Carbon Finance Labs

Article 6.4 Supervisory Body

29 October, 2023

By electronic mail submission to A6.4mechanism-info@unfccc.int

RE: Call for stakeholder input to A6.4-SB008-AA-A15 Draft recommendation Activities involving removals under the Article 6.4 mechanism

Thank you for the opportunity to provide comment on version 3 of the Draft recommendation for Activities involving removals under the Article 6.4 mechanism.

The following concepts are addressed in the comments below with benefits in the Climate change mitigation process.

It is suggested that the Article 6 drafting process include an explicit list of concepts/ terms and intended benefits of these terms.

Concept	Area of Concern	Potential Benefit
Monitoring Duration	Article 6 Process	Enhanced precision in removal data
Methodology Updates	Article 6 Process	Incorporation of the latest science
Carbon Reversal Disputes	Article 6 Process	Neutral resolution of disputes
Reporting of Reversals	Article 6 Process	Timely detection and mitigation
Reporting on Risk and Uncertainty	Article 6 Process	Comprehensive risk assessment
Designated Monitoring Party	Article 6 Process	Flexibility in monitoring assignments
Third-Party Independent Submissions	Article 6 Process	External validation of findings
Reporting Responsible Party	Article 6 Process	Ensuring continuous monitoring
Reversal Event Definition	Article 6 Process	Clear criteria for reversals
Accrual Risk	Article 6 Process	Addressing premature project closure
Buffer Pool	Article 6 Process	Mitigating risk of reversal
Quarterly Reporting	Article 6 Process	Frequent and high-quality data
Competitive Buffer Pool Determination	Article 6 Process	Maximizing incentive for projects
Insurance and Risk Management	Article 6 Process	Encouraging innovation and capacity
Event of Default Proportional Impact	Article 6 Process	Fair response to defaults
Removal Performance Measurement	Climate Mitigation Process	Ensuring environmental performance
Removals Ramp	Climate Mitigation Process	Encouraging innovation and scaling
Additionality	Climate Mitigation Process	Avoiding constraints on capacity
Carbon Leakage Tracking	Climate Mitigation Process	Preventing unwanted carbon transfers

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3.1.8 monitoring duration should be performed for the period of removal that has been declared or the expected removal duration for the delivered instruments. These could be in 25, 50 or 100 year plus increments. The portfolio delivery involves an environmental effective equivalence to 100 yr duration but may comprise multiple delivery durations subject to a combined environmental effect equivalent to 100 yrs.

3.11.11 methodologies should be updated with best practice on a preset periodic period to reflect changes in the science and understanding of data capture MRV or expected releases. Updates must be progressive i.e. reducing the uncertainty or increasing the quality etcetera of the process. Any update put forward must be reviewed and if accepted applied and recognized by the governing body.

3.15.1 Carbon reversal disputes should be resolved by a recognized third-party governing body who is neutral. A petition of finding an event of Reversals may also be put forward by any third party or recognized third party who may be an observer to the event.

There should be a penalty associated with failure to when reasonable being aware of a reversal report the reversal in the specified time period. This failure to report should be 5 to 10 times the amount of carbon failure and taken from the respective or the associated party. The penalty amount could be delivered 2 a supervisory party or the respective organizing party overseeing the risks of reversals to be distributed accordingly.

3.17. A reversal or unexpected leakage event should be considered negligible and below the reporting threshold if a third party would find or the party itself finds that **the risk of the reversal is less than a 1% likelihood with an expected 1% loss** for the given duration reported or expected for the instrument under review.

Reporting on risk or uncertainty. Risk occurs broadly across 3 dimensions which should be acknowledged in the report.

These dimensions are:

1. the duration of the exposure of the risk of reversal or undetected leakage
2. the chance or likelihood of the event occurring and

3. the magnitude of the potential event ranging from 1% to 100% failure relative to the expected performance of the removal for the given duration.

3.18 It should be noted that the designated monitoring party may be assigned when agreed to by the receiving party. It should also be noted that third party independent submissions of a finding or discovery of reversal likelihood or event is recognized as an appeal which could trigger a third-party monitoring audit.
This trigger should be recognized by the governing body and a third-party audit performed of either the ongoing MRV process or the correct application of the respective methodologies to assess environmental performance and / or risk of failure to perform.

3.20 the reporting party should designate a monitoring responsible party to take over in the event of the failure or the economic inability to perform the monitoring function this monitoring backstop ultimately should reside with the reporting national government to overcome private sector failures of potential monitoring.

The definition of a reversal event is the physical monitored report that reflects a greater than 1% reversal of the delivered credit with an estimated likelihood of greater than 95% certainty within any one given year.

Or the expectation that a failure may occur with a 95% certainty over the given 1% reporting threshold.

3.0 Accrual Risk An important risk to acknowledge is the premature closing of a facility or related risk this is equivalent to an **accrual risk** in that many reporting facilities will accrue the embodied carbon in the initiation of a project and assign that accrued carbon over the expected economic life of the project. In the event that the project is suspended prematurely there is an accrual shortfall which needs to be assigned to the prior credits thus effecting an accounting based reversal.

