

## Modalities and procedures for the new market-based mechanism

SBSTA 39

The Environmental Integrity Group (EIG) welcomes the opportunity to submit its views on the work programme under SBSTA to elaborate the modalities and procedures for the new market-based mechanism (NMM), based on the questions mentioned in the conclusions of SBSTA 38 contained in document FCCC/SBSTA/2013/L.8. The EIG supports a decision at COP 19 adopting modalities and procedures for the NMM so that these activities can be used for meeting commitments which include targets or action under the Convention in an environmentally integer way that gives confidence in the implementation of these efforts, before and after 2020.

This submission is to be read in conjunction with EIG's submission of May 2013, contained in document FCCC/SBSTA/2013/MISC.9/Add.1<sup>1</sup>.

### On the role of the NMM:

#### (a) In which aspects is the NMM different from existing market-based mechanisms?

In the view of the EIG, the NMM will have mainly three new aspects compared to the CDM and JI:

- The NMM focuses on **segments, sectors, subsectors or policies** to allow a scaling up of emission reductions compared to the project-by-project approach of the CDM and JI.
- The NMM has a **more flexible approach** than the CDM in the sense that it allocates larger responsibilities to the host country. For example, the UNFCCC will provide guidance on common requirements for baseline setting and check the conformity with the guidance, while leaving the responsibility to participating country Parties to propose adequate baselines, recognizing the host Party's own responsibility on mitigation. In addition, as a general principle, requirements need to be simple, objective and transparent and should not impose unnecessary transaction costs to participants of the private sector, while taking into account environmental integrity.
- The NMM, like other market approaches under the Framework for various approaches (FVA), should go **beyond pure offsetting** by achieving a net decrease/avoidance of emissions, that should lead to reductions beyond the commitment (which include targets or actions) of both the buyer and the host countries. This net atmospheric benefit can only be achieved if a certain share of the resulting emission reductions is **neither credited and used for compliance by a buyer country nor used by the host country for compliance with its commitment**. Therefore, it goes beyond a situation where the emission reductions are distributed between the buyer and host countries, with a share of the emission reductions being credited and used by the buyer country to meet its commitment and another share of the emission reductions not being credited but kept by the host country to meet its own commitment. There are mainly two ways for achieving this net atmospheric commitment: one

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<sup>1</sup> <http://unfccc.int/resource/docs/2013/sbsta/eng/misc09a01.pdf>

way is if these reductions occur outside the existing reduction commitment of a host country. Another way would be a post-issuance discount or cancellation by the buyer country where the emission reductions take place in segments of the economy covered by the commitment.

**(b) Is there a relationship between a Party's level of mitigation ambition and its use of the NMM and, if so, what is the appropriate relationship?**

The NMM is designed in the context of efforts to **achieve and raise mitigation ambition** before 2020 and to ensure that the post-2020 climate regime will be robust and ambitious. Therefore, the NMM is linked to a Party's level of mitigation ambition, both for Parties acting as buyer countries and for those acting as host countries.

The agreed principle of **avoiding double counting** requires that each unit of quantified emission reductions from domestic mitigation action is either (i) counted towards the host country's commitment or (ii) credited under the NMM and potentially used for compliance of an investor country, but not both.

On the **buyer** country's side, use of units resulting from the NMM for meeting commitments should be **supplemental to domestic action**. Indeed, while flexibility is important in the climate regime to increase global ambition, domestic action by all countries for reducing emissions is needed.

On the **host** country's side, following the principle of no double counting, **the level of ambition in setting host country commitments impacts how to set the crediting baseline and how to determine additionality for units to be credited under the NMM**. Indeed, a crediting baseline for the NMM should take into account the level of the commitment. That is to say, more ambitious host country commitments are more likely to lead to more stringent baseline/additionality setting. This may raise the level of effort needed for host countries to generate NMM credits under ambitious commitments. In order to achieve a level playing field between host countries in NMM markets, the level of ambition of their commitments should be comparable.

