

## **Revision of the modalities and procedures for the Clean Development Mechanism**

### **SBI 38**

Switzerland welcomes the progress made towards the revision of the modalities and procedures for the Clean Development Mechanism (CDM), in particular with the CDM Policy Dialogue, and welcomes the opportunity to provide further input with a view to adopt revised modalities and procedures at CMP 9.

The first review of the modalities and procedures for the CDM pursuant to decision 3/CMP.1 needs to draw upon the experience and lessons learnt so far with the CDM, Joint Implementation (JI) and national climate policies. Switzerland is of the view that CDM should continue being an important mechanism for global mitigation action and supports the revision of the modalities and procedures in view of:

- ensuring the environmental integrity of the CDM, in particular real emission reductions and its contribution to sustainable development,
- improving its governance
- improving its usability and reducing transaction costs and risks,
- fostering synergies with other market mechanisms,
- and integrating recent developments of the climate regime.

Switzerland is of the view that the review of the CDM should include both operational revisions - guided by the principle of simplification - and strategic revisions. In addition, an incremental approach to the revision of the modalities and procedures is needed, so that the CDM evolves with the strategic developments of the broader context, in particular with the elaboration of the post-2020 agreement. In addition, consistency between the flexible mechanisms and between market mechanisms under the Kyoto Protocol and the Convention should continuously be increased. 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, and to increase predictability for the private sector.

Switzerland commends the High-Level Panel on the CDM Policy Dialogue for its work and recommendations regarding the revision of the CDM. The following submission outlines Switzerland's views on the following recommendations of the Report on the CDM Policy Dialogue: 1) Demand/supply and access to the CDM; 2) Synergies with other mechanisms; 3) Standards and environmental integrity; 4) Governance.

### **1) Demand/supply and access to the CDM**

The CDM was built in a specific historical context of legally-binding mitigation targets by developed countries under the Kyoto Protocol. This historical situation is a stepping stone toward broader mitigation action, both in the pre- and post-2020 regime. In the context of the new climate regime and efforts to increase mitigation action under the Convention, the CDM need now to evolve and reflect the ever more pressing situation where nationally adequate mitigation actions are required by all countries, both developed and developing, either under the Kyoto Protocol or under the Convention. Against that background, the CDM modalities and procedures should set a regulatory environment and system that enables the CDM to be fit for the future, to facilitate the promotion of global mitigation action under the Convention,

and to increase demand for CERs.

The issue of imbalance between demand and supply of certificates needs to be further addressed in the context of mitigation actions by all countries under the Convention. In this broad context, Switzerland advocates full use of the potential of the CDM by all Parties and therefore **full access to the CDM to all Parties, including to developed countries without emission reductions inscribed in Annex B for the second commitment period of the Kyoto Protocol**. Since the CDM is regulated by a set of common rules, modalities and procedures, there is broad confidence in the contribution of the mechanism to global mitigation action, although the environmental integrity of the CDM can still be further reinforced. Therefore, broad use of CERs for achieving mitigation targets should be allowed. In the context of the new climate regime where all developed and developing countries contribute to emission reductions, in particular as of 2020, all Parties should be able to fully participate in the CDM, acquire and transfer CERs. This will increase demand for CERs and contribute to mitigate the imbalance between demand and supply for certificates. Adequate accounting rules and an extension of the procedures for surrendering/cancelling CERs used for meeting commitments and for avoiding double counting are needed for Parties without commitments in the second commitment period.

In order to further increase demand for CERs, Switzerland also supports **full access to the CDM to all Parties, including to developing countries** for meeting their nationally appropriate mitigation actions (NAMAs) pledged under the Convention, if they wish to do so. For example, a country may wish to allow its national companies participating in an Emissions Trading Scheme (ETS) to use CERs resulting from projects realised on its national territory and/or in other countries for meeting their national commitments. Developing countries would therefore benefit from the rules and infrastructure of the CDM that are already available (e.g. standards, tools, International Transaction Log) in order to promote the implementation of their national climate policies and actions. Adequate accounting rules and an extension of the procedures for surrendering/cancelling CERs used for meeting commitments and for avoiding double counting are needed.

