



POST-2020 CI-DEV PORTFOLIO TRANSITION REPORT

16 JUNE 2017



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EXECUTIVE SUMMARY

Against the backdrop of an uncertain future of the CDM as the second commitment period of the Kyoto Protocol draws to an end and the new mechanisms under Article 6 of the Paris Agreement yet to be operationalized, this report assesses how to best position the Ci-Dev portfolio in the developing landscape of UNFCCC mechanisms. It is uncertain whether the CDM infrastructure will continue to be available to serve the Ci-Dev portfolio after 2020. Whereas it is highly likely that the CDM infrastructure will remain in place until the end of the CP2 trueup period, expected to last until mid-2023, what will happen afterwards remains to be seen. Importantly, continued existence of the CDM infrastructure through the true-up period cannot be equated with continued CER issuance post-2020.

Considering these uncertainties regarding the future of the CDM, Ci-Dev may decide to transition its portfolio to "cooperative approaches" under Art. 6.2, or to the new mechanism under Art. 6.4 of the Paris Agreement, but also in this regard many uncertainties remain. At SBSTA 46, Parties have made further progress in operationalizing Art. 6.2 and Art. 6.4, however numerous areas of divergence still persist, making both the final shape of the mechanisms as well as the timeline of their availability unpredictable. It is not yet clear whether Parties can meet the timeline of delivering the Paris rulebook by end of 2018 as planned.

With regard to the "cooperative approaches" under Art. 6.2, Parties diverge on the scope of the guidance and the need for centralized oversight. A number of Parties suggest elements of centralized governance, tracking systems and guidance relating to environmental integrity and sustainable development. Conversely, others prefer minimal centralized oversight, whereby guidance would be limited to the avoidance of double counting. Whether or not to levy a share of proceeds on Art. 6.2, to limit the generation of ITMOs to sectors covered by a host country's NDC and to set eligibility criteria for Party participation are also still debated. Parties however more or less agree that a broad scope of activities should be eligible under cooperative approaches; that ITMOs should be expressed in tCO2e; and that Art. 6.2 accounting guidance should be additional to the general accounting guidance.

In the Art. 6.4 negotiations most Parties, with notable exceptions, agree on the main features of the mechanism. It should be centrally governed, available to all Parties and internationally transferred Art. 6.4 units should be deemed ITMOs. Furthermore, sustainable development criteria are to be developed at national level, possibly with some international guidance, and additionality and baselines should be redefined in the light of the NDCs. However, aspects such as the operationalization of overall mitigation, the extent to which the new mechanism resembles the CDM, the recognition of sectoral approaches including REDD+, and whether or not to include activities outside the scope of an NDC, are contentious. With regard to the CDM transition, the majority of countries see benefits in maintaining and building on elements of the CDM and many of them are concerned with what happens to registered CDM projects. Divergences exist whether or not the CDM should be actively terminated after 2020.

While during the recent SBSTA 46 session, Parties have again made progress towards operationalizing Article 6, they were unable to agree on the priority elements or sub-headings for the Article 6.2 guidance and the Article 6.4 rules, modalities and procedures, failing to deliver on the envisaged milestone. It remains to be seen whether divergences can be overcome when Parties meet again at COP 23 in November 2017 to produce a first "skeleton text".

Taking into account the persisting uncertainty regarding the future of the CDM and the modalities of the Art. 6.2 and Art. 6.4 mechanisms, four strategic choices or scenarios for the continuation of Ci-Dev activities post-2020 are identified and evaluated in the report. Whereas none of the scenarios is clearly dominant over the other ones, their consequences differ, meaning that identifying the preferable scenario depends on how various priorities and risks are weighed against each other.

Scenario 1 represents a continuation of the business-as-usual approach, in which Ci-Dev would continue its current engagement with program developers under the CDM. This means low transaction costs, but a significant risk of potential unavailability of the CDM mechanism post-2020, and even if CERs were issued, a risk that these are no longer eligible for compliance purposes. Hedging this risk, scenario 2 represents the transition of the Ci-Dev portfolio into the Art. 6.4 mechanism under the Paris Agreement. Whereas such transition would come with high adjustment costs to comply with the elements of the new mechanism and requires re-engagement with the UNFCCC process, benefits could be high as post-2020 reductions are relatively likely to be recognized under this scenario. Similarly, scenario 3 considers the transition of the Ci-Dev portfolio to cooperative approaches under Art. 6.2 of the Paris Agreement, whereby Ci-Dev would seek to obtain ITMOs. Compared to scenario 2, the third scenario would represent greater costs to Ci-Dev and the host country government as it would rely on bilateral governance and infrastructure, whereas it might save costs for program developers due to operational simplifications. The main risk for both scenario 2 and 3 is the considerable uncertainty about if and by when Article 6 will be operationalized and what its features will look like. Finally, scenario 4 foresees continuation of Ci-Dev as RBCF outside any UNFCCC market mechanism. Given that this scenario could be developed independently from the negotiations, it avoids any uncertainty that UNFCCC mechanisms currently carry. However, continuing Ci-Dev as RBCF only means disengagement from the UNFCCC market mechanism, meaning that Ci-Dev loses impact on mechanism development, and would send a negative signal to carbon market stakeholders.

Given the connectedness of scenarios and the fact that challenges are similar, the choice for Ci-Dev may not be an either or choice but different scenarios could be pursued at different stages or even in parallel. This way some options could serve as fall back options in case others prove unattainable. Specifically, the RBCF option could be a fall back option in case transition through Articles 6.4 or 6.2 is not feasible or mechanism development does not proceed in a timely manner. What is more, Ci-Dev has an opportunity to initiate the transitioning process under Article 6.2 already now while the same cannot be said for Article 6.4. So an option could be to initiate the portfolio transition via Article 6.2 and later submit the methodologies and approaches developed to the Article 6.4 supervisory board for vetting. Ci-Dev has already started this process by piloting the "Standardized Crediting Framework" (SCF) in Senegal. The SCF has been conceptually elaborated in a Ci-Dev report and builds on several elements of standardization and simplification (standardized baselines, additionality determination at the sectoral level, simplified MRV processes, and a reformed project cycle). Following the above reasoning, the SCF pilot could be developed as an Article 6.2 pilot transaction and as the process allows, methodological elements could be fed into the technical guidance for Article 6.4.

1. Introduction

With the end of the second commitment period of the Kyoto Protocol rapidly approaching, the future of the Kyoto Protocol's Clean Development Mechanism (CDM) is uncertain. Under the Paris Agreement Parties to the United Nations Framework Convention on Climate Change (UNFCCC) have elected not to continue the CDM but to create new mechanisms for international cooperation in Article 6 of the agreement. These share common traits with the CDM but are also distinctly different. In Article 6.2, Parties recognize the development of cooperative approaches by Parties themselves that result in internationally transferred mitigation outcomes (ITMOs). Article 6.4 establishes a mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development, which in many ways looks like a successor to the CDM. While some characteristics of these new Paris mechanisms have already been defined in the Paris Agreement and Decision 1/CP.21¹, Parties have to yet decide on many of their operational details. The negotiations of the guidance for cooperative approaches and the rules, modalities and procedures of the new centrally governed mechanism are currently ongoing under the Subsidiary Body for Scientific and Technological Advice (SBSTA), with the goal of completing the task by end 2018. In the developing landscape of UNFCCC mechanisms, the question is how the Carbon Initiative for Development (Ci-Dev) can best ensure the post-2020 continuity of its program.

Ci-Dev currently uses the CDM as a disbursement tool for its portfolio of 10 Programmes of Activities (PoA)², with which it has entered into Emission Reduction Purchase Agreements (ERPAs). In the ERPAs Ci-Dev intends to purchase emission reductions until well into the post 2020 period (see Figure 1). Given the uncertainty surrounding the use of the CDM post 2020, Ci-Dev already has a clause on the use of a standard comparable to the CDM in its ERPAs and agreed upon by the contracting parties. Most of the PoAs with which Ci-Dev has contractual relations have already been registered under the CDM. The key question with regard to CDM availability post 2020 therefore concerns the possibility for issuance of Certified Emission Reductions (CERs) as well as inclusion of new Component Project Activities (CPA) under the PoAs.

This report seeks to inform Ci-Dev's choice in hedging regulatory risks arising from the regime change. For this, the report first looks into the likely developments of UNFCCC mechanisms. Chapter 2 analyzes the availability of the CDM infrastructure post 2020 based on the legal and political situation. Chapter 3 then considers the status of negotiations of the new Paris mechanisms. Following this assessment, chapter 4 identifies and evaluates four strategic choices how Ci-Dev could continue to engage with its portfolio, ranging from a continuation under the CDM to options under the Article 6 mechanisms and results-based climate finance (RBCF) outside any UNFCCC market mechanism. The last chapter 5 draws up strategic recommendations.

As the main purpose of the report is to inform strategic decision-making, the report itself is a living document that is developing with the course of the negotiations. The current version includes the developments until SBSTA 46, which has taken place 8-18 May 2017 in Bonn, Germany. The next version of the report will be produced following the Bonn Climate Change conference (COP23) scheduled 6-17 November 2017.

Note that this Ci-Dev transition report is different in focus from the options report on CDM transition that was recently published by Climate Focus and Koru Climate and intends to inform UNFCCC negotiators on choices in the negotiations.³

- ² All of which in the area of rural electrification and household clean energy use and located in sub-Saharan Africa.
- ³ CDM Transition An Options Report, available at: http://www.climatefocus.com/publications/cdm-transition-article-6-parisagreement-options-report

¹ The Decision taken at COP 21, which complements the Paris Agreement and mandates several bodies with the further elaboration of the articles.

Figure 1: Ci-Dev timeline (adapted from: The impact of INDCs, NAMAs and LEDs on Ci-Dev operations and programs, October 2016)



2. Assessment of CDM infrastructure post 2020

Whether the CDM infrastructure will continue to be available to serve the Ci-Dev portfolio after 2020 is as much a legal question as it is a political one. Only time will tell which course of action Parties will individually or collectively pursue to either maintain parts of the CDM infrastructure or dismantle it post 2020. While future political decisions cannot be predicted, this chapter focuses on the legal basis for continuation of the CDM infrastructure, in particular its function to issue and transfer Certified Emission Reductions (CERs). The question is whether Ci-Dev can continue to rely on the existence of the CDM infrastructure once the second commitment period of the Kyoto Protocol (CP2 KP) comes to an end on 31 December 2020 and for how long beyond this date the CDM infrastructure might still operate. The analysis distinguishes between the time period during and after the end of the KP CP2 true-up period, as some functionality of the CDM infrastructure is still needed during true-up which may be relinquished afterwards.

2.1. DURING THE KP CP2 TRUE-UP PERIOD

2.1.1. Why is the true-up period relevant?

The 'true-up period' refers to the additional period of 100 days, which Annex 1 countries with commitments inscribed in Annex B of the KP may use to fulfil their respective commitments under the preceding commitment period (see box 1). During this period, Annex B Parties may continue to acquire and transfer KP units in order to comply with their respective targets. This includes Assigned Amount Units (AAUs,) Emission Reduction Units (ERUs), Removal Units (RMUs) as well as CERs.⁴

⁴ Section XIII of the annex to decision 27/CMP.1

Box 1 – Definition of true-up

XIII. Additional period for fulfilling commitments

For the purpose of fulfilling commitments under Article 3, paragraph 1, of the Protocol, a Party may, until the hundredth day after the date set by the Conference of the Parties serving as the meeting of the Parties to the Protocol for the completion of the expert review process under Article 8 of the Protocol for the last year of the commitment period, continue to acquire, and other Parties may transfer to such Party, emission reduction units, certified emission reductions, assigned amount units and removal units under Articles 6, 12 and 17 of the Protocol, from the preceding commitment period, provided the eligibility of any such Party has not been suspended in accordance with section XV, paragraph 4

Decision 27/CMP.1, Annex, Section XIII (FCCC/KP/CMP/2005/8/Add.3.)