**(c) What are the links between the NMM and other relevant matters under the Convention and its instruments?**

The NMM is mainly linked to the following matters:

**- Objective of the Convention**

The purpose of the NMM is to promote the development of further mitigation activities, to scale up mitigation in a cost-effective way and therefore to address the urgent need for global ambitious mitigation action, before and after 2020. In order to have a robust, transparent, environmentally integer and ambitious climate regime that supports sustainable development in participating countries, some common requirements are needed.

**- Framework for various approaches (FVA)**

The FVA should include market approaches and non-market based approaches. All these market mechanisms will benefit both from increased coherence of rules and structures across mechanisms and from efforts to streamline and simplify rules and procedures, which will increase usability and predictability for the private sector. Such synergies will contribute to the avoidance of double counting, increased environmental integrity, resource efficiency and consistency across mechanisms, and thus will reinforce comparability among activities and fungibility of carbon markets.

### **- Market mechanisms under the Kyoto Protocol**

The experience and expertise developed with the CDM and JI should be used as a stepping stone for reflecting on the design of the modalities and procedures for the NMM. Indeed, the CDM and JI have allowed the development of strong expertise by a wide range of stakeholders. Many synergies between market mechanisms can be identified, including: the large corpus of methodologies, standards and tools, the regulatory bodies, the International Transaction Log (ITL) and the accreditation procedures.

### **- Capacity building**

The development of market mechanisms (under the FVA or the NMM) requires expertise that host countries need to build. A possible share of proceeds to cover administrative expenses and to support the NMM (in addition to a share of proceeds to assist developing countries for adaptation) might be needed.

### **(d) How can the consistency of the NMM with the objective, principles and provisions of the Convention, with the science of climate change and with environmental integrity be ensured?**

The NMM is an instrument aimed at enhancing the cost-effectiveness and promotion of mitigation actions, and therefore aims at meeting the **objective of the Convention** by holding the increase in global average temperature below 2°C above pre-industrial levels, as **science** recommends it. By introducing instruments allowing flexibility on where the emission reduction takes place and therefore by reducing marginal abatement costs, countries can commit to globally more ambitious emission reduction.

In addition, the NMM is being designed consistently with the principles of the Convention. Firstly, it aims at contributing to the **sustainable development** of participating countries, especially host Parties and their local communities (see letter j below). Secondly, the implementation of the NMM has to consider national circumstances, e.g. in regard to the activities to be included under the mechanism.

Furthermore, the NMM operates under the Convention, including that **all Parties commit**, taking into account CBDR, respective capabilities and equity, to promote and cooperate in the development, application and diffusion of technologies, practices and processes that control, reduce or prevent emissions (Art. 4). Through the NMM, technology transfer and the diffusion of low carbon technologies will be facilitated.

Finally, to ensure that the climate regime is robust and ambitious, the **environmental integrity** needs to be guaranteed with **some common requirements**, allowing at the same time maximum flexibility to participating country Parties in the design and implementation of the activities whenever it does not endanger environmental integrity. The modalities and procedures should include:

- Definition of common accounting elements;
- Guidance for common requirements;
- Conformity checks, to check that the activities fulfil the common accounting elements and the guidance on common requirements, in order to allow recognition of activities as eligible for meeting commitments which include targets or actions under the Convention.

### **On the technical design of the NMM:**

**(a) Its operation under the guidance and authority of the COP: how should the COP exercise its guidance and authority over the NMM, what should the institutional**

**arrangements for the NMM be, and what should the role of the UNFCCC be in relation to the individual Parties that implement the NMM?**

The COP shall have the authority over and provide guidance to the NMM.

The COP shall provide guidance to an executive body under the COP or outside the Convention, by taking decisions on the recommendations made by the executive body on its rules of procedures, on the recommendations made by the executive body in accordance with relevant COP decisions. This body should be established taking into account the need to harmonize procedures and rules across mechanisms both under the Convention (for the FVA and the NMM) and the Kyoto Protocol (CDM EB, JISC or a possible successor).

The COP shall review annual reports of the executive body.

**(b) The voluntary participation of Parties in the mechanism: how should this be ensured, and how can the NMM incentivize wider Party participation?**

Parties' participation in the mechanism shall be voluntary. Parties can choose segments, sectors, subsectors or policies to be included in the mechanism. Participating Parties or participants authorized by the participating Parties may propose activities for review by the executive body.

