IETA
INTERNATIONAL EMISSIONS
TRADING ASSOCIATION

IETA Response to UNFCCC: FVA/NMM

September 2, 2013

Section 1: The Framework for Various Approaches (FVA)

UNFCCC Call for Input:

What is the purpose and scope of the FVA, including its role in ensuring environmental integrity?

The role of the FVA should be one in which it is the carrier for linked carbon markets.

The FVA should act as a basic framework with a broad, flexible scope that provides structure to emerging carbon markets. IETA is convinced that a global carbon market is the most efficient way for governments to achieve the necessary emissions reductions in the long-term. The FVA is a step in this direction due to its inclusiveness, but should also transition from current structures to allow for long-term continuity and stability in climate change mitigation.

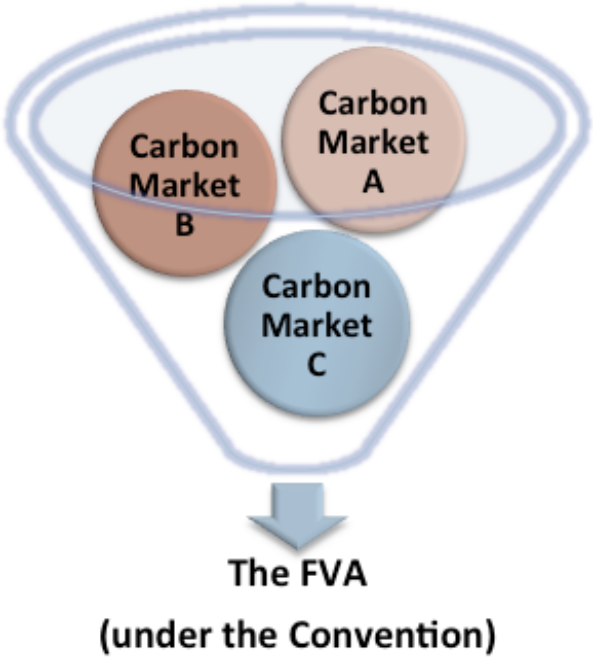

Figure 1: Carbon Market Approaches opting-in to a linked global market

IETA proposes a stepwise approach to the goal of a global carbon market, through an arrangement that allows linkage between emission reduction approaches within the FVA, utilizing existing market approaches and the New Market Mechanism (NMM) to establish initial supply and demand for carbon pricing units.

COP 19 should begin the process of this step-wise approach by establishing the modalities and procedures for both the FVA and the NMM. By establishing these procedures now, it will attract the attention and interest of the private sector and begin the process of re-investing in emissions reductions that will be encapsulated at the UN level by 2020.

The Scope of the FVA

The FVA will address a national, sub-national or sectoral level approach-as each Party will decide whether to be included in multilateral participation in developing a global carbon market. In order to do so, the FVA will encourage Parties to accept a fixed carbon emissions budget for a given future period in the form of tradable international allowances (an FVA unit, or "FVU"). The budget arises from the goals of the specific policy program(s) as a contribution to the global effort. The budget is fixed (i.e. absolute), irrespective of the nature of the mitigation program operating within the economy.

Therefore, Parties may be eligible to provide and trade FVUs in a global market if they voluntarily opt-in a segment or segments of their economy and subject the design of their approach to a process of oversight under the UNFCCC.