Transactions that involve trading of Kyoto units and the use of the International Transaction Log (ITL) are not limited in this period. CERs can be forwarded from the CDM registry to Annex I country registries. They can also be traded between national registries, retired in national registries and carried over to the subsequent commitment period. Once the true-up period lapses, however, trading, and/or the retirement of CERs from the commitment period in question is no longer allowed.⁵ For the first commitment period (CP1) the true-up period ended on 18 November 2015. Since that date the following transactions have been restricted:

- Transfers of CP1 CERs between national registries (i.e. trading);
- Voluntary cancellations of CP1 CERs in national registries;
- Retirements of CP1 CERs in national registries⁶.

However, internal transfers and voluntary cancellations within the CDM registry continue to be possible for CP1 CERs. Box 2 below explains the relevant transaction types for Kyoto units and their relation with the CDM registry and CERs. Furthermore, CP1 CERs do not as yet have a legal expiry date, and therefore if not voluntarily cancelled can remain inactive in the CDM registry⁷. Unrelated to the true-up period is CDM project registration and CER issuance, which has not yet been restricted and results in increasing numbers of CERs held in the CDM registry⁸. The true-up period is unlikely to limit the functioning of the activities in the Ci-Dev portfolio directly but rather will restrict the ability of Ci-Dev participants to trade and use CP2 credits purchased through Ci-Dev funds.

⁵ Decision 27/CMP.1, Annex, Section XIII, FCCC/KP/CMP/2005/8/Add.3.; FAQ on transactions of Kyoto Protocol units related to the true-up process for the first commitment period of the Kyoto Protocol and on the True-up Period Report template1 (v.4 – 30 Oct. 2015), available at http://unfccc.int/kyoto_protocol/true-up_process/items/9023.php

⁶ See "How does the end of the CP1 true up period affect the CDM?" available at https://cdm.unfccc.int/faq/index.html. Note that the website also deems forwarding of CP1 CERs from the CDM registry to national registries as restricted while in actual fact this is still feasible today unless an Annex I country clarifies that it no longer wishes to receive of CP1 CERs (e.g. Switzerland has done so)

See "What happens to CP1 CERs remaining in the CDM registry at the end of the CP1 true up period?", available at https://cdm. unfccc.int/Registry/test_index.html#.

⁸ The CM Executive Board may decide to set a deadline for receiving requests for issuance at some point but has not done so yet. See information available at https://cdm.unfccc.int/faq/index.html - "how does the end of CP1 true-up period affect my project?"

Indirect consequences of the true-up period may impact CDM infrastructure decisions. For example, Parties are keen on keeping the CDM EB operational and funded until at least the end of the CP2 true-up period. In the annual guidance to the CDM EB in 2014, the Conference of the Parties serving as the meeting of the Parties (CMP) requested the CDM EB "to ensure the prudent management of the resources of the CDM and its ability to perform its duties in maintaining and developing the mechanism up to the end of the true-up period of the Second commitment period of the Kyoto Protocol."⁹ This provides some assurance that the CDM will continue to be operational through the true-up period.

After the true-up period is over, the operation of the Board could end, resulting in the end of CDM activity registration and issuance which requires direct EB involvement. Additionally, Annex II Parties may decide to terminate financial contributions to the ITL at the end of the true-up period. Next to the financial risk factors, the operation of the CDM may de facto come to an end if UN regions unconvinced of its continued use fail to appoint members to the CDM EB. In this case the Board may no longer be able to perform its functions through the loss of quorum.¹⁰

Box 2 – CDM registry transaction types

In order to assist Kyoto Parties in the implementation of their GHG commitments and accounting for emissions and emissions reductions, the CDM registry and national registries can perform several different types of transactions involving Kyoto units. These include:

- **Issuance.** Refers to the initial creation of a Kyoto unit, where a unique serial number is assigned to each unit. The CDM registry is the only registry (so far) able to issue CERs.
- **Forwarding.** Refers to the distribution of CERs from the CDM registry pending account to another account. Once issued, the CDM registry will, at the request of a nominated account representative, 'forward' CERs to a specific account in the CDM registry or to an account in a national registry. A forwarding of CERs is not subject to Kyoto eligibility checks by the ITL. Furthermore, based on precedents from the previous commitment period, CERs can continue to be forwarded without restrictions (even beyond the respective true-up period), provided the relevant national registry does not unilaterally bar the receipt of CERs.
 - External transfer. Refers to transfers of Kyoto units between different national registries.
 External transfers are generally not applicable to the transactions initiated by the CDM registry, but are still relevant to CERs transferred from one national registry to another (also known as trading). External transfers are subject to Kyoto eligibility checks. In addition, it is not possible to engage in external transfers of Kyoto units after the respective true-up period has lapsed.
- **Internal transfer.** Refers to transfers of Kyoto units taking place within the same registry. Examples of internal transfers include cancellation and retirement of Kyoto units.

o **Cancellations** refers to the internal transfer of a unit to a cancellation account. Cancelled units cannot be further transferred and are invalid for compliance purposes. Cancellations can be voluntary or mandatory. Authorized CDM participants are able to voluntarily undertake a cancellation of CERs in the CDM registry (on their own behalf or on behalf of third parties) without any restrictions related to the true-up period. There is not yet a rule or procedure that requires mandatory or automatic cancellation of CERs sitting in the CDM registry.

⁹ Decision 4/CMP, paragraph 20, see http://unfccc.int/resource/docs/2014/cmp10/eng/09a01.pdf#page=15

¹⁰ CDM EB decisions require at least two thirds of the members, representing a majority of members from Annex I Parties and a 9 majority of members from non-Annex I Parties. See Decision 3/CMP. 1, Annex, C, paragraph 14 (FCCC/KP/CMP/2005/8/Add.1)

o **Retirement** refers to the internal transfer of a Kyoto unit to a retirement account for compliance purposes. Retirement of CERs (so far) only takes place in national registries and is subject to both Kyoto eligibility checks and applicable quantitative restrictions.

Carry-over. Refers to the banking of a Kyoto unit from one commitment period to the next, where the period of validity of the relevant unit is adjusted. Similar to retirement, carry-over of CERs is only relevant to national registries and is subject to Kyoto eligibility checks and applicable quantitative restrictions.

2.1.2. What is the length of the KP CP2 true-up period?

While the length of the true-up period does not change for commitment periods (100 days), the precise date in which countdown begins is set by the CMP as a function of the completion of the annual review process established under Article 8 of the Kyoto Protocol (Article 8 review process).¹¹

For the first commitment period¹², the CMP established 10 August 2015 as the deadline for completion of the Article 8 review process¹³. The CMP also decided that, in the event that the expert review process had not been finalized by 10 August 2015, the review process would continue and the completion date would become the date of publication of the last inventory review report for 2012¹⁴. Reviews by expert review teams took place in 2014, and were the last reviews for the first commitment period. Publication by the Secretariat of the last annual review report for CP1 took place on 10 July 2015¹⁵.

Since the initial deadline established by the CMP was successfully met by the review team (10 August 2015), the CP1 true-up period expired 100 days thereafter, on 18 November 2015. This date is also known as the 'CP1 cut-off date'.

The annex to decision 22/CMP.1 sets the timeframe for the Article 8 review process for the first commitment period. In turn, decision 4/CMP.11 extends *mutatis mutandis* the same review guidance and timeframe to the second commitment period¹⁶. Together these decisions establish a number of milestones for review of annual reports under the Protocol, including initial checks, preparation of status reports, and individual inventory reviews (see box 3).

¹¹ Review by expert review teams of annual GHG inventories and national communications submitted by Annex I Parties.

¹³ Decision 3/CMP.10, paragraph 1.

¹² The first commitment period began on 1 January 2008 and concluded on 31 December 2012.

¹⁴ Decision 3/CMP.10, paragraph 1.

¹⁵ See "True-up period information report by the Secretariat", available at http://unfccc.int/kyoto_protocol/reporting/items/9044.php

¹⁶ See Part I, Sections D and F, Part II, Sections C and D, of Annex to Decision 22/CMP.1.

Box 3 – Milestones and timeline of the Article 8 review process (22/CMP.1)

- 1) Submission of national inventories and supplementary info. normally by 15 April (but delays are quite common);
- 2) Initial check and draft status report within four weeks from submission date (para. 61);
- 3) Party to comment on the draft status report;
- 4) Status report to be finalized within 10 weeks from submission due date (para.63);
- 5) Individual inventory review. Expert review teams list problems with individual inventories and send to Parties within 25 weeks of submission due date (para.73);
- 6) Party to comment on questions and provide revised estimates within 6 weeks (para. 74);
- 7) Expert review teams to prepare a draft individual inventory review report within 8 weeks from receiving comments from the relevant Party (para. 75);
- 8) Party has another 4 weeks to comment on the draft individual inventory review report (para. 76);
- 9) Expert review team to prepare final individual review report within 4 weeks from receiving comments on the draft (para. 77). FCCC/KP/CMP/2005/8/Add

Parties are required to submit annual reports by 15th April of each year. The entire review process by expert review teams should, in theory, be completed within one year from the submission due date of the last annual report¹⁷.

It is not uncommon, however, for review cycles to miss the deadlines established by the aforementioned CMP decisions¹⁸. The causes of delays in concluding review cycles vary significantly and range from delays by countries in submitting their annual inventories, formation of expert review teams and shortage of reviewers, upgrades in common reporting formats, use of new review tools and revised guidelines, among others.

The second commitment period will end on 31 December 2020 and the last inventory reports (related to 2020) should be submitted by Parties by 15 April 2022. Given the experience with the CP1 review procedures and based on informal conversations with UNFCCC legal staff, it appears likely that the CP2 Article 8 review process will be concluded by mid-2023, but the exact date has yet to be fixed by the CMP. This CMP decision will likely be taken in 2020 or 2021, once the Article 8 review process has been scheduled.

¹⁷ Decision 22/CMP.1, annex, paragraphs 16 and 72.

¹⁸ See, for instance, 'Conclusions and recommendations - Eleventh meeting of inventory lead reviewers', 3-5 March 2014.



This is also the expectation of the CDM EB, which has stated in its annual report to the CMP that the Board intends to carefully manage CDM-related resources so that administrative expenses "may be covered until at least the end of the true-up period for the Kyoto Protocol's second commitment (expected to be around mid-2023)"¹⁹.

As with CP1, the CP2 true-up period will commence on the date established by the CMP – or, in the event that the expert review process has not been finalized by such date, the date of publication of the last inventory review report for 2020 – and end 100 days thereafter. Considering that the CP1 true-up period ended only in mid-November, mid-2023 appears to be a conservative assumption, although it likely factors in some learning and efficiency gains since the first true-up period. For the purpose of the subsequent scenario analysis in chapter 4, mid-2023 is equated with June 2023.

¹⁹ FCCC/KP/CMP/2013/5 (Part I), Annual report of the Executive Board of the clean development mechanism to the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol, 24 October 2013.

2.1.3. Is it possible to issue and transfer CERs for ERs generated post 2020 within the true-up period?

As the final additional period for fulfilling commitments, the true-up period directly only concerns transactions of units whose emission reductions were generated during its preceding commitment period. The CP2 true-up period therefore has no direct implications for emission reductions generated post 2020. However, indirectly the issuance and transfer of CERs for emission reductions generated post 2020 could be facilitated by the fact that the CDM infrastructure is more likely to be kept in place during the true-up period than afterwards. It is likely that the material conditions for issuance and transfer of CERs (operation of the Board and the ITL) will remain available during the true-up period.

2.1.4. Will there be a KP CP2 true-up?

A final question that merits attention is whether there would be a true-up period in the event that CP2 did not enter into force. As of 15 June 2017, only 77 countries have ratified the Doha Amendment²⁰, which establishes CP2, while 144 ratifications are required for it to legally take effect²¹. The question therefore is what happens to CP2 and the true-up in case the Doha Amendment is not ratified by a sufficient number of Parties by the end of 2020.

