countries in a manner that supports a just transition. The target audience for these communications should include State actors, project developers, investors, funders, credit buyers and the general public.

### ***Additional guidance on corresponding adjustments to avoid double counting***

#### **Issue guidance on corresponding adjustments and the VCM.**

The new governing bodies should continue to prioritise the ongoing work to address the differences in opinion that exist around the risk of double counting within the Paris mechanisms and the VCM. The outcome of this work should be a clear, co-ordinated message on what constitutes double counting in the context of the Paris mechanisms, distinguishing it from the concept of double claiming (addressed below), and detailing how market participants can avoid the risk of the VCM being undermined by allegations of double counting. Consideration should be given to how this message is best communicated, but we expect that some form of shared thought leadership paper and/or guidance document disseminated widely amongst the international community would be welcomed. The Art. 6.2 Decision (COP27) requests the SBSTA to continue its work to develop recommendations on the elaboration of further guidance in relation to corresponding adjustments. If there are opportunities for the new governing bodies to link in with this ongoing work, this should be explored.

### ***Address the issue of double claiming***

**Issue guidance on double claiming and the VCM.** Related to the issue of double counting, the new governing bodies should consider making clear their position on double claiming. As above, it will be important for the future of the VCM to distinguish double claiming from double counting (recognising the latter is purely an accounting tool for the purposes of NDCs). Beyond that, however, the new governing bodies should consider publishing a common position on what constitutes double claiming and when it is, and is not, appropriate. Consideration should be had to the signals coming out of COP27 with respect to “mitigation contribution A6.4ERs” and the possible implications of these on the VCM. It will be important that any position put forward has the buy-in of carbon credit buyers and VCM stakeholders to ensure a broad adoption and legitimacy within the market.

### ***Address the uncertainty surrounding sovereign credits issued under REDD+ and the ACMI***

#### **Determine the role of sovereign credits issued under REDD+ and the ACMI in the VCM.**

The new governing bodies should consider the impact of sovereign credits for REDD+ activities and the ACMI from the perspective of the VCM and come to a consensus as to their potential impact and possible role going forward. In particular, if the issuance of huge quantities of sovereign credits could cause significant downward pressure on VCM prices, how the VCM should react to protect VCM projects and justify prices. To the extent that they are to be brought into the VCM, the new governing bodies, possibly in concert with leading recognised carbon standards, should publish guidance on the appropriate treatment of these credits.

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Recommendations

### *Support capacity building through knowledge sharing*

**Facilitate knowledge-sharing initiatives to support capacity building within the VCM.** In the more medium term, the VCM governing bodies, together with other industry and thought-leadership groups, should continue to support ongoing capacity-building initiatives to support a high integrity VCM. Capacity building can take many forms and will depend on national circumstances. However, we expect governing bodies can make the biggest impact by ensuring ongoing information sharing to raise awareness and knowledge about the opportunities and benefits of engaging in the VCM. This could include disseminating documents about the VCM and the Paris mechanisms, such as overview papers, policy briefs, or templates for relevant documentation in the VCM and Paris mechanism contexts. This could be further supported by offering training courses or practical workshops on the VCM and Paris mechanisms. The promotion of cross-sector and jurisdictional collaboration and information sharing is key.

These initiatives could be targeted at both governments and private companies looking to participate in both (both on the sell-side and the buy-side). For example, over the past year the VCMI, in partnership with the UNDP Climate and Forests Team and others, have been offering small amounts of flexible support to countries to develop country-specific VCM Access Strategies for accessing carbon finance and maximising investment into VCM activities that are aligned with national climate strategies and contribute to compliance with NDCs. We understand the VCMI is collating lessons learned from this workstream and intends to publish a VCM decision-tool for policymakers. The VCMI has said that it is clear from this work that strong, sustained, and well-coordinated support is needed to help countries navigate the complexities of carbon markets and implement systems to access

high integrity finance. For developing countries in particular, this could also include highlighting what pro bono assistance may be available to support them in this respect, such as Advocates for International Development, a global charity aimed at facilitating international legal expertise with local needs in developing countries to support achievement of the UN Sustainable Development Goals.

VCM governing bodies should also look for opportunities to share their knowledge and experience with other stakeholders in the VCM and Paris mechanisms, and new emerging initiatives. The Integrity Council's work on the CCPs is a prime example of this. Key industry personnel and thought leaders have made a significant effort to produce the CCPs which represent market-leading thinking for defining a threshold for high-quality criteria for a carbon credit. This work should not be ignored or repeated; it is in the global interest for initiatives such as the CCPs to be shared as widely as possible and considered for adoption. The Integrity Council should consider whether there is an opportunity to share these CCPs with the Supervisory Body so that they can be adopted or reflected within the emerging Paris framework. These VCM governing bodies should consider what opportunities this new initiative presents to the VCM and engage in it with a view to ensuring that the scheme develops in a way that furthers, rather than undermines, the VCM.



