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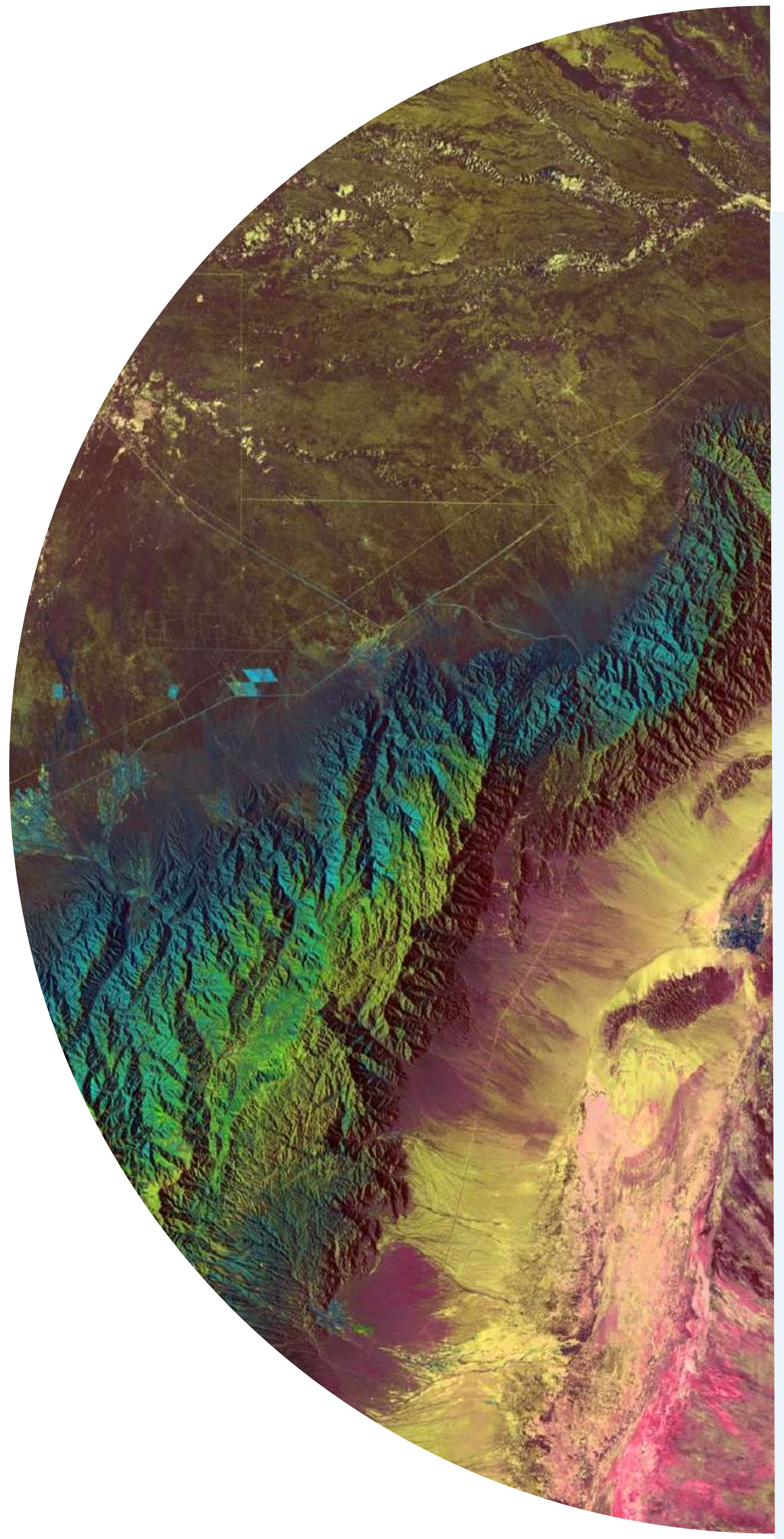
ARTICLE 6:
Your guide to the new rule book for carbon markets agreed at COP26



Content

Executive summary

- The rule book for carbon markets, under Article 6 of the Paris Agreement, was agreed at COP26. It provides clarity on carbon trading between countries, outlined in Article 6.2, and the creation of a new global mechanism, outlined in Article 6.4, to replace the previous mechanism, and produce carbon credits including ones for potential use by the private sector.

- This clarity is expected to help carbon markets scale while maintaining integrity. However, uncertainties remain. These will, hopefully, be clarified at COP27 starting 7 November 2022 in Egypt.

- To prevent the integrity threat of double-counting, or double-claiming, of emissions reductions, a carbon accounting framework, known as Corresponding Adjustments (CA), will be required for carbon trading between countries. Private sector voluntary carbon markets can continue trading carbon across borders, without being concerned with CAs. However, if a company wants to buy a credit under the new global mechanism, then the host country will likely require a CA as soon as the credit leaves its borders.

- CA will also be required for "other international mitigation purposes". This is interpreted as referring to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) and similar schemes.