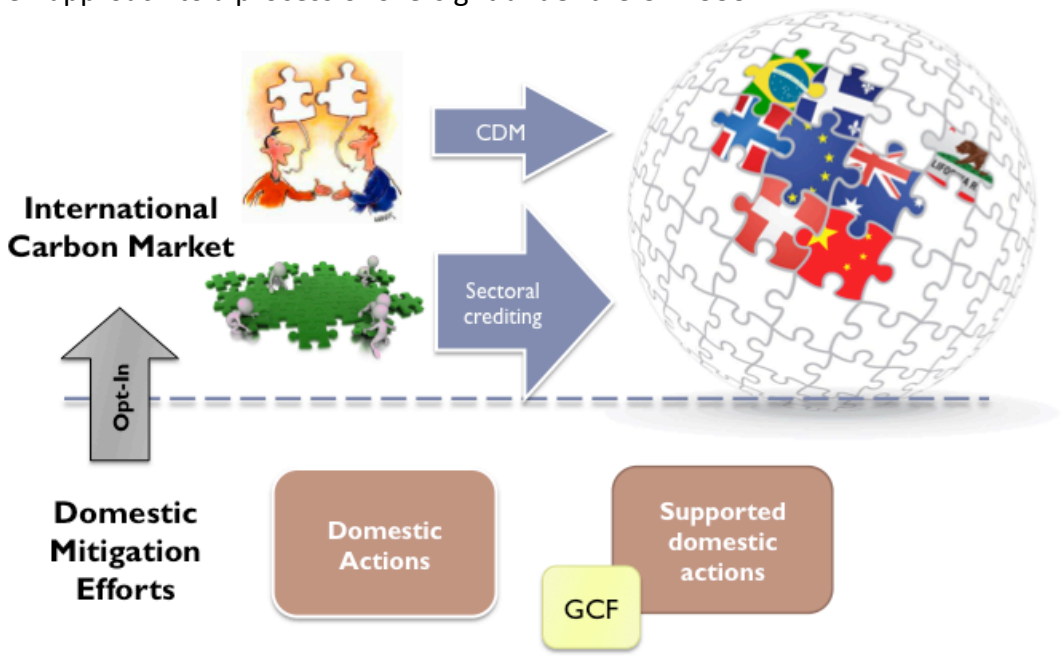

Figure 2: The FVA and a global carbon market

UNFCCC Call for Input:

What are the possible links between the FVA and other relevant matters under the Convention and its instruments?

The FVA must ensure that national approaches are being developed that incorporate and address environmental integrity.

In order to do this effectively, the Convention would need to create at least 2 system checks:

1. A process to ensure that countries' approaches are in broad compliance with the Convention (meeting their respective emission reduction commitments/pledges under the Convention). This is no different than the process for Annex-1 Parties under the Kyoto Protocol.

2. An 'oversight body' within the network of countries that do pledge to develop a carbon market that is linked and recognized by the UNFCCC. This oversight body would provide a critical function inside the FVA itself to ensure that as systems emerge and begin to link, their design is based on a quality standard and allows the country to meet the ambition of its target. Such a standard would not duplicate the existing methodologies and processes established for flexible mechanisms under the UNFCCC, but rather serve the function of a critical pillar of UNFCCC architecture in order to ensure that systems recognized by the FVA are of the upmost quality.

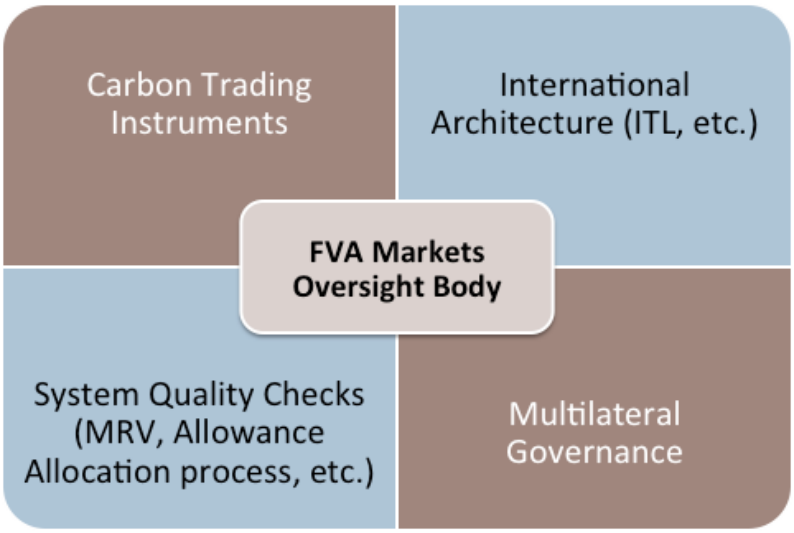

Figure 3: FVA Oversight Body Functions

Participation in this model is not mandatory, but once a Party opts in, participants must fulfill their commitments and meet their agreed emission budgets through the surrender of FVUs. Participation would always be dependent on a review of the carbon

