

Article 6 of the Paris Agreement

What you need to know post-COP27

COP27
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Introduction

COP26 in Glasgow last year saw a big milestone for carbon markets. After several years of negotiations, the section of the Paris Agreement that deals with international cooperation and carbon markets, Article 6, was finally agreed.

That an agreement was reached after several stalemates, was no small feat, and was a testament to the will to use carbon markets to cooperate internationally and benefit all involved. The new rules brought greater clarity and are far better in terms of environmental integrity than many feared.

Nevertheless after COP26, there remained many unresolved questions about how Article 6 would work in practice, and what it would mean for the wider carbon markets. Since then there has been steady progress on both Article 6.2 and 6.4. At COP27 there were robust discussions on many aspects of implementation and alignment between the Article 6 mechanisms and voluntary carbon markets (VCMs), but perhaps fewer decisions and answers than optimists had hoped for.

So here's a reminder of what the Article 6 rule book actually says, as well as an update on the progress made over the last year, and what questions and disagreements still remain.

What happened at COP26?

An agreement was reached on the rules for international cooperation, which include two market-based mechanisms for trading carbon among parties to the Paris Agreement.



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Mechanisms for cooperations under Article 6

Article 6 features two market-based mechanisms:

- Article 6.2, which allows decentralized bilateral trades between parties, and
- Article 6.4, which allows countries to issue carbon credits through a new centralized mechanism governed by the United Nations Framework Convention on Climate Change (UNFCCC).

A third mechanism, Article 6.8, covers non-market cooperative approaches. It remains unclear exactly what form these will take.

	Description	Example
Article 6.2	A market-based mechanism which allows decentralized bilateral trades between parties.	Switzerland buys ITMOs from Ghana for use towards its NDC.
Article 6.4	A centralized market-based mechanism governed by the UNFCCC for issuing carbon credits.	Indonesia issues 6.4ERs which can be sold to state or non-state buyers, for a number of possible uses (see page 12).
Article 6.8	Non-market based approaches to international cooperation.	TBC - the details on Article 6.8 are still vague. It is likely to involve donations and sharing expertise, so will require little regulation.

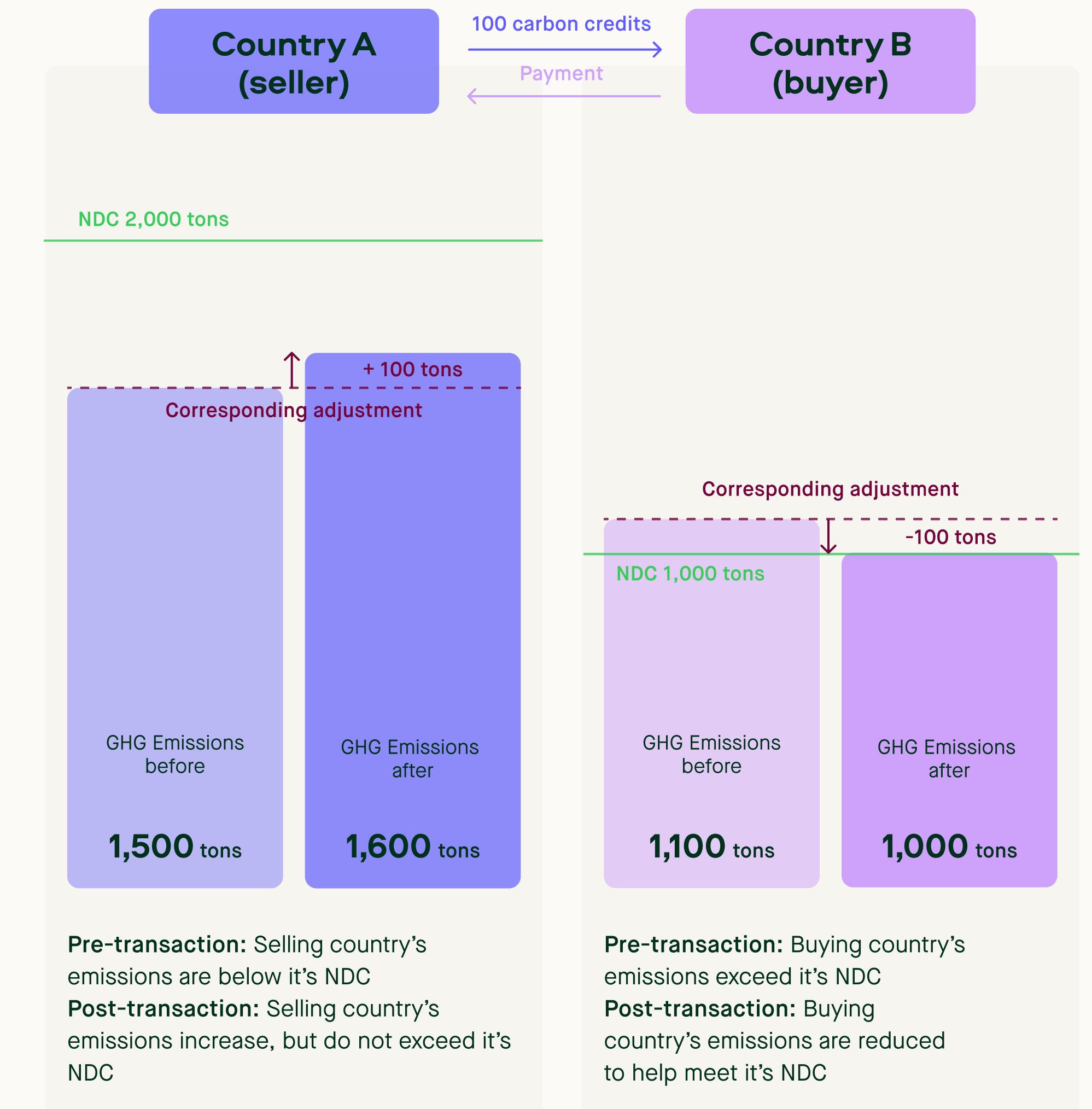
The concept of Corresponding Adjustments

