



C L I F F O R D
C H A N C E

SCALING THE GLOBAL CARBON MARKETS:
A WAY FORWARD FOR THE VCM AND PARIS MECHANISMS



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PREFACE

The global climate conference COP29 takes place in Baku, Azerbaijan on 11-22 November 2024. The 198 countries that have signed the UN Framework Convention on Climate Change are meeting once again in the hope of driving further progress on global climate commitments. The COP29 President-Designate, H.E. Mukhtar Babayev wrote to the Parties in July 2024 outlining a vision for COP29 based on two pillars: to enhance ambition and to enable action. The COP29 President-Designate describes each as:

- Enhancing ambition involves setting out clear plans to keep 1.5°C within reach, whilst leaving no one behind. Key to this will be the Parties signalling their own determination to act with ambitious, comprehensive and robust Nationally Determined Contributions, National Adaptation Plans and Biennial Transparency Reports, as well as their wider engagement in international cooperation.
- Enabling action involves putting in place the means of implementation and support – finance, technology and capacity building, and the wider enabling conditions at a national, regional and global level spanning all stakeholders. Within this, the COP29 President-Designate has expressed a commitment to finalise the operationalisation of Article 6 which he describes as “*a long overdue priority*”.

A question that many stakeholders continue to grapple with, particularly in light of the ongoing operationalisation of Article 6, is the role that the voluntary carbon market (“**VCM**”) can or should play in the global community seeking to achieve its climate commitments. We expect this will be front-of-mind for many heading to COP29. In this paper, we take a look at what has happened to the Paris mechanisms and the VCM in recent years and consider what needs doing if both the Paris mechanisms and the VCM are to reach their full capabilities and deliver the climate action so desperately needed.

EXECUTIVE SUMMARY

The need for urgent, effective climate action is more important now than ever before. The first-ever global stocktake of the Paris Agreement at COP28 in Dubai presented a stark warning of just how far the global community still has to go to meet the objectives of the 2015 Paris Agreement and the urgency in achieving these. Among other things, the global stocktake noted a huge implementation gap in meeting the Paris Agreement goal of limiting global warming to 1.5°C, whereby full implementation of all existing NDCs would result in only a 2 per cent. reduction in emissions by 2030 compared with the 2019 level. The global community must utilise all available tools to further climate action if the Paris objectives are to be achieved.

In this paper, we revisit the paper we published following COP27 in Sharm el-Sheikh in collaboration with the City of London and the UK Carbon Markets Forum titled “Enabling the voluntary carbon market in the context of the Paris Agreement” (the “**2022 paper**”). In our 2022 paper, we considered the then emerging market mechanisms under Article 6.2 and Article 6.4 the Paris Agreement, and the interaction between these mechanisms and the VCM, and the role the VCM could have in helping to deliver climate action. Notably, we recognised that the VCM presented an opportunity for immediate climate action while the Paris mechanisms were being operationalised. However, we also recognised that certain issues were at risk of preventing the VCM from realising its full capabilities including concerns about integrity, lack of transparency and certain legal uncertainties. We presented recommendations aimed at addressing these issues and unlocking the true potential of both the Paris mechanisms and the VCM.

We are now two years on, and a lot has happened. On the one hand, operationalisation of the Paris mechanisms has continued (albeit with varying degrees of success), whereas the VCM has suffered a difficult time; Chapter 2 provides a brief market update reflecting on these changes. The purpose of this report is to reflect on our 2022 recommendations in light of these market developments, considering what (if any) progress has been made against each of these, and to refresh our recommendations in light of current conditions.

Our refreshed recommendations

The following refreshed recommendations are aimed at market participants within both the Paris mechanisms and the VCM and identify actions that these key stakeholders can take to further these market mechanisms. The actions seek to address the prevailing issues currently hampering the Paris mechanisms and the VCM (many of which remain unchanged

since our 2022 paper unfortunately); concerns about carbon credit quality and integrity, a lack of transparency and harmonisation, and persisting legal uncertainties. If implemented, these recommended actions should help secure the future of the VCM, enabling it to continue to play a crucial role in mobilising critical climate finance, whilst also helping the ongoing, and hopefully near final, operationalisation of the Paris mechanisms. In the following table, the recommendations shaded darker green are those where we have seen limited progress, and where significant further work is needed. We expand on these recommendations in Chapter 3 of this paper.

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| For governing bodies to: | Develop a proactive communications strategy to highlight the integrity improvements in, and overall benefits of, the VCM to counter prevailing negative perceptions and promote its crucial role in global climate action. |
| | Issue clear, definitive guidance on corresponding adjustments and double claiming in the VCM to address ongoing uncertainties. |
| | Continue to develop knowledge-sharing initiatives and enhance capacity building within the VCM. This should include promoting greater collaboration amongst governing bodies, carbon standards and market participants. |
| For the COP to the UNFCCC to: | Finalise the operationalisation of the Paris mechanisms by resolving the key outstanding issues including the form of and guidelines for use authorisations, the role of emissions avoidance, applicable Article 6.4 methodologies, and ensuring the necessary infrastructure is in place and effective to support these Paris mechanisms. |
| | Clarify the role of sovereign credits from REDD+ under the Paris mechanisms. This requires clearly distinguishing the different types of “REDD+” and “emissions avoidance” and the COP should consider ways to align with the VCM on this. |
| For project proponents and buyers to: | Engage early with host governments to ensure project alignment with national climate goals and a shared understanding of expectations, procedures (including use authorisations and the availability of the different carbon trading market mechanisms) and requirements. Consider the role that business-to-government arrangements can play to secure such arrangements. |
| | Foster increased transparency and information sharing within the VCM to improve overall integrity and encourage greater due diligence on behalf of buyers. |
| | Engage in the VCM in an informed and discerning manner, for example, by using the emerging carbon credit labelling tools to seek out higher quality carbon credits whilst ensuring that carbon offsetting remains secondary to emission reduction. |
| For governments to: | Demonstrate clear support for VCM activities within their jurisdiction and consider opportunities to engage with the VCM in a strategic manner to help achieve their own national decarbonisation goals. This could include confirming the ability to trade internationally carbon credits generated in their country. |
| | Continue implementing the Paris mechanisms at a domestic level. For those Parties yet to do so, this may involve establishing a legal framework (or modifying existing legislative or regulatory frameworks) to provide for the Paris mechanisms in-country. For those Parties that already have implemented such legislative changes, they should continue to maintain, and look for opportunities to further develop, these legal frameworks as the Paris mechanisms are finalised. |
| | To the extent governments wish to secure benefit-sharing arrangements, they should do so by setting clear requirements and parameters for such arrangements in their national regulatory frameworks. Care must however be taken to ensure such arrangements are not overly restrictive or burdensome so to discourage investment. |

Deliver updated NDCs that are “ambitious, comprehensive and robust”. In particular, government should aim to identify sectoral targets and pathways, quantify investment needs, provide for whole of government engagement and achieve greater global harmonisation and consistency.

Consider government-to-government or business-to-government arrangements to formalise their position with respect to the Paris mechanisms and the VCM. Such arrangements can foster greater cooperation amongst Parties and key stakeholders, whilst delivering greater clarity and transparency. Governments should consider what learnings may be taken from such arrangements already in existence.

Monitor progress by the CMA regarding use authorisations under the Article 6 mechanisms and consider developing their own clear guidelines for the issuance, scope and rules surrounding use authorisations that align with any such decisions by the CMA.

Ensure access to the carbon registries needed to facilitate the Paris mechanisms and VCM activities in their country. This may involve developing their own national carbon registry or ensuring access to the UNFCCC international registry. Either way, such efforts should seek to achieve the interoperability of, and technological innovation within, such registries.

Formalise the legal nature and ownership rights of carbon credits to enhance market certainty and attract broader participation. Such certainty is important if a meaningful secondary market is to develop.

Consider the role that financial regulators and existing financial regulatory frameworks can have in supporting VCM activities. The market has demonstrated that a certain degree of financial regulatory oversight can help drive a meaningful secondary market, but care must be taken not to over-regulate carbon trading activities.

As with the recommendations in our 2022 paper, these recommendations are by no means a perfect, nor complete, solution. Rather, they seek to target the main, as yet unresolved, issues that are holding the Paris mechanisms and the VCM back; namely, lingering concerns about the quality and integrity of carbon credits, the lack of transparency, and persisting legal uncertainties. Our recommendations recognise that everyone has a role to play in helping to address these issues, from the Conference of the Parties serving as the meeting to the Paris Agreement (“CMA”) to VCM governing bodies, market participants (both sellers and buyers), and individual governments. If the global community is to achieve the Paris objectives, it is imperative that all stakeholders actively engage with and contribute to these efforts.