budget submission by an oversight body. Any such body, while having a critical role to play in providing guidance and recommendations, will need to fit the realities of international governance, where nations will retain much of their existing authority over capital flows and broader trade policies. The oversight body could either fall under the UNFCCC, or be independent of the UNFCCC (i.e. a Board elected by countries participating in the market ensuring a balance of representation from developed and developing countries).

Such a body would perform the following functions:

a) Establish the framework within which projects and national programs can link.
b) Create the global carbon-trading instruments that will underpin the linkage process and issue those instruments in response to submitted projects and programs (as per Assigned Amount Units (AAU) and CERs within the Kyoto Protocol).
c) Develop measurement, reporting and verification rules associated with the issuance of instruments and the later step of annual reconciliation.
d) Develop and issue guidelines for the basic structure of national programs. Programs designed along similar lines will facilitate linkage.
e) Develop and operate the necessary international registries for linking (e.g., an expansion of the current International Transaction Log - ITL).
f) Govern the overall framework, including periodic reconciliation.
g) Assess submissions for inclusion in the international framework that will earn FVUs.
h) Expand and operate the existing project mechanism(s) (CDM, JI).

UNFCCC call for input:

Which experiences from the Kyoto Protocol flexible mechanisms, domestic and regional schemes, existing institutional arrangements and infrastructure are relevant to the elaboration of the FVA and how can they be applied to the FVA?

The FVA should establish or make available market infrastructure components, such that Parties may use common (or as similar as feasibly possible) issuance procedures, registry, auction mechanisms, etc.

Much of this infrastructure has already been built for the Kyoto flexible mechanisms. Standardization underpins the use of fungible carbon price instruments and builds a common understanding of how markets operate. For the business community, it is essential that registries provide a level of confidence and assurance to private sector

actors. This is a role that the Assigned Amount Unit (AAU) and the International Transaction Log (ITL) provides under the Kyoto Protocol. The ITL could be re-designed in such a way that it would also allow for unit tracking between different national and subnational mechanisms. In addition, all new crediting mechanisms should build on the experience garnered through the CDM, including its MRV and standards.

UNFCCC call for input:

What could be the role of a share of proceeds for the approaches under the FVA?

IETA would like to understand how Parties envision the share of proceeds under the FVA to work in practice, and particularly so for 'non-market approaches.'

For market participants, the Share of Proceeds can be easily understood via the New Market Mechanism. It could replicate the adaptation fund contributions used under the CDM. This would be particularly effective at raising significant adaptation and climate resiliency funds through the New Market Mechanism and a linked global carbon market.

However, it is difficult to foresee how a Share of Proceeds could be implemented and managed under the FVA.

UNFCCC call for input:

What common accounting rules, standards, criteria and/or procedures, if any, could be established under the Convention, taking into account internationally agreed common accounting rules, to ensure the environmental integrity of the approaches under the FVA, and avoiding all types of double counting, including mitigation outcomes and support?

To avoid double counting, the FVA should ideally manage a centralized tracking system, through an international transaction log (ITL) or similar centralized registry. Governments participating in the carbon market under the FVA need to ensure they have robust domestic registries and GHG accounting systems in place. The mitigation approaches proposed, even if not designed as an absolute reduction or limitation of GHG emissions at a national level, should result in a **fixed carbon emissions budget for a given future period in the form of tradable international allowances**. Parties may wish to explore criteria on scarcity of allowances in order to allow for a clear price signal to develop over time. The budget would stem from the goals of the specific policy or program. As noted, this budget would be exchanged for an equivalent international allowance allocation, held by the national government, and recognized in the international centralized registry. The national government would then ensure that

sufficient allowances are in the international registry to cover the agreed emissions budget.