In this respect, it is important to note that there is some consensus among scholars and jurists that the provisional application of treaties (and by consequence of their amendments) has legal force under international law and is apt to create rights and obligations. The International Law Commission appears to recognize, for international law purposes, that there is no distinct degree of legal significance between a treaty in force and a treaty that is provisionally applied²². In addition, the provisional application of the Doha Amendment contains no pre-agreed date of validity and thus remains binding for each country that has accepted the provisional application until that country notifies Parties that it no longer intends to ratify the Amendment. The result is that CP2 is in effect unlikely to be nullified, although this is a possibility. It is therefore expected that CP2 will be concluded as currently designed incorporating the CP2 true-up period reporting and review.

2.2. AFTER THE KP CP2 TRUE-UP PERIOD

Ultimately the question whether CDM projects can generate credits after 31 December 2020 applies to both the period of the true-up as well as the time beyond. While it can be argued that during true-up the CDM infrastructure still needs to be kept in place anyway, this does not automatically guarantee the possibility of credit issuance. Issuance of CERs post 2020 or any time thereafter could be actively terminated by Parties or, conversely, actively enabled through a CMP decision. More political momentum may exist for wrapping up the CDM after 2023 than for maintaining it. As argued by Cames et al.: As soon as the *mechanism described under Article 6.4* "…comes into force, there is little sense to maintain other crediting mechanisms which aim at reducing the same emissions and are largely based on the same concepts but do not take into account the new context under the Paris Agreement. Therefore, it seems very unlikely that CDM and JI [Joint Implementation] will continue generating and issuing credits post-2020."²³

²⁰ http://unfccc.int/kyoto_protocol/doha_amendment/items/7362.php

²¹ The Doha Amendment to the Kyoto Protocol was adopted by decision 1/CMP.8. Paragraph 5 of this decision recognized that Parties may provisionally apply the Doha Amendment pending its entry into force.

²² International Law Commission, Chapter XI Provisional application of treaties, 2015

²³ Cames, M. et al (2017): International market mechanisms after Paris – Discussion Paper, published by DEHSt, p.23

This assessment is shared by some of the negotiating Parties. In informal consultations Brazil and the EU noted that the CDM EB should terminate its work in 2023 in order to avoid duplication of bodies, assuming that the Article 6.4 mechanism will start operations at the latest in 2020. Japan on the other hand suggested that the business-as-usual scenario [i.e. a situation in which Parties do not actively take a decision] would be for the CDM to continue even without a third commitment period (CP3), given the precedent set by the CDM EB to continue issuance of credits in the absence of CP2. CERs generated could then be traded as Internationally Transferred Mitigation Outcomes (ITMOs)²⁴. In its submission on Article 6, Norway states "it will be crucial to keep the CDM running through the true up of the second commitment period in 2023. However, it should be considered whether it is worthwhile to continue to operate the CDM under the Kyoto Protocol after this."

Considering the arguments provided for discontinuing the issuance function of the CDM, it is unclear whether Parties would want to condition the termination on the end of the CP2 true-up period or simply make its termination at the point the Article 6.4 mechanism becomes operational. For now, the end of the true-up period seems to prevail as the fix point for discontinuation, which may be because even with all its uncertainties it is still the more tangible date. Members of the German emission trading authority (DEHSt) who are member of the Board and CDM negotiator for the EU however clarified that they would see the true-up period only relevant for the issuance of pre-2020 credits, but expressed concern with issuance of post-2020 credits due to the unclear relationship with the Nationally Determined Contributions (NDCs)²⁵.

The other scenario to consider is that Parties will not actively take a decision whether to continue or discontinue the CDM. What would happen in the case of a non-decision is still subject to legal debate²⁶. Based on current practices and the fact that no sunset provision exists for the CDM, it appears possible that the CDM could be sustained beyond a second commitment period. In fact, the continuation of the CDM does not appear to be attached or conditioned to commitment periods and/or true-up periods. This interpretation is mainly supported by:

- the fact that there is no provision in the KP or in CMP decisions leading to the interpretation that the Protocol and its institutions may automatically expire. While it is true that, in the complete absence of further commitment periods, the Protocol infrastructure could largely become an empty vessel, instruments such as the CDM are not conditioned on commitment periods²⁷;
- the precedent set by the transitional arrangements between the first and second commitment periods. In effect, the KP and the CDM are currently operating informally since the Doha Amendment has only been provisionally adopted by Parties and has not yet entered into force;

Previous considerations made by the Secretariat in connection to the consequences of a possible gap between the first and subsequent commitment periods confirmed that "(...) as a general rule, neither the text of the Kyoto Protocol, nor the subsequent decisions of the COP and the CMP explicitly link the clean development mechanism (CDM) to the first commitment period of the Kyoto Protocol".²⁸

²⁴ Interventions made on 5 November 2016 during the informal meeting on Article 6 hosted by ICTSD in Marrakech

²⁵ Statements made on 25 January 2017 during workshop "Options for enhancing international cooperation to implement Article 6 of the Paris Agreement" in Berlin, organized by Adelphi, Öko-Institut and New Climate Institute in cooperation with DEHSt.

²⁶ Cames et al. (2017) p. 23

²⁷ See, for instance, Legal Response Initiative, "Legal options to avoid a gap and legal implications of a possible gap", 19 July 2010; and Secretariat's Note on "Legal considerations relating to a possible gap between the first and subsequent commitment periods", FCCC/KP/AWG/2010/10, from 20 July 2010.

²⁸ I See paragraph 45 of Secretariat's Note on "Legal considerations relating to a possible gap between the first and subsequent commitment periods", FCCC/KP/AWG/2010/10, from 20 July 2010

While the Secretariat does recognize a possible interpretation under which the fate of the CDM in the absence of a commitment period could depend on how important (i.e. mandatory) Parties perceive the fulfilment of the CDM objective related to assisting Parties included in Annex I in achieving compliance with their Quantified Emission Limitation and Reduction Obligations (QELROs), the Secretariat goes on to state that "If it is sufficient for CDM project activities to meet some but not all of the elements of [the CDM's] stated purpose, it could be argued that the absence of QELROs during the gap period would not prevent the continuation of the CDM. Under this interpretation, new CDM project activities could be validated and registered, emission reductions or removals that occurred after the first commitment period could be verified, and corresponding CERs could be issued"²⁹.

The fact that Parties embraced the voluntarily cancellations of CERs at COP19 appears to indicate that countries do not view offsetting to assist Annex I Parties with complying with their targets as a mandatory component of the CDM, hence, reinforcing the Secretariat's second interpretation outlined above. This is also in line with the gradual evolution of the CDM under Kyoto, moving from a pure compliance instrument to a multilaterally-agreed standard available for both compliance and non-compliance mitigation efforts. In addition, informal conversations with legal staff of the UNFCCC Secretariat held during COP22 confirmed the view that issuances of CERs can continue for as long as the CDM's operational infrastructure is in place and does not depend on the true-up period.

This is not to say, however, that the CDM would remain unaffected by the complete absence of a third commitment period. Unless there is agreement by Parties to modify certain rules and procedures, without a third commitment period, after the CP2 cut-off date the CDM could potentially see its capabilities reduced to issuance, holding of CERs in the CDM registry, forwarding and voluntary cancellation. Annex B countries would thus not be able to transfer and acquire CERs. The pathway of allowing the continuation of CDM projects while making the compliance use of CERs subject to legal commitments under a compliance period is already set by the Doha Amendment for CP2 (see box 4).

In sum, while it can be expected that the CDM infrastructure will still be in place until at least mid-2023 and possibly thereafter, there is no guarantee that the CDM EB will continue issuing CERs post 31 December 2020. Chances for continued issuance are higher until the end of the true-up period than afterwards, however it is in the hands of Parties and members of the CDM EB to either enable or obstruct the issuance. With regard to the use of issued CERs, until the end of the true-up period both the compliance use and voluntary cancellation should be equally possible. Thereafter, however, voluntary cancellation is the more robust option since it is performed within the CDM registry and does not depend on the existence of an ITL and Annex I country registries. Ci-Dev is well advised to continue to monitor the situation and prepare for hedging strategies beyond the CDM.

²⁹ See paragraph 46-48 of Secretariat's Note on "Legal considerations relating to a possible gap between the first and subsequent commitment periods", FCCC/KP/AWG/2010/10, from 20 July 2010.

Box 4 – Continuation of CDM after 2012

12. Clarifies that, for the second commitment period, starting from 1 January 2013, Parties not included in Annex I continue to be able to participate in ongoing project activities under Article 12 of the Kyoto Protocol and in any project activities to be registered after 31 December 2012 in accordance with the provisions of the annex to decision 3/CMP.1;

13. Clarifies also that for the purposes of the second commitment period, from 1 January 2013 onwards, a Party included in Annex I may continue to participate in ongoing project activities under Article 12 and in any project activities to be registered after 31 December 2012, but only a Party with a quantified emission limitation and reduction commitment inscribed in the third column of Annex B as contained in annex I to this decision shall be eligible to transfer and acquire certified emission reductions (CERs) in accordance with decision 3/CMP.1 and with paragraph 15 below.

Doha Amendment, Decision 1/CMP.8, IV, paragraphs 12 and 13 (FCCC/KP/CMP/2012/13/Add.1)

3. Stocktaking of UNFCCC negotiations on Article 6.2 and Article 6.4 of the Paris Agreement

Considering the uncertainties around the future of the CDM, Ci-Dev may decide to shift its portfolio to one of the successor mechanisms established in Article 6 of the PA, the "cooperative approaches" (Art. 6.2) or the "mechanism to contribute to the mitigation of greenhouse gas emissions and support sustainable development" (Art. 6.4). The purpose of this chapter is to provide an overview of the main areas of convergence and divergence in the negotiations of these new cooperation mechanisms. This serves two purposes: First, it allows to get a sense, albeit an uncertain one, of the key features that can be expected to become part of the new mechanisms. Second, it shows the bottlenecks in the negotiations and provides an indication of what it will take to resolve outstanding differences in order to operationalize the mechanisms. The last section explicitly addresses the question of the timeline, i.e. by when the new mechanisms may become available. Given the multitude of issues under negotiations, the chapter presents only a summary of the main lines of convergence and divergence while more details on issues and Parties' stance on these issues are presented in table format in the annex. The chapter is based on the emerging position in country submissions and statements made during negotiations at COP 22 and SBSTA 46. Note that the chapter only addresses two of the three approaches which are bundled under Article 6, leaving out the framework for non-market based approaches of Art. 6.8. Considering the political need for balanced progress across all three approaches also Art. 6.8 can impact the speed by which the market oriented cooperation mechanisms are developed.

3.1. MAIN AREAS OF CONVERGENCE AND DIVERGENCE FOR ARTICLE 6.2

Although there is no clear-cut division among Parties and the level of complexity of the various issues renders attempts to generalize views at this stage premature, it is still possible to distinguish certain main areas of convergence and divergence for Art. 6.2. For the purposes of better structuring this analysis, these are clustered below in the following categories: scope of guidance, governance, scope of cooperative approaches, ITMOs accounting, environmental integrity, sustainable development, eligibility issues, and share of proceeds.

3.1.1. Scope of guidance

One particular and overarching line of diversion in implementing Art. 6.2 has been whether the scope of guidance should be restricted to defining the rules for avoidance of double counting or, whether all aspects of environmental integrity, transparency, sustainable development and accounting contained in Art. 6.2 should be addressed at the level of the UNFCCC. Recently acceptance seems to have grown among Parties for the latter interpretation, currently supported by AOSIS, CARICOM, African Group, South Africa and the EIG. Japan, on the other hand, continues to see the scope of guidance for Art. 6.2 limited to accounting of ITMOs towards the achievement of NDCs. New Zealand is proposing a more nuanced approach by agreeing that all aspects of Art. 6.2 should be operationalized by the CMA, but suggesting that environmental integrity and transparency could be operationalized via the enhanced transparency framework (rather than through Art. 6.2 directly). Similarly, the EU focuses on guidance of tracking promotion of sustainable development, environmental integrity and transparency under the requirements of Art. 4.13 and Art. 13.7 PA.