What we hope is that our recommendations provide thought leadership and help to drive continued progress in the right direction. Ultimately, the Paris mechanisms and the VCM are two market tools that are vital for directing finance to essential climate mitigation action and should continue to co-exist and develop in response to current challenges.



**CHAPTER ONE:
INTRODUCTION**

1. INTRODUCTION

In December 2022, following COP27 in Sharm el-Sheikh we, together with the City of London and UK Carbon Markets Forum, published a paper titled “Enabling the VCM in the context of the Paris Agreement”¹. The purpose of that paper was to consider the emerging mechanisms for trading carbon credits under Articles 6.2 and 6.4 of the 2015 Paris Agreement (“**Paris mechanisms**”), their likely interaction with the VCM, and the future role that the VCM could have in delivering climate action. In it, we recognised that the VCM presented an opportunity for immediate climate action while the Paris mechanisms were being operationalised. However, we also recognised that certain issues plagued the VCM which, without resolution, could prevent it realising its full capabilities. These issues were broadly summarised into three key themes:

- Areas of uncertainty preventing engagement in the Paris mechanisms and the VCM.
- Concerns regarding the integrity of carbon credits.
- Lack of government support in the VCM.

Given the need for urgent action from the international community to combat climate change, and the valuable role that the VCM could play in delivering such action, we presented recommendations aimed at unlocking the true potential of the VCM and the Paris mechanisms, asserting that the two could operate effectively and harmoniously alongside each other. Our recommendations were divided between key stakeholder groups. Namely, new governing bodies of the VCM; the Conference of the Parties to the

United Nations Framework Convention on Climate Change (“**COP**”), under which the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (“**CMA**”) and various subsidiary and supervisory bodies are also relevant; project proponents; buyers; and governments.

Much has happened in the two years since our paper was published. The Paris mechanisms of Articles 6.2 and 6.4 are close to being operationalised and agreements have already been struck and ITMO transactions have taken place under Article 6.2. The VCM has suffered a difficult time. Media reports of carbon projects allegedly inflating actual emissions and errors in methodologies have called into question the quality of carbon credits and integrity of the VCM². Strikingly, in the US in October 2024, the CFTC and DOJ announced

parallel actions against project developer C-Quest and its former senior executives for the fraudulent generation of 6 million voluntary carbon credits³. These high-profile issues and greenwashing accusations have driven many corporates from the market. In May 2024, Ecosystem Marketplace reported that the carbon market had shrunk by 61% between 2022 and 2023, falling from \$1.9bn in 2022 to \$723m in 2023 as a result of this negative press coverage and quality concerns⁴. At the same time, several prominent corporates have announced large-scale purchases of voluntary carbon credits, including Microsoft (which in May 2024 agreed to buy 3 million credits from re.green’s forest restoration carbon removal project in Brazil⁵, June 2024 reportedly agreed to buy 8 million credits from the forestry arm of Brazilian investment

¹ Clifford Chance, December 2022, Enabling the Voluntary Carbon Market in the Context of the Paris Agreement. Available at: <https://www.cliffordchance.com/expertise/services/esg/esg-insights/voluntary-carbon-market-decarbonisation.html>

² See, for example: the Guardian, 18 January 2023, Revealed: more than 90% of rainforest carbon offsets by biggest certifier are worthless, analysis shows (available at: <https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe>); Bloomberg UK, 24 March 2023, Faulty Credits Tarnish Billion-Dollar Carbon Offset Seller (available at: <https://www.bloomberg.com/news/features/2023-03-24/carbon-offset-seller-s-forest-protection-projects-questioned>); and the Guardian, 24 May 2023, ‘Worthless’: Chevron’s carbon offsets are mostly junk and some may harm, research says (available at: <https://www.theguardian.com/environment/2023/may/24/chevron-carbon-offset-climate-crisis>).

³ QCI, 10 October 2024. Available at: <https://www.qcintel.com/carbon/article/editorial-us-doj-criminal-charges-against-ken-newcombe-rock-an-already-rocky-vcm-30397.html>

⁴ Ecosystem Marketplace, 2024 State of the Voluntary Carbon Market (“SOVCM”). Available at: <https://www.ecosystemmarketplace.com/publications/2024-state-of-the-voluntary-carbon-markets-sovcm/>

⁵ ESG News, 10 May 2024, Microsoft Partners with re.green for Largest Carbon Removal Project Worth 3 Million Tons of Carbon Removal Credits. Available at: <https://esgnews.com/microsoft-partners-with-re-green-for-largest-carbon-removal-project-worth-3-million-tons-of-carbon-removal-credits/>

bank BTG Pactual⁶) and Total Energies (which in August 2024 agreed to invest \$100 million in US-based credit projects⁷).

However, such moves are only meaningful so long as a high degree of integrity in the credits purchased can be ensured. To the project developers and communities involved on the ground on the sell side of the market, integrity means that funds from credit sales reach the meaningful and effective climate mitigation and sustainable development projects that are a lifeline for the planet's future. To corporates, governments, and other entities on the buy side of the market, integrity is what enables them to make valid claims about offsetting the emissions they produce. Recently there have been promising signs of a revival in the VCM, with reports that retirements and issuances have risen year-on-year to October, by 36% and 50% respectively (and this doesn't include cancellations by C-Quest capital)⁸.

Notwithstanding these recent challenges, we consider the VCM still has an important role to play in the global community achieving its climate commitments. The many benefits of the VCM which we highlighted in our 2022 paper hold true. Not only does the VCM direct funding into projects with considerable climate and sustainable development benefits, but given the delays in operationalising the Paris mechanisms, many companies will also be looking to the VCM to ensure they meet their net zero targets.

Ultimately, the nascent Paris mechanisms and the VCM are both key market tools to direct finance to climate mitigation action, and they can and should co-exist in the carbon market ecosystem. This is particularly important because

whilst some projects will be ready to go through relatively quickly (i.e. projects transitioning from the Clean Development Mechanism established under the Kyoto Protocol ("**CDM**") it will take time to incorporate all types of projects and deliver credits to the market, even if an agreement is reached at this COP. A member of the Article 6.4 Supervisory Body ("**Supervisory Body**") has said that there will "definitely" be a role for the VCM post-operationalisation of the Paris mechanisms, describing the Paris mechanisms as introducing a measure of healthy competition⁹. COP29 is being referred to as the "Finance COP" because a primary focus of the conference is to establish a New Collective Quantified Goal concerning the sum of financial resources which will be dedicated to supporting climate action in developing countries. In this context, many stakeholders recognise the importance of carbon markets in helping unlock the trillions needed in private transition finance.

Carbon offsetting and carbon markets are a fundamental component of global (and national) emission reduction policies. They are an effective mechanism for climate change action and achieving carbon emission reductions and provide an important temporary solution for those hard-to-abate sectors where emission removals at source are not yet an option. The first-ever global stocktake of the Paris Agreement at COP28 (discussed further below), was a stark warning of just how far the global community still has to go to meet the Paris Agreement objectives and the urgency in achieving these. Among other things, the global stocktake¹⁰ noted a huge implementation gap in meeting the Paris Agreement goal of limiting global warming to 1.5°C, whereby full

implementation of all existing NDCs would result in only a 2 per cent. reduction in emissions by 2030 compared with the 2019 level. The stocktake also found that historical cumulative net carbon dioxide emissions already account for about four fifths of the total carbon budget for a 50 per cent. probability of limiting global warming to 1.5°C. Every available resource must be used if the global community is to achieve what it set out to, and this includes the VCM.

In this report we reflect on our 2022 recommendations and consider what (if any) progress has been made against each of these, and to refresh our recommendations in light of current conditions. Our aim is that these recommendations highlight the most pertinent issues concerning the Paris mechanisms and the VCM. We identify actions that key stakeholders can take to ensure that both the Paris mechanisms and the VCM fulfil their maximum climate mitigation and development potential as soon as possible. This requires:

- the Paris mechanisms to be fully operationalised;
- a VCM that is high integrity, and maintains a clearly defined role alongside the Paris mechanisms as they continue to be operationalised; and
- continual close collaboration between all stakeholders to build capacity, share knowledge and harmonise their efforts to achieve a clear, detailed and interoperable, international set of frameworks for carbon investment, trading and carbon claims.