## Recommendations



## 2. COP to the UNFCCC and the Supervisory Body

### *Continue operationalising the Paris mechanisms*

**Continue driving forward operationalisation of the Paris mechanisms whilst working collaboratively with the new governing bodies of the VCM.** Whereas the new governing bodies of the VCM should focus on strengthening the VCM, the Supervisory Body should continue driving forward operationalisation of the Paris mechanisms.

It is important for both the Paris mechanisms and the VCM that this is done as quickly as possible. However, ensuring that this ongoing work is undertaken in a manner that supports the continued operation of the VCM will be critical.

Key to this operationalisation will be:

- delivering sufficient clarity on how the Paris mechanisms are intended to work;
- ensuring that the Paris mechanisms are not too bureaucratic; and
- making clear its position on both the separation between the VCM and the Paris mechanisms and on the requirements surrounding corresponding adjustments (i.e., including how corresponding adjustments should be applied in respect of co-operative approaches to avoid double counting). We consider that a clear statement or additional guidance on these matters would be very well received by Parties and VCM market participants.

The Supervisory Body should also work collaboratively with the new governing bodies of the VCM and look for opportunities to learn from or even adopt the work that has already been undertaken or is underway by those governing bodies, where equally applicable to the Paris mechanisms. As above, the CCPs being developed by the Integrity Council are a good example of this.

### *Clarify the position on avoidance credits*

**Issue a decision on whether avoidance credits qualify as ITMOs for the purposes of Article 6.** As part of operationalising the Paris mechanisms, a firm view must be reached on the future of avoidance credits for the purposes of the Paris mechanisms. As noted above, the SBSTA is tasked with considering and developing recommendations on whether ITMOs and Article 6.4 activities should include emission avoidance. The Art. 6.2 Decision (COP27) requests a decision for adoption by COP in November 2023. Careful consideration must be had to whether avoidance credits are suitable for the Article 6 mechanisms and what the potential impacts of incorporating such credits would be on those mechanisms as well as the VCM.

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### 3. Project proponents

Project proponents and sellers of carbon credits are fundamental to the success of both the Paris mechanisms and the VCM. In particular, their actions have a defining impact on the credibility and perception of the VCM and we consider there are several actions that they can take to improve both.

#### *Early engagement with host governments*

**Project proponents should engage early with host governments to ensure a shared understanding of expectations, procedures and requirements.** Project proponents should engage with their host country governments early in the project development process to understand the relevant domestic laws that will apply to their carbon project (particularly around ownership and rights to carbon credits), to explain their carbon project and to establish clear intentions (and governments should be willing to engage). These early engagements should (amongst other things) seek to clarify whether, and if so how, the carbon project will contribute to implementation of the host country's NDC; whether the carbon credits generated are intended for the Paris mechanisms or the VCM (or both); if the Paris mechanism, whether any A6.4ERs issued in respect of that project will be authorised for Paris Uses; and if authorised for Paris Uses, confirmation that the host country will apply any necessary corresponding adjustments to its NDC in accordance with the Paris Agreement. These engagements could be recorded in a form of B2G arrangement like an MoU or via a State-issued Letter of Authorisation or similar, but the greater the clarity and transparency both between the parties and publicly, the greater the confidence prospective investors and buyers will have in the carbon project.

Project proponents seeking to proceed under the Paris mechanisms should ensure that they fully understand the procedures and requirements of those mechanisms so as to enable full compliance. Engaging with their host countries as recommended above will help to achieve this. Project proponents seeking to proceed under the VCM should be critical in their choice of applicable carbon standards and seek to align themselves with reputable carbon standards that maintain high accreditation and verification standards and seek to deliver the highest quality of carbon credits. It will also be important that any arrangements agreed between the project proponent and the host country as part of early engagement reflect and/or satisfy the requirements of the applicable carbon standard (e.g., in terms of accreditation and verification). As reiterated throughout this paper, verified, high-quality carbon credits are critical to the integrity of the VCM.

#### *Ensure open communication and information sharing*

**Facilitate information sharing by establishing and maintaining open and transparent lines of communication regarding carbon projects.** Finally, project proponents and sellers of carbon credits should seek to establish and maintain open and transparent lines of communication and information sharing with prospective investors and buyers. They should be willing to disclose information about their project's permitting processes, accreditation with an applicable carbon standard, including the nuances of that carbon standard (e.g., the accreditation standards, methodologies, issuance processes, etc.), and overall compliance with those permitting processes and carbon standards. This will enable prospective investors and buyers to conduct the necessary due diligence into a carbon project and get comfortable as to the nature and quality of both the carbon project and the carbon credits generated. This, in turn, helps to improve the integrity of the market generally.

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#### 4. Buyers of carbon credits

Mobilising private capital and channelling it into positive climate action is critical to achieving net zero; governmental action alone will not be sufficient. Hence, the role that buyers and investors have in the VCM cannot be understated. However, for the VCM to succeed, it is important that the actions of non-State actors further the integrity and trust in the VCM, rather than undermine it.

The UN High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities (**UN Export Group**) paper titled “Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, City and Regions”<sup>48</sup> presents a roadmap to prevent net zero from being undermined by false claims, ambiguity and “greenwashing”. A number of its recommendations centred on the use of voluntary carbon credits by non-State actors are relevant to this paper and we draw on them below.

