

ARTICLE 6 OF THE PARIS AGREEMENT AND IMPLICATIONS FOR THE VOLUNTARY CARBON MARKET

December 2021

Introduction

On November 14, 2021, the Parties to the Paris Agreement reached decisions on Article 6 that may impact the voluntary carbon market (**VCM**). In setting Article 6 (**A6**) rules, the Parties defined what is required within Nationally Determined Contributions (**NDCs**) and for related cooperative market mechanisms. They did not define what is excluded or not permitted. The final A6 text approved in Glasgow requires that all A6 emission reductions need corresponding adjustments (**CAs**), but it does not state that the trading of other voluntary emission reductions (**ERs**)¹ in the VCM is not permitted. However, certain voluntary market ERs may be affected by the A6 decisions. A6 does not therefore directly regulate the VCM, but it is conducive to increased convergence of the Paris and voluntary markets.

Both Decision A6.2 and A6.4 reference each Party's ability to *authorise* ERs to be used toward (a) an NDC (**NDC ERs**) or (b) for *international mitigation purposes* (which *may* include the CORSIA scheme) or *other purposes* (which *may* include the VCM) (collectively referred to as *other international mitigation purposes*, "**OIMP ERs**"). However, the OIMP ER terms are often used interchangeably and are ill-defined. OIMP ERs require CAs, but do not, by definition, count towards an NDC. It is entirely up to the host country to decide whether or not to *authorise* ERs to be OIMP ERs or NDC ERs. Parties agreed that OIMP ERs also need CAs and the rules for the OIMP ER CAs are different than CAs for NDC ERs.

The VCM may therefore generate and allow for the use OIMP ERs that are backed by CAs, as well as ERs without host country *authorisation*, which do not require CAs. The decision on whether an ER is *authorised* sits solely with the host country. There are therefore potential A6 impacts on the VCM that are likely to be observed in the future.

We anticipate that NDC ERs will form part of the developing Paris Agreement compliance market, and the VCM will continue to operate and transact on the basis of the following two instruments:

- (i) OIMP ERs that have been correspondingly adjusted or where a CA is pending
- (ii) ERs without host country *authorisation* that are neither NDC ERs nor OIMP ERs, and are not under the umbrella of A6 i.e. they are certified by an independent Standard and are not *authorised* for any use by the host country. These ERs may be freely created and used by VCM participants.

Double entry bookkeeping

Corporate buyers of ERs should be aware of their specific status and the potential accounting implications. For example, OIMP ERs are subject to CAs. If a corporate buyer that implicitly is not a Party to the Paris Agreement uses such OIMP ERs, the global GHG inventory and A6 accounting will be impacted, whether this buyer is located in the host country or in another country. It is the host country that will determine whether the CA occurs at the time of *authorisation*, issuance or use/cancellation

¹ "ER" is referring here to VCM carbon credits, which can be reduced/avoided emissions or removals.

of the OIMP ER, and the timing of the corporate buyer's use of the OIMP ER may be impacted by that host country choice.

A way to ensure correct double entry bookkeeping and transparency over the OIMP ER portion of the VCM, could be to track and retire these OIMP ERs in a new global "VCM registry", showing that such units are over and above mitigations reported by Parties and contribute to Overall Mitigation of Global Emissions (OMGE). In the absence of such a registry, these OIMP ERs would still be visible in various and distinct VCM Standard registries that allow for a A6 tagging of voluntary credits, but there would be no consolidated view.

Price and supply issues

It will probably take a while before we see sufficient supply of correspondingly adjusted OIMP ERs. In addition, CORSIA and other international compliance schemes have the demand for a significant portion of the OIMP ER volume that is likely to become available. This also raises the question of whether a host country will make OIMP ERs available in the first instance, given that, like NDC ERs, they do not contribute to the host country's NDC.

OIMP ERs that are purchased for VCM uses will likely be a premium product that is in short supply for some time as the modalities for CAs are put in place across all Parties. They are therefore likely to trade at a higher price. Host countries may choose to only *authorise* ERs from projects in sectors with a high greenhouse gas abatement cost. In doing so, host countries may choose to:

- Keep lower cost abatement options for use towards their own country's GHG inventory or NDC, and/or
- Apply a carbon tax on lower cost emission abatement activities and/or the ERs that result from them in order to fund additional domestic GHG emission abatement for use toward their own GHG inventory or NDC.

Even OIMP ERs with a pending CA at the time of use may also be a premium priced product when compared with ERs that are not subject to an *authorisation*, despite the risk of the host government failing to apply such CA to its GHG inventory at the end of the NDC period.

