Submission to the Article 6.4 Mechanism Supervisory Body

MDB Article 6 Working Group submission of input in relation to the Call for Input 2023
Structured public consultation: Requirements for the development and assessment of mechanism methodologies.

The MDB Article 6 Working Group (MDB WG) wishes to convey its sincere gratitude for the opportunity to share our inputs on the vital efforts of the Supervisory Body of Article 6.4 mechanism. We duly acknowledge the significance of the work of establishing criteria for the formulation and evaluation of mechanism methodologies.

We would like to share our observations on key topics embedded within the questions related to baseline discounting (i.e., downward adjustment), additionality-positive list, policy crediting, and transformative potential of activities. The observations are based on the experience so far and to support incentivizing the development of the robust carbon markets under Article 6 of the Paris Agreement.

Baseline discounting (i.e., downward adjustment)

> *{Question for additional inputs: should the downward adjustment be eligible/applicable for all the approaches to setting the baseline?}*

The downward adjustment should not be applied to the best available technology (BAT) and ambitious benchmark approach. It is required, however, in the context of estimating baseline emissions using existing actual or historical emissions only. BAT and ambitious benchmarks are determined as below business-as-usual (BAU), thereby not requiring any downward adjustment. However, in scenarios where it is difficult to ascertain the below business-as-usual, a lenient downward factor can be considered depending on the decarbonization pathway of the sector/country set in their NDCs or any other relevant documents.

While we acknowledge the importance of applying downward adjustments (discounting) to approaches that rely on actual or historical emissions data, comprehensive and well-defined guidelines for setting baseline emissions downward should be provided to ensure accuracy, fairness, and credibility in emission reduction initiatives. We recommend incorporating the following points in such guidelines, including such applicability to all approaches to setting the baseline:

- Default discounting (of baseline emissions) through introducing such a factor in the specific methodologies
- Country-specific discounting (of baseline emissions) linked to the NDC and associated targets from the (host) country
- Methodology/criteria for adjustment of emission factor

In addition, the guideline might include the following elements:

- Treatment of early reduction efforts: Specify how and when countries that have undertaken emission reduction efforts prior to the baseline period will be rewarded, encouraging early action.
- Historical data verification: Establish protocols for verifying historical emission data, including data collection methods, accuracy checks, and documentation requirements.

- Normalization for production changes: Develop a method for normalizing emissions to account for changes in production levels, ensuring that reductions are not solely due to decreased activity.
- Documentation and reporting: Outline documentation requirements, considering the resource needs and capacity of relevant stakeholders, for historical emission data, adjustments made, and the rationale behind those adjustments. This supports transparency and auditability.
- Periodic review and updating: Specify a timeline, also considering the official publication timelines of NDCs and relevant sector/country decarbonization pathways, for reviewing and updating the baseline adjustment guidelines to reflect evolving best practices and technological advancements.
- Stakeholder engagement: Include mechanisms for involving stakeholders, such as industry experts, environmental organizations, and affected communities, in the development and review of baseline adjustment guidelines.

Any identification of a downward discounting factor should reflect the country's context, efforts needed to develop such one, and the incentives that it creates for the underlying activity. Whether the project activity should apply this adjustment once in a specific time period or during the renewal of the crediting period must be clarified. And if such adjustment is required during the crediting period, whether that should be linked to the NDC update period or any other timelines need to be clarified. Developing comprehensive and transparent guidelines for downward baseline adjustments will help ensure the integrity and effectiveness of emission reduction activities while fostering trust among participants and stakeholders. In addition, allowing countries/project developers to develop/propose such factors should be considered to allow more innovation and capacity building.

Additionality-positive list

- *{Question for additional inputs: should there be a statement about the general additionality test before specifying how it may be simplified in certain cases, or be subject of a positive list? Could be a more nuanced approach, i.e. all projects need to demonstrate additionality, some can be excluded or included based on one sort of assessment while others require a more detailed assessment: (a) What are the general rules? (b) Where may they be simplified, or deemed to have been satisfied?}*
- *{Question for additional inputs: are positive lists needed? If yes, is the above guidance on positive lists too specific and detailed, and may the guidance be shortened?}*

The MDB WG recommends revisiting the additionality demonstration outlined in Article 6 of the Paris Agreement. This should involve aligning the baselines with the country's NDCs and/or Paris Agreement goals, as well as introducing a baseline downward adjustment factor to support increased ambition (as already included in the downward adjustment factor for actual or historical emissions). By adopting these approaches, there may no longer be a need for adopting traditional additionality demonstration approaches (such as financial additionality or barriers assessments). Furthermore, given the NDC targets and countries' requirements to avoid double counting and meet their NDC goals first, it is necessary to encourage countries to develop positive/negative lists. In such scenarios, similar to earlier approaches, no further additionality test is required. Guidelines for developing these positive lists should be developed, building on the CDM experience.