3.1.2. Governance

A number of Parties suggest elements of centralized governance even for the cooperative approaches, affirming the need for a central oversight by the CMA to ensure integrity of the range of mechanisms and emission reductions produced. While some countries go as far as suggesting the use of a specific institutional arrangement (LDCs) or a supervisory board (African Group, South Africa), others emphasize the need for specific guidance and consistent accounting rules between Article 6.2 and 6.4 (EIG and AOSIS). On the other side of the spectrum are Parties which prefer minimal centralized oversight, consisting of a set of international reporting guidelines combined with mere facilitative guidance on Art. 6.2. They consider a system of disclosure, reporting and review to demonstrate consistency with CMA guidance as the backbone of the Art. 6.2 governance, which avoids prescriptive centralized standards for bottom-up initiatives. The transparency and review approach to governance is advocated by Japan, New Zealand, the EU, US, Australia and Canada, among others.

3.1.3. Scope of cooperative approaches

Most countries appear to support a broad interpretation of the scope of cooperative approaches. Examples include: (a) Japan, whose primary interest in Art. 6.2 is the facilitation of Party-driven crediting approaches like the Joint Crediting Mechanism; (b) Canada, which favors guidance facilitating a variety of marked-based cooperative approaches (including the participation by sub-nationals jurisdictions); (c) Norway, which explicitly mentions REDD+ as an Art. 6.2 cooperative approach; and (d) AILAC and the African Group, for whom the scope of approaches can be bilateral or plurilateral and take many different shapes, including the linking of trading programs, crediting approaches, and government-to-government transactions. While not specifically addressing the point in its submissions, the EU seems to agree with the broad scope of cooperative approaches. One notable exception is Brazil, which adopts a very narrow stance and focuses on government-to-government transactions only (similar to the trading of Assigned Amount Units under Art. 17 of the Kyoto Protocol). According to Brazil, any type of baseline and credit approach should be channelled through Art. 6.4.

3.1.4. Accounting for ITMOs

Type of guidance

Countries generally agree that accounting guidance under Art. 6.2 will be additional or complementary to the general accounting provisions covering NDCs, negotiated under the transparency framework (Article 13). For the majority, specific Art. 6.2 accounting guidance should include, at a minimum, what constitutes ITMOs, how and when corresponding adjustments are made, how conditional targets are to be considered, as well as the relationship between vintage of ITMOs and NDC target years.

Nature of ITMOs

There is increasing convergence in that ITMOs should be quantified and expressed in tCO2e (EU, AOSIS, Japan, EIG, LDCs, Ethiopia, AILAC, Brazil and New Zealand). The African Group agrees that ITMOs should be expressed quantitatively, however considers that ITMOs could include both GHG and non-GHG outcomes. The African Group and Indonesia observe that ITMOs should not become fungible and tradable units (a feature that should be reserved for Art. 6.4 units, according to these countries).

Corresponding adjustments

A number of Parties indicate a preference for using Parties' GHG inventories as a starting point for corresponding adjustments rather than converting NDC pledges into an emissions budget. While mathematically both approaches are the same, some Parties express more comfort with the informational value contained in GHG inventories (EU, AOSIS, EIG).

The EU, in particular, suggests the establishment of an accounting balance as a basis for accounting and to enable corresponding adjustments for ITMOs. In a similar approach, New Zealand suggests that one option would be to report on ITMOs-adjusted emissions totals in common tabular formats. Brazil, following their view that Art. 6.2 resembles Kyoto style trading of AAUs, supports the use of budgets and units, where corresponding adjustments would require additions (for acquisitions) and subtractions (for transfers) of units from specific budgets.

Within and outside the NDC scope

Parties are diverging on the question whether the generation of ITMOs should be limited to only those sectors that are covered by a host country's NDC or whether activities that fall either within or outside NDCs should be allowed. Brazil and the LDCs want to limit eligible sectors to those covered by the NDCs that have absolute emission reduction targets. The AGN, on the other hand, highlights the need for inclusiveness and maintains that all Parties with all types of NDC should be eligible to participate in Art. 6.2 transactions. Other Parties are in principle open to allowing activities from both covered and non-covered sectors but argue that corresponding adjustments should be done in either case, so that incentives are created to increase coverage of NDCs in host-countries (EU, AOSIS, EIG, Japan, Canada). Panama acknowledges that while accounting does not apply to activities outside NDCs for the time being, one should still keep track of exported emission reductions in another format.

Net reduction in emissions

Although only expressly foreseen under Art. 6.4, several countries are advocating for ensuring that cooperative approaches under Art. 6.2 also result in net emission reductions (or overall mitigation in global emissions). This includes the LDCs, AOSIS, EIG, AGN and Indonesia.

3.1.5. Environmental Integrity

Countries that see some level of centralization in a more favourable light also tend to see Art. 6.2 concerned not only with the transfer and use of mitigation outcomes, but also with the environmental integrity and quality of the underlying schemes that generate ITMOs. The EIG, CARICOM, AOSIS and the African Group support common environmental integrity standards under Art. 6.2 that are as rigorous as those underlying Art. 6.4. For example, EIG demands that emission reductions transferred as ITMOs should be real, permanent, additional and verified. Similarly, AOSIS emphasizes that ITMOs should be additional and beyond those reductions that a country needs to achieve under its NDC. The group also differentiates between quality standards that would apply to activity based vs. non-activity based ITMOs. On the other side of the spectrum, Japan sees environmental integrity as an issue to be dealt with by countries at the national or cooperative level. Occupying a middle ground, New Zealand suggests the development of basic principles at CMA level to guide and frame the use of ITMOs, including that ITMOs are real, measurable, verifiable, additional and permanent. According to New Zealand, additional guidance on environmental integrity may also be addressed through the enhanced transparency framework. For the EU the issue of environmental integrity is predominantly addressed through a set of robust accounting, reporting and tracking guidelines, through which progress made in implementing and achieving different NDCs should be tracked and double counting be avoided (while formulating additional criteria in relation to the Art. 6.4 mechanism).

3.1.6. Sustainable Development

While many Parties stress the need for cooperative approaches to contribute to sustainable development (African Group, South Africa and LMDC) it remains an open question how this can be operationalized. Most Parties agree that the definition of sustainable development is first and foremost a national prerogative of the implementing country (or countries). Brazil is very vocal in rejecting any international definition on sustainable development. Different nuances exist, however. AOSIS, for instance, adds that countries should make public the criteria they wish to apply to Art. 6.2 approaches. Some countries, like the EIG and Korea, stress the need for minimum safeguards or common standards in line with the UN Sustainable Development Goals (SDGs). Indonesia, in turn, suggests common guidance or a minimum set of criteria which can be used differently according to national circumstances. Saudi Arabia on behalf of the LMDCs insists that as a general principle, all voluntary cooperation must "do no harm" and not have any negative social or economic consequences including on third party countries that are not part of the transaction as this would go against sustainable development. With that, Saudi Arabia links Art. 6 to the discussion of "response measures" under Art. 4.15 PA as well as to the subject of "mitigation co-benefits resulting from Parties" adaptation actions and/or economic diversification plans" under Art. 4.7 PA.

3.1.7. Tracking arrangements

Several Parties support the use of registry systems to report on the use of ITMOs. These include Japan, EU, and India. Some countries, like the EIG, note that registries may only be required for countries willing to engage in secondary transfers of ITMOs. Parties that favor greater international oversight under Art. 6.2 tend to support the use of centralized tracking arrangements, i.e. a central registry and/or transaction log (AOSIS, CARICOM, African Group, LDCs, South Africa, and Singapore). Brazil suggests that the Secretariat makes available a multilateral registry for countries that wish to engage in cooperative approaches, but do not want to maintain their own national registry.

3.1.8. Party eligibility

Participation in cooperative approaches may also be restricted by certain eligibility or foundational requirements applicable to the transfer and/or use of ITMOs. These eligibility requirements may refer to the type of NDCs or to the domestic (procedural and institutional) system of countries. With respect to the former, several countries refer explicitly to the need for quantifying NDCs (EU, AOSIS, LDC, South Africa). The LDCs also argue for allowing the creation of ITMOs only in countries with absolute multi-year targets. Brazil suggests the need for economy-wide NDCs. In relation to domestic systems, the LDCs observe that only countries that fulfil the necessary accounting system and governance requirements would be allowed to participate. Similarly, Korea observes the need for national accrediting institutions for activities of cooperative approaches. Brazil proposes a series of steps involving both NDCand domestic system-related requirements. The first include quantification of NDCs and the conversion of the quantified target into an equivalent pool of units (the quantified contribution units or "QCUs"). The second relates to establishing a national registry to ensure the accurate accounting of QCUs. On the other hand, some countries oppose any type of restrictions to participation in cooperative approaches and in the use of ITMOs, regardless of the type of NDCs (African Group, LMDC and Arab Group). The EIG also takes an inclusive approach to participation by requiring a Party to have ratified the PA, submitted an NDC and maybe comply with additional elements.

3.1.9. Share of proceeds

The issue whether or not to levy a share of proceeds (SOP) on Art. 6.2 transactions became a major stumbling block during SBSTA 46. Applying a levy on ITMOs to channel resources to the Adaptation Fund enjoyed broad political support of developing countries and was suggested by a number of Parties (AGN, Arab Group, Argentina, COMIFAC, Kuwait, LDCs). The proposal was vehemently opposed by members of the Umbrella Group, particularly US, Canada, Australia and New Zealand, noting that during the negotiations in Paris it was agreed not to establish such a SOP mechanism to fund adaptation activities. Any issues that do not have a "hook" in the PA should not be put on the table. The AGN however see a hook in Art. 6.1, which states that voluntary cooperation shall enhance ambition in mitigation and adaptation. The LDCs note that a SOP centralized account would be "a holding account for transfer to the Adaptation Fund, originally established under the Kyoto Protocol and through a decision authorized to operate under the Paris Agreement."

3.2. MAIN AREAS OF CONVERGENCE AND DIVERGENCE FOR ARTICLE. 6.4

In general, the large majority of countries appear to perceive the benefits in maintaining, building on, and/or recycling elements of the CDM based on an assessment of both positive and negative CDM experiences. Countries however diverge on the perceived need for reform of the CDM and the extent to which Art. 6.4 should mirror the CDM. Correspondingly, JI countries (Russia, Ukraine) highlight the benefits of building the new mechanism on elements of JI.

For a structured overview of elements of divergence and convergence among countries, this section 3.2 is clustered as follows: eligibility and scope; governance; accounting; additionality and baseline; sustainable development; overall mitigation in global emissions; and CDM transition.

3.2.1. Eligibility and scope

Most countries favour having the Art. 6.4 mechanism available to all Parties (assuming all Parties have an NDC in place). In addition, most countries agree that Art. 6.4 should encompass not only project-based and programmatic activities, but also sectoral approaches. Brazil is the main exception, suggesting that a very similar approach to the CDM should be followed (hence, likely excluding sectoral programs and broader policies). Norway, Panama and the Congo Basin countries would like to see REDD+ included under 6.4, which is opposed by Brazil.³⁰ The AGN, in turn, suggests that possible extension of the scope to include for example REDD+ or policy crediting should be assessed by the CMA in the future. Panama and AILAC raise the point that Art. 6.4 could also function as a certification process for other mechanisms and standards seeking recognition by a UN body. In a similar vein, the EU considers that Parties may wish the mechanism to assist in the implementation of domestic instruments, which would imply a modulated architecture for the mechanism including different levels of supervision, assessment, validation and registration by the supervisory body.