It is likely that ERs that are not *authorised* by the host country may be available at a lower market price given that, unlike NDC ERs and OIMP ERs, there is no need to discount them for a 5% Share of Proceeds for Adaptation (SoP), and a 2% contribution to OMGE, and pay a yet to be determined administration fee. These ERs also cannot be used for Paris Agreement compliance purposes. However, corporate buyers taking on voluntary commitments may increasingly view it as environmentally desirable to contribute to global adaptation to climate change through the Adaptation Fund and toward the overall mitigation of global GHG emissions. It is therefore unclear as to how demand in ERs that are not *authorised* by a host country will develop over the next years given both the desirability of OIMP and NDC ERs and the corresponding need to rapidly scale all forms of ERs, including ERs that are not *authorised*, in this decade.

In the end, supply and demand will set prices and, it is important to note that buyer preferences are not homogenous. For example, some corporates may value ERs without CAs from least developed economies because they believe this is where carbon finance can have the most impact.

Private sector claims

When it comes to the claims of ERs by corporates, what constitutes best practice is still under discussion among many stakeholders. Article 6 does not directly regulate the VCM and we expect further discussions.

Further guidance on claims made using ERs that are not *authorised* by a host country is needed. ICROA is working closely and diligently with market stakeholders, civil society, the private sector, governments and key VCM initiatives such as the Integrity Council for Voluntary Carbon Markets (**IC-VCM**) and the Voluntary Carbon Market Integrity Initiative (**VCMI**) in order to set out a pragmatic path forward for corporate climate action claims and ensure the highest level of quality, integrity and impact² of the VCM. Such guidance, once defined, will be incorporated in the ICROA Code of Best Practice.

Host countries may also decide how they wish to use the VCM and be very selective in *authorising* ERs for either NDCs or OIMP. In fact, it may be valuable for developing host countries to attract sustainable finance from the private sector in order to cooperatively achieve emissions reductions in their GHG inventory, through the use of assets and securities that include ERs that are not NDC or OIMP ERs.³ It will therefore be critical to engage host governments in identifying priority sectors where the VCM can finance mitigation that cannot otherwise be achieved. In this way the VCM may help achieve host country mitigation and further guidance is required in order to resolve the question of whether the corporate buyer may still make an offsetting claim (e.g. carbon neutrality) or an alternative claim (of contributing to the host country's achievement of its NDC).

The use of ERs without host country *authorisation* (which are not NDC ERs or OIMP ERs) that are issued through independent VCM Standards, such as those currently endorsed by ICROA, means that the involvement of host country governments would be consistent with market practices to date. This is in contrast to the process required for NDC and OIMP ERs.

While A6 provides a strong framework for transparency and avoiding double counting in response to Party concerns, some may argue that all ERs used for voluntary corporate or other offsetting should be *authorised* by the host country and therefore correspondingly adjusted. This is likely to have repercussions on project developers, who would then need to secure *authorisations* from the host country, and affect the scale and impact of mitigation actions financed through the VCM.

Finally, the country where the buyer is located may also decide to regulate claims that can and cannot be made by the private sector. Some environmental NGOs and a small number of national governments⁴ have been calling for all voluntary offsetting to be subject to CAs. This may prompt some countries to directly regulate, or require *authorisation* of, voluntary offsetting and associated claims, as is currently under consideration in Europe.

