Submission to the Article 6.4 mechanism Supervisory Body

World Bank submission of input in relation to the Call for input 2023
Structured public consultation: Requirements for the development and assessment of mechanism methodologies

The World Bank would like to express appreciation for the opportunity to submit our views on the important work that Article 6.4 mechanism Supervisory Body is undertaking on requirements for the development and assessment of mechanism methodologies.

As a carbon market practitioner, the World Bank is actively involved in working on concrete carbon market transactions under Article 6 of the Paris Agreement and engages in related discussions with potential host countries of activities generating Internationally Transferred Mitigation Outcomes (ITMOs).

We would like to share our observations on several interrelated questions pertaining to: encouraging broad participation (2b); sharing of mitigation benefits and NDC alignment (2g/h); scalability and replicability (7a); accounting for policies in baseline setting and additionality demonstration (33); non-permanence and reversals (30, 31); and general questions on baseline and additionality (20, 23).

(i) Encouraging broad participation (2b)

We support the need for encouraging broader participation with as many Parties as possible to create the circumstances that allows cooperation through the Article 6.4 Mechanism. In order to support broader participation, issues like overselling risks and hence the risk of not meeting their NDC targets should be well understood by countries and need to be resolved with practical solutions. Market liquidity that would allow to hedge this risk is currently not available. Building up such liquidity seems difficult as ITMOs generated for mitigation outcomes achieved in one NDC period cannot be used for NDC compliance purposes in the subsequent NDC period, i.e., unused ITMOs lose their compliance value at the end of the NDC period of their generation as per Guidance on Article 6.2, (paragraph 8b). This “non-banking rule” creates a barrier for building up market liquidity through negatively affecting both demand and supply of ITMOs.

The World Bank is working on innovative solutions to enable ITMO transactions under conditions of lack of market liquidity. Results-based Climate Finance (RBCF) can be used to support implementation of mitigation activities generating mitigation outcomes that can at a later stage – once countries are closer to their NDC target year – receive ITMO authorization. This requires adopting a flexible ruling on the timing of ITMO authorization.

To allow broad participation, it is important that the Article 6.4 Mechanism covers as many sectors as possible including the land use sector. In that context, all of the performance-based approach(es) identified in paragraph 36 of the RMP should be considered under the Mechanism.

(ii) Sharing of mitigation benefits and NDC alignment (2g/h)

Our second observation is that significant heterogeneity of NDCs makes it challenging to derive broadly applicable approaches on how best to share mitigation benefits and ensure NDC alignment through selecting the most suitable mitigation activities for Article 6 carbon market transactions and through baseline setting.

Early experiences so far have shown that flexibility in activity selection is needed to enable buyer-seller matches, and even more so in a piloting and early market phase. Deriving NDC aligned baselines requires a similar degree of flexibility, and cases are rare where unconditional NDC targets would be directly translatable in crediting baselines.

It seems therefore preferable to encourage Parties to use the existing flexibility under Article 6.4 to come up with tailor-made solutions according to their respective circumstances. This is not meant to discourage offering of default solutions but to caution against aiming for prescribing a pre-defined set of exclusive options.

(iii) Scalability and replicability (7a)

Project-based carbon crediting quickly reaches limits of scalability simply due to the physical limitations of the underlying mitigation activities. The World Bank aims to pilot carbon crediting of mitigation policies and of crediting approaches targeting whole segments of the economy such as sectoral or jurisdictional crediting and whole of economy approaches for small emitter countries.

Experiences with jurisdictional approaches addressing REDD+ and first experiences with policy and sectoral crediting have shown that these approaches indeed hold substantial potential to scale up carbon market transactions.

Article 6.4 is in principle not limited to project-based approaches, and we would suggest considering within the development of further guidance on Article 6.4 the eligibility of the above-mentioned scaled-up crediting mechanisms.

Scale in carbon crediting can also be reached by replicating individual project activities following the programmatic carbon crediting approach. Key to reach scale through replicability is standardization. The CDM went a long way in operationalizing programmatic crediting through Programmes of Activities (PoAs). When combined with standardized approaches to baseline setting and positive lists on additionality, PoAs helped to reach small and micro scale activities in low-income countries enabling access and replicability of such activities to carbon markets and reaching scale through aggregating large numbers of small project activities.

The World Bank has developed the concept of programmatic carbon crediting further through simplifying the project cycle and the MRV process. This led to Standardized Crediting Frameworks (SCFs).[1] SCFs use a host country governance structure and can be tailor-made for the circumstances of each country. The World Bank has piloted the SCF concept in several low-income countries and has now moved in a second phase to fully roll out the SCF under Article 6.2.

Under Article 6.4, participating Parties have a much stronger role in defining the modalities and crediting parameters of carbon market transactions compared to the CDM. To provide further guidance on Article 6.4, it may be helpful to examine concepts such as the SCF and consider their potential eligibility under Article 6.4.