3.2.2. Governance

All countries agree that Art. 6.4 establishes a centralized mechanism. This said, a number of issues remain still to be decided, such as the composition of the supervisory board and responsibilities of the different bodies. For instance, with respect to the composition of the supervisory board, Japan notes that membership should ensure better representation of all Parties, with costs being borne by all countries making use of the mechanism. During the SBSTA 46 roundtable discussions many Parties noted that all five UN regions should be equally represented on the board, as opposed to the bifurcated representation of Annex I and non-Annex I countries on the CDM Executive Board.

³⁰ Brazil's stance regarding REDD+ has long been to oppose the use of emissions reductions from REDD+ as offsets. The country sees REDD+ mainly as a tool to achieve domestic targets.

Brazil on the other hand, notes that the new supervisory body should succeed the CDM Executive Board in virtually all aspects. A number of Parties also see an increased role for domestic governments and DNAs. For instance, the EU notes that despite the centralized character of the mechanism, under the Paris Agreement host countries will necessarily have a greater role to play, in particular, in clarifying the scope of NDCs and how the relevant mechanism or activity contributes to achieve or overachieve a given NDC. The African Group emphasizes the need to adjust role for the DNAs in accordance with the new requirements of the Paris Agreement and Kuwait highlights the important role of Parties' DNAs in linking the Art. 6.4 mechanism to national circumstances and national sustainable development plans and strategies.

3.2.3. Accounting

Most countries agree that when Art. 6.4 units are transferred internationally and used against NDCs they should be deemed ITMOs and be subject to the guidance of Art. 6.2 (EU, New Zealand, Japan, EIG, AILAC, AGN and Korea). Japan believes that units generated under the Art. 6.4 mechanism should always be considered ITMOs while the African Group seeks a differentiation by use. Only if units from the Art. 6.4 mechanism are internationally traded and used for compliance should they be considered ITMOs while this would not be the case when units are voluntarily cancelled or used in the disbursement of climate finance. Brazil is a notable exception, maintaining that Art. 6.4 units are not ITMOs. It explains that when Art. 6.4 units are transferred from the "SDM Registry" to a buyer country registry, this would equate to a 'forwarding' of units (as opposed to a 'transfer') and, therefore, not be subject to corresponding adjustments. Corresponding adjustments would only apply when Art. 6.4 units are transferred onwards from a country registry that received these units from the "SDM Registry". As a result, there would be no need to differentiate between accounting for Art. 6.4 activities that occur within and outside the scope of the NDC. Conversely, for the EU, EIG and AOSIS, corresponding adjustments are required within the scope of the NDCs and should also be considered for Art. 6.4 activities taking place outside the NDC in order to avoid perverse incentives and ensure that host-countries gradually expand the scope of their NDCs to other sectors. Finally, the LDCs propose a hybrid system to deal with the issue of within/outside the NDC. Activities within and outside the NDC scope should follow a separate set of rules, and hence are not interchangeable. Accordingly, a Sustainable Development Mechanism Outside (SDMO) the scope of the NDC would be established and follow rules similar to the CDM, whereas a Sustainable Development Mechanism Inside (SDMI) the scope of the NDC could be structured in a similar way to the JI mechanism.

3.2.4. Additionality and baseline

For most countries, additionality should be seen in light of pledges and/or policies communicated by countries in their NDCs. For instance, the EIG posits that additionality implies that emission reduction go beyond the host country NDC. Furthermore, for the group additionality must be periodically reviewed and all domestic policies must be accounted for in the setting of baselines. Similarly, the EU sees the need to demonstrate additionality in the context of meeting or enhancing ambition of a given NDC and domestic policies. The EU also notes that baseline methodologies will have to be much more ambitious than those applied by the CDM (for instance by adopting benchmarking or best available technologies). The AGN similarly observes that "emission reductions must be real and additional to the BAU scenario", where BAU takes into account policies and measures specified in the NDC.

For Brazil, the SDM supervisory body would be responsible for assessing additionality based on whether mitigation activities would (or not) have happened in the absence of the Art. 6.4 mechanism. In its submission, the country highlights that the Art. 6.4 mechanism should reward reductions that are additional to BAU and (re)defines BAU as the scenario "in which Parties are expected to implement their NDCs and associated national policies". However, in a contrasting vein, Brazil also observed during the negotiations that there would be no material distinction between the additionality approach adopted by the CDM and the one to be adopted under Art. 6.4.

Some AILAC countries observed in the negotiations that going forward, they see a greater role of host country governments in defining additionality and eligible sectors from which emission reductions may be internationally transferred.

Finally, for Panama, the interpretation of additionality could potentially go beyond that what is normally applicable to baseline-and-crediting approaches, and be broadened to include the setting of stringent caps.

3.2.5. Sustainable development

Countries largely agree that sustainable development is a national prerogative. In that sense, applicable sustainable development criteria are to be developed at the national level and in line with national sustainable development priorities of each country. However, countries differ as to what extent the conceptualization of sustainable development should be based on or guided by internationally agreed definitions. For instance, South Africa and the AGN note that SDGs and CDM sustainability tools (respectively) may guide countries when developing their sustainable development criteria. Brazil adopts a similar stance, observing that the 2030 Agenda for Sustainable Development should guide the promotion of sustainable development at domestic level, but reinforces that the Paris Agreement should not attempt to provide an international definition or criteria for sustainable development. EIG and Korea, in turn, propose a somewhat stricter approach by suggesting a minimum international standard for sustainable development. This standard could entail that activities should be consistent with the SDGs, sustainable development objectives, and represent no threat to human rights. Similarly, the EU notes that host countries will not only have to demonstrate how activities contribute to sustainable development, but also respect and promote human rights (in accordance with the preamble of the Paris Agreement).

For Saudi Arabia, speaking on behalf of the LMDCs, sustainable development is the central theme of all Art. 6 approaches. As noted in section 3.1.6 above, it highlights the need for safeguards to identify and address the negative social and economic impacts arising from cooperation including for third parties.

3.2.6. Overall Mitigation in Global Emissions

Japan suggests that overall mitigation can be achieved by using conservative baselines, whereas AOSIS notes that this would only work for activities outside the scope of NDCs (as the hostcountry would benefit from the non-credited portion of the emission reductions, not resulting in net atmospheric benefits). In addition, both AOSIS and CARICOM argue that overall mitigation requires emission reductions to go beyond the sum of the pledges made by the host country and the recipient country. This could be operationalized through the cancellation of a (fixed) portion of the verified emissions reductions (thereby, preventing that any of the countries involved in a given transaction recognize or use these cancelled emission reductions). On the other hand, the Arab Group notes that as long as a mitigation outcome is verified, the accumulation of these mitigation outcomes should automatically lead to an overall mitigation. Moreover, the group stresses that the requirement of overall mitigation of global emissions should not be used as a barrier to participation in the mechanism. For the EU it is important that the mechanism enables and reflects a contribution to mitigation by the host Party and that it catalyzes the deployment of ambitious public and private action towards a transition to a low emissions future, incorporating incentives to increased ambition, and avoiding lock-in to lower ambition and high emission technologies. Its operationalization must create incentives to broaden, quantify and account for NDCs and it must also avoid (perverse) incentives to increase emissions.

3.2.7. CDM transition

Several countries mention CDM transitional arrangements and grandfathering aspects in their submission or have expressed support for the issue in the negotiations (Brazil, EIG, AGN, South Africa, Ethiopia, Tunisia, Korea, Norway, Arab Group, Panama and Australia). Brazil is particularly vocal in calling for a smooth transition in order to ensure credibility of UNFCCC mechanisms, promote pre-2020 ambition and provide legal certainty to private sector stakeholders. The African Group is predominantly concerned with the migration of PoAs. Most countries focus on the migration of registered CDM projects to the PA context while Brazil also advocates for an eligibility of existing CERs under the PA. The European Commission, on the other hand (not representing all its Member States), is of the opinion that transitional aspects should only be discussed once the new mechanism has been defined. Russia and Ukraine insist that the topic of transition must be extended to include JI as well. With regard to building out the Art. 6.4 mechanism on the basis of the CDM rules, the divergent views on the need for CDM reform, experienced in the negotiations of the review of the CDM modalities and procedures, pervade the negotiations of Art. 6.4 as well. Some countries seek to terminate the CDM after 2020 (AOSIS, EU, LDCs) while for others this is a secondary question, to be addressed once transition is solved.

3.3. STATUS OF THE NEGOTIATIONS

At SBSTA 46 Parties made further progress in operationalizing the Article 6 mechanisms. For the first time substantive documents on the possible elements of the three Article 6 sub-articles were produced in the form of "informal informational notes"³¹. A constructive exchange on substance happened during negotiations, with Parties delving into technical issues during the roundtable discussions. This marked a considerable jump in the understanding and common structuring of the issues compared to earlier negotiating sessions. The SBSTA 46 negotiations resulted in the adoption of conclusions, with the main elements consisting of another call for submissions by Parties (to be made by 2 October 2017), and the mandate to the secretariat to organize a new roundtable in conjunction with SBSTA 47. This is symmetric to the conclusions taken in Marrakech at COP 22. In addition, Parties this time also agreed to the development of a roundtable report. It is expected that Parties will refine their views on the elements of Article 6 when making the next submission based on the exchanges that have taken place. Overall, SBSTA 46 resulted in meaningful conclusions and some progress towards the operationalization of Article 6.

Nevertheless, the completion of the task by the deadline remains a major challenge. During SBSTA 46 Parties affirmed the timeline to adopt the Paris "rulebook" in 2018, at the third part of the first session of the CMA (CMA1-3). In order to achieve this timeline, Parties are working on the basis of the following roadmap for Article 6:

- at SBSTA 46, identify priority areas and agree on work or a path for SBSTA 47;
- at SBSTA 47, frame the draft text, which is then to be produced between SBSTA 47 and 48; and
- at SBSTA 49 (COP24), recommend guidance for Art. 6.2, as well as modalities and procedures for Art. 6.4.

³¹ Available at http://unfccc.int/meetings/bonn_may_2017/in-session/items/10276.php as agenda item 10(a), 10(b) and 10(c)

Considering the back-calculated timeline, Parties have failed to deliver on the SBSTA 46 milestone. They have not been able to agree on the priority area (or elements) of Article 6. The three informal information notes carry numerous disclaimers, clarifying that they represent views expressed by Parties but not an agreed list of elements. Neither should they be considered as the basis for further work. It has to be seen whether Parties will succeed in the task of formally agreeing on a "skeleton" for the Art. 6.2 guidance and the Art. 6.4 rules, modalities and procedures (as well as the Art. 6.8 work programme) at the next session, or whether the divergences prove overwhelming. Many Parties also expressed disappointment at not yet being able to commission technical work to the secretariat, e.g. on the options for accounting. An issue that has consumed much of the negotiation time and exacerbated tensions between Parties is whether to allow UNFCCC accredited observers to participate in the negotiations or the roundtable as well as whether to allow submissions from observers. While not being related to the features of the mechanisms, the treatment of observers in the Article 6 negotiations almost led to a collapse of the negotiations during the final hours of SBSTA 46 when countries raised concern about the lack of evaluation of the participation of non-state actors and the lack of transparency as to their role and source of funds, and potential conflicts of interests in the process. This issue can be expected to come up again during the next sessions. In sum, it is not clear whether Parties will manage to deliver on the 2018 timeline for concluding the work on the Article 6 agenda items.