6 Reuters, 18 June 2024, Microsoft to buy 8 million carbon credits from BTG Pactual in largest-ever sale. Available at: <https://www.reuters.com/sustainability/climate-energy/microsoft-buy-8-million-carbon-credits-btg-pactual-largest-ever-sale-2024-06-18/>

7 Reuters, 30 August 2024, TotalEnergies invests \$100 mln in the US to offset climate emissions. Available at: <https://www.reuters.com/sustainability/totalenergies-invests-100-mln-us-offset-climate-emissions-2024-08-30/>

8 QCI, 4 November 2024, Voluntary carbon credit issuances, retirements rise yoy in October. Available at: <https://www.qcintel.com/carbon/article/voluntary-carbon-credit-issuances-retirements-rise-yoy-in-october-31511.html>

9 QCI, 29 October 2024, A new UN carbon market 'wouldn't kill VCM standards'. Available at: <https://www.qcintel.com/carbon/article/a-new-un-carbon-market-wouldn-t-kill-vcm-standards-webinar-31275.html>

10 Available at: <https://unfccc.int/documents/637073>



**CHAPTER TWO:
A BRIEF MARKET UPDATE**

2. A BRIEF MARKET UPDATE

Before revisiting our 2022 recommendations, it is worth considering what the past two years have meant for the Paris mechanisms and the VCM.

2.1 The Paris mechanisms

Our 2022 paper was published shortly after COP27 in Sharm el-Sheikh. COP27 was expected to be the “implementation COP”. From an Article 6 perspective, COP26 delivered the rulebook such that COP27 was expected to deliver key decisions on definitions, procedures and machinery necessary to enable operationalisation of the Paris mechanisms.

To this end, a couple of decisions on Article 6.2 and Article 6.4 were published but they failed to tackle some of the biggest areas of contention holding the Paris mechanism back. For example, COP27 agreed on the reporting obligations on Parties when trading ITMOs, and whether reporting should be confidential (ultimately leaving this up to a country’s discretion). It was also decided to link the infrastructure needed to trade carbon credits via a “centralised accounting and reporting platform” (“**CARP**”). COP27 also introduced the “mitigation contribution” class of Article 6.4 credits, which are not authorised for NDC or their international use, and therefore do not demand corresponding adjustments. However, issues left unresolved included the role of emission avoidance, the issues surrounding double counting and double claiming, and the purposes for which Article 6.4 mitigation contribution credits

may be used, with COP27 failing to deliver clear decisions or guidance on any of these. Key aspects of the Article 6.4 mechanism, including authorisations and whether they can be revoked or modified, the definition of “removals”, and how legacy credits from the CDM could be transferred to the Article 6.4 mechanism, also remained unresolved.

Given the mixed results from COP27, many hoped COP28 would deliver the decisions needed to fix the Paris mechanisms and, importantly, finally bring into operation the Article 6.4 mechanism (now referred to as the Paris Agreement Crediting Mechanism (“**PACM**”). It was therefore greatly disappointing that consensus could not be reached yet again. Despite intense negotiations on Article 6, and several draft texts, the Parties were unable to agree on:

- the definition of an Article 6.2 cooperative approach;
 - certain aspects of ITMOs’ use authorisation;
 - the role of emissions avoidance (albeit progress has since been made at the 2024 Bonn Climate Change Conference (discussed further below)); or
 - whether secondary trading in ITMOs should be permitted.
- Parties also failed to agree on the Supervisory Body’s technical recommendations for rules for methodologies and

removals under Article 6.4, preferring no agreement to the weak agreement that ended up being tabled.

Following COP28, a common feeling among stakeholders was the presidency had prioritised delivering the first-ever global stocktake against the Paris Agreement (discussed further below) ahead of making progress on Article 6, with the result that no material decisions were reached in respect of either Article 6 mechanism at COP28.

Attention has therefore turned to COP29. The urgent need for clear, decisive resolutions on the persisting uncertainties, methodologies and procedures to finally operationalise the Paris mechanisms is now greater than ever. Recent sittings of the Supervisory Body in the lead-up to COP29 suggest that this will indeed be a key focus and certain preliminary decisions have been taken in preparation, including publication of approved standards for carbon dioxide removals and methodologies which now await endorsement by the Parties (discussed further below).

If agreement can be reached, it is estimated that the Paris mechanisms market could be worth \$12 billion annually by 2030¹¹.

11 QCI, 1 November 2024, PACM could become 8 times bigger than current VCM: analyst. Available at: <https://www.qcintel.com/carbon/article/pacm-could-become-8-times-bigger-than-current-vcm-analyst-31490.html>

2.2 Voluntary carbon market

The past two years has seen ups and downs for the VCM. In 2022, the VCM was experiencing record growth and being lauded as a USD2 billion market, with estimates it could reach between USD5 billion and USD180 billion by 2030.¹² Just two years later, much of this growth has been wiped out as a result of alleged integrity issues and negative press. This has been a known risk of the VCM for some time; certain industries bodies have been diligently pushing work programmes to address this risk and to improve the overall integrity and perception of the VCM. In this regard, notwithstanding the setbacks, considerable progress has been made.

A key milestone was publication of the ICVCM's Core Carbon Principles ("**CCPs**"), the Assessment Framework and Assessment Procedure, first launched in 2023 and updated in 2024, which aims to set a benchmark for high integrity carbon credits.

The CCPs are ten fundamental, science-based principles to identify high-quality carbon credits that create "real, verifiable climate impact". The principles are divided into three key themes: governance; emissions impact; and sustainable development, and include, for example:

- the carbon crediting programme shall have effective programme governance to ensure transparency, accountability, continual improvement and ensure the overall quality of carbon credits;

- GHG emission reductions or removals shall be additional (i.e., would not have occurred in the absence of the incentive created by carbon credit revenues) and permanent or, where there is a risk of reversal, there shall be measures in place to address those risks and compensate reversals. There shall also be no double counting (which for ICVCM purposes refers to only being counted once towards achieving mitigation targets or goals; double counting covers double issuance, double claiming and double use);
- the carbon crediting programme shall have clear guidance, tools and compliance procedures to ensure the mitigation activities conform with or are better than industry best practice and environmental safeguards when delivering sustainable development impacts.

ICVCM is now in the process of assessing different carbon crediting programmes and methodologies against the CCPs. Verra, Gold Standard, American Carbon Registry ("**ACR**") and Climate Action Reserve, for example, have been approved as "CCP-Eligible". This development filtered down into VCM carbon credit purchase agreements in real time: CCP-approval becoming a required quality mark for any credits supplied.

On the buy-side, in June 2023 the VCMI published the final version of its Claims Code of Practice¹³ ("**Claims Code**")

following extensive public consultation. The Claims Code seeks to assist buyers with making reputable claims about their use of voluntary carbon credits and details the criteria companies must meet to make a VCMI Silver, Gold or Platinum offsetting claim. The first claim under the VCMI's Claims Code was made in February 2024 by global consultancy firm Bain & Co,¹⁴ which successfully made a platinum tier claim (requiring the purchase and retirement of high-quality carbon credits for at least 100% of its remaining emissions once it has demonstrated progress against science-aligned, near-term emission reduction targets).

Another initiative that has gained considerable traction in recent years is the Oxford Principles for Net Zero Aligned Carbon Offsetting ("**Oxford Offsetting Principles**"). First developed in 2020 and revised in 2024, the Oxford Offsetting Principles provide guidance for companies, cities and other non-state actors in developing offsetting strategies that align with achieving net zero by 2050 or sooner. The Oxford Principles recognise the important role good quality carbon credits should play in achieving net zero and urges a move away from (i) credits for emission reductions and (ii) avoided emissions to credits for carbon removal. The Science Based Targets initiative ("**SBTi**"), which validates the net zero plans of companies whose climate targets are in line with the Paris Agreement's goals, has also been influential. The organisation was deeply opposed to the use of carbon offsets until April 2024, when its announcement of plans to permit companies to use credits to offset certain scope 3 emissions caused internal uproar (culminating in the resignation of its CEO), despite being welcomed by many market actors. A final

¹² McKinsey & Company, October 2021, Putting carbon markets to work on the path to net zero. Available at: [How investors can help decarbonise the economy and manage risk-adjusted returns](https://www.mckinsey.com/capabilities/sustainability/our-insights/putting-carbon-markets-to-work-on-the-path-to-net-zero). Available at: www.mckinsey.com/capabilities/sustainability/our-insights/putting-carbon-markets-to-work-on-the-path-to-net-zero.

¹³ Available at: <https://vcmintegrity.org/vcmi-claims-code-of-practice/>

¹⁴ VCMI, 26 February 2024. Available at: <https://vcmintegrity.org/bain-company-makes-the-inaugural-vcmi-carbon-integrity-claim/>

decision on this has been pushed to 2025, with the SBTi's position (in the meantime) remaining that companies may not use carbon credits to show emission reductions progress towards their near- or long-term science-based targets (and must instead achieve this through direct action within their own boundaries or their value chains).