To prevent double-counting or double-claiming, a Corresponding Adjustment in carbon accounting will be required when traded carbon is used for international compliance purposes.

Double-counting and double-claiming have long been considered a threat to making credible climate claims using carbon credits. The new regulations make it mandatory for parties to apply a carbon accounting correction known as a Corresponding Adjustment (CA) when trading credits:

1. towards their NDCs, or
2. for “Other International Mitigation Purposes” (OIMP) such as the aviation compliance scheme CORSIA.

When a CA is applied, transferred carbon is discounted from the selling country’s emissions accounting, before it can be counted in the buyer’s.



Clean Development Mechanism transition

Article 6.4 is the successor to the Clean Development Mechanism (CDM).

The precursor to the Paris Agreement, the Kyoto Protocol, had its own carbon trading mechanisms, including the CDM. Although the CDM issued a huge number of credits, many of which are still available on the market today, it has been criticized by some countries for having a patchy record on environmental integrity. Specifically, it has been accused of allowing “hot air”, or poor quality credits, to be issued and traded.

Some countries have long argued that a new mechanism should be created to replace it and learn from its successes as well as its shortcomings. The Article 6.4 mechanism will hopefully be able to achieve this.

Some CDM credits will be carried over, but they will be easily distinguishable.

The controversial question of whether credits from the CDM, known as Certified Emissions Reduction (CER) units, would be carried over into the new Article 6.4 system was finally settled in Glasgow.

A limited amount of these credits can be carried over, provided they were issued by projects registered after 1 January 2013. They will be clearly labeled 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.

All Article 6.4 carbon trades will fund climate adaptation in developing nations and result in net negative emissions.

Trade done under Article 6.4 will include two automatic cancellations. The first, 5%, known as a Share of Proceeds (SoP), will go towards the Adaptation Fund, 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.

Article 6 Oversight

The two bodies overseeing the implementation of Article 6 were agreed.

There are two distinct bodies that make recommendations on two sets of questions to the COPs, which then take the final decisions. The two bodies are the new Supervisory Body for the Article 6.4 crediting mechanism and the UNFCCC's Subsidiary Body for Scientific and Technological Advice (SBSTA). Supervisory Body was finally appointed in July 2022 after much wrangling and was able to present some draft texts at COP27, but was limited by the short timeframe it had to achieve its objectives.

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.

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 CAs 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.

What happened at COP27?

After last year's breakthrough deal, this year's work on Article 6 focused on agreeing the technical details necessary for implementation.

In amongst the procedural decisions, there were also debates which reflected the divergence in parties' fundamental vision of what market mechanisms should look like. These are the issues that are most likely to have an impact on VCMs.



Latest Article 6 developments

The first transfer under Article 6.2 was authorized, but 6.4 still needs some time.

Even ahead of COP26 countries such as Switzerland had started to agree specific partnerships in anticipation of a deal on Article 6. In the year since the details of Article 6.2 were first agreed, countries have continued to sign agreements and memoranda of understanding (MOUs).