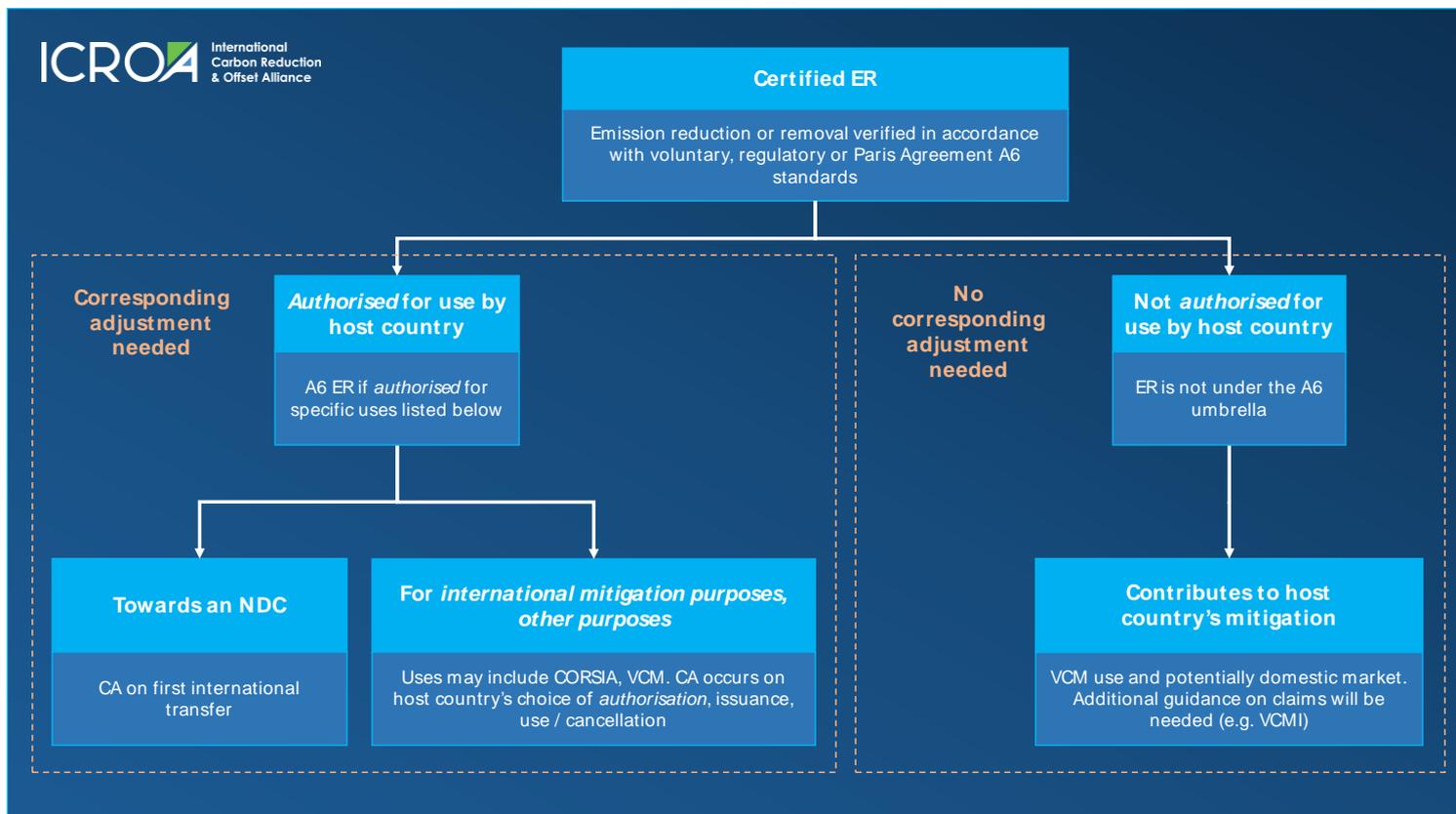
In conclusion, the A6 Decisions bring new, nuanced requirements into consideration for the VCM. ICROA and IETA remain at the forefront of these developments in order to assist their members in navigating them in a manner that is consistent with the Paris Agreement and Net Zero pathway.

² For further details on ICROA's guidance on corporate climate action, click [here](#).

³ In stating this, we assume that ERs that contribute to achieving only the host country's NDC are not NDC ERs. This is not clear in the wording of article 6.4, which classifies NDC ERs as those that have been *authorised* toward "an" NDC, not "another" NDC.

⁴ <https://cambioclimatico.go.cr/following-cop26-climate-talks-the-san-jose-principles-coalition-recommits-to-principles-for-high-integrity-carbon-markets-pledges-to-act-on-them-together/>

Summary: Visualizing potential implications of Article 6 for the VCM



Appendix: Article 6 Decisions, Next Steps

Article 6.2: ITMOs

- International Transfer of Mitigation Outcomes
- Measured in tCO₂e, covers BOTH Reductions and removals
- Corresponding Adjustment (CA) on ALL first transfers
- Reporting, recording, tracking
- No mandatory Share of Proceeds (SoP)
- No mandatory haircuts for Overall Mitigation of Global Emissions (OMGE)

Article 6.4: New Crediting Mechanism

- New Supervisory Body
- Baselines must be “below business as usual”
- Art. 6.4ERs authorised by host Party can be used for NDCs, “other international mitigation purposes” or “other purposes”
- CA on ALL first transfers
- Crediting period (years): 5+5+5 or 10 non-renewable; for removals 15+15+15
- 5% SoP + 2% OMGE cancellation => 7% haircut + fees
- CDM projects can transition with current methodology until up to y/e 2025 (if request by y/e 2023)
- CERs from projects registered from 2013 onwards can be used towards first NDC w/o CA and OMGE

Article 6: Next Steps

- **Art. 6.4 Supervisory Body**
 - Appointment of 12 members and 12 alternate members
 - Develop and approve rules of procedure and methodologies by COP27
 - Review CDM accreditation standards and procedures with a view to apply them by end-2023
 - Recommendations on removals
- **SBSTA Work Programme** – further guidance in relation to:
 - Special circumstances of least-developed countries and small island nations
 - Corresponding adjustments
 - Emission avoidance
 - 6.4 mechanism registry
 - Reporting
 - Implementation of 5% SoP and 2% OMGE cancellation

Links to final Article 6 texts

- [Decision 12a/CMA.3: Guidance on cooperative approaches referred to in Article 6.2 of the Paris Agreement](#)
- [Decision 12b/CMA.3: Rules, modalities and procedures for the mechanism established by Article 6.4 of the Paris Agreement](#)
- [Decision 12c/CMA3: Work programme under the framework for non-market approaches referred to in Article 6.8 of the Paris Agreement](#)