Section 2: Non-market based approaches

Emissions Trading in an overall climate change policy framework

IETA is convinced an emissions trading scheme is preferable to any non-market based approach. IETA notes that while a non-market based approach such as a carbon tax ensures an increase in energy prices, it does not ensure that emissions will be reduced to the level necessary to deliver the required environmental policy outcome.

Generating positive economic value for reducing emissions create different incentives to the negative economic value channeled through a carbon tax. A market offers the opportunity to undertake projects through offsetting mechanisms that impact supply, something more challenging to replicate under a tax system. It is difficult for Governments to create confidence that tax revenues will be recycled into initiatives to incentivize emission reductions, at least longer-term. The key practical difference between the two tends to be greater flexibility for the company or installation, which reduces the concerns of business without compromising the overall objective of the policy. Linking carbon markets to harmonize the price of carbon is more politically achievable than negotiating common carbon tax rates. Most climate economists and market experts agree that linked carbon markets will lead to the least possible cost to participation for both the household and the emitting entity, In addition to providing greater liquidity in the market and moving towards a tangible price on pollution.

As an example, the European Union Emissions Trading System (EU-ETS) has shown that cap-and-trade can be extended to carbon coordinated across multiple countries, and in doing so creates a price on carbon that drives emissions reductions. However, the EU-ETS has also suffered as the leading policy instrument for driving down emissions, as a result of conflicting policies and targets being set at the EU and national levels. These incentives to reduce emissions are not matched by a reduction in the cap of allowances in the EU-ETS (which is set in advance). The EU has seen a rise in alternative policies such as targets and national subsidy schemes, which create conflicting incentives for reducing emissions. Conflicting policies and incentives have contributed to the situation of oversupply of allowances.

IETA recognizes that policymakers will want to regulate some areas of emissions through direct Regulation, rather than include it in a GHG market (e.g. agricultural methane or HFCs). We believe that as policymakers put together the pieces for a country's emissions reduction policy, the goal should be a coherent policy framework whereby a carbon market is the driving instrument for reducing emissions in a

harmonized and cost-effective manner. Other segments of a country's emissions inventory can be addressed in a non-market. Experience shows that most emerging policies include markets as the key policy, alongside non-market components. The example of the EU-ETS has shown that an overall policy framework with targeted measures that regulates emissions outside of the ETS should be addressed at the outset.

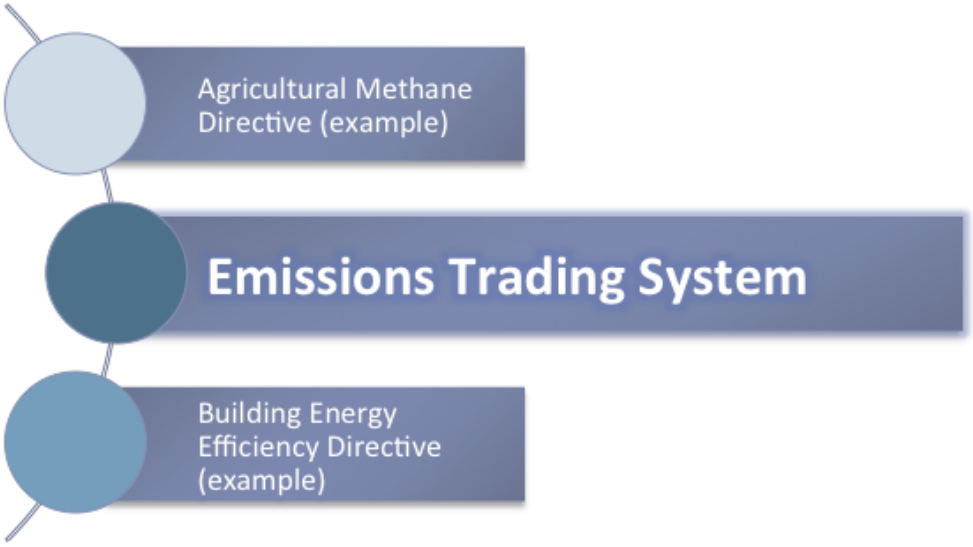

Figure 4: Examples to address economy-wide GHG's

Section 3: The NMM

UNFCCC Call for Input:

In which aspects is the NMM different from existing market-based mechanisms?