In addition, **use of CERs for further mitigation actions in sectors currently poorly addressed by the CDM and other instruments** should be facilitated. For example, given the recent developments under the International Civil Aviation Organization (ICAO) and the International Maritime Organization (IMO) for introducing market-based instruments for mitigation purposes (e.g. offsetting, national/regional/global efforts), encouraging the use of CERs for complementary purposes to commitments under the Kyoto Protocol or the UNFCCC is needed. This will increase demand for CERs and allow developing countries to further benefit from the promotion of sustainable development, technology transfer and capacity-building. To allow a smooth implementation of complementary actions and synergies, the extension of the necessary arrangements and procedures for surrendering/cancelling CERs used for meeting commitments and for avoiding double counting is needed.

Switzerland recognizes that an **increase in mitigation action by all Parties under the Convention, in the context of the corresponding process under the Durban Platform (ADP)**, is a key element to close the mitigation gap and to increase demand for certificates, in parallel to increased domestic mitigation action. In addition, increased mitigation actions are needed from development banks, for which emission reductions should be a guiding principle for action. Furthermore, the private sector should be increasingly involved in mitigation actions, not only through adequate national and international policies, but also through enhanced voluntary actions.

At the same time, **reducing supply from some CDM project types which are not additional and environmentally integer** should be adequately addressed (see section 3 below) and adequate alternatives for these projects should be put in place.

## 2) Synergies with other mechanisms

The CDM is a success in its capacity to attract private resources in emission reduction activities and to contribute to sustainable development, technology transfer and capacity-building. The CDM has allowed the development of **strong expertise** by many stakeholders (project developers, Designated Operational Entities, Designated National Authorities, the CDM Executive Board) and a **large corpus of methodologies, tools and structures**. These competences and lessons learnt regarding needed improvements have to be taken on board when revising the modalities and procedures of the CDM, but also when revising the JI guidelines and designing the framework for various approaches and the modalities and procedures for the new market mechanism under the Convention.

Many **synergies between market mechanisms** established under the Kyoto Protocol or the Convention can be identified, including: **using the infrastructure, expertise and tools** of the CDM for JI, for the framework for various approaches and for the new market mechanism under the Convention (whose standards and processes are currently being designed), such as: methodologies and standards, the regulatory bodies, the international transaction log, accreditation procedures, the future appeal process and the reporting and reviewing processes. This will increase environmental integrity, resource-efficiency and consistency across mechanisms, and thus comparability among activities and fungibility of carbon markets. Furthermore, increased interactions and synergies between mechanisms are needed to **avoid double counting of emission reductions across market mechanisms**. For example, avoiding double counting of emission reductions achieved by an installation that is registered as a CDM project and at the same time that participates in a new market mechanism would require specific arrangements, such as retiring CERs for these emission reductions that are also rewarded with units under the new market mechanism. In addition, market mechanisms are an instrument that can contribute to the implementation of NAMAs by developing countries and experiences with the CDM can be useful for further elaborating climate financing instruments such as the Green Climate Fund (GCF).

Given the evolution of the climate regime and the urgent need for global mitigation action, both the flexible mechanisms and other new market mechanisms under the Convention need to reflect that market mechanisms have to go beyond pure offsetting, so that **net emission reductions** are achieved on a global scale. This will ensure that only a part of the emission reduction is accounted toward the emission reduction objective of the developed country (buyer country) and that the other part is accounted toward the emission reduction objective or NAMA of the developing country (host country), while at the same time avoiding double counting. Striving for an approach that allows for the principle of net emission reductions not only to the framework for various approaches and the new market mechanism under the Convention but also to the CDM will allow consistency across market mechanisms and a smooth enhancement of mitigation actions by all Parties and participants. Switzerland recommends further analytical work on instruments and methodologies to facilitate the implementation of net emission reductions and avoidance of double counting.

