

**Response to the Call for input on Issues included in the annotated agenda and related annexes of the sixth meeting of the Article 6.4 Supervisory Body:**

**Annex 3 - Article 6.4 mechanism activity cycle procedure for projects**

Dear Article 6.4 Supervisory Body Members and Alternate Members,

I'm a carbon market expert who has been closely involved in project development and assessment of carbon offset projects. I'm submitting this input anonymously for fear of potential identification and professional repercussions.

Noting that current call for inputs provides the last opportunity to comment on the draft Activity Cycle Procedure for Projects elaborated by the Supervisory Body, I would like to urgently bring to your attention that the proposed procedure does not include any protections against fraudulent and criminal activities that are often concurrent with the carbon markets.

Carbon markets, as new asset class, have been and continue to be markets where the potential for fraud is high. In one sense, carbon emission reductions were the first digital currency created many years prior to cryptocurrencies and as a non-physical asset shares many attributes with cryptocurrencies and the same risks as well – specifically the risks of fraud, corruption, money laundering, and terrorist financing. The historic experience of the carbon markets shows that fraud is a very important risk to which the market is inherently exposed to. Suffice to mention just a few examples of carbon fraud:

- [“Operation Carwash”](#)
- [Sustainable Growth Group](#)
- [Recycled CERs scandal](#)
- [Carbon Fraud & Illicit Networks: Risks in REDD+](#)
- [Carbon Harvesting Corporation](#)

Nonetheless, the main points of focus in the proposed Article 6.4 project cycle approval process, like in the CDM, are related to the methodological issues, their application, verification of correctness of the calculations and related project conditions. It remains unclear how the Article 6.4 Supervisory Body intends to address the risks of money laundering, terrorist financing, corruption, fraud, bribery, and other illegal financial activities.

It is obvious that developed country host parties might lack capacity to conduct due diligence checks on the proponents, the designated operational entities are not required, nor positioned, to conduct such checks, and not all of the buyers are interested in pursuing these types of inquiries.

If not corrected, this omission is likely to result in huge reputational risks that could undermine the integrity, transparency, and effectiveness of Article 6.4 as a multilateral carbon market designed to incentivize genuine emissions reductions and combat climate change.

**Proposed solution – Integration of due diligence beyond methodological issues in the new mechanism’s project approval life cycle:**

**1. Know-Your-Customer (KYC) process:**

Considering that carbon credits are a form of concessional finance instrument, it would be useful to apply the same processes which Multilateral Development Banks and many private sector financial institutions use towards applicants, i.e. namely a standardized Know-Your-Customer process in which the applicant for the grant or loan is assessed with the aim of mitigating the risks of

- a. Corruption and Bribery
- b. Conflicts of interest directly by applicants or by Ultimate Beneficial Owner
- c. Money laundering and terrorist financing
- d. Tax evasion
- e. Misuse of funds
- f. Political exposure, sanction and watchlists
- g. Reputational risk to the MDBs for being associated with a grantee or loan recipient.

**2. Business Model assessment & prevention of negative market disruption:**

In addition to the KYC process, the recommended expansion of the Due Diligence in the early stages of the project approval life cycle should require a qualitative and quantitative assessment of the applicant’s business model and business plan. This in order to assure that the business model does not create perverse incentives, is not fraudulent and does not use illegal or quasi-illegal approaches such as price dumping subsidized by carbon credit revenues.

**3. Ownership of expanded process:**

The expanded process should be managed by the UNFCCC as an integral part of the project approval process in the following manner:

- a. National NDA involvement in the process should be voluntary, but UNFCCC central ownership should be key.
- b. Companies providing validation and verification services – who are paid directly by applicants – should not be used. Their expertise is technical and standard-related in nature, and does not include systemic fraud risk.
- c. The costs of the expanded Due Diligence process should be covered by the application fee paid to the UNFCCC, with the UNFCCC paying the entities performing the expanded Due Diligence directly.

This input has also been shared with civil society organizations.

Thank you for the opportunity to provide feedback on the draft procedures under Article 6.4 of the Paris Agreement. I wish you success in your deliberations.

Best regards,

Carbon Markets Expert