Providing a global positive list while allowing host countries to submit their own national positive lists is a commendable approach. However, there seems to be some ambiguity regarding the acceptance of proposals from host countries for their national positive lists by the Supervisory Body (SB). Hence, clear guidance from the SB for the development of national positive lists and the procedure for their consideration/approval by the SB would be needed. Also, contradictory approaches when host countries develop such positive lists/additionality demonstration approaches for Article 6.2 to the approaches that the SB develops for Article 6.4 should be minimized. In this regard, the guideline could consider the following aspects.

- Criteria for inclusion/exclusion of activities: Define clear and specific criteria for activities to be included in the positive list. Example criteria could include emission reduction potential, contribution to sustainable development, technological feasibility, and social and environmental co-benefits.
- Flexibility and regular updates: Allow for flexibility by periodically reviewing and updating the lists to reflect technological advancements, changing circumstances, and new information.
- Monitoring and reporting: Develop a robust monitoring and reporting mechanism to track the implementation of activities on the positive list and to assess any potential negative impacts of activities on the negative list.
- International cooperation and harmonization: An extended positive list could be a clear indicator of additionality even for voluntary markets. For example, in the case of India, a list of 13 activities has been clearly specified to be considered for the trading of carbon credits under Article 6.2 mechanism to facilitate the transfer of emerging technologies and mobilize international finance in India. A few other countries also followed similar approach. The (positive) list could be extended further for other activities wherein bilateral/ cooperative approaches are not envisaged.

In order to have a faster execution of the positive list and the involvement of the host country, the following could be considered in the context of paragraph 95:

1. Automatic approval of the national positive list submitted by the host party for the first submission, with the understanding that the validity of the positive list should expire, say three ((3) years after the approval date or align with the NDC updating timelines.
2. Periodic update (annual) of the positive list by the Host Party following paragraph 93. While a rigorous approval process, as outlined in Paragraph 93, is desirable, considering the resources, time and capacities involved, could consider increased timelines as proposed above.
3. Fast-track process of accepting the proposal of national positive lists (unlike the lengthy process of developing standardized baselines under CDM), especially in situations where host countries already established such lists for other international carbon markets (Article 6.2).

Positive lists will help guide the types of activities that countries can undertake in their cooperative efforts while ensuring that emissions reductions are meaningful and aligned with climate objectives. These lists will contribute to transparency, accountability, and the overall effectiveness of international cooperation in addressing climate change.

The World Bank, together with the MDB WG, has developed a range of knowledge products that aim to support the development and assessment of mechanism methodologies under Article 6. One such product is the draft approach paper on the "Considerations for additionality concepts to Article 6 approaches", which offers a number of scenarios to guide the evaluation of activity-based additionality and to help mitigate risks to both the host and buyer. Additional details on this topic can be found in the draft approach paper attached.

Policy crediting

{Question for additional inputs: should it be specified that only activities triggered by policies can be credited? Will there be complexities in relation to additionality assessment in this regard?}

{Question for additional inputs: how does this issue link to policy crediting where policies deliberately intended to generate credits? What considerations are needed in this regard?}

It is encouraging that the Supervisory Board considers the possibility of policy crediting under Article 6.4. Implementing regulatory policies such as energy efficiency standards, fuel standards, and building codes; price-based policies such as removal of fossil fuel subsidies, reform of agricultural subsidies, and direct or indirect carbon pricing; as well as incentive policies such as feed-in tariff schemes for renewable energies or feebate schemes for low carbon vehicles are critical to achieve the long-term climate targets of the Paris Agreement. The impact of such policies in transforming and decarbonizing economies is very high.

The World Bank has more than a decade of experience in conceptualizing policy crediting, developing policy crediting methodologies and applying them to concrete policies. Recently, the World Bank included the first ever policy crediting program in the portfolio of Transformative Carbon Asset Facility (TCAF), i.e., the Uzbekistan Innovative Carbon Resource Application for Energy Transition (iCRAFT) program crediting emission reductions caused by the removal of energy sector subsidies in Uzbekistan https://projects.worldbank.org/en/projects-operations/project-detail/P180432. Earlier the World Bank developed a model-based methodology to quantify emission reductions resulting from such policies https://documents1.worldbank.org/curated/en/964331541085444404/pdf/Morocco-Energy-Policy-MRV.pdf. A recent TCAF report provides a narrative, theory of change, and blueprinting of crediting policies of different types https://www.tcafwb.org/sites/default/files/2023-05/WB_RBCF_Report_FINAL.pdf. The World Bank's forthcoming program Scaling Climate Action by Lowering Emissions (SCALE) will use policy crediting as one of its crediting approaches aiming to deploy it and other scaled-up crediting approaches on the next level https://www.worldbank.org/en/programs/scale/overview.