4. Scenario Analysis

This chapter considers four plausible scenarios for the continuation of Ci-Dev activities post-2020 and makes an assessment of the associated risks and benefits. The scenarios are to be understood as alternative courses of action that Ci-Dev can choose to take. They are not scenarios in the sense of assumptions on external developments. Considering the regime change from the Kyoto Protocol to the Paris Agreement, Ci-Dev has to make a choice whether to continue disbursing funds to its investment portfolio based on the CDM or whether to switch to an alternative mechanism. Four relevant choices have been identified by Ci-Dev:

- 1. Continuation of Ci-Dev portfolio under the CDM;
- 2. Transition of Ci-Dev portfolio to the Article 6.4 mechanism;
- 3. Transition of Ci-Dev portfolio under Article 6.2 cooperative approaches; and
- 4. Continuation of Ci-Dev as RBCF outside any (UNFCCC) market mechanism.

This chapter seeks to inform the choice by evaluating key risks and opportunities associated with each scenario or course of action, taking into consideration the likely development of the CDM and the PA mechanisms discussed in previous chapters.

4.1. ASSESSMENT FRAMEWORK

4.1.1. Focus on post-2020 emission reductions

The analysis in this chapter focuses on emission reductions that are generated after the second commitment of the Kyoto Protocol comes to an end on 31 December 2020. This is because emission reductions occurring within CP2 do not face a significant risk that the CDM infrastructure will become unavailable. Hence there is no reason for Ci-Dev to change its current strategy.

The delivery risk for pre-2020 CERs can generally be deemed low. As long as issuance is requested during the true-up period, which is likely to be the case for CP2 credits, the CDM operational infrastructure will still be in place to facilitate issuance, forwarding and transfer. After the CP2 true-up period, however, Ci-Dev delivery risks associated with pre-2020 CERs would increase. While issuance and forwarding of CP2 CERs may still be possible after June 2023, transfers of CP2 CERs between Annex-I registries are likely to be restricted. It is also safe to assume that CP2 CERs will not be available for compliance use after the CP2 true-up period³². In addition, the CDM Executive Board may eventually set a deadline for issuance of CP2 CERs once the CP2 true-up period lapses or seize to operate altogether. CER delivery risks can be deemed medium for those emission reductions generated pre-2020, but issued or transferred after June 2023 – this is a risk that will increase over time.

Emission reductions generated after CP2, by contrast, face a systematic risk that the CDM issuance process will be discontinued. The CDM is not recognized under the Paris Agreement and a third commitment period under Kyoto is not a realistic option. There is no legal mandate for the continued operation of the CDM and this will dampen new activities and issuances of CERs for post 2020 emission reductions. Although Parties have not made a clear decision on this issue, the continued operation can in any case not be taken for granted. For the post 2020 context it would be a useful risk mitigation approach to ensure the recognition of the Ci-Dev activities under one of the Paris mechanisms.

A complication lies in the fact that CP2 and the start of the Paris Agreement contributions overlap by one year. Emissions occurring in the year 2020 are covered by both the Kyoto Protocol and the Paris Agreement. This means that the determination of baselines is already complicated by the prevalence of NDCs in the year 2020 itself where it could delay or even endanger issuance. However, as a result of CP2, the CDM Executive Board still has a legal mandate to issue CERs.

4.1.2. Categories of risk

In order to inform Ci-Dev's choice among the four identified scenarios, an evaluation has been made that considers delivery risks, opportunities and transaction costs. It also takes into account Ci-Dev objectives (notably to promote energy access in low-income countries) and the implication for Article 6 UNFCCC negotiations. To enable a systematic comparison of the scenarios, these criteria are translated into categories of risk. Where an evaluation criteria is positive, such as contribution to Ci-Dev's objectives, the risk is expressed as the inverse thereof, i.e. loss of a contribution.

For the purpose of the analysis four relevant risk categories are distinguished:

- 1. **Uncertainty of mechanism development** referring to the risk that the features of a mechanism are not fully known as negotiations under the UNFCCC are ongoing or uncertainty prevails with regard to the availability of the mechanism over time.
- 2. **Transaction costs** describing the costs that the use of a mechanism could entail, including additional costs for switching from the status quo use of CDM procedures but also potential savings, if an alternative mechanism allows for the use of less expensive procedures. The category comprises both the costs to Ci-Dev as well as to program developers whom Ci-Dev seeks to support. Cost factors include, for example, the redetermination of baselines along with the preparation of additional project documentation, and engagement with host country authorities on the transfer of emission reductions in the context of the Paris Agreement.

³² As with the case today of CP1 CERs, which can still be issued and forwarded, but no longer traded, carried-forward, or retired.10(c)

- 3. **Loss of impact on mechanism development** considering Ci-Dev's objectives to inform the Article 6 market negotiations and to improve the workings of the CDM, this risk category covers the potential loss of this ability.
- 4. **Delivery risk of UNFCCC compliance credits post 2020** describing the risk that a scenario will not result in the issuance of UNFCCC vetted credits, which can be used for voluntary cancellation and possibly also towards NDC compliance.

Before going through the scenario assessment in detail, the graph below provides a high-level view on how the scenarios compare to each other based on these categories. It shows that the strategy to continue with the CDM is relatively in the middle and scores neither high nor low on any of the risk categories. The scenarios in which Ci-Dev transitions its portfolio to one of the Article 6 mechanisms scores better in terms of impact on mechanism development and reduces delivery risks of UNFCCC compliance credits. However these scenarios require a larger amount of resources and face greater uncertainty regarding how to implement the mechanisms in practice. Conversely, the scenario in which Ci-Dev pursues a RBCF approach has lower transaction costs and faces less uncertainty but foregoes the delivery of UNFCCC compliance credits which would compromise Ci-Dev's ability to shape the emerging new Paris mechanisms. The graphic is meant to illustrate these principle considerations but without seeking to indicate a quantitative relationship between risks.

Figure 3: Scenario assessment



4.2. CONTINUATION OF CI-DEV PORTFOLIO UNDER THE CDM

4.2.1. Scenario description

In this scenario Ci-Dev continues to use the CDM for the disbursement of funding. Ci-Dev and program developers would not undertake any transition efforts to recognize programs under the Paris Agreement. As such, Scenario 1 represents a continuation of the business-as-usual approach and Ci-Dev could simply continue its current engagement with program developers without any substantial modifications related to standards applied, monitoring and verification procedures, and host country government related approvals.

4.2.2. Evaluation

Overall, the CDM scenario scores neither high nor low on any of the risk categories but occupies a middle ground.

Uncertainty of mechanism development: CDM modalities and procedures are well-known and tested so that this scenario holds little uncertainty with regard to its practical implementation. It faces a significant risk, however, related to mechanism availability post 2020. Currently it is not clear whether the CDM Executive Board will continue issuing credits post 2020. The main risk consists of the CMP not providing guidance regarding how to reconcile post-2020 emission reductions with host-country NDC pledges and that the issue will be left unresolved. This could lead to host countries withdrawing their support of a CDM activity by withdrawing the Letter of Approval or to the CDM Executive Board delaying issuance of CERs. If three members of the Board request a clarification on the grounds of CERs for emission reductions post 2020 is not backed by a legal mandate to do so.

Transaction costs: as continuation under the CDM represents the business-as-usual case no additional costs would accrue in this scenario. On the flipside, no cost savings would be possible either. The CDM imposes strict requirements on carbon certification, which are considered costly. The scenario holds opportunity costs for program developers by not preparing them for market transactions under the Paris Agreement. The scenario does not help program developers to monetize emission reductions generated in access to their ERPA with Ci-Dev as it does not facilitate the switch to the Paris mechanisms.

Loss of impact on mechanism development: in this scenario Ci-Dev could continue to shape the development of the CDM, making inputs to the CDM Executive Board and the CMP negotiations based on experiences with its portfolio operations. However, it would have a limited role in providing inputs to the development of market mechanisms under Article 6. Experience would be limited to CDM procedures and would not test procedures, methodology and operational aspects of the new Article 6 mechanisms.

Delivery risk of UNFCCC compliance credits post 2020: As already noted above, there is a risk that CERs may not be issued for emission reductions post 2020 due to double counting issues with the NDCs. In addition, even if CERs are issued, their use could be limited. It is likely that CERs can still be voluntarily cancelled in the CDM registry, at least until the end of the true-up period. It is unlikely however that CERs could be used for NDC compliance by an acquiring Party, since this would only be possible if the CERs also comply with Article 6 rules. As discussed in scenarios 2 and 3 below, it will likely require additional effort on the part of the program developer and the host country to secure the transition of activities to the Article 6.4 mechanism or ensure the conversion of CERs into ITMOs under 6.2.

4.3. TRANSITION OF CI-DEV PORTFOLIO TO THE ARTICLE 6.4 MECHANISM

4.3.1. Scenario description

This scenario considers the transition of the Ci-Dev portfolio into the Article 6.4 mechanism under the Paris Agreement (Scenario 2). It assumes that Ci-Dev activities would be eligible for transitioning into Article 6.4, either automatically or through an application process, and that both Ci-Dev and relevant program developers would agree to actively pursue this mode of transition. The moment in which transition would take place is unclear. Options include before 2020 through special ruling or once the Article 6.4 mechanism becomes operational. Under Scenario 2, program developers would have to either follow (possibly fast-track) transition steps or apply anew for registration under Article 6.4. While one cannot rule out the possibility of automatic grandfathering of certain CDM activities into the Article 6.4 mechanism, it is more likely that program developers would either have to demonstrate consistency or make adjustments to become consistent with Article 6.4 modalities. The exact adjustments would be subject to CMA modalities and procedures. Considering the already certain features of Article 6.4, i.e. the need to clarify the relationship with host-country NDC pledges, avoidance of double counting and delivery of an overall mitigation in global emissions, adjusting to Article 6.4 could entail:

- reviewing the program baseline to account for the unconditional NDC pledge³³;
- revisiting additionality to ensure that Ci-Dev programs go beyond existing and planned policies in the NDC;
- taking additional measures to ensure overall mitigation, such as further tightening of crediting baselines, discounting and cancelling units, and/or shortening crediting periods; and
- seeking national authorization for activities under Article 6.4.
- seeking approval of the methodology for calculating emission reductions from the Article 6.4 supervisory board
- potentially undertaking further efforts to demonstrate the program's contribution to sustainable development

It is furthermore possible that the host country will be required to make a "corresponding adjustment" for any emission reductions certified under Article 6.4 that are transferred outside the country. While negotiations are still ongoing and divergences exist on this point, some Parties argue that any emission reductions transferred should be treated as ITMOs and fall under the guidance of 6.2, which means that the host country would have to add a corresponding amount to its emission balance in order to avoid double counting of emission reductions between countries.

4.3.2 Evaluation

This scenario can be described as a high-cost / high reward scenario. Transaction costs are highest whereas the chances for ensuring post 2020 CER delivery are significantly increased compared to scenario 1 and the chance for impacting mechanism development is highest among all scenarios.

³³ Unconditional pledges refers to those contributions that a country pledges to achieve on its own, without additional support. Note that the term is not used in the Paris Agreement and lacks a formal definition.

Uncertainty of mechanism development: this risk is particularly high as it is not clear if and by when the mechanism will be operationalized and how its features will look. While Ci-Dev can take reasonable measures to meet anticipated requirements, there is no perfect foresight. In order for Article 6.4 to be fully operational, the CMA must not only agree on the modalities and procedures of the mechanism but its supervisory body also has to be constituted and agree on detailed methodological and operational processes, either by developing guidance top-down or approving methodologies developed by program developers. Compared to all other scenarios this scenario will take the most time to provide Ci-Dev and program developers certainty on rules and procedures. As long as the modalities and procedures and further guidance by the supervisory board have not been developed there is a risk that Ci-Dev's portfolio will not be able to qualify under the Article 6.4 mechanism.

Transaction costs: Given the expected adjustments to activities and program documents as well as the re-engagement with the UNFCCC process to recognize Ci-Dev programs, Scenario 2 clearly carries higher costs than Scenario 1. Technical work to review program baseline and additionality and re-submit relevant documentation could be around USD 100,000 per Ci-Dev program.³⁴ Ci-Dev would also incur in-kind costs associated with engaging with program developers and with host countries, possibly requiring a new national approval process. Ci-Dev would have to engage with both the UNFCCC and the host country government to ensure transition of its portfolio to Article 6.4. As the approval of methodological choices and project cycle procedures remains under the auspices of the Article 6.4 supervisory board, the effort of engaging with the host country government can however be deemed lower than under Scenario 3.