##### *Offsetting as complementary to decarbonisation*

**Ensure that offsetting is secondary to reducing emissions whilst being transparent as to the use of offsetting measures.**

Carbon credit buyers must recognise that offsetting their emissions through the buying of carbon credits must come as second priority to investment in emission reduction and mitigation measures, and buyers should reduce their own emissions as much as possible in the first instance. As recognised above, there is a common fear that offsetting gives the illusion of a “fix” but, in fact, leads to complacency in addressing climate change and practices of “greenwashing”. Purchasing and using carbon credits therefore

presents a degree of reputational risk to buyers. Buyers should be mindful of this and act so as to dispel this fear. They can do this by demonstrating that they are committed to, and are prioritising, reducing their own emissions (i.e., Scope 1, 2 and 3 emissions), to the extent possible, and the use of carbon offsetting is a necessary stopgap or (where relevant) to offset irreducible emissions. Those who choose to purchase carbon credits to counterbalance residual emissions or unabated emissions must buy credits associated with credibly governed carbon standards that maintain the highest levels of environmental integrity and which seek to deliver positive social and economic outcomes where the projects are located.

Related to this, credit buyers should communicate clearly both the emissions associated with their activities and their efforts to decarbonise through reducing their own emissions or the use of carbon offsetting. The UN Expert Group describes a need for any credit transactions to be “transparently reported, and associated claims must be easily understandable, consistent and verified”. This level of transparency will enable the public to assess an entity’s overall impact on the climate, which will, in turn, build market trust and improve the credibility of offsetting and the VCM.

##### *Address information gaps*

**Act in an informed, discerning manner to build market trust and improve the legitimacy and integrity of the VCM.** Buyers should also be wary of the information gaps and asymmetries that exist within the carbon markets. The quality of carbon credits available on the market varies significantly. Buyers should conduct thorough due diligence into the carbon market and any prospective carbon project before transacting. As part of their due diligence, buyers should seek to understand the different carbon standards within the market and the nuances of their respective

**The UN Expert Group describes a need for any credit transactions to be “transparently reported, and associated claims must be easily understandable, consistent and verified”.**

<sup>48</sup> United Nations’ High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities, November 2022, *Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities and Regions* Available at: [https://www.un.org/sites/un2.un.org/files/high-level\\_expert\\_group\\_n7b.pdf](https://www.un.org/sites/un2.un.org/files/high-level_expert_group_n7b.pdf) (Accessed on 9 November 2022).

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accreditation programmes, so as to strive for high-quality carbon credits that meet the fundamental principles of credibility, additionality and permanence, whilst also contributing to biodiversity, climate resilience, and community well-being. As with increased transparency, buyers acting in a discerning way when participating in the VCM will help to build market trust and improve the legitimacy of the VCM.

Buyer awareness is also particularly important to achieving a just transition to net zero; a key focus of COP27. Buyers should consider how the carbon projects they engage with contribute to the economic development of the countries they are located in, including job creation, job upgrading, social justice and poverty eradication.



## 5. Government-led action

There is much that countries can do, both from the supply-side and the demand-side, to support both the Paris mechanisms and the VCM in their countries in a manner that provides the right enabling conditions for project development, attracting investment, scaling participation and reducing investment risk.

### ***Demonstrate support for, and engage strategically in, the VCM***

**To foster VCM activities, host governments should demonstrate clear support for, and engage strategically in, the VCM.** Whilst the details and practical implementation of the Paris mechanisms are being established and undertaken, it is important that global climate action is not put on hold. Further, even when the Paris mechanisms are fully functioning, operational market mechanisms (which may be some years away), the VCM is likely to have a role to play going forward. Therefore, we think it is important that countries seek to engage actively in the VCM now. As set out above, there appears to be a concern in some jurisdictions that carbon trading with non-Parties might somehow undermine NDC implementation. For the reasons we set out in this paper, this is not the case. Indeed, as we have explained, private projects can contribute to a State's NDC. Therefore, governments should be looking to create an enabling environment for carbon projects to operate within the VCM in their countries. The first step is for governments to signal clearly their support of the VCM. This will help to drive a change in behaviour and public perception of the VCM and international carbon trading.

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There are various ways in which governments could do this. For example, governments could consider:

- engaging strategically with different carbon market mechanisms. Governments could develop a holistic strategy outlining the role of carbon markets in meeting their NDCs and attracting investment in mitigation projects;
- improving information on the VCM, including project activities within their jurisdiction and the carbon credits that have been generated, traded and used;
- using the VCM to drive investment towards those sectors which they consider require more financing for climate ambition and capitalise on the benefits that the VCM offers over the Paris mechanisms (i.e., speed and scale); and
- enhancing dialogue with stakeholders to better understand how the VCM can be used to deliver on their climate policies.

As set out above (see p52), governments should also be willing to engage strategically with project proponents and sellers of carbon credits seeking to establish carbon projects within their jurisdictions. The parties should seek to work together to identify the best way forward for such projects.