At COP27, Ghana announced they had authorized the first transfer of ITMOs to Switzerland. This reflects that although the exact details of the mechanism are still being ironed out, there are no barriers to Article 6.2 cooperation starting now.

In contrast, the lack of agreement on the specifics of Article 6.4 is still a while away from being operationalized. It now seems that 6.4ERs (emission reductions) will not realistically be issued until 2025, as there is still a considerable amount of work for the 6.4 SB and SBSTA, the outcomes of which must then be agreed by parties.

Some rules for CDM transitions were clarified.

Projects which wish to transition from the CDM to Article 6.4 now have clarity on the process they must follow. They can expect the template for transition requests to be published by next June.

However, on the issue of methodologies for Article 6.4, and whether CDM methodologies can be rolled over, consensus was not reached by the 6.4 SB. This issue is therefore on the work program for the 6.4 SB for 2023.

The issue of authorization and Corresponding Adjustments is still a hot topic for Article 6.2...

Authorization was a particularly controversial issue for discussions on Article 6.2. Authorization by the host country is the process, which turns a carbon credit into an ITMO and triggers a CA. Discussions focused on the timing of this, and also whether authorization could be revoked at a later date.

Ultimately, the draft language on this was removed from the final text, as no agreement was reached.

New category of credits

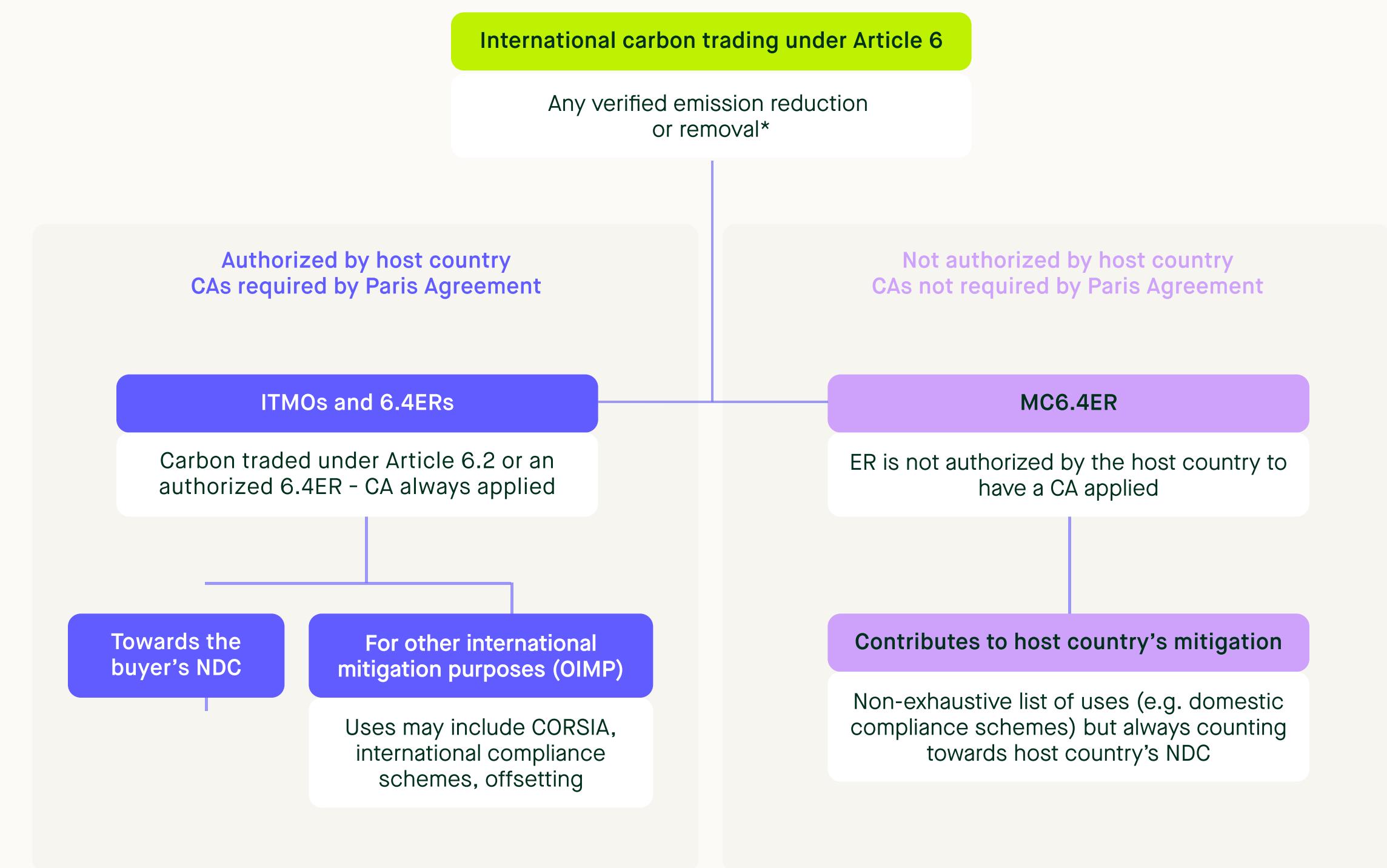
...and for 6.4, leading to a new category of credits.