Loss of impact on mechanism development: this scenario offers substantial learning opportunities relevant for the operationalization of Article 6 mechanisms, particularly Article 6.4. The potential impact and relevance to the UNFCCC negotiations is high and conversely the risk of a loss of impact is low. Compared to all other scenarios, this scenario scores highest in potential impact because any impacts on the features of Article 6.4 achieved would apply globally.

Delivery risk of UNFCCC compliance credits post 2020: Scenario 2 increases the likelihood of recognition of post-2020 emission reductions compared to Scenario 1, where unaltered CDM procedures and methodologies are used. This is because Ci-Dev programs would likely need to ensure consistency with the host-country NDC pledges and planned policies in order to reduce the risk of inflated crediting baselines or crediting of emission reductions which are no longer additional after 2020. Without those changes, there would be a risk of undermining the stringency of NDC pledges and diluting collective mitigation ambition. It could also lead to reputational damages for Ci-Dev and possibly affect the credibility of the market in general.

From an operational and infrastructure perspective, delivery risks could be deemed low. Those Ci-Dev activities that meet the criteria established for the new Article 6.4 mechanism either under a transitional arrangement or through a new registration process would carry lower delivery risks. These Ci-Dev programs would be officially recognized under the Article 6.4 mechanism and, as a result, the respective post-2020 emission reductions would achieve issuance and follow registry operations as determined by the new Article 6.4 supervisory board.

It is important, however, that Ci-Dev program developers have the proper (contractual and financial) incentives to timely pursue the transition under Art. 6.4 during the window in which application is opened. This could take place before or after 2020.

³⁴ Based on standard industry fees for developing PDDs and new methodologies. Potentially also the costs for re-validation have to be added, depending on which requirements will be placed on CDM projects that migrate to Article 6.4.

From a technical and a project standpoint, however, risks could increase. For instance, the volume of post-2020 emissions reductions expected under the Ci-Dev may be reduced as a result of baseline review procedures in light of the unconditional NDC pledge. Additionality will have to be re-assessed to consider NDC existing and planned policies and measures which carries the risk of programs not qualifying under the mechanism. Finally, Ci-Dev programs may need to apply the overall mitigation concept which could result in another haircut of credits.

On the other hand, Scenario 2 would mitigate certain host-country risks described for post-2020 CERs in Scenario 1. Host countries would be less likely to block the continuation of CDM activities which are duly aligned with NDCs and transitioned into the Article 6.4 mechanism, although some host countries may still perceive these post-2020 emission reductions as lowhanging fruit which should be entirely used to achieve their own NDC pledges. In that sense, risks could be somewhat reduced if Ci-Dev would agree to the voluntary cancellation of post-2020 units recognized under the Article 6.4 mechanism.

4.4. TRANSITION OF CI-DEV PORTFOLIO UNDER ART. 6.2 COOPERATIVE APPROACHES

4.4.1. Scenario description

This scenario considers the transition of the Ci-Dev portfolio into cooperative approaches aligned with Article 6.2 of the Paris Agreement (Scenario 3). Post-2020 CERs would be converted into (or re-labelled as) ITMOs. It assumes that Ci-Dev activities would be adjusted to become consistent with relevant CMA guidance and that both Ci-Dev program developers and host-countries would be willing to participate in a cooperative arrangement.

Operational changes required under Scenario 3 are likely to be similar or greater than those described under Scenario 2 above. With time, however, a more lenient and pragmatic approach facilitated by Article 6.2 guidance is likely to reduce costs of future mitigation activities.

More flexibility can currently be expected in designing arrangements for cooperative approaches under Article 6.2. Existing methodologies can be freely adapted in agreement with host country partners and program developers. There will likely be greater leeway to design and test standardized as well as sectoral crediting mechanisms. In addition, project cycle and additionality considerations could be revisited to become more streamlined and less-cumbersome.

On the other hand, activities being governed by bilateral or plurilateral cooperative arrangements under Article 6.2 would still need to have in place, at domestic or cooperative level, all proper checks and balances to secure environmental integrity, sustainable development and avoidance of double counting. Therefore, despite the extra-room allowed for designing and adapting methodologies and the project cycle, Ci-Dev programs underlying the generation of ITMOs would still have to ensure the necessary adjustments to capture host country NDC unconditional pledges and plans, as well as relevant CMA guidance.

In this respect, distilling NDCs into metrics that can be applied to adjust baselines of Ci-Dev activities can become quite complex, in particular in the absence of detailed international modalities and procedures³⁵. This might imply that additional work may first be required to further articulate and clarify methodological premises used for NDC BAU scenarios and pledges, the sectoral scopes of measures, and the use of markets by the host-country vis-àvis conditional and unconditional pledges. Furthermore, depending on available GHG-related

³⁵ See Carbon Limits AS, Stockholm Environment Institute-US Center and INRAS, "Environmental integrity and additionality in the new context of the Paris Agreement crediting mechanisms", Final Report, 2017

governance infrastructure, Scenario 3 may also require additional technical and financial capacity for developing appropriate institutional, legal and procedural MRV frameworks at the national or, at least, at sectoral level.

In addition, under Scenario 3, a broader (umbrella) cooperative agreement may be needed between the relevant countries to regulate issues such as domestic approval process, general criteria for baseline setting and MRV requirements, corresponding adjustments, governance set-up and transparency considerations, as well as the transfer, tracking and specification of the intended use of ITMOs. It may also require that the host country is able to clarify how it intends to apportion its emissions and emission reductions to the relevant sector.

When there is no intention to use ITMOs as tradable units in the secondary market, issuance could potentially be waived, further reducing costs to cooperative participants. Provided CMA guidance is followed, Ci-Dev, host-country and program developers may agree to different forms of keeping track of ITMOs.

4.4.2. Evaluation

Scenario 3 scores similar to Scenario 2 but may incur greater costs to Ci-Dev and the host country government while saving costs for program developers.

Uncertainty of mechanism development: as Parties seek to operationalize all sub-approaches of Article 6 in a balanced manner, Article 6.2 and Article 6.4 are in principle on a similar timeline. This means that uncertainty of mechanism development would in principal be similar for Scenarios 2 and 3. However, uncertainty of Scenario 3, transition via Article 6.2, is judged slightly lower compared to Scenario 2 because it requires less detailed guidance from Parties. Specifically Article 6.2 does not rely on the operationalization of a Supervisory Board and its methodological guidance as the Article 6.4 mechanism.

Transaction costs: Overall, establishing a pilot cooperative arrangement is likely to lead to higher initial transaction costs given the additional negotiations required with the host-country government and program developers, the development of standardized or sectoral crediting mechanisms (if applicable), and possibly the need to invest in a more sophisticated (sectoral) accounting and MRV framework.

Hence, Scenario 3 would probably result in similar to greater upfront costs for Ci-Dev when compared with Scenario 2, where the more traditional CDM PoA cycle would likely prevail for existing Ci-Dev activities. With time, however, costs per activity under a particular umbrella cooperative agreement would tend to decrease as a result of a more lenient and pragmatic approach. Due to the long-term cost saving potential lower costs are mapped in figure 3.

Loss of impact on mechanism development: by pioneering the workings of Article 6.2 related to, inter alia, host country approval structures, methodology modifications, sectoral monitoring approaches, tracking and reporting systems and accounting towards the NDCs, the impact of this scenario on mechanism development is high.

Delivery risk of UNFCCC compliance credits post 2020: The design flexibility embedded in Article 6.2 is likely to be countered with greater reporting scrutiny at international level. Although it is unlikely that an international body will have a role in sanctioning the use and transfer of ITMOs, there is a greater risk of a reputational backlash in the event environmental integrity and transparency at cooperative level is deemed weak or too lax by the international community.

In terms of operational and infrastructure needs, delivery risks can be deemed lower. ITMOs could either be delivered through the CDM registry (if Parties agree to make use of the CDM registry also for the purposes of transferring ITMOs) or new delivery steps and procedures could be agreed with Ci-Dev program developers and host-countries.

From a technical perspective, however, risks may increase. Quantifying NDC pledges by delineating a clear emissions trajectory and apportioning those emissions to different sectors and sources may become necessary in order to (re-)define sectoral or activity baselines. This may have to be achieved without detailed guidance from the CMA, generating further uncertainties. Furthermore, it would likely require the provision of additional capacity building to strengthen national or sectoral systems for accounting and reporting of GHG emissions. Arguably, this will be more difficult to achieve where local governance is weak and highly susceptible to political interference.

Another issue is the risk that the NDC is not achieved by the host country. Whilst the Paris Agreement does not set an obligation of result in this respect, the risk remains that ITMOs transferred may lose market or 'compliance' value if eventually the NDC is not achieved. In the worst-case scenario, ITMOs could be retracted (by mutual agreement or via host-country unilateral act) and the cooperative arrangement shifted, wholly or in part, into a results-based finance system. The cooperative agreement to be established between the relevant participants may however attempt to address this risk upfront.

For Ci-Dev programs operating **outside the host-country NDC scope**, a first uncertainty lies on whether these will actually be acknowledged as ITMO-generating activities. ITMOs from outside the NDC scope could be deemed too vulnerable to perverse incentives as host-countries would have little interest in ensuring ITMOs are underpinned by actual emission reductions. They could also create an incentive to postpone the inclusion of certain sectors in future in NDCs, thus delaying progression towards an economy-wide NDC coverage. The lack of centralized international modalities and procedures under Article 6.2 are likely to reinforce those fears. There remains a regulatory risk that these types of ITMOs may be required to either undergo the approval process made available under Article. 6.4, or, alternatively, ensure (demonstrate) that similar checks and level of scrutiny are implemented at cooperative level.

4.5. CONTINUATION OF CI-DEV AS RBCF OUTSIDE ANY (UNFCCC) MARKET MECHANISM

4.5.1. Scenario description

This fourth scenario foresees the continuation of Ci-Dev as a RBCF outside any UNFCCC market mechanism (Scenario 4). Ci-Dev would shift from CDM verification and issuance process to an RBCF based on Ci-Dev's own quality standards. This would mean that monitoring protocols could either remain the same or be somewhat relaxed, with the frequency of verifications reduced or verification tasks being placed in the hands of local experts as opposed to costly international accredited entities.

Ci-Dev would no longer seek issuance of units in respect of post-2020 emission reductions. It would suffice to Ci-Dev and program developers to come to an agreement on an alternative and simpler system to track reductions generated and verified. There would be no need to adjust program baselines to reflect the unconditional component of the host-country NDC pledge.

4.5.2. Evaluation

In contrast to Scenarios 2 and 3 this fourth scenario would likely increase certainty and lower transaction costs vis-à-vis the status quo but puts at risk Ci-Dev's objectives to contribute to the UNFCCC negotiations and shape of the Article 6 market mechanisms.

Uncertainty of mechanism development: As Scenario 4 does not foresee the use of the CDM or Paris Agreement mechanisms, the risks related to their development under the UNFCCC are not relevant. From a technical point of view, however, a shift to RBCF with a simpler tracking system could result in the overlap of market mechanism unit accounting and climate finance reporting. This could result from an overlap in coverage between Ci-Dev programs and:

- activities developed under Article. 6.4; or
- other crediting or RBCF approaches developed at bilateral level which may fall under Article 6.2, such as Nationally Appropriate Mitigation Actions (NAMAs) and the Joint Crediting Mechanism (JCM).