- There is disagreement about whether CA requirements will help or hinder voluntary carbon markets. Regardless, the two largest certifiers of voluntary carbon credits, Verra and Gold Standard, will both be adding CA labels to their credits. This will create a split in the voluntary carbon markets between those credits with a CA, likely to attract a premium, and those without.

- It is still to be determined what climate claims companies can credibly make on the back of credits that either have CA attached or not. The Voluntary Carbon Markets Integrity Initiative (VCMI) will be influential in this discussion and is expected to issue fresh guidance in April 2022.

Executive summary

- Credits created under the previous global mechanism, or Kyoto-era carbon credits, will be carried over, provided they were registered in 2013 or later, but they will be easily distinguishable. Due to concerns about their environmental integrity, some countries have refused to purchase them.
- While the private sector can continue to trade Reducing Emissions from Deforestation and forest Degradation (REDD+) without restrictions, the role of REDD+ in this new global mechanism for creating carbon credits, remains uncertain, but is expected to be significant.
- For each carbon trade that takes place under this new global mechanism, 7% of carbon credits will be cancelled. 5% will fund climate adaptation in developing nations and 2% will go towards overall mitigation of global emissions resulting in net negative emissions.

After several years of negotiations, the rule book for carbon markets, under Article 6 of the Paris Agreement, was agreed at COP26 in Glasgow.

That an agreement was reached in Glasgow, after several stalemates, is no small feat, and is a testament to the will of countries to use markets to cooperate internationally at this critical time in our history. It shows that there is unanimous agreement among the governments of the world to use carbon trading to scale climate ambition.

The new rules bring greater clarity and are a statement of intent, as well as a sign of real confidence in the ability of carbon markets, including Voluntary Carbon Markets (VCMs), to benefit all involved. In terms of environmental integrity, the new rules are also far better than many feared.

But there are still some unresolved questions about how Article 6 will work in practice, and what it means for wider carbon markets. So here's a summary of what we know, what we think we know, and what we still don't know about the new Article 6 rule book.

Article 6: A section of the Paris Agreement that sets the rules for carbon trading, in particular through Article 6.2 which outlines country-to-country trading and Article 6.4 which establishes a new global crediting mechanism.

COP26: The 26th United Nations Climate Change Conference or Conference of the Parties, held in 2021 in Glasgow.

VCMs: Voluntary Carbon Markets

What we now know about Article 6

An agreement was reached on two major topics in Glasgow: Article 6.2, which allows countries to trade with one another, and Article 6.4, which allows countries to produce carbon credits through a new mechanism.

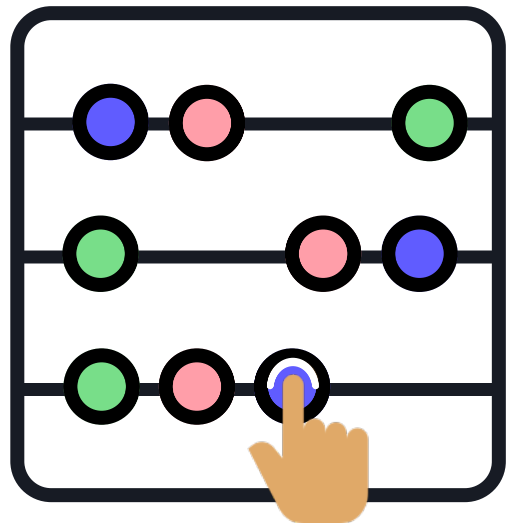
The two topics will work together, and share some common frameworks, most notably regarding their carbon accounting framework, which will be discussed later.

Bilateral trading under 6.2 is already underway, with countries such as Switzerland having agreed to a number of specific partnerships ahead of COP26 in anticipation of this agreement. In contrast, the new mechanism under Article 6.4 will take some time to set up.

NDCs: Nationally Determined Contributions

CA: Corresponding adjustments

ITMOs: Internationally Transferred Mitigation Outcomes.



Avoiding double-counting or double-claiming

To prevent double-counting or double-claiming, a carbon accounting framework will be required for countries to make claims towards their emissions reduction pledges to the UN, known as their Nationally Determined Contributions (NDCs). It will not be mandatory for private market trading.

Double-counting and double-claiming have long been considered a threat to making credible climate commitments using carbon credits. The new regulations make it mandatory for countries trading credits between themselves that count towards their NDCs, formally known as Internationally Transferred Mitigation Outcomes (ITMOs), to apply a carbon accounting framework known as Corresponding Adjustments (CAs). CAs will not be a requirement for the carbon credits traded in the private sector unless the host country chooses to make it one.

The two largest certifying bodies of voluntary carbon credits, Verra and Gold Standard, have traditionally held opposing views as to whether CAs will help or hinder climate ambition and environmental integrity in VCMs, but both will now be adding "adjusted unit" labels to credits. It remains to be seen how this accounting framework will be used by participants in the private sector.

It is still to be determined what climate claims companies can credibly make on the back of credits that either have CA attached or not. The Voluntary Carbon Markets Integrity Initiative (VCMI) will be influential in this discussion and is expected to issue fresh guidance in April 2022.

Kyoto-era credits will be carried over, provided they were registered in 2013 or later, but they will be easily distinguishable.