The NMM should not follow the structure of the project based CDM, but be modeled on the current AAU-led system. Whereas the FVA provides the parameters within which an international carbon market can function, the NMM governs the exchange of units. For cross-jurisdictional trading, this is crucial.

The trading structure within the Kyoto Protocol illustrates the part played by the market mechanism. Within its design, the unit of account is the Assigned Amount Unit (AAU). The AAU establishes the need for trade and creates basic supply and demand through the allocation process against national targets relative to actual emissions. This gives value to the AAU, which in turn creates demand and value for CERs under the Clean Development Mechanism (CDM). Without the AAU, the CER and similar instruments would have no value and could not exist in a meaningful sense.

The New Market Mechanism should be modeled on such a design, in effect replicating the role of the AAU under the Kyoto Protocol. However, it will operate in a world of bottom up pledges, nationally designed trading systems and NAMAs – a series of various approaches operating within a common framework (the FVA). The NMM is the exchange unit that translates all of the different policies within the FVA into a tradable commodity. The private sector needs this level of assurance in order to conduct trading between different units for compliance purposes. This design for the core NMM instrument would give renewed value to the CER and allow the development of additional crediting mechanisms within a new framework.

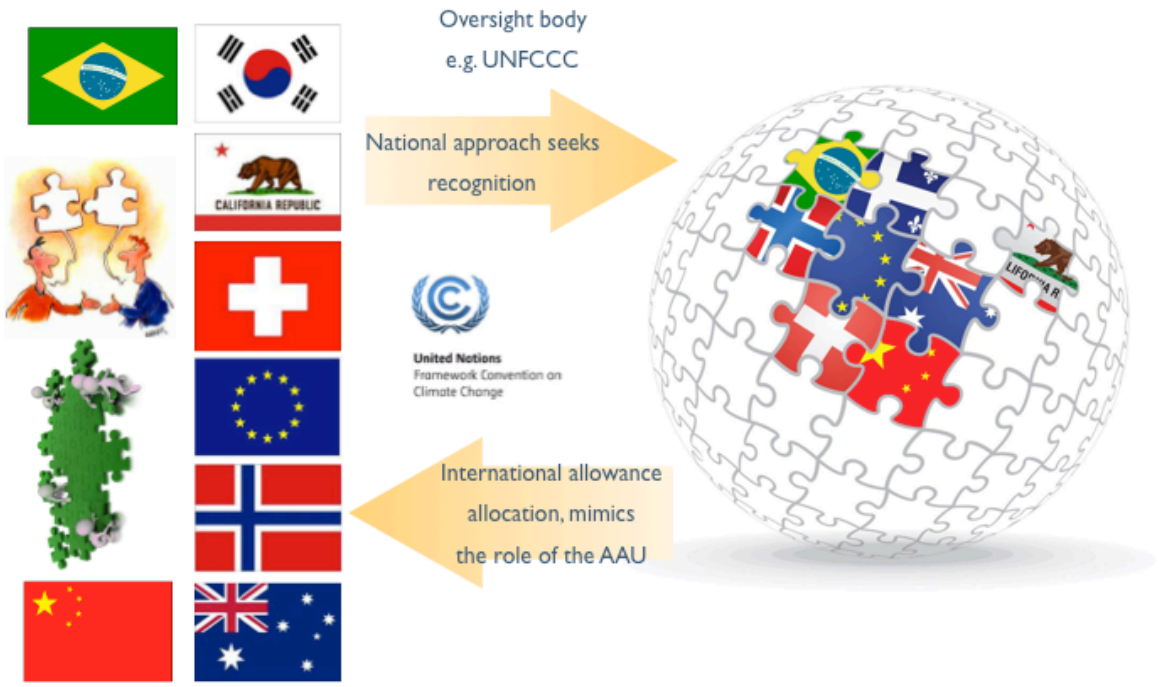

Figure 4: The Flow and Function of the NMM

Such an approach will achieve scale beyond existing crediting mechanisms, such as the Clean Development Mechanism (CDM) and Joint Implementation (JI) by generating impact across entire sectors. This will provide a new avenue for private investment in reducing emissions and meeting overall emissions goals in a more cost effective way. The NMM must take on board the experience gained from the pioneering AAU, CDM, JI and voluntary market mechanisms within its infrastructure, while still maintaining the confidence of the private sector that has generated over $200 billion in developing country investment since 2005.

UNFCCC Call for Input: *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: Ambition and Economy-Wide Trading

The FVA now under discussion, in combination with plans for a New Market Mechanism (NMM) under the Convention, offers the opportunity to deliver such a global market that could then sit at the heart of the new agreement negotiated under the ADP. IETA believes that not pursuing such a goal at this time would be a major lost opportunity for the UNFCCC and could ultimately undermine its attempts to limit global emissions.

The NMM will enable countries and regions to transition from project-based crediting to real carbon pricing and economy-wide trading of GHG emission reductions, by promoting mitigation across multiple sectors or sub-sectors. As such, NMMs will embody a commitment to reduce emissions by the host country that reflects some level of aspiration. Importantly, as countries unveil plans for market based systems, there could be an opportunity to establish an international expert review of each system under design as a way to ensure best practice and commonality.