**(c) Standards that deliver real, permanent, additional, and verified mitigation outcomes, avoid double counting of effort and achieve a net decrease and/or avoidance of greenhouse gas emissions: what are these standards, how should they be developed and applied, and what lessons should be learned from other experience, including under the Kyoto Protocol?**

A **common set of rules** on the following elements should be developed, in conjunction with other requirements mentioned above and below:

- 1) Eligibility criteria for participating country Parties, including for the development of national arrangements necessary for the international coordination of the activities;
- 2) Definition of segments, sectors, subsectors or policies and the scope of the activities;
- 3) Data quality (e.g. regarding verifiable mitigation outcomes and the quality of emission-related data) and ways for reducing leakage and for ensuring permanency of emission reductions, while leaving the responsibility to the participating country Parties to choose activities to be included under the mechanism;
- 4) Methods or instruments for achieving net decrease and/or avoidance of emissions, that can be chosen by participating country Parties to fulfil this requirement, such as crediting baselines and thresholds that are commonly agreed upon according to the elements mentioned below;
- 5) A review process, led by the executive body, to carry out conformity checks of the activities with the guidance, in a non-political manner; activities that have successfully passed the conformity checks are eligible for meeting commitments under the Convention; iterations through the review process after adequate revisions of the proposed activities are possible, but activities which do not successfully pass the conformity checks cannot be recognized for meeting commitments under the Convention.

**(d) Requirements for the accurate measurement, reporting and verification of emission reductions, emission removals and/or avoided emissions: what are these requirements, how should they be applied, and what lessons should be learned from other experience, including under the Kyoto Protocol?**

The accurate MRV of mitigation outcomes is essential and the following guidance on common requirements is needed:

- 1) Guidance on common minimum MRV requirements for ensuring that mitigation outcomes are real, permanent, additional and verified, including with requirements on monitoring and verification reports;
- 2) Independent verification from entities accredited under the UNFCCC or accredited by the national authority based on the common standards to be agreed upon related to accreditation of independent verifiers;
- 3) Publication in English on the UNFCCC website of all information required as per the set of criteria, on the approaches and activities to be reviewed by the executive body and on the implementation of these activities.

**(e) Means to stimulate mitigation across broad segments of the economy, which are defined by the participating Parties and may be on a sectoral and/or project-specific basis: what are examples of such segments, how should the NMM stimulate mitigation within them, and on what basis should the participating Parties define them?**

The NMM is designed in the context of efforts to raise mitigation ambition before 2020 and to ensure that the post-2020 climate regime will be robust and ambitious. Therefore, the NMM need to scale-up mitigation action in comparison to the CDM and JI by facilitating mitigation activities on a broader scale, such as segments, sectors, subsectors or policies.

**(f) Criteria, including the application of conservative methods, for the establishment, approval and periodic adjustment of ambitious reference levels (crediting thresholds and/or trading caps) and for the periodic issuance of units based on mitigation below a crediting threshold or based on a trading cap: what are these criteria and how should they be applied?**

Guidance on common requirements for baseline setting for broad segments of the economy is needed, while leaving the responsibility to participating country Parties to propose adequate baselines, recognizing the host Party's own responsibility on mitigation. Guidance should ensure that:

- 1) Baselines are demonstrably below projected business-as-usual scenarios;
- 2) Conservative methodological approaches are applied when setting baselines and determining additionality, for example when using simplified approaches that would result in increased uncertainty; this includes taking into account that some mitigation outcomes can become common practice over time and should be included in the business-as-usual scenario after a specific period of time when the host Party carries out the periodical revision of the baselines (e.g. after 5, 7 or 10 years);
- 3) Perverse incentives at national levels to delay mitigation policies are avoided;
- 4) The length of crediting periods is adjusted when simplified baseline approaches that increase uncertainty are used;

- 5) Regular revisions of baselines take place.