It is worth noting also that insurance products are emerging to mitigate some of the risks that hamper the VCM, particularly risks of underperformance and/or reversals. Other key risks include political risks such as changes to carbon credit ownership rights, export bans and revocation of corresponding adjustments, and reputational risks for buyers. Whilst there are few insurance products on the market that would cover all such risks, it is an area where we expect to see growth in the short-term. Notably the World Bank's insurance arm, the Multilateral Investment Guarantee Agency, has announced plans to launch insurance products aimed at risks emanating from both the VCM and Paris mechanisms¹⁵.



¹⁵ QCI, 7 November 2024, INTERVIEW: World Bank to launch insurance for UN carbon markets. Available at: <https://www.qcintel.com/carbon/article/interview-world-bank-to-launch-insurance-for-un-carbon-markets-31636.html>



**CHAPTER THREE:
A REVIEW OF OUR RECOMMENDATIONS**

3. A REVIEW OF OUR RECOMMENDATIONS

Our 2022 report examined in detail the issues and uncertainties concerning the relationship between the VCM and emerging Article 6.2 and 6.4 mechanisms as they stood at that time. Consequently, we set out recommendations for each of (i) new VCM governing bodies, (ii) CMA and the subsidiary and supervisory bodies, (iii) project proponents, (iv) buyers of carbon credits and (v) governments. In this chapter we take each of these recommendations in turn, set out key relevant developments and examine whether our original recommendations need to be adjusted to reflect the current picture of the Paris mechanisms and the VCM.

3.1 New governing bodies

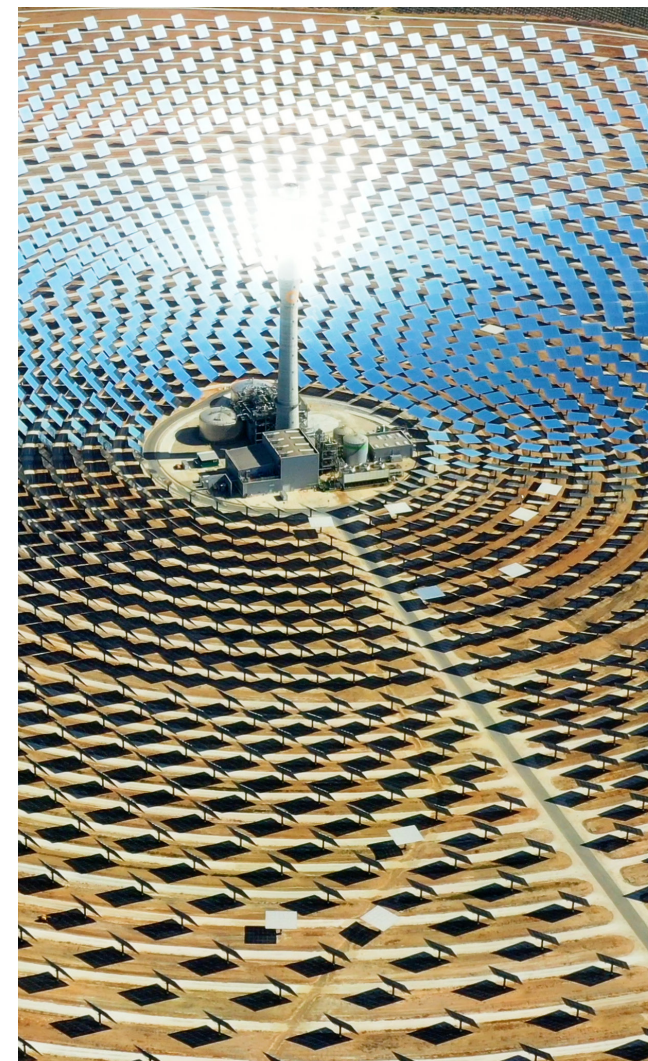
As outlined in Chapter 2, the ICVCM and VCMI continue to lead a variety of workstreams designed to build a high-quality VCM. These initiatives form part of a growing body of work by other stakeholders and not-for-profit organisations seeking to improve integrity in carbon credits and carbon offsetting, such as the Carbon Credit Quality Initiative and the International Carbon Reduction and Offset Alliance.

3.1.1 Implement a communications strategy to promote the benefits of the VCM with the aim of dispelling increasing criticism

What has happened

There are well-recognised benefits of the VCM, including:

- Mobilising significant private capital into projects which provide both climate and social benefits;
- Accelerating climate action, by enabling companies and individuals to voluntarily purchase credits;
- Enhancing corporate responsibility by allowing companies to demonstrate their commitment to climate mitigation and sustainable development;
- Developing rapidly and flexibly to scale and meet market needs without rigid regulatory oversight; and
- Encouraging innovation by supporting the development and implementation of new technologies and practices for carbon reduction and removal.



Despite these benefits, the past couple of years have not been particularly positive for the VCM. Reports of carbon projects allegedly inflating actual emissions, errors in methodologies and recently allegations of fraud within a prominent carbon credit project developer outfit have called into question the quality of carbon credits and integrity of the VCM¹⁶. A 2023 study led by the University of Cambridge and VU Amsterdam¹⁷ into voluntary REDD+ projects found that millions of carbon credits are based on crude calculations that inflate the conservation successes of those forestry-based projects. Data collected by independent ratings agency Calyx backs this up, with less than 10% of the credits they have rated over the past 5 years achieving a GHG integrity rating of B or better¹⁸.

In addition, over the past couple of years numerous companies have been accused of greenwashing, with some of the accusations being directed at their carbon offsetting programmes. As a result, many corporates and investors have been driven out of the market. In May 2024, Ecosystem Marketplace reported that the carbon market had shrunk by 61% between 2022 and 2023, falling from \$1.9bn in 2022 to \$723m in 2023 as result of this negative press coverage and quality concerns¹⁹.

However, as set out in Chapter 2, considerable work has been done to address these issues and improve the overall integrity of carbon offsetting. Interestingly, the Supervisory Body tasked with defining the guidelines, rules and

methodology under the PACM received a mandate to review existing methodologies for the purpose of developing their own. Others, including governments and certified carbon standards were invited to propose methodologies to the Supervisory Body. This desire to work with the VCM on harmonising Article 6 with the VCM integrity efforts should be seen as an endorsement by COP of the VCM.

Going forward

Negative public perception is undoubtedly the greatest challenge facing the VCM presently. If the VCM is to thrive, a concerted effort is needed to change this narrative. Hence, the need for a clear communications strategy to promote the benefits of the VCM is more important than ever if it is to continue to have a role to play in the global action against climate change.

To counter the negative perceptions, a greater understanding is needed of the opportunity that the VCM presents. It is therefore crucial for governing bodies to continue to publicly and actively promote the VCM's role in climate action, to highlight the great work being undertaken to address its flaws. Doing so lessens the risk of "greenhushing" whereby companies adopt a communications strategy that minimises discussion of climate mitigation or other sustainable practices for fear of reputational damage or legal action if their approaches are found to be in some way deficient. A broader uptake of initiatives such as VCM-aligned offsetting claims should go a considerable way to mollifying some of the fears that are currently holding the VCM back.

3.1.2 Issue guidance on corresponding adjustments and double claiming in the VCM

What has happened

A key concern of carbon offsetting generally, but particularly with respect to the intersect between the emerging Paris mechanisms and the VCM, is the risk of double counting and double claiming. Double counting is an accounting concept for NDC implementation and refers to a scenario where more than one Party counts the same emissions reduction or removal for the purposes of its NDC. The Paris Agreement expressly prohibits double counting, and the accounting mechanism of corresponding adjustments is designed to prevent exactly this.

Double claiming, on the other hand, refers to when a carbon credit is used to satisfy multiple climate goals simultaneously – such as a corporation using a credit towards its emissions reduction target while a Party counts that same credit towards achievement of its NDC. Whilst not prohibited, some consider double claiming a problem alleging that it can result in reduced overall climate mitigation action, as the benefit of a climate mitigation action is claimed twice, artificially inflating the perceived level of climate effort. Others view corresponding adjustments as unnecessary in the VCM, arguing that the VCM and the Paris mechanisms are fundamentally different systems with different purposes and 'target audiences' (i.e., voluntary responsible action by private entities is the focus of the VCM, as opposed to the Paris mechanisms' aim of enabling host Parties to meet treaty-based international legal obligations). In light of this,

16 See Chapter 1 and, for example, QCI, 17 October 2024, C-Quest cancels 5m clean cookstove credits after review. Available at: <https://www.qcintel.com/carbon/article/c-quest-cancels-5m-clean-cookstove-credits-after-review-30742.html>

17 Science, 24 August 2024, Action needed to make carbon offsets from forest conservation work for climate change mitigation. Available at: <https://www.science.org/doi/10.1126/science.ade3535>

18 Calyx Global, June 2024, The State of Quality in the VCM 2024. Available at: <https://calyxglobal.com/resource-post?q=20>

19 Ecosystem Marketplace, 2024 SOVCM.

some stakeholders suggest that mandatory corresponding adjustments for VCM transactions could place an undue administrative burden on host countries, as well as limit a host country's means of achieving its NDC (especially as they are revised to reflect greater ambition). These factors could discourage Parties from participating in the VCM and benefiting from associated financial flows.