Further developments of the CDM towards **sectoral approaches** and implementation of NAMAs should be encouraged, building upon the experience with CDM Programmes of Activities (PoAs). Sectoral approaches can address both challenges of leakage and scaling up of mitigation actions. In this regard, synergies and convergence of the CDM with the new market mechanism under the Convention would strongly benefit all mechanisms and reinforce environmental integrity.

The recommendation of the CDM Policy Dialogue for using an existing fund or encouraging countries in their efforts to scale up climate finance to purchase and cancel certificates to be accounted by these Parties as contributions to international climate finance, and the proposal to create stabilization funds functioning as reserve banks, Switzerland recommends **further analytical work** on: the impacts on market liquidity and stability, the financial resources that

would be needed and the consequences on the optimisation of climate benefits and co-benefits with climate finance. Such work could be done by the UNFCCC, by other fora such as the OECD and by the financial services industry. For the time being, Switzerland is not in a position to assess such recommendations given the lack of in-depth analysis.

### 3) Standards and environmental integrity

Switzerland is of the view that both host and investor countries must have the possibility to **withdraw or suspend their Letters of Approval (LoAs)** when projects violate national regulations or international treaties, in particular human rights. Indeed, such implications may appear only after the registration of a project or during its implementation. However, such withdrawal and suspension of LoAs need to have robust safeguards to ensure that there is certainty for investment by the private sector. Violations need to be clearly demonstrated and a clear and transparent process is needed, in particular regarding the conditions for a Designated National Authority (DNA) to withdraw or suspend a LoA, the process for mitigating the negative situation within a specific deadline and the related consequences in case of absence of resolution of the situation. DNAs should transparently inform on the conditions for withdrawing or suspending LoAs, e.g. in the LoAs they issue or in their national procedures for issuing LoAs. This will support the credibility and environmental integrity of the CDM and encourage project developers to better take care of sustainable development and interests of local communities when implementing a project.

The assessment of **additionality** needs to be improved and streamlined, by relying increasingly on standardized approaches such as performance benchmarks. A conservative approach is needed when setting reference levels in order to take into account uncertainties. Evolving conditions (e.g. context related to a country, use of technologies) need to be reflected in the baselines, which must be regularly reviewed and updated.

In general, methodologies need to be **simplified**. Using simple and conservative approaches will increasingly ensure environmental integrity, transparency, objectivity and usability. It is necessary to increase use of performance benchmarks, clear and transparent indicators for additionality and baselines, and positive lists. Simplified requirements for monitoring should be applied to both new and already registered projects, without further validation.

The **length of the crediting periods** should be revisited. The length of the crediting periods should be limited to a maximum number of 10 years. Indeed, **technology diffusion** over time must be better taken into account, since some investments would have been done anyway after a few years, in particular for large scale power supply projects. For large projects, the crediting period should be limited to 10 years, while for small projects the crediting period should 7 years with a single possibility to renew the crediting period for an additional period of 7 years.

Furthermore, some developing countries might want to phase out existing CDM projects or allow the participation of new CDM projects only for a specific period of time, so that these projects can be **integrated in a national climate instrument such as an ETS or in a new market mechanism with a broader scope than the CDM**. This would be an option for avoid double counting of emission reductions through two different mechanisms. Therefore, modalities should allow host countries to choose to reward these CDM projects through a domestic instrument or another international instrument, instead of through the CDM. In such a situation, the ex-CDM installation would still be rewarded for its emission reduction by benefiting from a comparatively better situation in an ETS in comparison to other installations (and therefore it would be able to sell its surplus of emissions allowances to other participants of the scheme) or by receiving units issued for its participation in a new market mechanism.