A similar type of risk is when a new form of constraint occurs altering the accounting or the measurable deliverable benefit for example a shift in the operational boundaries due to constraints such as biodiversity or other related social, political, economic or other risks should be acknowledged and these issues could be brought forth to the governing party by any third party wishing to file a petition of reversal on either physical or an accounting basis.

35. **Carbon Safety Body** Reversal reporting should be designed so that it could support something equivalent to be set up by the governing body similar to a National Transportation Safety board. This Carbon safety Body would review and assess the nature of the accident or failure and then share that data and findings publicly so that there could be accrued knowledge and reporting benefits to either other project holders or a better assessment of risks of like or similar projects this would allow for third parties to review the data and the nature of the reversal.

Reporting ongoing or expected risks with similar or other projects and to shift risk horizons if required to adjust either existing methodologies or risk assessment techniques used by either the governing body or other third parties involved in developing projects.

This **Carbon Safety body** would involve the establishment of a shared public data pool of reversal events, best practices and the posted expectations and science or methodologies used to assess the likelihood of reversal.

39. The reversal buffer pool or a callable matched instrument should be set up to match the expected delivery performance of the instruments this could be maintained by recognized or regulatory authorities.

46. There is an open question regarding who manages the allocated vintages and the duration matching of those vintages such that the failure or the breach of removal is cured in such a way that the environmental effects are fully mitigated in line with expectations of the recipient or reporting body of the claimed removal.

49. Buffer pools will need to be regulated by a third-party independent entity or a series of third-party entities all adhering to regulatory guidelines to maintain the integrity of the buffer pool for the associated risk durations. These guidelines should be periodically updates as science and methods improve.

51. It is suggested that reporting be on a quarterly basis to increase the frequency and the quality of data and the ability to learn faster across this removal sector.

52. Buffer pool amounts should be determined on a competitive basis to allow for the highest potential yield by actors engaging in removals this is done to create the largest marginal incentive for actors to develop projects.

Why insurance or innovation in risk management is important to capacity growth.

An example of over buffering by 15% follows if all actors who are potential project developers have a requirement of a 12% IRR (internal rate of return) prior to developing projects and the buffer pool across all actors is set at 20% many potential actors may sit on the sidelines as they economic yield is too small.

Even though a high buffer pool is conservative and induces extra removal activity by a participant the impact to the incentive of greater actors may actually diminish the amount of removal activity. This is due the marginal impact of diminishing the economic returns and shrinking the scale of potential projects.

Whereas if the marginal threshold is set accurately. Say for example if the actual likelihood of reversal over the duration was closer to 5%, the excess marginal shift in economic returns would induce significantly more actors, causing a significant 5 or 10 times increase in the aggregate removal activity.

The goal of those either setting the buffer pool or supporting the insurance is to get as close to accurate a reflection of the reversal risk as possible. This ensures environmental integrity while at the same time creating as much economic incentive as possible for innovation and capacity deployment.

Insurance and private sector involvement in risk manage means continuous learning and innovation using loss history data from new methodologies and new methods to incentivize innovation. This not only accelerates the development of removal technologies but may create the development of innovation in the transfer and the mitigation of the risks associated in both the financial and the regulatory environments.

53**. When an event of default occurs there should be proportionality buckets compared to the scale or the expected scale of the default** with an accordingly proportional impact to the project developer or related projects such that for example a:

- 5% breach may cause a suspension of credits until the breach is mitigated.
- 10% may cause a freeze of projects and a
- >25% failure may require freezing of all projects

The idea is proportionality in regard to the risk so that project developers or related industries aren't harmed from either the actual suspension of activities or volatility in economic signaling to other participants in related activities.

If an entity goes bankrupt due to too many reversals or failures there should be a tiered level of backstops starting first at the submitting entity level and then ultimately using a pooled risk approach maintained by the UNF triple C or related governing body overseeing the mitigation of reversals risk.

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26.
G. Removal performance should be measured in duration in terms of 50, 100 and +100 year plus durations with a 95% certainty of expected environmental performance. Removals are then delivered such that the environmental equivalent effect of 100 year duration is delivered this allows and enables shorter term immediate removals to occur as well as innovation to scale such removal technology and capacity.

This is done to acknowledge the very real risks to fail to scale at the same time it also allows for an accelerated innovation and technology and discovery across the potential landscape of solutions.

Removals Ramp: With respect to additionality, it is argued that all removal activities should be considered additional until global capacity is at or exceeds of removals ramp. The removals ramp is defined as the annual target of removals both capacity and cumulative activity ranging from the year 2020 to a target of 2040 of 2 - 5 gigatons of installed capacity per the IPCC AR 6 report.

It is important to in no way inhibit the development of removals capacity with artificial accounting constraints or to balkanize the market where

additionality may vary across the global South or various economic actors. All actions must be in place to encourage the development of innovation, development of capacity and resource and scale for removals. This includes removing the uncertainty of additionality which was a relic from offsets and avoidances relying on baseline calculations.

6. Carbon leakage should be tracked across borders wherever possible as a function of economic goods transfers. The very real likelihood of carbon leakage requires that trade flows of bulk goods or assembled are managed and the embodied carbon is tracked to mitigate such leakage or transference.

At a bare minimum an appointed accounting or regulatory body should track and makes estimates of reported leakage across countries based on goods and should net these transfers out against reported NDC's.

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