The existing 6.4 guidance did not require all credits to be authorized and have a CA applied. There was much debate about this in and around this year's negotiations, especially as this will have significant implications for how these credits can be used and what claims can be made. These agreements are very likely to have impacts on claims and norms in the VCMs too.

It was agreed that for 6.4ERs to be used towards NDCs or for OIMP, they must be authorized and have a CA applied. Non-authorized 6.4ERs are now also known as 'mitigation contribution 6.4ERs' or MC6.4ERs. These will still have the same fees applied, as well as SoP and OMGE cancellations, but cannot be used in the same way as authorized 6.4ERs.

The agreed text lists how they can be used: "inter alia, for results-based climate finance, domestic mitigation pricing scheme, or domestic price based measures." The key term here, which has already been poured over, is *inter alia* - a legal term meaning among other things. So, although the list focuses on domestic uses, it does not rule out international transfer of MC6.4ERs, as long as they are not used for international compliance purposes. As it stands, it is understood that MC6.4ERs also cannot be used for offsetting purposes.

This seemingly very technical dissection of the legalese actually has fundamental implications for the future of carbon markets. The claims that buyers can make from using carbon credits is what determines the demand for them. What is ultimately decided for 6.4 is likely to be reflected in VCMs too.



*in accordance with voluntary, regulatory or Paris Agreement A6 standards

What we think we know now

CAs will not be required for all voluntary transactions, at least for now. But the claims that can be made from using credits with no CA might change.

In the aftermath of COP26 there was significant debate among VCM players over whether CAs would help or hinder climate ambition and environmental integrity in VCMs. Over the last year the market seemed to reach some consensus that CAs would not be required when credits were voluntarily used to increase companies' climate ambitions, unless the host country or standard requires one.

However, 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 eventual decision reached on this is likely to have significant implications for credit demand, especially from private-sector buyers.

Uncertainty around this, as well as the implications of adjusted credits on host country NDCs, has contributed to some of the uncertainty limiting VCM growth this year. In addition, specific policy decisions, such as Indonesia's pause of some credit issuances, are thought to be as a result of concerns that future voluntary transactions might require CAs, and therefore hinder host countries in achieving their NDCs.

The discussion around MC6.4ERs will only have added more confusion to this conversation. If using MC6.4ERs for offsetting is not permitted, it could be that in future VCM credits without CAs also cannot be used for offsetting.

Organizations claiming to be carbon neutral would therefore have to use credits with a CA, which are likely to be in limited supply and attract a price premium. Meanwhile, there might be limited demand for credits without CAs unless companies can justify spending money on them with a worthwhile climate claim.

Market initiatives such as the VCMI and IC-VCM will be looked to in order to help define new market norms around claims.

What we think we know now

Continued

Reducing Emissions from Deforestation and forest Degradation (REDD+) will be permitted in these new mechanisms.

REDD+ was excluded from the CDM, and there has been concern that unless it was explicitly approved in the Article 6 text it might not be allowed in these new mechanisms either.

This confusion was compounded by discussions around “emissions avoidance activities” not being included. In VCMs the term “avoidance” is often used to refer to projects including REDD+, cookstoves, and renewable energy. However, in this context the terminology is different, and REDD+ is thought to fall under “emissions reduction” activities. Avoidance refers to specific activities, such as leaving fossil fuel reserves in the ground, where it is much harder to prove additionality and baselines. For this reason most countries do not support the inclusion of avoidance activities in Article 6.

So, although REDD+ is not explicitly mentioned in Article 6, it is thought to meet the requirements currently outlined, and we expect it to be accepted for use in Article 6.4 in the future. It will probably fall under the category of “emissions reductions” or another existing category, rather than the more controversial ‘emissions avoidance’.