In addition, the **environmental integrity and mitigation impact of some project types**

need to be reassessed. Project types for which perverse incentives or leakage endanger the environmental integrity of the CDM, as it is the case with HFC-23 projects and projects that reduce N<sub>2</sub>O from adipic acid plants, need to be addressed as soon as possible with alternative instruments to market-based instruments. Alternatives based on non-market approaches would consist in financing measures for phasing down HFCs in a cost-effective way in order to maximize both protection of the ozone layer and climate change mitigation, by creating synergies between the Montreal Protocol and the UNFCCC. HFC-23 projects and N<sub>2</sub>O from adipic acid plants CDM projects should be excluded from the CDM with immediate effect. In addition, it is necessary to include a general provision for these projects that ensures continuation of emission abatement of HFC-23 and N<sub>2</sub>O adipic acid CDM projects and monitoring beyond the end of the crediting period. Another example is coal-fired plants, which should not be able to be rewarded by CERs since these projects imply a net increase of emissions, do not contribute to sustainable development and lead to a technological lock-in. Adequately addressing the concern of HFC-23, N<sub>2</sub>O adipic acid and coal-fired plants in the CDM would contribute to improve the issue of imbalance between demand and supply of CERs.

The Executive Board should address **significant deficiencies in validation, verification and certification reports** and make recommendations for adoption at CMP 9. These new recommendations should ensure a quantifiable limited risk and liability for Designated Operational Entities (DOEs). Alternative options should be considered by the EB, such as levying a share of proceeds to offset significant deficiencies and therefore guarantee mitigation effects.

The CDM should increasingly contribute to sustainable development of host Parties, and especially local communities. **Sustainable development impacts** and co-benefits of the projects against various criteria need to be described more extensively. Use of the CDM sustainable development declaration tool should be made mandatorily to better inform stakeholders on these elements. The development of projects with high co-benefits should be promoted, in particular with simplified requirements, especially regarding additionality and monitoring issues, whenever it does not endanger environmental integrity and conservativeness. Public consultations and stakeholder interaction should be improved in order to best take into account the interests of local communities, so that confidence in the CDM and its positive impacts can be reinforced.

#### 4) Governance

**Governance of the CDM Executive Board (EB)** needs to be revised so that the EB becomes less politicized and more objective in terms of environmental integrity. EB members should act as independently as possible and without conflicts of interests. As such, they should not have any negotiating mandate under the UNFCCC and should not take instructions from Parties. Political issues should be deferred by the EB to the CMP, if they cannot be resolved within the EB. In addition to representation of developed and developing country Parties, representatives of the private sector and of accredited NGOs, both from developed and developing countries, should be represented in the EB, in order to enhance cooperation with the private sector and civil society. In order to keep this body as efficient as possible, the current size of the EB (20 persons) should not be exceeded. Therefore, adding representatives of the private sector and from accredited NGOs should imply the replacement of current alternates by these new representatives. We suggest having half of the members of the EB representing the private sector and NGOs (10 persons).

The Chair and Vice-Chair of the EB, the Panels and Working Groups should be elected on a full-time basis, other members of the EB at least on a half-time basis to allow **professionalization and dedication** of the work of EB members. Terms limits on membership are needed, with terms both as member and alternate member to be taken into account. The process for selecting candidates should be transparent and well-structured with

and adequate time plan. Nominations to the EB should include written documents highlighting qualifications and relevant background of the nominees. Several years of significant technical, regulatory, climate change and/or financial experience should be required for an application as an EB member. Drawing upon the experience of stakeholder involvement, interactions between the EB and stakeholders should be fostered. Switzerland supports a harmonization and unification of governing bodies for the CDM and JI, for reasons of efficiency and consistency.

Negotiations under the SBI on the **appeal process against decisions of the EB** need to be completed as soon as possible, in order to strengthen consistency and transparency of the decision-making process, and therefore confidence in the CDM. The independent appeal process should be based on principles of rules of law and due process, such as independence and impartiality, transparency, prevention of conflict of interests, timely decisions and fairness. The appeal process for the CDM should be the same as the appeal process for JI, in order to promote synergies between structures and efficient use of resources. All stakeholders that are directly affected by a project should be able to have access to the appeal procedure. However, appropriate safeguards and procedures need to be established so that the appeal process is not inefficiently overburdened and does not block implementation of CDM projects.