In our 2022 report, we raised concerns about the lack of clarity and inconsistencies regarding what constitutes double counting and double claiming, and identified a need for clearer guidance and a more unified approach across the VCM and Paris mechanisms to addressing these risks. To this end, some progress has been made.

Double counting/ corresponding adjustments

As between the carbon standards there remains a difference of approach as to when corresponding adjustments to prevent double counting are required. Gold Standard's updated 2023 rules consider corresponding adjustments necessary when credits are used towards voluntary offsetting claims, while Verra is narrower in its approach, and only mandates corresponding adjustments for ITMOs (i.e., where the Article 6.2 or 6.4 emission reduction is authorised for certain uses, including NDC use, by the host Party). Verra has started applying Article 6 labels for credits on its registry that are authorised for such uses, and which therefore require corresponding adjustments (and such labels are revoked if the host country fails to apply corresponding adjustments).

In a promising move, in January 2024 the ICVCM and VCMI announced that they would be collaborating on a work programme to consider scenarios where corresponding adjustments will be necessary in the VCM, and the impacts of corresponding adjustments for carbon credit integrity²⁰. Until now, the position of both bodies has been that corresponding adjustments should not be mandatory in the VCM, emphasising instead the importance of registries' transparency as to whether or not a particular credit is associated with a corresponding adjustment. Such work will help carbon standards reach an aligned position and clarify the status of corresponding adjustments within the VCM.

It should also be noted that while the Subsidiary Body on Scientific and Technological Advancement to the CMA ("SBSTA") has a mandate as a result of Decision 6/CMA.4 to provide recommendations on corresponding adjustments, no guidance or definitive position has yet been reached. Co-ordination work between VCM governing bodies and carbon standards is therefore even more important in the short term.

Double claiming

While the Paris Agreement does not explicitly prohibit double claiming, the emerging market consensus appears to be that preventing double claiming is necessary to achieve and maintain a high integrity VCM. To this end, each of the ICVCM, Verra and Gold Standard now expressly define "double counting" to include "double claiming". Verra's VCS standard document²¹ sets out the requirements for project

proponents to demonstrate how they have ensured credits will not be double claimed and includes specific guidance to avoid double claiming of credits targeting scope 3 emissions. Similarly, Gold Standards' 2023 guidelines²² stipulate clear tracking mechanisms to ensure transparency in credit ownership and usage to avoid double claiming.

Going forward

Whilst progress has been made in the VCM in recognising and tackling the risks of double counting and double claiming, there is still far to go in clearly differentiating between the two and engineering solutions accordingly. Further, tailored guidance on each is needed, as is a clear consensus amongst market participants as to what the most appropriate solution(s) for addressing these risks are. Consideration should also be had of the extent to which such guidance should be aligned with the further work being carried out by the ICVCM and VCMI on corresponding adjustments in the VCM.

3.1.3 Facilitate knowledge-sharing initiatives to support capacity building within the VCM

What has happened

Capacity building remains one of the key focuses for climate action including within the VCM. The sooner and more widespread the deployment of meaningful and effective emission reduction and removal projects the greater impact such efforts will have on global climate commitments, and knowledge sharing is key to this. Thankfully, there has been some progress by the governing bodies in this respect.

²⁰ ICVCM, January 2024, Summary for Decision Makers (Version 2). Available at: <https://icvcm.org/wp-content/uploads/2024/02/CCP-Section-3-V2-FINAL-6Feb24.pdf>

²¹ Available at: <https://verra.org/wp-content/uploads/2024/04/VCS-Standard-v4.7-FINAL-4.15.24.pdf> (16 April 2024 version)

²² Available at: <https://www.goldstandard.org/publications/our-new-double-counting-guidelines>

The ICVCM and VCMi have advanced their initiatives by setting, communicating and facilitating expected best practice for participation in the VCM. The Claims Code is supported by documents assisting practical implementation of the Code, including a Monitoring, Reporting and Assurance (MRA) Framework, the VCMi Claims Reporting Platform, Carbon Integrity Brand Guidelines, and a Beta version of the Scope 3 Flexibility Claim (which aims to help companies that cannot reduce their scope 3 emissions (for example due to complex supply chains) to use offsets appropriately).

The Claims Code is itself a collaborative effort involving the ICVCM and SBTi: part of the Claims Code's foundational criteria requires companies to set science-based targets in accordance with the SBTi. From 1 January 2026, companies must only use CCP-approved credits to offset their residual emissions. This is a good example of governing bodies working together to avoid duplication of work and collaborating efficiently to maximise the potential of their initiatives.

The VCMi's other flagship initiative is the VCM Access Strategy Toolkit²³. Published in May 2023 in partnership with the UN Development Programme and Climate Focus, the toolkit sets out key considerations for governments and policymakers considering participating in the VCM and

guidance on unlocking their country's potential for high integrity credits and socio-economic prosperity.

Examples of recent capacity-building initiatives by the VCMi include partnerships with the Climate Vulnerable Forum's V20 Finance Ministers²⁴ aimed at maximising their carbon finance opportunities (announced in June 2024), with the Mexican state of Yucatan²⁵ to develop a best practice guide to developing VCM projects in the region and the ACMI (announced in September 2024) to scale up high integrity carbon markets across Africa.

The ICVCM operates numerous working groups to share expertise between concerned stakeholders, including expert-led working groups to categorise credits and consider relevant methodologies' compatibilities with the CCPs, and a market consultation working group where the ICVCM shares information on their workstreams and latest news as well as providing a channel for it to receive feedback on its infrastructure and processes. Its continual improvement work programmes are a notable example of capacity building in the VCM, as they aim to consider ten essential but complex areas of the VCM's operation in order to feed into a revised version of the CCP Assessment Framework by mid-2025. Publishing the original CCPs and Assessment Framework, while maintaining further work in the background, represents a pragmatic approach to iterative construction of a

well-functioning VCM. The ICVCM also engages directly with indigenous peoples and local communities and has recently established an engagement forum to enable these people to collaborate more closely with the VCM's other stakeholders and so elevate their voices.

In addition to these initial governing bodies of the VCM, six of the biggest carbon standards have adopted a quasi-governing role for themselves by agreeing to collaborate²⁶ to share and learn from each other's best practices and align their approaches to critical topics like removals, durability, and community benefits. The six standards – Verra, Gold Standard, American Carbon Standard, Climate Action Reserve, Global Carbon Council and Architecture for REDD+ Transactions – agreed to this knowledge-sharing initiative at COP28. Importantly, one aspect of their agreed collaborations is to support the ICVCM's effort to assess carbon standards and their programmes in line with the CCPs, signalling widespread support for the initiative and evidencing the increasing productive cross-fertilisation of ideas between the VCM's core bodies.

²³ Available at: <https://vcmin integrity.org/wp-content/uploads/2023/05/VCMi-VCM-Access-Strategy-Toolkit.pdf>

²⁴ VCMi, 13 June 2024, The Voluntary Carbon Markets Integrity Initiative and Climate Vulnerable Forum and its V20 Finance Ministers Partner to Leverage Carbon Markets in Support of Climate Prosperity. Available at: <https://vcmin integrity.org/vcmi-cvf-v20-partnership/>

²⁵ VCMi, 11 September 2024, Yucatán Government Launches Innovative Guide for Carbon Project Development in the Voluntary Carbon Market. Available at: <https://vcmin integrity.org/yucatan-government-launches-innovative-guide-for-carbon-project-development-in-the-voluntary-carbon-market/>

²⁶ Verra, 4 December 2023, Independent Crediting Programmes Announce Ground-Breaking Collaboration to Increase the Positive Impact of Carbon Markets. Available at: <https://verra.org/independent-crediting-programmes-announce-ground-breaking-collaboration-to-increase-the-positive-impact-of-carbon-markets/#:~:text=COP%2028%2C%20Dubai%20%E2%80%93%20December%20,2024,and%20consistency%20across%20the%20market.>

Going forward

Whilst progress has certainly been made, there is still scope for increased knowledge sharing to support capacity building. Governing bodies, alongside industry and thought-leadership groups, should continue to bolster information sharing and capacity-building efforts to help repair and thereafter maintain a high integrity VCM.