### THE UK EXAMPLE:

The UK Government in its Net Zero Strategy signalled an intention to become “a leader in high-quality carbon voluntary carbon markets”, acknowledging that it was working closely with various sector-led initiatives including the TSVCM and the UK VCM Forum to achieve this. In June 2022, the UK Climate Change Committee (**CCC**) issued a report to Parliament, “Progressing in reducing emissions”, recognising a role for voluntary carbon credits in delivering on corporate net zero ambitions. A further report from October 2022 titled “Voluntary Carbon Markets and Offsetting” found that high integrity carbon credits purchased by businesses (i.e., in the VCM) “can play a small but important role in supporting the transition to Net Zero”. However, the CCC recommended the UK Government put in place stronger guidance, regulation and standards to ensure purchase of carbon credits is not used as a substitute for direct business emissions reductions, and to improve the integrity and transparency of carbon credits.

Whilst we would caution against overly regulating the VCM, it is promising to see the UK Government and the CCC engaging in the VCM, recognising the opportunities it presents and role it can play in supporting the transition to net zero. This type of government signalling in support of the VCM is critical to increase its legitimacy and support for it.

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### ***Confirm the ability to trade carbon credits internationally***

**Host governments should expressly recognise the ability to internationally trade carbon credits generated within their countries.** In the wake of the RMP, a number of jurisdictions have introduced moratoria on the issuance and/or international trading of carbon credits pending further clarity on how voluntary carbon trading relates to NDC implementation and the frameworks needed to provide for the Paris mechanisms.

Such moratoria and bans are likely to turn many prospective investors and international buyers off investing in, or purchasing, carbon credits from carbon projects within those countries. In the absence of a meaningful domestic carbon market, there is a risk that such laws may destroy the carbon market in those jurisdictions. Host Parties that are keen to support Article 6 activities and the VCM should consider recognising the ability to export carbon credits from their country. In the immediate term, this could take the form of an authoritative statement from government outlining the government's support for international carbon trading and the export of carbon credits.

Over time, governments may choose to go further and formalise this position by publishing government policy or guidance or developing a formal legislative instrument on the matter. Of course, certain processes and controls will be necessary to ensure that any exports align with the requirements of the Paris Agreement, if applicable; for example, that the export of A6.4ERs authorised for Paris Uses is subject to all necessary corresponding adjustments being applied. However, we expect that any positive action from host Parties confirming the ability to export carbon credits will be well received by market participants.

### ***State-specific benefit sharing***

**Host countries concerned with benefit-sharing arrangements may wish to incorporate express benefit-sharing requirements within existing national regulatory frameworks.** Governments wishing to secure State-specific benefit-sharing opportunities from VCM and/or Article 6.4 carbon projects in their jurisdictions could consider expanding their existing regulatory role to incorporate benefit-sharing arrangements.

There are various ways this could be achieved. For example, benefit-sharing arrangements could be introduced through government policy requiring project proponents to demonstrate and agree how their carbon projects will deliver benefit sharing for the country. Alternatively, governments wishing to take a firm approach could consider introducing a specific levy or tax on revenues generated by carbon projects in their country. Any new tax on revenues would need to be clear and imposed fairly. It would also need to be approached with significant caution as it has the potential to drive prospective carbon projects into alternative jurisdictions where such levies do not exist.

### ***Maintain a clear, defined NDC***

**Parties should maintain a clear and well-defined NDC.**

To foster market confidence in a country's approach to the Paris mechanisms and the VCM, countries should commit to maintaining clear, defined NDCs. The UN Development Programme paper, *Designing and Preparing Intended Nationally Determined Contributions*, suggests how Parties could best design their Intended NDCs for mitigation and adaptation

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respectively, which are equally applicable to NDCs.<sup>49</sup> It recommends that:

- actions proposed (i.e., intentions to implement specific means of achieving GHG emissions) should relate to targeted sectors or subsectors (and gases) such as the five main sectors identified in the IPCC 2006 *Guidelines for National Greenhouse Gas Inventories* (i.e., energy, industrial processes and product use, agriculture, LULUCF, waste, and other), prioritising sectors based on national classifications; and
- actions should take into account both national and global considerations, but be based on national feasibility, priorities and criteria. Not only does the type of action matter but the NDC should address the specific interventions to be carried out as part of the actions, the implementing entity(ies), their legal status, the jurisdiction or geographic area where actions are implemented or enforced and the time frame for implementing those actions.

By maintaining a clear, defined NDC, countries can demonstrate their political decarbonisation intentions, including the types of carbon projects they intend to operationalise to achieve the objectives of their NDCs and the role that cooperative approaches will play in this. It will also help to signal a country's likely approach toward use authorisations for the purposes of Article 6.2 and Article 6.4 and, by extension, the VCM. Together, we consider this increased transparency will help project proponents, investors

or international buyers gain confidence in that country's approach to carbon offsetting, which will, in turn, help to mobilise public and private, national and international, investment in climate action.