The inclusion of REDD+ in Article 6.4 will require new methodologies to be developed by the 6.4 Supervisory Body. This is included in their work programme for next year.

What work is still to be done to operationalize Article 6?

The talks this year agreed a significant program of work for the SBSTA and 6.4 SB over the next year, with some topics even pushed to 2024 due to the amount that needs to be achieved.

On Article 6.2 this includes:

- Agreeing the scope of changes of authorization allowed, and the process to be followed.
- Processes for reviews of confidential information to ensure all activity is compliant, even when it will not be publicly shared.
- Considering special circumstances for the least developed countries and small island states.
- Establishing the international registry to track trading.

On Article 6.4 this includes:

- Reworking the text on removals, avoidance and conservation enhancement activities.
- Guidelines on methodologies.
- Connecting the 6.4 registry with the international registry for Article 6.2.

What does this all mean for VCMs?

We meant it when we said much of the progress this year was detailed and technical! However, that isn't to say nothing agreed will have importance for VCMs. In the immediate future, the key discussions will be around the use of Corresponding Adjustments for Article 6.4, and how the decisions and norms decided here will spill over to VCMs. This is also likely to have implications for exactly how Article 6.4 integrates with VCMs - a near parallel, or very distinct? Another pertinent question is how host countries will react to these developments - will they embrace these new mechanisms designed to support global cooperation, or spook at the potential impacts on their NDCs?

These questions cannot be answered yet, but as the market digests and discusses the outcomes of COP27, we will start to have a clearer vision of the direction of travel.

For a more in depth insight into these thorny questions, watch our COP27 Debrief fireside panel



Watch here

If you have specific questions about climate policy and carbon markets, contact us to speak to our team of carbon market experts.

Contact us

Glossary

Term	Abbreviation	Definition
Corresponding Adjustment	CA	The accounting mechanism built into Article 6 to avoid double counting. The amount of emissions traded are subtracted from the buyer's NDC and added to the seller's NDC.
Clean Development Mechanism	CDM	One of the mechanisms of trading carbon under the Kyoto Protocol.
Certified Emissions Reduction	CER	Credits issued under the CDM.
Carbon Offsetting and Reduction Scheme for International Aviation	CORSIA	International scheme for the aviation industry to achieve carbon neutral growth. Implemented in phases, with the compliance phase starting in 2027.
Internationally Transferred Mitigation Outcome	ITMO	Carbon transferred between countries under Article 6.2.
The Kyoto Protocol		The first major international climate-related treaty signed as part of the UNFCCC in 1997 and in force from 2005-2020.
Mitigation Contribution 6.4 Emissions Reductions	MC 6.4ERs	Carbon credits issued under the Article 6.4 mechanism, which have not been authorized by the host country to have a Corresponding Adjustment applied. This has implications for use, see page 11
Nationally Determined Contributions	NDC	Each party to the Paris Agreement must submit an NDC, which includes its emissions targets at least up to 2030 and steps to achieve it. These must be resubmitted every 5 years, with increasing ambition.
Other International Mitigation Purposes	OIMP	Carbon traded between a country and another international compliance scheme, such as CORSIA.
Overall Mitigation of Global Emissions	OMGE	Every trade under Article 6.4 has an automatical cancellation of 2%, to ensure that as a whole, the mechanism contributes to global emissions falling.
The Paris Agreement		The latest UNFCCC treaty on climate change, agreed in 2015 at COP21 to replace the Kyoto Protocol.
Subsidiary Body for Scientific and Technological Advice	SBSTA	Body of the UNFCCC that advises parties on the implementation of Article 6, among other things.

Glossary Continued

Term	Abbreviation	Definition
Share of Proceeds	SoP	Every trade under Article 6.4 has an automatical cancellation of 5%, to raise funds for the Adaptation Fund, a scheme to finance climate adaptation in developing nations.
United Nations Framework Convention on Climate Change	UNFCCC	An international treaty signed between governments, with the ultimate aim of preventing "dangerous" human interference with the climate system.
Voluntary Carbon Markets	VCMs	The forum for carbon to be traded for purposes not required by national or international policies and regulations. For example, companies that want to voluntarily offset their emissions can purchase carbon credits via VCMs.
Emission Reduction	6.4 ER	The carbon credits issued under Article 6.4 of the Paris Agreement.
Supervisory Body	6.4 SB	The UNFCCC body advising parties on the implementation of Article 6.4.



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