The question of whether Kyoto-era Certified Emission Reduction (CER) units, created under the Clean Development Mechanism (CDM), would be carried over into the new system has finally been settled. A limited amount of these credits, estimated at 120–300 million, will be carried over. They will be clearly labelled and their use will be restricted. Some countries had argued that none of these-credits should be carried over, due to concerns about their environmental integrity, and many of these countries have ruled out purchasing them.

CER: Certified Emissssion Reduction

CDM: Clean Development Mechanism

A new mechanism will replace the Clean Development Mechanism (CDM).

The CDM, created as part of the Kyoto Protocol, has been criticised by some countries for having a patchy record on environmental integrity, and specifically for allowing "hot air", or poor quality credits, to be issued and traded. These countries have long argued that a new mechanism should be created to replace it and learn from its successes as well as its shortcomings. We now have confirmation that a new mechanism will be designed and that it is likely to be known as the Sustainable Development Mechanism (SDM).

The new mechanism will be guided by a 12-member Supervisory Body, though we don't yet know who will be on this body. What we do know is that baselines for this new mechanism will be set below Business as Usual (BAU) and that crediting periods will include:

- 5 years, which will be renewable twice
- 10 years, which will be non-renewable
- 15 years, which will be renewable twice only for carbon removals.

BAU: Business as Usual

SDM: Sustainable Development Mechanism

All carbon trades will fund climate adaptation in developing nations and result in net negative emissions.

All carbon trades will include two automatic cancellations. The first, 5%, known as a Share of Proceeds (SoP), will go towards the Adaptation Fund (AF), a scheme to finance climate adaptation in developing nations. The second, 2%, will simply be deducted to ensure that all carbon trades result in Overall Mitigation of Global Emissions (OMGE). While these percentages are small, they do set a precedent for scaling further ambition through this and similar frameworks.

SoP: Share of Proceeds

AF: Adaptation Fund

OMGE: Overall Mitigation of Global Emissions

What we think we know about Article 6

To prevent double counting or claiming, stricter carbon accounting will also be required for "other international mitigation purposes".

Article 6.4 states that corresponding adjustments will also be required for "other international mitigation purposes". This open-ended term is interpreted by a consensus of experts to refer to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) and similar schemes to be agreed to by the International Maritime Organization (IMO) and other international organisations.

CORSIA: Carbon Offsetting and Reduction Scheme for International Aviation

IMO: International Maritime Organization

The role of Reducing Emissions from Deforestation and forest Degradation (REDD+) remains uncertain.

REDD+ is not explicitly mentioned in Article 6. However, the stricter standards to be developed by the new Supervisory Body mean that historic REDD+ credits will not automatically be able to count towards a country's NDC. We expect clarity on REDD+ and the eligibility of the various CDM methodologies in the new Article 6.4 framework at COP27 in November 2022.

Besides REDD+ units, the future of emissions avoidance projects, such as projects involving cookstoves, or renewable energy, will be decided at COP27. They will likely be ruled out of the new system, though there is room for a compromise whereby these project types are phased out over a number of years.

REDD+: Reducing Emissions from Deforestation and forest Degradation

What we do not know yet about Article 6

The Glasgow outcome on Article 6 calls on two distinct bodies to make recommendations on two sets of questions to COP27, which will then make the final decision. The two bodies are the new Supervisory Body for the Article 6.4 crediting mechanism and the UN Climate Convention's Subsidiary Body for Scientific and Technological Advice (SBSTA).

SBSTA: Subsidiary Body for Scientific and Technological Advice.

The new Article 6.4 Supervisory Body will:

- → review CDM accreditation standards and procedures
- → establish new procedures and methodologies for the mechanism to replace the CDM
- → make recommendations on projects relating to greenhouse gas removals, such as afforestation and reforestation projects.

Importantly, we will also learn who will be on the Article 6.4 Supervisory Body.

The Subsidiary Body for Scientific and Technological Advice (SBSTA) will report on:

- → whether avoided emissions projects should be allowed to count towards NDCs and any other claims
- → how CA should work
- → how the automatic cancellation of credits that lead to SoP, AF and OMGE should work
- → what the special circumstances for Least Developed Countries (LDCs) and Small Island Developing States (SIDs) should be.

We will learn more at COP27

When: 7–18 November, 2022

Where: Sharm El-Sheikh, Egypt

At COP27, taking place in Sharm El-Sheikh, Egypt, we will learn what recommendations the Article 6.4 Supervisory Body and The Subsidiary Body for Scientific and Technological Advice (SBSTA) will make to COP27 delegates on the specific issues they were tasked with at COP26. It will then be up to the delegates to make the final decisions. We look forward to following their progress throughout the year, and at COP27, and will keep you posted.

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About Sylvera

Sylvera provides the data you need to pick the best carbon credits. Our platform rates the quality of projects that generate carbon credits on a scale of AAA to D. The projects are rated on carbon, additionality, permanence and co-benefits using our breakthrough technological solutions. We help our clients save time and money while minimising financial and reputational risk. Request a demo of our ratings platform today.

Request a demo

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Clarity for the carbon markets