### *G2G and/or B2G arrangements*

**Host governments should consider G2G and/or B2G arrangements to make clear their positions with respect to Paris mechanisms and the VCM in order to support greater investment activity.** Parties seeking to generate significant investment activity in Paris activities and/or the VCM within their countries should consider entering into formal G2G arrangements with other Parties. For the reasons **as outlined on p42**, we consider that the most appropriate way of formalising G2G arrangements would be through an MoU.

Parties should also consider, or be open to entering into, B2G arrangements with private market participants such as investors, project developers or even buyers. Whilst not as scalable as G2G arrangements, B2G arrangements will nevertheless deliver the counterparty in question certainty sufficient to support investment. **As outlined on p44**, B2G arrangements could be implemented via an MoU or private B2G arrangements.

To deliver the greatest benefits, we would encourage as much information and transparency as the parties are prepared to share. This might include, for example: details of the types of carbon projects in respect of which the parties are willing to authorise carbon trading, and whether this is trading under the Article 6.4 mechanism or the VCM; the volumes of carbon credits that are intended to be traded; if there are any restrictions or limitations to those general permissions; where trading is to occur under the Article 6.4 mechanism; and how the parties will ensure

<sup>49</sup> Ahead of COP21, Parties were invited to outline publicly what post-2020 climate actions they intended to take under the emerging Paris Agreement. These were communicated via "Intended NDCs", which reflected each country's ambition for reducing emissions, taking into account its domestic circumstances and capabilities. Once countries formally joined the Paris Agreement, these Intended NDCs were converted into NDCs.

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that they satisfy their accounting obligations, including the making of any necessary corresponding adjustments.

By formalising these arrangements and making this information public, governments can deliver clear signals to project proponents, international investors and buyers about how carbon projects in their countries will be treated. Increased transparency will also help to drive increased integrity of the VCM as a tool in helping governments speed up or enhance the implementation of their climate policies.

### *Establish clear parameters for use “authorisation”*

**Establish clear parameters for the granting of, and a standard form for, use authorisations.** The defining feature of Article 6.2 and the Article 6.4 mechanism is the use “authorisation”. It has implications across all the Paris mechanisms and is in essence the determining factor for corresponding adjustments. It is up to host Parties to decide whether ITMOs, including A6.4ERs, are authorised for Paris Uses and therefore when corresponding adjustments are required. Specifically, if A6.4ERs are not authorised for Paris Uses, then those unauthorised credits (now referred to as “mitigation contribution A6.4ERs”) can be traded internationally without the host Party having to make corresponding adjustments. This means that should it choose to do so, the host Party may account for those carbon credits within its NDC whilst enabling the carbon credits to be traded in the VCM, provided buyers are happy to purchase on those terms. How the VCM reacts to the signal given in the Art. 6.4 Decision (COP27) that these mitigation contribution A6.4ERs should not then be claimed by private companies against their own carbon targets remains to be seen. The Paris mechanisms cannot regulate the VCM so it is

within a buyer’s discretion how it wishes to use or claim mitigation contribution A6.4ERs it chooses to purchase.

Given the importance of these use authorisations, and in the absence of a specific methodology for authorisations being issued by the Supervisory Body, governments may wish to consider establishing clear parameters for the granting of these authorisations. This could be done by way of amending existing legislation or introducing new legislation (see p59 and p60) but this is likely to take considerable time and political will. An easier alternative would be to implement government guidance or policy defining the process and decision-making criteria for obtaining such use authorisations. Of course, this too would take time; however, it would be easier to introduce than legislation. The government guidance or policy would be intrinsically linked to the country’s NDC and, like a well-defined NDC, would enable market participants to understand the country’s decarbonisation plans, its intentions with regard to the Article 6.4 mechanism and more generally its attitude and approach to the VCM.

Alongside guidance or policy, governments may wish also to develop standard form “authorisations” to be issued on a project-by-project basis. As noted above, certain industry bodies have published suggested templates and the SBSTA has received a technical paper on requisites for use authorisations. Countries should seek to align themselves with this emerging knowhow and guidance as far as possible, as doing so will ensure a level of standardisation that supports good international market mechanics.

**It is up to host Parties to decide whether ITMOs, including A6.4ERs, are authorised for Paris Uses and therefore when corresponding adjustments are required.**

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### *Establish a registry*

**Establish a registry for the tracking of ITMOs and possibly even VCM activities.** As outlined above, Parties must have, or have access to, a registry for the purpose of tracking ITMOs. Parties may choose to establish an account in the international registry maintained by the secretariat; however, we consider host Parties would be better placed to maintain their own registry, to the extent that they have resources available to do so. This will enable complete oversight and control of activities within the registry.

The registry should act as a central, possibly public (at least to some extent), record of carbon projects that are approved for the purposes of Article 6.4 and decisions and actions being taken from that. The Art. 6.2 Decision (COP27) contains further guidance on the form, function, processes and interoperability of registries under Article 6.2 (**as outlined on p23**). Parties should ensure that when developing their registries, they give due regard to this guidance.