The experience of emissions trading shows us that the most robust policy driver for changing the overall energy mix of an economy is a nation-wide carbon pricing and market based system. As countries begin to link their respective markets together, there will be increased scope for greater ambition of GHG emissions reductions. At the same time, this will offer more flexibility to users of the system as they can participate in more than one system. More linkages also increase the usage of the NMM, and therefore appropriate oversight of policy design will be of greater importance.

Key steps to participation in the NMM under the FVA

a) National governments begin (or continue) the task of designing policy measures to manage emissions in their own economies, but with the specific goal of a tangible national contribution to the global goal (e.g 2°C).
b) Industry sectors affected by such policy measures look for the flexibility to manage emissions more widely and in particular seek access to reduction opportunities outside their national borders. This can only be realized through some form of international trading.
c) A national government seeks to be included in the international market and proposes that a sector covered by specific policy architecture (e.g., cap-and-trade) is allowed to participate. The budget (or cap) for the sector is exchanged for an equivalent international allowance allocation.

d) The international allocation is held by the national government, but an equivalent tradable instrument within the industry sector program is recognized on the international registry.
e) The national government recognizes any flow from the international registry as compliance units within its industry program, and at the periodic reconciliation for the international agreement, a national government will ensure that sufficient allowances are in the international registry to cover the agreed emissions budget with other countries that participate in the NMM.

UNFCCC Call for Input:

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?

Self-Financing the NMM

Like the CDM under the Kyoto Protocol, the NMM should have a share of proceeds (SoP) to provide financing to parties that are most vulnerable to the effects of climate change and also to cover the administrative costs of the NMM itself.

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IETA greatly appreciates the opportunity to provide our input on this issue. Please do not hesitate to contact IETA's Director for International Policy, Jeff Swartz (swartz@ieta.org) should you have any questions regarding this input.

IETA - Climate Challenges, Market Solutions

24, Rue Merle d'Aubigné
Geneva, 1207, Switzerland
Tel: +41 (22) 737 0500

Boite 27
Rue de la Loi 235
Brussels, 1040, Belgium
Tel: +32 (0)22 30 11 60
Reg. 0889.072.702

1730 Rhode Island Ave., NW,
Suite 802, Washington, DC
20036 USA
Tel: +1 (202) 629-5980

100 King Street West, Suite
5700, Toronto, Ontario
M5X 1C7, Canada
Tel. +1 (416) 913 0135