As we suggested in our 2022 paper, this could involve disseminating detailed information about the VCM and Paris mechanisms, be that in the form of overview papers, policy briefs and/or template documents. Training courses and practical workshops could also be offered to facilitate understanding and engagement. The recent initiatives mentioned above, such as the best practice guide developed in Mexico, could be further expanded to include lessons learned and decision-making tools for policymakers, ensuring countries can navigate carbon markets effectively, or adapted for and disseminated to other jurisdictions.

3.1.4 Determine the role of sovereign credits issued under REDD+ and the ACMI in the VCM

What has happened

At the time of our 2022 report, there was concern that large scale crediting programmes would flood the voluntary carbon market with millions of credits, potentially undermining credit prices and destabilising the market. Concerns centred on initiatives such as the Africa Carbon Markets Initiative (“**ACMI**”) and various programmes under the REDD+

umbrella (Reducing Emissions from Deforestation and forest Degradation, plus associated sustainable development activities). The ACMI aimed to retire 300 million credits annually in Africa by 2030, while forestry-based programmes like REDD+ were suggesting they could deliver millions of credits.

Since 2022, ACMI secured \$200 million in advance market commitments from global corporates at COP27, and seven African nations committed to developing “carbon activation plans”²⁷. In June 2024, the UAE Carbon Alliance pledged to purchase \$450 million in African carbon credits by 2030²⁸.

REDD+ has seen several large issuances, with the pipeline for certain projects set to expand, raising pricing and demand concerns. Market developments have focused on differentiating the term “REDD+” between project based, jurisdictional and sovereign REDD+ and debating whether certain REDD+ credits qualify as ITMOs under Article 6 mechanisms.

Background and terminology

The concept of reducing and removing carbon emissions through forestry activities was introduced by the 1997 Kyoto Protocol’s Joint Implementation. It evolved through COPs in the 2010s, with methodology and financing formalised at COP16 in 2013 under the “Warsaw Framework for REDD plus” and was incorporated into Article 5 of the Paris Agreement in 2015. It allows host countries with significant

forests to maintain ecosystems in return for REDD+ Results Units (“**RRUs**”) which they can sell, a form of results-based finance.

The term “REDD+” is also used colloquially in the VCM without Article 5 oversight, typically within agriculture, forestry, and land use (“**AFOLU**”) or land-use change and forestry (“**LULUCF**”) categories. The REDD+ projects could refer to afforestation (including plantations), enhanced forest management, or avoided deforestation projects. These are often project-level activities focused on specific forest areas (“**project-based REDD+**”). In contrast, “**jurisdictional REDD+**” considers all forests in a national or subnational area to reduce risks like leakage and inflated baselines. Key bodies implementing jurisdictional REDD+ include Architecture for REDD+ Transactions (“**ART**”), which issues “**TREES**” credits, and the World Bank’s Forest Carbon Partnership Facility (“**FCPF**”). In 2023, Guyana was issued over 30 million ART-TREES credits.

Integrity concerns

Forestry-based projects in the VCM have faced significant integrity-related criticism. Key issues include impermanence, complexities in assessing additionality and baselines, leakage, and unreliable funding for local communities. A Calyx report²⁹ found most forestry-based credit projects fall into the very low “E” ratings category. In response, the VCM has improved practices; for instance, Verra overhauled its REDD+

27 Global Energy Alliance for People and Planet, 16 January 2023, Africa Carbon Markets Initiative builds on momentum from COP27, announces 13 action programs. Available at: <https://energyalliance.org/acmi-adsw/>

28 Zawya, 26 June 2024, UAE Carbon Alliance to purchase US\$450m in African carbon credits by 2030. Available at: <https://www.zawya.com/en/world/africa/uae-carbon-alliance-to-purchase-us450m-in-african-carbon-credits-by-2030-wv44ix23>

29 Calyx Global, June 2024, The State of Quality in the VCM 2024. Available at: <https://calyxglobal.com/resource-post?q=20>

methodologies³⁰ in November 2023 and continued aligning with the ICVCM's CCPs in 2024³¹.

Integrity concerns extend beyond project-based approaches. A Rainforest Foundation report concluded that no REDD+ programme meets UN requirements on benefit distribution or requires offset users to reduce fossil fuel emissions first, posing a high risk of greenwashing. Questions about RRUs' effectiveness persist, as reporting on RRUs, recorded in the Lima REDD+ Information Hub, shows that two thirds of results generated have received no funding. Despite the FCPF's existence since 2007, it has only agreed on two ERPA's. The report found little evidence that REDD+ has significantly reduced deforestation, degradation, or global carbon emissions.

Poor uptake of sovereign credits

Until recently, most REDD+ credits sold were VCM project-level credits. However, in recent years the Article 5 process has seen large issuances of "sovereign" credits, notably by Papua New Guinea in 2021 and Gabon in late 2022. Due to poor market perception and integrity concerns, these sales struggled: Papua New Guinea sold just over 20,000 of 9 million RRUs listed on the redd.plus platform (established by Coalition for Rainforest Nations ("**CfRN**")), while Gabon's Forest Minister reported "no interest" in its 90 million RRUs issued in February 2023³².

Demand dynamics

Demand for forest-based offsets peaked in 2021-22, driven by factors including clarity on using Article 6 mechanisms for NDCs, increased mandatory corporate emissions reporting, and rising activist voices and extreme weather events. A sharp rise in demand was accompanied by a rapid increase in the REDD+ project pipeline. Despite recent concerns about demand dropping, data from November 2024 shows increased issuances and retirements of credits year-on-year³³, with REDD+ retirements rising from 22% to 30% of total retirements³⁴. However, the integrity concerns besetting the VCM, the potential volume of jurisdictional and sovereign credits, and the number of credits which could be delivered by Verra's projects that are currently "under validation", all mean future demand dynamics and pricing remain uncertain.

A noticeable trend is the market's preference for REDD+ initiatives that remove carbon emissions, like forest restoration, over those avoiding future emissions. This trend may strengthen following the Supervisory Body's June 2024 decision that emission avoidance is ineligible under Article 6 mechanisms.

RRUs as ITMOs?

Poor demand for RRUs has severely limited funding for forest protection in nations like Papua New Guinea and Gabon. As an alternative method to channel funds into these essential

ecosystems, in mid-2023, CfRN advocated for the capacity of RRUs generated through Article 5 to be sold as ITMOs under Article 6 mechanisms, arguing they could be treated as carbon credits in both Paris and VCM contexts. This has sparked debate, with some in the VCM raising concerns about integrity, independent verification and lack of enforceability of improvement recommendations by the UN inspectors.

In contrast, CfRN have published a detailed think piece³⁵ showing how RRUs could become ITMOs under Article 6.2 by adhering to CMA guidance and meeting the detailed participation, assessment, reporting, and verification requirements. This would allow ITMOs to be traded internationally and contribute to NDCs, driving climate finance to sovereign nations for rainforest conservation. CfRN emphasises the strength of additionality and reversals measures (provided for through the setting of forest reference levels and hosts' reporting through Biennial Transparency Reports) and the strength of independent validation processes under Article 5. They highlight that no host country has ignored the improvement recommendations of the United Nations Framework Convention on Climate Change ("**UNFCCC**"), and 48% of countries have resubmitted their national strategies to address critical comments from expert reviewers. In the Article 6.2 negotiations CfRN have sided with the EU in pushing for all of the requirements in the COP decisions to be met before ITMOs can be issued and traded.

30 Mongabay, 28 November 2023, Carbon credit certifier Verra updates accounting method amid growing criticism. Available at: <https://news.mongabay.com/2023/11/carbon-credit-certifier-verra-updates-accounting-method-amid-growingcriticism/#:~:text=However%20recent%20criticisms%20of%20REDD%2B,a%20metric%20on%20of%20CO2.>; Climate Impact Partners, 30 November 2023, Are you REDDy for Verra's new methodology? Available at: <https://www.climateimpact.com/news-insights/insights/are-you-reddy-for-verras-new-methodology/>

31 Carbon Pulse, 7 August 2024, Verra updates voluntary carbon REDD methodology to match CCP definition. Available at: <https://carbon-pulse.com/311125/> ; <https://www.qcintel.com/carbon/article/verra-expands-data-collection-for-new-redd-methodology-28516.html>

32 QCI, 22 February 2023, "No interest" in Gabon sovereign credits after 3 months: Minister". Available at: <https://www.qcintel.com/carbon/article/no-interest-in-gabon-sovereign-credits-after-3-months-minister-11960.html>

33 QCI, 4 November 2024, Voluntary carbon credit issuances, retirements rise yoy in October. Available at: <https://www.qcintel.com/carbon/article/voluntary-carbon-credit-issuances-retirements-rise-yoy-in-october-31511.html>

34 Environmental Defense Fund, 25 June 2024, Average Prices for Jurisdictional REDD+ Credits to Reach \$15 in 2028. Available at: <https://www.edf.org/media/average-prices-jurisdictional-redd-credits-reach-15-2028>

35 CfRN 2024, "How Article 6 brings Article 5.2 REDD+ to Global Carbon Markets". Available at: <https://www.rainforestcoalition.org/publications/>

Recent developments suggest RRUs being sold as ITMOs may become reality. In September 2023, Suriname announced plans to sell Article 5-generated credits as ITMOs via CfRN's ITMO Ltd³⁶, issuing a Letter of Authorisation for NDC use³⁷. CfRN indicated Honduras and Belize may follow, signing MoUs with both countries³⁸.