Assuming countries wish to foster VCM activities alongside Paris activities, there may be opportunities for the registry to be expanded to include information about voluntary carbon projects as well. A meta registry which records both VCM and Paris carbon projects within a jurisdiction, including details about use authorisations and where and when corresponding adjustments have been applied, would help to address the information gaps that currently exist. This, in turn, is likely to attract greater interest and investment in carbon projects within a jurisdiction and, over time, help to improve the credibility of these market mechanisms. The International Emissions Trading Association, together with the World Bank and Government of Singapore, have recently announced the Climate Action Data Trust (**CAD Trust**), launching

in December 2022. The CAD Trust has been designed to act as “a global platform that links, aggregates and harmonises all carbon credit data from project registries to facilitate transparent accounting”, through the use of distributed ledger technology. Other entities are looking to set up something similar. Countries may wish to consider what opportunities these meta registries present for their own registries.

### *Establish a legal framework for the operation of the Article 6.4 mechanism*

**Establish a legal framework to operationalise the Article 6.4 mechanism at a domestic level.** In the longer term, host Parties will need to enact legislative changes to incorporate and implement the Paris mechanisms in their country. Establishing a legal framework which provides a clear route for carbon projects into the Article 6.4 mechanism will provide project proponents, potential investors and international buyers with certainty as to when activities are within the Paris mechanisms and, by extension, when they lie outside and therefore within the VCM.

The RMP prescribes a detailed process that carbon projects must adhere to in order to participate in the Article 6.4 mechanism. Any processes laid down would need to align with the requirements set out in Article 6 and the RMP and should include a clear procedure by which offset projects will be assessed for the purposes of determining their suitability for Article 6. For some countries, this may be as simple as extending existing permitting regimes to include carbon credits. For example, a State government in Malaysia has recently amended its existing forest concession to provide expressly for the granting of carbon-related licences over the carbon stocks in forests. Those licences give their holders the rights to any carbon credits granted in respect of those carbon

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stocks (including rights to use, trade, etc.), subject to compliance with set procedures and guidelines, including around accounting reporting. For other countries, however, it may require the establishment of a new, standalone legal framework dedicated to the permitting of carbon projects for the generation of carbon credits.

Regardless of how a framework is implemented, to support Paris mechanisms, it will be important that the process aligns with the requirements of the RMP. As a minimum, the process will need to provide for consideration of:

- whether the carbon project relates to the implementation of the country's NDC;
- whether the carbon project contributes to the country's NDC;
- whether the carbon project is, or is not, to be authorised for the issuance of A6.4ERs;
- if the carbon project is to be authorised for the issuance of A6.4ERs, whether those A6.4ERs are authorised for Paris Uses (to the extent not otherwise already dealt with separately); and
- the terms and conditions that may be applied by the host Party to use of such A6.4ERs for Paris Uses,

(all being information a host Party is required to supply to the Supervisory Body when nominating an offset project for registration).

Assuming the carbon projects proceed through this permitting regime successfully, the legal framework should provide for the host Party to subsequently nominate that project to the Supervisory Body for the purposes of Article 6, subject to the above-mentioned terms and conditions, in accordance with the RMP. In addition, care needs to be taken in drafting the relevant

framework to ensure that it does not inadvertently capture the VCM within it.

In a similar vein, Parties could also consider whether it would be constructive to introduce legislation to formalise Article 6.2 within their domestic regimes.

It is recognised that implementing legislative changes to formalise Article 6.2 or the Article 6.4 mechanism will take time and effort from governments. Therefore, while taking such steps would help to eliminate current uncertainties, it may be more appropriate for governments to focus on what steps they can take in the immediate-to-medium term to ensure that the momentum as described above is not lost.

### ***Confirm legal nature of and ownership rights over carbon credits***

**Formalise the legal nature of, and ownership rights over, carbon credits.** In the medium term, countries wishing to foster the VCM should consider addressing some of the legal uncertainties that have plagued the market in the past and caused some prospective market participants to refrain from entering; namely, the uncertainties relating to:

- the legal nature of carbon credits; and
- ownership rights over carbon credits.

To clarify the legal nature of carbon credits countries will need to legislate or issue an authoritative legal statement. This may be as simple as confirming within a legislative instrument that carbon credits shall be treated as intangible property (or possibly some new type of property). This could be supported by additional law or policy setting out the precise regulatory, tax and accounting



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treatment to be applied to carbon credits. Achieving this level of legal certainty would assist in attracting investment in carbon projects within the jurisdiction as well as international buyers. Of course, achieving greater alignment at an international level of the treatment of carbon credits will further strengthen international trading of carbon credits so host Parties may wish to consider emerging international trends when taking any such legislative action.

As for ownership rights over carbon credits, there are various actions countries could take to clarify this. Governments could choose to recognise ordinary property rights over carbon stocks and/or carbon reductions or removals in respect of those carbon stocks, meaning the person responsible for those carbon reductions or removals is deemed the owner of any carbon credits issued in respect of those carbon reductions or removals. Again, clear parameters or guidance around who is considered “responsible” for carbon removals or reductions would need to be implemented.