**(g) Criteria for the accurate and consistent recording and tracking of units: what are these criteria, how should they be applied, what technical systems need to be in place and what lessons should be learned from other experience, including under the Kyoto Protocol?**

The accurate and consistent recording and tracking of units is needed to avoid double counting and to track effectively emission reductions resulting from the NMM toward the commitments. Guidance on the following common requirements is needed:

- 1) Avoidance of double counting, through common accounting elements under the Convention and transparent reporting instruments to be used by participating country Parties; double counting should be avoided: between host and buyer countries; between market mechanisms, and between market and non-market-based mechanisms; between financial contributions and mitigation purposes;
- 2) National arrangements (similar to the appointment of a Designated National Authority or a Designated Focal Point) for the international coordination of the activities;
- 3) Registries under the responsibility of each Party to the Convention, by extending existing national registries and establishing registries for countries not connected to the ITL yet, and a central registry under the UNFCCC for countries that do not have capacities to administer their own registry;
- 4) Use of the ITL managed by the secretariat, by extending its current scope to the NMM;
- 5) Issuance by the executive body of units for the activities that have successfully passed the conformity checks;
- 6) Tracking of the above-mentioned units by the ITL;
- 7) Adequate surrendering and cancelling of units used for meeting commitments which include targets or actions under the Convention, and adequate reporting in the appropriate reporting documents of both the host and buyer countries of the units.

**(h) Supplementarity: should this be defined and ensured and, if so, how?**

Use of units resulting from the NMM for meeting commitments should be supplemental to domestic action. Please refer above to the concept “beyond pure offsetting” (page 1).

**(i) A share of proceeds to cover administrative expenses and assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation: should there be a share of proceeds and, if so, how should it be structured and applied and at what level should it be set?**

A possible share of proceeds to cover administrative expenses (depending on the administrative work load on the international level described above), to support capacity building for the NMM and to assist developing countries for adaptation might be needed.

**(j) The promotion of sustainable development: how can the NMM promote this?**

The NMM should contribute to sustainable development of host Parties, and especially local communities. Sustainable development impacts should be monitored, reported and verified. The development of projects with high co-benefits should be promoted. Public consultation and stakeholder interaction need to take into account interests of local communities, so that confidence in the activities under the NMM and their positive impacts are promoted.

**(k) The facilitation of the effective participation of private and public entities: how should the NMM facilitate such participation and how can its incentives be structured appropriately?**

For mitigation actions to be able to stimulate mitigation outcomes across broad segments of the economy, participating Parties, and in particular host Parties, need to put in place instruments for passing incentives to individual investors and actions, especially if carbon market revenues go directly to governments on an aggregated way. For example, in the case of an ETS used as a basis for crediting overachievement at the end of the period, the host country would need to redistribute units or revenues to companies that have overachieved.

**(l) The facilitation of the prompt start of the mechanism: what measures should be taken to facilitate the prompt start of the NMM and what criteria should be in place?**

Pilot projects will facilitate the development of criteria for the NMM and its continuous improvement. As for the Activities Implemented Jointly (AIJ) under the Kyoto Protocol, pilot projects will be helpful for elaborating requirements. Such piloting would imply that the mitigation outcomes can be credited once the set of criteria and requirements have been fully developed and if the piloting activities can demonstrate that they meet the criteria and requirements.

**(m) Eligibility criteria for the use of the mechanism: should there be such criteria and, if so, what are they and how and to whom should they be applied?**

Eligibility criteria work in conjunction with the guidance on common requirements (see above elements on the “Technical design of the NMM”, letters f and g). In addition, the design of the new market mechanism should not create incentives for low ambition in commitments (see above the elements under “Role of the NMM”, letter a). Indeed, countries wishing to participate in the NMM or activities aimed at the NMM, but which are not in conformity with the guidance on common requirements, will not be able to pass the conformity checks and would therefore not be eligible.

**(n) Role of the implementing Party: what should be the role of the implementing Party in the operation of the NMM?**

Some common requirements are needed to ensure environmental integrity, transparency and confidence in the climate regime. At the same time, implementing country Parties should have maximum flexibility in the design and implementation of the activities whenever it does not endanger environmental integrity.

**(o) Governance: what measures can be taken to ensure the good governance of the NMM?**

Good governance is essential to ensure confidence in the climate regime, credibility in the carbon market and predictability to the private sector. Transparency and efficiency in procedures are therefore key elements. Actors need to be in conformity with the guidance on common requirements, which will be evaluated through conformity checks.