[1] https://ci-dev.org/standardized-crediting-framework

(iv) Accounting for policies in baseline setting and additionality demonstration (33)

Implementation of policies such as removal of fossil fuel subsidies, reform of agricultural subsidies, mandatory energy or fuel efficiency standards, building codes, etc., are key to achieving long-term decarbonization. Results-based payments can support successful policy implementation and reduce risks of policy reversal in the critical early years of implementing new policies. The World Bank pilots policy crediting for that purpose.

While the current Article 6.4 RMPs require taking into account policies in baseline setting and demonstration of additionality, it does not rule out crediting of new policies. Further guidance on Article 6.4 could look at modalities for eligibility of policy crediting under Article 6 to set the right incentives for increasing ambition and achieving mitigation at large scale.

(v) Non-permanence and reversals (30, 31)

The question for public inputs refers to the non-permanence risks in respect of emission reductions. Some experience with this has been gained in REDD+ where generally emission reductions are considered as non-permanent when the reported emissions are higher than the baseline at any time after units are issued (therefore creating a situation where the cumulative emission reductions are lower than the already issued units). In REDD+, this risk is generally addressed through the use of buffers. For the purpose of Article 6, it is important that a consistent approach is taken across all sectors when it comes to defining non-permanence and requiring addressing the risks.

(vi) Baseline setting

To encourage ambition over time, the CDM methodologies under A6.4 could shift from BAU to below BAU using, but not limited to the following options:

a. Default discounting (of baseline emissions) through introduction of such a factor in the existing methodologies.
b. Country specific discounting (of baseline emissions) linked to the NDC and associated targets from the (host) country.
c. Adjustment of emission factor: Taking the case of grid emission factor determination, although the inclusion of IFI grid emission factors database as a source in TOOL07 was rejected in CDM EB-117, the underlying difference in weightage for operating margin (OM) and build margin (BM) for firm generation; and BM determination makes sense for future projection and appears aligned with the below BAU aspect. Further, literature research has indicated that the average grid emission factor should not be used for calculating abatement by intervention. Rather a marginal emission factor is more appropriate in these circumstances because it is designed to take into account the change in electricity generation at the margins. However, the average grid emission factors published by IEA have been generally found to be much lower when compared with marginal grid emission factors quoted in registered CDM project(s) from the respective countries. As a result, the emissions reduction estimates from electricity saving or renewable energy power generation projects are bound to be underestimated with the average grid emission factors. Furthermore, the reference emission factors in the case of Joint Crediting Mechanism (JCM) are derived corresponding to the respective grid mix in a conservative and simple manner to secure net emission reductions. Such a calculation takes into consideration the most advanced

technologies being used in the currently operational power plants in the country. Therefore, apart from reference to the combined margin (CM) approach, the average and reference emission factors may also be included or embedded in the CM approach. Detailed explanation of the approach can be found in a draft approach paper on the topic (attached separately) along with examples.

(vii) Additionality

The additionality determination methods used in earlier market-based mechanisms had inherent uncertainty, and they may become a risk-management tool to determine the quantity of emission reductions to avoid overselling rather than a yes/no decision tool. New approaches like in the table below under different scenarios, linking to the NDC stringency of countries, should be looked into.

<table>
<tr><td rowspan="2"></td><td rowspan="2">Independent Asssement*</td><td rowspan="2">NDC Stringency</td><td colspan="2">Transferred (authorized) mitigation occurs…</td></tr>
<tr><td>Inside the scope of NDC</td><td>Outside the scope of NDC</td></tr>
<tr><td rowspan="3">Issuing[2] country's NDC is…</td><td rowspan="2">Possible</td><td>More stringent than BAU</td><td>Apply corresponding adjustments

[**To avoid over-selling/transferring, ensure unit quality]</td><td>Ensure unit quality

AND

Apply corresponding adjustments</td></tr>
<tr><td>Less stringent than BAU</td><td colspan="2">Apply corresponding adjustments
AND
Ensure unit quality</td></tr>
<tr><td>Not possible</td><td>Difficult to ascertain</td><td colspan="2">Apply corresponding adjustments
AND
Ensure unit quality</td></tr>
<tr><td colspan="5">*Third-party assessment[3] of the stringency of the NDC is a recommended best practice and is possible in cases where NDC is transparently presented with all assumptions, data used and its sources and methodology used and all this information is made available for the assessment.
**For stringent NDC(if the NDC is transparently disclosed and independently assessed by a third-party that it is more stringent than BAU), corresponding adjustments would be sufficient to ensure environmental integrity. Ensuring unit quality is desirable from the issuing country's perspective to avoid overselling because if the country overtransferred, it will require substantially higher effort by the issuing country to meet the increased ambition.</td></tr>
</table>

[2] Though the Madrid draft text refers to the term 'Participating Party' in general, for the purpose of clarity, the term 'issuing party' is used in this paper.

[3] The best practice to assess the stringency of NDC is through the third-party assessment, and a suggestive terms of reference for independent assessment of BAU is available in the Annex.