Going forward

The VCM must address persisting integrity concerns by critically assessing forestry and land-use projects. Only high-integrity jurisdictional or project REDD+ credits should be supported.

Significant work is needed from the UNFCCC and VCM governing bodies to define REDD+ roles in Paris mechanisms and VCM. Developing a definition of “emissions avoidance” is key, given its exclusion under Article 6. As the line between avoidance as opposed to reductions or removals is hazy, there is a risk that excluding avoidance projects will lead to a suspension of essential funding for projects that maintain, protect and restore vital forest ecosystems.

The CMA could also take the opportunity to confirm the relationship between Article 5 RRUs and Article 6 Paris mechanisms. Although if Suriname issues and transfers its RRU based ITMOs having gone through all of the procedures and requirements of the decisions under Article 5, 6 and 13 this will be seen as the UNFCCC approving sovereign credits and the relationship between Article 5 RRUs and the Paris mechanisms.



³⁶ QCI, 13 September 2024, OPINION: How Suriname will sell ITMOs under UN REDD+. Available at: <https://www.qcintel.com/carbon/article/opinion-how-suriname-will-sell-itmos-under-un-redd-29297.html>

³⁷ IETA, Visualising Article 6 implementation: <https://www.ieta.org/resources/visualising-article-6-implementation/>

³⁸ QCI, 21 September 2023, Rainforest nations start new effort to sell sovereign units. Available at: <https://www.qcintel.com/carbon/article/rainforest-nations-start-new-effort-to-sell-sovereign-units-17095.html>

3.2 COP and Supervisory Body

The CMA oversees implementation of the Paris Agreement. It is supported by several subsidiary bodies and supervisory bodies tasked with assisting this implementation. This includes the SBSTA who provide scientific and technical support, and the Supervisory Body which focuses on implementation of the Paris Agreement Crediting Mechanism (“PACM”).

3.2.1 Continue driving forward operationalisation of the Paris mechanisms whilst working collaboratively with the new governing bodies of the VCM

What has happened

In our 2022 paper, we recognised that much of the uncertainty surrounding the VCM was due to the Paris mechanisms still being in their infancy. So long as the Paris mechanisms remain in an operationalisation phase, questions will remain as to exactly how the VCM should fit alongside it. This is why in our 2022 paper we stressed the importance of stakeholders continuing to drive forward the operationalisation of the Paris mechanisms.

In Chapter 2, we provided a brief market update on the Paris mechanisms. As outlined, there has been some progress. With decisions taken at COP27 in Sharm el-Sheikh providing some additional clarity and guidance on matters such as reporting requirements for countries trading ITMOs and introducing the concept of Article 6.4 “mitigation contribution emission reductions”. COP27 also saw the milestone of the first ITMO trade, which took place between Ghana and Switzerland³⁹. However, important issues regarding baselines, additionality and removals were left outstanding

and deferred to COP28. COP28 in Dubai also failed to deliver, with the Parties unable to reach a consensus on the definition of an Article 6.2 cooperative approach, Article 6.4 methodologies and removals, certain aspects of ITMOs’ use authorisation, or whether secondary trading in ITMOs should be permitted (among other things). The treatment of avoidance credits was also left unresolved (albeit progress has since been made (see below)).

At the pre-COP meeting of the Subsidiary Bodies in Bonn in June 2024 (known as SB60), Article 6 was agreed as a focus area for discussion. In particular, use authorisations for ITMOs, the design of registries to be used under the Article 6.2 mechanism and emissions avoidance (discussed further below). At a meeting in Baku in October 2024, the Article 6.4 Subsidiary Body approved standards for carbon dioxide removal and methodology requirements. The move to adopt standards rather than making full recommendations for approval was an attempt to avoid the log-jam that their previous recommendations have encountered. The Subsidiary Body will be asking COP29 to endorse these new standards, rather than seeking approval and adoption (of recommendations). While purely symbolic in nature (nothing prevents the CMA reopening the adopted text) this move nonetheless represents a pragmatic shift in approach for the Supervisory Body.

Separate to their meetings in Bonn, the Subsidiary Body has also made significant progress in transitioning CDM activities to the PACM, receiving almost 1,500 transition requests by the deadline of 31 December 2023, and adopting numerous procedures, standards and forms throughout 2023 and 2024

to enable transition. This means that a pipeline of activities for the PACM is already in place, and the first issuances under the mechanism may come as soon as Q1 2025. However, details pertaining to the operation of the Article 6.4 registry, and outstanding discussions on a new sustainable development tool to complement the mechanism, remain to be finalised.

Whilst high-level principles are still being negotiated, on a practical level steps have been taken to support the ongoing operationalisation of the Paris mechanisms. For example, the UNFCCC has established an interim platform to support and facilitate the submission of reports and publication of non-confidential information according to Decision 2/CMA.3, annex, chapter IV (Reporting). This interim platform is a step towards development of CARP as required by Decision 6/CMA.4 (which requests a first version be finalised by June 2025).

Going forward

Finalising Article 6 is clearly front of mind for many heading into COP29. The key issues remaining as barriers to the full operationalisation of the Article 6 mechanisms are:

- The “sequencing discussion” for the issuing of ITMOs under Article 6.2, including the definition of “first transfer” (which triggers the requirement of a corresponding adjustment), whether a Party’s initial report needs to be reviewed (both by the UNFCCC Secretariat, who run an automated consistency check process, and by a team of technical experts) and go through Article 13 enhanced transparency measures and the GHG inventory undertaken

39 UNDP, 12 November 2022, Ghana, Vanuatu, and Switzerland launch world’s first projects under new carbon market mechanism set out in Article 6.2 of the Paris Agreement. Available at: <https://www.undp.org/geneva/press-releases/ghana-vanuatu-and-switzerland-launch-worlds-first-projects-under-new-carbon-market-mechanism-set-out-article-62-paris-agreement>

before an ITMO can be issued and a transaction take place.

- Use authorisations for ITMO transactions (specifically, for each Article 6 mechanism, the process and timing of authorisation, the content and format of authorisation statements, and whether such statements can be modified or revoked once given);
- The form and function of the Article 6.2 international registry (particularly the level of oversight by the UNFCCC and frequency of updates to the registry's data); and

Considering that the COP29 President-Designate has already committed to finalising the operationalisation of Article 6 which he describes as “a long overdue priority”, the hope is that the Parties address outstanding issues with renewed determination and vigour and finally reach a consensus in order to finalise the Paris mechanisms.

3.2.2 Issue a decision on whether avoidance credits qualify as ITMOs for the purposes of Article 6

What has happened

At the time of our 2022 paper, a key uncertainty for the VCM and the Paris mechanisms was the role that avoidance emissions and avoidance credits could play in carbon offsetting. There were differing views as to the merits of such mitigation methods. Some argued that avoidance credits do not represent any actual additional sequestration of GHG from the atmosphere, whereas others argue that avoided emissions are just as important to global climate change

efforts as reducing or removing emissions and should therefore be recognised.

At the 2024 Bonn Climate Change Conference, following a request by the CMA (Decision 7/CMA.4), the SBSTA considered whether Article 6.4 activities could include emission avoidance. Following considerable debate, the SBSTA decided to exclude emission avoidance as an eligible activity type under the Article 6.2 and 6.4 mechanisms, citing the absence of consensus on the issue and a general lack of alignment on what the definition of “emissions avoidance” is. It did, however, agree to revisit the matter in 2028.

A related issue has been whether conservation enhancement activities have a role in Article 6.4. In this respect, the Parties at Bonn also decided that “conservation enhancement activities” (which is undefined but broadly understood to mean credits generated by projects which enhance biodiversity and restore ecosystems) should not be considered a separate activity type but should be considered emissions reductions or removals, depending on the specific project. This means that, in the context of Article 6.4, it will be for the Supervisory Body to determine the eligibility of conservation enhancement activities as emission reductions or removals. For the Article 6.2 cooperative approach, that determination will be for the Parties.

