

6

The number of Article 6.4 Supervisory Body meetings held to date, with no concrete progress being achieved

30

The current total of Article 6.2 bilateral agreements signed to date

40.5MtCO<sub>2</sub>e

The volume of technology-based removal offsets issued in 2022

## Carbon's Coming Clash: Article 6.4 and the Offset Market

Corporations, financial institutions and governments that rely on voluntary carbon markets will all be impacted by a new global trading mechanism for offsets being introduced. Set out in Article 6.4 of the Paris Agreement, this mechanism could be implemented as early as the COP28 climate summit in November. For a time, it could co-exist with the voluntary carbon market and result in inconsistent standards, putting the roles of many current market players in jeopardy.

- While high-level agreement to establish an Article 6.4 mechanism has been secured, a number of details remain unresolved, including the eligibility criteria of traded offsets, verification, and corresponding adjustment procedures to avoid the double counting of emissions savings. The impact on voluntary carbon markets will ultimately depend on the rigidity and level of detail of the standards for credits.
- Should Article 6.4 launch prematurely at COP28 and fail due to inefficient trading mechanisms and unclear guidelines on the eligibility of credits, the voluntary carbon market would continue to operate as usual, albeit with some possible increased pressure for regulation as it becomes the only venue for trading offsets. This is a likely outcome in the short term, as the Article 6.4 Supervisory Body is rushing to meet its COP28 deadline. It has plans to transfer Clean Development Mechanism credits to Article 6.4, which are of questionable environmental integrity and serve as a warning of failed global policy on carbon markets.
- If the Article 6.4 Supervisory Body issues stringent standards that are unique from the voluntary carbon market, it would cause a market split where both systems co-exist. In the short term, this will pressure companies into buying Article 6.4 credits of perceived higher quality due to the heightened regulation, exposing the remaining voluntary offset buyers to reputational and financial risk. The many bureaucracies and unresolved questions for the Article 6.4 Supervisory Body makes this an unlikely outcome in the short term.
- On the chance Article 6.4 borrows the exact standards currently used in the voluntary carbon market, which were created by independently led organizations, it would create consensus on credit eligibility, causing the two markets to merge and operate under one umbrella. This would centralize regulation and boost the credibility of both markets. BloombergNEF estimates this outcome has a medium likelihood in the short term, as Article 6.4 may leverage existing offsetting standards to accelerate its launch.

### Possible effects of Article 6.4 on the voluntary carbon market in the short term

Rigor of Article 6.4 standards	Outcome	Likelihood
Weak and relaxed	Article 6.4 fails and VCM persists	High
Stringent and robust	Market split: Article 6.4 and VCM co-exist	Low
Mirrors existing VCM standards	Article 6.4 merges with VCM	Medium

Source: BloombergNEF. Note: VCM refers to the voluntary carbon market.

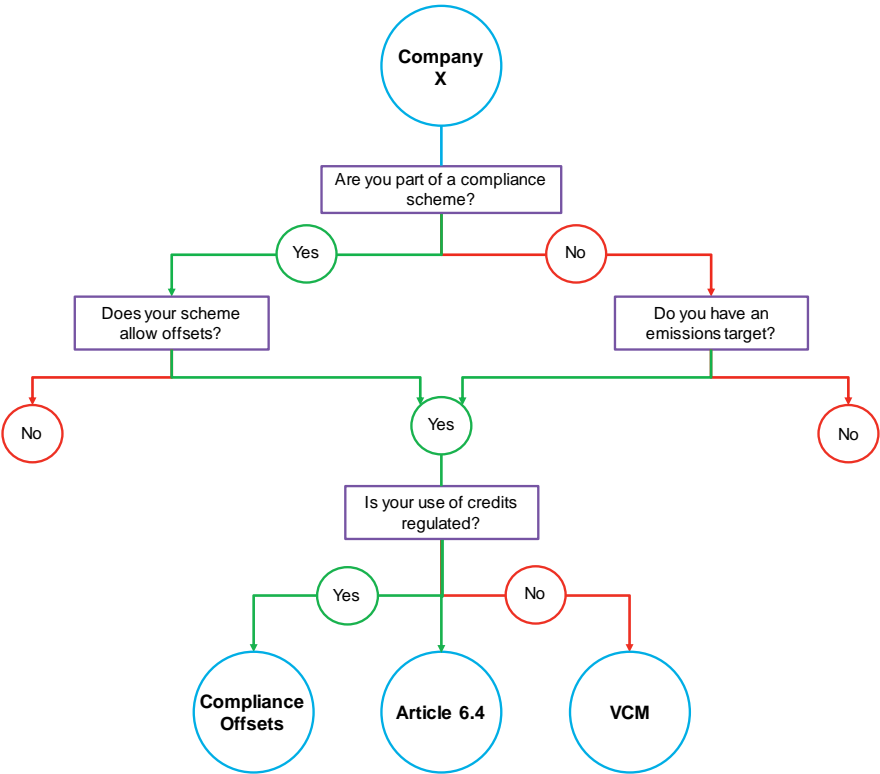
Countries, corporations and voluntary carbon market players are at risk.

While stakeholders may gain some clarity on the future of an Article 6.4 mechanism and voluntary offset markets in the coming months, many questions will likely remain unanswered. Thematically, there are a few key areas that investors, traders, corporations and policymakers should keep in mind moving forward:

**The uncertainty of Article 6.4 eligibility criteria puts *everyone* at risk.** Implementing Article 6.4 will have repercussions for public and private entities, especially those invested in carbon trading. Governments looking for a cheap alternative to decarbonize may need to think about the wider political implications of emissions trading. Companies will also be vulnerable to the shifting market dynamics and big price shocks to their usual cheap offsets. More so, market players well-established in the current voluntary carbon markets, such as brokers, will be at risk of vanishing if a new Article 6.4 replaces the shaky offset market.

**Article 6.4 is not a Band-Aid that can solve quality issues.** It is important to remember that a functioning global trading mechanism does not necessarily mean a robust one. The question of quality remains unresolved due to its complexity, and Article 6.4 cannot settle this debate on its own. The work of ratings agencies and private-led initiatives like the ICVCM could still play an influential role in carbon markets should Article 6.4 succeed.

Article 6.4 decision tree for companies looking to offset their emissions



Source: BloombergNEF. Note: VCM refers to the voluntary carbon market.

**Issues of double counting and maintaining corresponding adjustments will prevail.** While an Article 6.4 mechanism is likely to exist in some form or another in the near to medium term (given the global political commitment to it), the risk of double counting remains. Parties have previously addressed this issue by enacting corresponding adjustments to the host country's NDCs upon signing Article 6.2 bilateral agreements. However, this has not yet been agreed upon

for Article 6.4. Developments on corresponding adjustments in the coming years will be important to follow.

**The overlap between compliance and voluntary markets hinges on the robustness of new policy.** If the new criteria for Article 6.4 reflect a level of robustness that satisfies compliance markets, this may spur more demand from compliance schemes for offsets eligible under Article 6.4. By contrast, in the absence of strict regulation, compliance markets may shy further away from offsets and their tainted reputation. This will feed into Outcome 2, where the market splits, and put companies in a position where they need to make careful decisions.

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