Transaction costs: Scenario 4 is likely to incur the lowest transaction costs among all four scenarios considering that Ci-Dev can employ whichever MRV standards it deems appropriate. Without a transfer of compliance grade emission reductions involved, there will be no need host country authorization of the transfer. For program developers the disengagement could result in opportunity costs as they would 'lose touch' with relevant international program cycle requirements making it more difficult for them to return to the carbon market later on.

Loss of impact on mechanism development: The scenario in which Ci-Dev disengages from using UNFCCC market mechanisms would go hand-in-hand with a loss of impact on mechanism development. Ci-Dev could still feed program lessons learned into the negotiations but these would likely be less relevant for issues under consideration by Parties. As a long term champion for the CDM, Ci-Dev's withdrawal from market mechanisms would also send a negative signal to carbon market stakeholders. Ci-Dev could of course continue to positively impact the energy access agenda and test new approaches for the disbursement of climate finance.

Delivery risk of UNFCCC compliance credits post 2020. Under this scenario Ci-Dev would not seek delivery of CERs post 2020 so that this risk is maximum under Scenario 4. There is on the other hand no risk that emission reductions achieved by the programs would have to be adjusted downward to reflect host country contributions under the NDCs, unless Ci-Dev wishes to do so for internal credibility standards.

5. Strategic Recommendations

First of all it can be noted that none of the four scenarios is clearly dominated or dominant over any of the other scenarios. Hence the right choice for Ci-Dev ultimately comes down to priorities and depends on Ci-Dev's weighing of the four risk categories assessed above and possibly other considerations.

Another observation is that the same type of complexity arises in all scenarios even though consequences appear different. The question how to reconcile NDC pledges with the generation of emission reductions by Ci-Dev programs has a significant impact on all four scenarios.

Whether this is by reducing the likelihood of the CDM continuing issuance post 2020 (Scenario 1), uncertainty regarding rule development by the UNFCCC for the Article 6.4 mechanisms (Scenario 2) or high transaction costs and uncertainty in converting a program's emission reductions into ITMOs (Scenario 3). The underlying cause of the risk always is the need to avoid double counting of emission reductions with host country contributions. Even when continuing to operate outside the UNFCCC mechanisms as a purely RBCF mechanism (Scenario 4), Ci-Dev will need to ensure that any climate finance disbursed will trigger additional emission reductions, avoid windfall profits to program developers and enhance host country ambition rather than reducing a country's own efforts. Ci-Dev is therefore well advised to engage in additional technical work to clearly understand the relationship between programs in its portfolio with the respective host country NDC. While eventually this work should be performed for all programs with which Ci-Dev has an ERPA it can be staged so that lessons learned from engaging with one program and host country can inform the engagement with others.

Given the connectedness of scenarios and the fact that challenges are similar, the choice for Ci-Dev may not be an either or choice but different scenarios could be pursued at different stages or even in parallel. This way some options could serve as fall back options in case others prove unattainable. Specifically, the RBCF option could be a fall back option in case transition through Articles 6.4 or 6.2 is not feasible or mechanism development does not proceed in a timely manner. What is more, Ci-Dev has an opportunity to initiate the transitioning process under Article 6.2 already now in consultations with program developers and host countries while the same cannot be said for Article 6.4. So an option could be to initiate the portfolio transition via Article 6.2 and later submit the methodologies and approaches developed to the Article 6.4 supervisory board for vetting. Ci-Dev has already started this process by piloting the "Standardized Crediting Framework" (SCF) in Senegal. The SCF has been conceptually elaborated in a Ci-Dev report and builds on several elements of standardization and simplification (standardized baselines, additionality determination at the sectoral level, simplified MRV processes, and a reformed project cycle). Following the above reasoning, the SCF pilot could be developed as an Article 6.2 pilot transaction and as the process allows, methodological elements could be fed into the technical guidance for Article 6.4.

There are two ways in which Ci-Dev can manage its portfolio risks. First, a reactive strategy in which Ci-Dev closely observes the developments in the negotiations, continues to gauge the likely outcome and reorganizes its portfolio in anticipation of the likely features of the Article 6 mechanisms or alternatively give up on UN certification entirely. Ci-Dev could settle for one of the scenarios or apply different scenarios to different programs in the pipeline. If differentiations are to be made across the portfolio the choice of scenario for individual programs could depend on the duration and delivery schedule of the ERPA, as well as the sophistication and willingness to experiment of the host country government and program developer, among others.

The second way in which Ci-Dev can manage its portfolio risk is through actively and strategically influencing the course of the negotiations. This would not be a stand-alone strategy but could complement the portfolio hedging efforts. It could consist of showcasing the operational design and cost savings potential of the SCF in pilot transactions, informing UNFCCC negotiations through host country engagement and disseminating the experience in order to ensure that stakeholders are well-informed of options.

Annex

The tables below map key issues of the Art. 6 negotiations and country positions.³⁶

Country negotiating positions pertaining to Article 6.1

Issue	Position / Option				
	Avoidance of perverse incentives	Related to overall mitigation of global emissions (Art. 6.4)	Art. 6 can be used to meet NDC or raise ambition beyond target	Use of int. cooperation must go beyond NDC targets/scope	Art. 6 must give incentive for adopting economy wide absolute targets
Ambition Understanding of ambition as laid out in Article 6.1	EIG ³⁷ EU ³⁸ CARICOM ³⁹ LMDC	AGN ⁴⁰ CARICOM	LMDC ⁴¹ Indonesia AILAC ⁴² New Zealand EU CARICOM Venezuela AGN LDC	Brazil (for 6.2 only) CARICOM	CARICOM Ethiopia

Country negotiating positions pertaining to Article 6.2

Issue	Position / Option			
Second of	Restricted to defining rules of double counting	Covering environmental integrity and transparency	Broad guidance	Include Limitations
guidance	Japan	New Zealand	AOSIS ⁴³ /CARICOM AGN EIG South Africa	Arab Group (limitations on acquisitions)

Issue	Position / Option		
	National consistent with UN guidance	More centralized oversight	Centralized with dedicated supervisory board/institutional arrangements
Governance Construction of governance/ oversight for eligible approaches	Australia Canada Japan Norway New Zealand Tunisia COMIFAC EU	AOSIS EIG CARICOM Singapore	AGN LDC South Africa

³⁶ The positions displayed in the Annex draw on countries' submissions to the UNFCCC, complemented by statements made during COP22 in Marrakech and SBSTA 46 in Bonn, http://www4.unfccc.int/submissions/SitePages/sessions.aspx

³⁷Environmental Integrity Group (EIG), comprised of Liechtenstein, Mexico, Monaco, the Republic of Korea and Switzerland.

³⁸European Union (EU), comprised of the 28 members of the European Union that agree on common negotiating positions.
³⁹Caribbean Community (CARICOM), comprised of Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada,

- Guyana, Haiti, Jamaica, St Kitts and Nevis, Saint Lucia, St Vincent and Grenadines, Suriname, and Trinidad and Tobago.
- ⁴⁰ African Group of Negotiators includes all African Member States' senior officials, experts and negotiators in the UNFCCC negotiations.

⁴¹ Likeminded Developing Countries (LMDC)

⁴²Independent Alliance of Latin America and the Caribbean (AILAC), comprised of Chile Colombia, Costa Rica, Guatemala, Honduras, Panama, Paraguay, Peru.

⁴³ Alliance of Small Island States, consisting of 39 small island and low-lying coastal countries. Note that both CARICOM and AOSIS are represented by St. Lucia in the negotiations so that their positions are in most instances aligned.

Issue	Position / Option	
Scope of cooperative	Broad scope of approaches	Government-to-government only
approaches Which approaches are eligible under cooperative approaches?	AILAC AGN Canada Japan (party-driven crediting mechanisms) Norway (including REDD+)	Brazil

Issue	Position / Option		
	GHG or non-GHG	GHG-based only (tCO2e) or corresponding electronic units	Not fungible and tradable units
Nature of ITMOs	AGN Korea	AILAC AOSIS Brazil EIG EU Japan LDC New Zealand	AGN Indonesia

Issue	Position / Option	
	Emissions-level adjustments	Budget-based system
Corresponding adjustments	AOSIS EIG EU New Zealand AILAC	Brazil

Issue	Position / Option		
	Guidance should elaborate on treatment of sectors outside NDC scope	Only guidance on treatment sectors within NDC scope	No distinction between within and outside NDC scope
Within and outside NDC scope	AOSIS Canada EIG EU	LDC Japan Panama (outside NDC scope possible in future)	EIG

Issue Position / Option		
	Cooperative approaches must result in net emission reductions	No such requirement for 6.2
Overall mitigation for 6.2	AOSIS EIG Indonesia LDC Senegal	New Zealand US Australia Canada

Issue	Position / Option		
	Decided by Parties	Basic principles only	Common standards / more specific guidance
Environmental Integrity	Japan	New Zealand Norway	AOSIS/CARICOM AGN EIG (quality of units generated should be real, permanent, additional, verified) Tunisia

Issue	Position / Option	
Sustainable Development	Prerogative of host country	But also following minimum standards (SDGs/Human rights)
	Majority of countries	EIG Indonesia Korea

Issue	Position / Option		
	Registry system to report on ITMO use	Registry only for secondary transfers	Centralized tracking arrangements
Tracking arrangements	EU India Japan	EIG	AGN AOSIS/CARICOM Brazil (only if no national registry available) LDCs Singapore South Africa

Issue	Position / Option		
	No exclusions	Quantified NDCs only	Specific requirements to NDCs
Party eligibility	AGN Arab Group LMDC USA Singapore Tunisia	AOSIS EU LDC South Africa Japan	Brazil (only NDCs with emission budgets) Korea (national accrediting institutions) CARICOM (only economy-wide absolute targets)

Issue	Position / Option	
	Adaptation Share of Proceeds	No share of proceeds for 6.2
Share of proceeds	AGN Arab Group LMDC Argentina COMIFAC Kuwait LDC AOSIS	New Zealand US Japan Australia Canada

Country negotiating positions pertaining to Article 6.4

Issue	Position / Option		
	Implementation of activities to take place in developing countries	All countries can be host parties and buyers	
Eligibility of host Parties	AGN	Brazil US New Zealand EU	

Issue	Position / Option			
Eligibility and	Activity level	Broad range (Projects, PoAs, sectoral approaches)	Focus on sectoral approaches	Possibility to include REDD+
scope	Brazil (focus on private sector involvement)	AILAC AGN	EU Norway	Congo-basin countries Norway Panama

Issue	Position / Option		
	Supervisory board same as CDM EB	Different composition of the board	Expanded role of DNAs
Governance	Brazil	Most Parties (no longer Annex I/Non-Annex I division but equal representation of all UN regions) Japan (only users of 6.4 should pay for its infrastructure) Norway (technical expertise) LDCs (seat for LDCs)	AGN (link to NDCs) EU Kuwait

Issue	Position / Option		
	No corresponding adjustments under 6.4	Corresponding adjustments only for activities within scope	Corresponding adjustments for activities within and outside scope
country NDCs	Brazil	AGN LDC (Separate rules for activities inside/outside scope) EIG	AOSIS EU

Issue	Position / Option		
	Same as CDM	Reflect NDC in baseline	
Additionality and baseline	Brazil	AGN AILAC EU Panama	

Issue	Position / Option		
	National Prerogative	National prerogative including voluntary international guidance	Consistent with SDGs, introducing safeguards
Sustainable development	LMDC	AGN (sustainable development tool) Brazil South Africa	EIG EU (not infringing on human rights)

Issue	Position / Option			
Overall	Automatically assumed if mitigation outcome is verified	Ensured through conservative baselines	ER must go beyond NDC, link to ambition	Mandatory cancellation of units
mitigation	Arab Group	Japan	AGN	AOSIS/CARICOM

Issue	Position / Option		
	6.4 very similar to the CDM	CDM transitional arrangements to be considered	CDM transition only relevant once new mechanism has been defined
CDM Transition	Brazil Panama	AGN Australia Brazil Ethiopia Norway South Africa Tunisia	EU Korea





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