On a separate but related note, it would be helpful to clarify if the "policy" includes jurisdictional-scale crediting (or inventory-based crediting). Under the LULUCF sector, most under the REDD+ mechanism, the World Bank's Forest Carbon Partnership Facility (FCPF) has been supporting 46 countries in creating their national frameworks to enable access to results-based payment and carbon markets. Through its carbon fund, the FCPF is also piloting results-based payment with the implementation of jurisdictional-scale REDD+ emission reduction programs which implement different GHG mitigation measures (policies, project activities, enabling environment, etc.) that seek to reduce emissions and enhance removals. The FCPF has in place requirements related to methodological aspects, safeguards, third-party validation/verification, double counting/claiming, permanence, transactions, and others that enable countries to generate high-social and environmental integrity emission reduction credits that could potentially be transacted in carbon markets. This FCPF program has been recognized under CORSIA through the approval of the FCPF to generate CORSIA-eligible units. The FCPF Methodological Framework already states, in its requirements related to ambition, that new and enhanced measures (with regards to the historical reference period) need to be implemented and is therefore in line with these Art. 6.4 proposals.

Against this background, the World Bank would be delighted to share its experience in more detail with the SB and the UNFCCC secretariat helping efforts to operationalize policy crediting under Article 6.4 as well.

Related to the concrete questions on policy crediting, it is important to note that, different from project-based or programmatic crediting, it is in general not possible to break down crediting to the individual activity level under policy crediting. Most policies are affecting millions of different choices of private households and businesses and in most cases quantifying the mitigation impact of policies requires economic modelling using sectoral and macroeconomic data. In terms of jurisdictional REDD+ programs, accounting is based on a comprehensive inventory of the main sources of emissions and removals in the whole jurisdiction, and crediting is based on the creation of a downward trend in emissions below a conservative baseline which is based on average historical emissions. This makes attribution to specific policies very difficult, but also makes estimation much more accurate as it already considers potential interaction and feedbacks between policies and activities on the ground and incentivizes ambition of countries to reduce emissions at large scale. For instance, under policy crediting a certain policy could be shown to be great in terms of emission reductions, but due to different interactions, it might still result in emissions in a sector or a jurisdiction going up. Therefore, we consider that limiting crediting to activities directly related to policies may limit incentives for jurisdictional actors.

Accordingly, in most cases, additionality of policy crediting needs to be established at the policy level, not at the level of individual activities triggered by the respective policy. This requires theories of change demonstrating that crediting is essential for successful policy implementation and/or continuation. The mentioned TCAF report on policy crediting provides initial guidance on developing such theories of change for selected policy types.

In our view, crediting of policies under Article 6.4 does not conflict with the RMP requirement to consider national policies in additionality testing. This requirement rather relates to existing policies, not to new policies or to policies in risk of discontinuation. Overall, policy crediting can be done in full alignment and compliance with all RMP requirements, and the MDB WG would like to encourage the SB to continue with its efforts to operationalize policy crediting under Article 6.4.

Transformative potential of activities

> *Option 2: Demonstrating that activities eligible under the methodologies are transformative to enable deep decarbonisation aligned with IPCC's IMPs, i.e., have the potential to transform an entire sector to low carbon option, as opposed to producing incremental improvements, taking into account the specifics of a sector, geographical location and level of uncertainty of greenhouse gas estimation;*
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> *Option 2bis: Application of positive list to demonstrate that activities eligible under the methodologies are transformative, i.e. have the potential to transform an entire sector, as opposed to producing incremental improvements, taking into account the specifics of a sector, geographical location and level of uncertainty of greenhouse gas estimation;*

Option 2ter: Setting baselines that do not assume growth of emissions in the absence of Article 6.4 activities.

{Question for additional inputs: would option 2 above fit under 'adjustment downwards? And is it linked to additionality demonstration? How can 'transformative' be defined?}

First, it is important to acknowledge that the RMP do not include a definition of transformative impact of mitigation activities and related requirements for eligibility under Article 6.4. Transformative impact requirements should therefore not be introduced via methodological requirements.

Still, transformative impact can be a useful concept to prioritize methodology development for different types of mitigation activities, identify the appropriate linkages with additionality demonstration based on the criteria defined and selection of such activities for crediting under Article 6.4 by participating parties. This speaks for non-binding guidance on assessing transformative impact provided as a resource to parties, project entities, and stakeholders in Article 6.4.

In our view, transformation has two dimensions, i.e., a qualitative and a quantitative one. Activities with transformative quality are those that are aligned with the mid-century net-zero mitigation target. The MDB WG would therefore recommend using for transformative quality the same criteria as for alignment with the long-term climate goals of the Paris Agreement, i.e., use LTSs, if they are available, as the reference point.

If such LTS-aligned mitigation activities are transformative, it would then depend on their quantitative impact either in reaching large enough scale to shift sectoral emissions pathways to net-zero compatibility or in triggering a suite of replicating activities achieving the same objective. In general, such assessments will need to be done on a case-by-case basis, but there certainly are activities where such transformative impact is obvious such as in the case of policies with high mitigation impacts and sectoral reform programs (see our input above on policy crediting). The MDB WG would indeed recommend developing a positive list on transformative mitigation activities and a heuristic for case-by-case assessments for voluntary use by parties and stakeholders in Article 6.4 activities.