Alternatively, countries could introduce legislation which assumes, on behalf of the government, ownership over all carbon reductions or removals generated or to be generated within their country; in the same way that countries have in the past assumed ownership of the sea and foreshore. A regime could then be established to enable the government to transfer ownership of those carbon reductions or removals to third parties (i.e., to the person who was responsible for them such as a project owner, developer, or investor). The eligibility requirements for receiving ownership rights and the process for transferring and recording the transfer of ownership rights would need to be clearly established. The most appropriate route will, of course, depend on national circumstances but, to the extent that there is opportunity for consistency amongst States, this should be strongly encouraged.

### A BRAZILIAN EXAMPLE:

On 19 May 2022, the Brazilian Government published a decree (number 11,075/2022) establishing the National Greenhouse Gas Emissions Reduction System (**Sinare**) and setting out Sectoral Plans for Climate Change Mitigation. The decree was published in response to discussions about the need for Brazil to regulate and set a price on carbon.

Sinare is a centralised digital platform allowing for the registration of “greenhouse gas emissions, removals, reductions and offsets as well as trades, transfers, transactions and retirement of certified emissions reduction credits”. It provides for the Ministry of Environment and the Ministry of Economy to set the rules on registration, accreditation, implementation and management of Sinare. Brazil’s Environment Minister, Joaquim Leite stated that such a market will “enable the export of high-quality environmental credits that are important for generating revenue for emission reduction projects”. Credits registered on Sinare will be regarded as certified emission reduction credits.

## Case study



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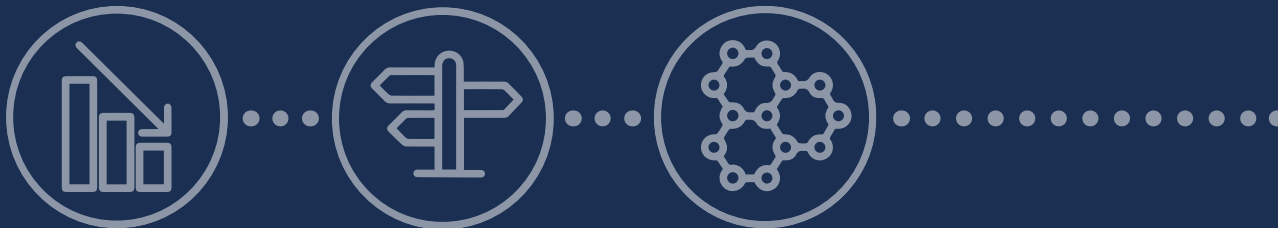
Recommendations***Consider the role of financial regulators***

**Consider the role that financial regulators could play in the VCM going forward.** As expressed throughout this paper, the fact that the VCM is largely unregulated is one of its greatest strengths. This enables the market to be agile in the face of market developments or changes. Care should be taken to ensure that such agility and flexibility are maintained. However, that is not to say that some form of regulation does not have, or cannot have, a role to play in the VCM going forward, particularly if the aim of such regulation is to improve market integrity. The Board of the International Organization of Securities Commission is seeking to advance the discussion about what role financial regulations may play in promoting integrity in the VCM.<sup>50</sup> Its paper identifies certain considerations that regulators may find relevant when contemplating frameworks to promote market integrity in the VCM based on principles and standards applicable to existing financial markets. Key considerations include matters such as open access, market integrity (i.e., ensuring that it operates without fraud, manipulation or disruption), transparency, price discovery, product standardisation and interoperability. Governments, particularly on the buy-side, should engage in these considerations.

<sup>50</sup> The Board of the International Organization of Securities Commissions, November 2022, *Voluntary Carbon Markets Discussion Paper*. Available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD718.pdf> (accessed on 30 November 2022).

## 7. Possible further work

In this paper we have sought to identify the most pertinent issues currently facing the Paris mechanisms and the VCM and provide recommendations for how these might be overcome. However, this is by no means a complete answer. Some of the issues identified require further, more detailed consideration than this paper could provide. Similarly, there are issues that were simply beyond the scope of this paper. Further work will be needed in the future to resolve these issues.



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Possible further work

We consider that the following areas warrant further consideration in particular:



The future of avoidance credits in the Paris mechanisms and the VCM. For the reasons outlined in this paper, it will be particularly important for the UNFCCC to consider and determine how these mechanisms interplay with Article 6.2 and the extent to which they should be incorporated into the Article 6.4 mechanism.



The likelihood of price differentials developing between (and within) the Paris mechanisms and the VCM and the impact this could have on the VCM. Price differentials may be positive or negative and are likely to be influenced by how the market views the quality of carbon credits within the various market mechanisms. If price differentials arise, the VCM will need to be able to justify its prices. Related to this, in order to scale any market in a way that can ultimately support a secondary market, it is widely seen that greater certainty and uniformity of price is needed. Significant variances in carbon credit pricing both within the VCM and between the VCM and the Paris mechanisms may therefore hinder development of a secondary market.



The possibility of the VCM converging with the Paris mechanisms and the implications were this to occur. A number of market commentators foresee VCM activities ultimately converging with the Paris mechanisms. Additional work is needed to understand what the positives and negatives of this would be. There is also the prospect of the Paris mechanisms converging with existing compliance markets. Again, it warrants further consideration whether this is a good or a bad thing, and what should be done in the interim either to support or prevent this occurring.



## Possible further work

Of course, the Paris Agreement and the VCM are just two of many initiatives aimed at combating climate change. It is important that they are not considered and/or developed in isolation. Thought also needs to be given to how these initiatives do or should interact with other similarly focused initiatives and what opportunities there are to streamline approaches. For example, in due course, consideration should be given to the Paris Agreement and VCM arrangements and:



their interaction with existing and future international or United Nations-led social and environmental standards, including the EU taxonomy for environmentally sustainable activities;



their interaction and possible integration with the Carbon Border Adjustment Mechanism (**CBAM**). CBAM is a climate measure that seeks to prevent the risk of carbon leakage between countries (i.e., where companies based in the EU move carbon-intensive production abroad to take advantage of lax standards or where EU-generated products are replaced by more carbon intensive imports);



their interaction with other national initiatives such as Germany's 'Climate Club'. The Climate Club aims to protect members' domestic industries from competitors with less stringent climate policies. It will do so by setting ambitious targets, agreeing standards for carbon trading projects and exempting other members from climate-related trade tariffs;



the emergence of carbon taxes or percentage-sharing arrangements that governments may seek to introduce;



other social, economic and environmental benefits; and



international trade generally.



# Appendix 1



## Appendix 1

Table 1: Summary of recommendations

	SHORT TERM (0-3MONTHS)	MEDIUM TERM (6-12 MONTHS)	LONG TERM (12 MONTHS+)
<b>NEW GOVERNING BODIES</b>	<ul style="list-style-type: none"> <li>Implement a communications strategy to promote the benefits of the VCM with the aim of dispelling the rising criticisms</li> <li>Issue guidance on corresponding adjustments and the VCM</li> <li>Issue guidance on 'double claiming' and the VCM</li> <li>Determine the role of avoidance credit schemes such as REDD+ and the ACMI in the VCM</li> </ul>	<ul style="list-style-type: none"> <li>Facilitate knowledge sharing initiatives to support capacity building initiatives within the VCM</li> </ul>	<ul style="list-style-type: none"> <li>Work with UN Supervisory Body to enable adoption by UN of VCM work</li> </ul>
<b>UN SUPERVISORY BODY</b>	<ul style="list-style-type: none"> <li>Issue a decision on whether avoidance credits qualify as ITMOs for the purpose of Article 6 of the Paris Agreement</li> </ul>	<ul style="list-style-type: none"> <li>Continue driving forward operationalisation of the Paris mechanisms whilst working collaboratively with the new governing bodies of the VCM</li> </ul>	
<b>PROJECT PROPONENTS / INVESTORS</b>	<ul style="list-style-type: none"> <li>Engage early with host countries to ensure a shared understanding of expectations, procedures and requirements</li> </ul>	<ul style="list-style-type: none"> <li>Facilitate information sharing by establishing and maintaining open and transparent lines of communication regarding carbon projects</li> </ul>	
<b>CREDIT BUYERS</b>	<ul style="list-style-type: none"> <li>Ensure offsetting is secondary to reducing emissions whilst being transparent as to the use of offsetting measures</li> </ul>	<ul style="list-style-type: none"> <li>Act in an informed, discerning manner to build market trust and improve the legitimacy and integrity of the VCM</li> </ul>	
<b>GOVERNMENTS</b>	<ul style="list-style-type: none"> <li>Demonstrate clear support for, and engage strategically in, the VCM</li> <li>Expressly recognise the ability to export carbon credits generated within their countries</li> </ul>	<ul style="list-style-type: none"> <li>Maintain a clear and well-defined NDC</li> <li>Establish clear parameters for the granting of, and a standard form for, use authorisations</li> <li>Establish a registry for the tracking of ITMOs and possibly even VCM activities</li> <li>Consider Government-to-Government and/or Business-to-Government arrangements to clarify their position on the Paris mechanisms and the VCM</li> <li>If benefit sharing is a concern, incorporate express benefit sharing arrangements within existing national regulatory frameworks</li> </ul>	<ul style="list-style-type: none"> <li>Establish a legal framework to operationalise the Article 6.4 mechanism at a domestic level</li> <li>Formalise the legal nature of, and ownership rights over, carbon credits</li> <li>Consider the role of financial regulators in the VCM going forward</li> </ul>

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The UK Voluntary Carbon Markets Forum was established in April 2021 to support the growth of a high-integrity scaled Voluntary Carbon Market in the UK and to support and amplify the work of global governing bodies such as the Integrity Council for Voluntary Carbon Markets and the Voluntary Carbon Markets Integrity Initiative.

The Forum is chaired by Dame Clara Furse, with City of London providing secretariat support.

[uk-voluntary-carbon-markets-forum](https://uk-voluntary-carbon-markets-forum)

UK Voluntary  
Carbon Markets  
Forum

Clifford Chance is a global law firm, with 30 offices across five continents. The firm advises clients from all commercial and industrial sectors, governments, regulators, trade bodies and not-for-profit organisations.

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