Whilst these issues would appear settled, and no further discussion on them is expected at COP29, there remains a certain degree of uncertainty around emission avoidance and the implications of these decisions on avoided deforestation activities in the Paris Agreement context. The International

Emissions Trading Association (“**IETA**”) has recently published a paper⁴⁰ which considers emissions avoidance. It identifies various possible interpretations of emission avoidance (and emission reduction). Contrary to what some stakeholders have argued, IETA suggests that these interpretations permit the continuation of forestry and land-based carbon projects (including those based on REDD+ related methodologies) as they may be classified as emission reduction or removal activities rather than as emission avoidance. Such discussion poses additional challenge and nuance to the fierce debate on the role of REDD+ credits, which is explored further below.

Going forward

On the face of the SBSTA's direction, it would seem that the debate as to whether emission avoidance qualifies as ITMOs has been settled, for now at least. SBSTA has directed that emission avoidance does not fall within the Paris mechanisms pending any further guidance from the CMA. Whilst the SBSTA has left the door open to reconsidering the matter in 2028, some market commentators, including Carbon Market Watch, have suggested that the position is unlikely to change because most countries oppose emission avoidance due to the integrity concerns associated with issuing credits for avoided emissions.

However, persisting uncertainties as to how “emissions avoidance” is or should be defined, as highlighted by IETA, has the potential to undermine this blanket disqualification. It would seem that the only way this issue will be resolved definitively is if the CMA can adopt a clear, agreed definition of “emission avoidance”.

⁴⁰ IETA, October 2024, Finalising the Article 6 Rulebook at COP29. Available at: https://ieta.b-cdn.net/wp-content/uploads/2024/10/IETA-Article-6-Position-Briefs-ahead-of-COP29_Oct2024.pdf

3.3 Market participants (i.e. project proponents and buyers)

Market participants sit at the core of carbon markets. Their actions, whether sell-side or buy-side, will ultimately shape the VCM and the Article 6 carbon market, and will have a defining impact on the integrity, credibility and perception of the carbon markets. Market participants must be cognisant of the impact that their actions have, and should act with appropriate foresight and care if the VCM and the Article 6 carbon market are to co-exist and thrive.

3.3.1 Project proponents should engage early with host governments to ensure a shared understanding of expectations, procedures and requirements

What has happened

Our 2022 report outlined the importance of host countries communicating certainty around their plans for implementing the Paris mechanisms and/or VCM in their jurisdictions in order to attract investment. We suggested B2G arrangements in the form of memoranda of understanding (“**MoUs**”) were likely a preferred approach to formalising intentions, due to the speed and simplicity with which they can be prepared, their flexibility in terms of ease of amendment and the ability to include non-state parties, and they are usually taken very seriously by signatories despite not being formally binding. Since 2022, many countries have progressed their national frameworks and the domestic policies needed to implement the VCM, which provides clarity without the need for numerous MoUs. As such frameworks and policies continue to take place, the role of MoUs will decline; however, it is still worth briefly exploring the uptake of MoUs around the world.



We have seen evidence of MoU arrangements being put in place. One notable example is the MoU between Panama and Verra, signed in 2023, whereby Verra agreed to assist with establishing a national carbon market in Panama to support its NDC. Recent reporting⁴¹ indicates that Panama is on track to launch its national market by the end of 2024 and is currently finalising necessary domestic regulation. Another set of MoUs which received considerable attention were those signed between Blue Carbon – a carbon crediting company owned by a UAE-based sheikh – and almost a dozen developing countries across Africa and the Caribbean. While the number of agreements reached is impressive, the projects demonstrate the long lead times and uncertainties that persist even after an MoU is signed: only the Zimbabwe project is under development, and the implementation of several is threatened by local opposition to some projects over land rights and community control. Additionally, at least a dozen host countries have issued letters of authorisation to private project developers granting them the ability to generate and issue ITMOs (see further below).

In a number of other cases, B2G arrangements are being agreed following competitive tender process involving a number of private project developers submitting bids for projects proposed by governments. This structure has been used in the northern Brazilian state of Maranhão, and arguably should achieve a reasonable level of confidence and certainty for prospective investors as the chosen developer has been selected according to established criteria (often

including how they address land tenure issues, social benefit sharing, and their legal framework).

Going forward

Early engagement between project proponents and host countries should remain a priority. Such alignment will ensure a greater understanding of how proposed projects align with the host country's NDC and whether carbon credits issued by those projects will be available via the Paris mechanisms, the VCM or both, and, importantly, whether corresponding adjustments will be available for such carbon credits.

Such early engagement should also mean greater levels of compliance by projects with any requirements imposed on them when proceeding under (in whole or part) Article 6 mechanisms. In addition to MoUs, letters of authorisation by host countries (discussed further below) represent another useful tool for formalising these arrangements.

In relation to this, those projects proceeding under the VCM should take care to choose reputable carbon standards that uphold high accreditation and verification standards. Increasingly the CCPs are being adopted as the quality standard which the market should meet, and project proponents should seek to align their projects with CCP-approved methodologies.

3.3.2 Facilitate information sharing by establishing and maintaining open and transparent lines of communication regarding carbon projects

What has happened

In our 2022 paper, we suggested project proponents and sellers of carbon credits should seek to establish and maintain open and transparent lines of communication and information sharing with prospective investors or buyers. It is difficult to comment on the extent to which this has happened but the negative press that has tarnished the VCM in recent years would suggest there is considerable room for improvement in this respect.

Nevertheless, there are several ways in which information concerning carbon projects is shared. One is the public information available on standards' websites, which often details project specifications and methodologies in respect of every project, as well as highlighting successful case studies and outlining pipeline projects. Gold Standard, for example, has a policy of publishing all information other than confidential information through its registry, and Verra keeps projects open for public comment before they go live. Any comments are published on the project's record and must be taken into consideration by the project proponent.

Clear labels are another way that project developers and standards can communicate simply and effectively with buyers. Gold Standard's SDG labels, for example, clearly indicate the sustainable development co-benefits of projects by showing the applicable SDG icons. Verra's introduction at

⁴¹ QCI, 9 September 2024; Panama reactivates committee to establish carbon market rules. Available at: <https://www.qcintel.com/carbon/article/panama-reactivates-committee-to-establish-carbon-market-rules-29022.html>

the end of 2023 of Article 6 labels⁴² stating the use authorisations that host countries have bestowed upon ITMOs generated in their jurisdiction also introduces a welcome degree of transparency and provides for alignment with the Paris mechanisms. The ICVCM's CCP-Eligible labels (for standards) and CCP-Approved label (for credits from a particular project) are another example of plain communication between participants in the VCM.

Recently, there have been indications that the flow of information between project participants is set to increase, at least in certain segments of the market. Certified removals under the EU's recent Carbon Removals Certification Framework ("**CRCF**") may be used in the VCM. The CRCF will certify carbon removals, carbon farming and carbon storage activities across the European Union and thereby aim to boost the use of higher quality credits. The CRCF requires EU-based project developers to follow the "QU.A.L.ITY" criteria, obtain certification from third parties following specific methodologies, and, crucially, publish all certification-related information in an EU-wide registry.

Also helping to foster transparency and information sharing in the VCM is the emergence since 2020 of carbon credit rating agencies. Agencies such as Sylvera, BeZero, Calyx Global and Renoster now offer independent assessments of carbon projects and/or carbon credits and present standardised ratings for the actual emissions reductions or removals associated with those projects, having analysed certain key factors such as additionality, permanence and co-benefits. BeZero Carbon was the first ratings agency to implement "ex

ante" ratings for carbon projects, which represent intended emissions reductions of a project that has yet to be fully developed and are intended to raise the initial funding needed to get them off the ground. It remains to be seen whether these ex ante ratings will catch on but, if they do, they may encourage greater information sharing about carbon projects at a much earlier stage. Such moves should be welcomed by cautious buyers of voluntary carbon credits, for whom conducting due diligence prior to VCM transactions has become commonplace.

From a transactional perspective, we are seeing much higher expectations on behalf of buyers with respect to information sharing and reporting obligations on the project proponent or seller, and far more stringent warranty protections. Buyers are coming to carbon trades very alive to the potential reputation risks and are looking to insulate themselves from those risks as much as is commercially possible.

Going forward

As highlighted throughout this paper, there needs to be concerted effort to improve the integrity of the VCM. Increased transparency and information sharing is a simple way in which project proponents can help to achieve this and so alleviate the concerns that exist around greenwashing. Initiatives such as CRCF and the various carbon rating agencies are helping to deliver greater information sharing. We expect this will remain a focus for months and years ahead as the VCM recovers. In the face of a plethora of risks associated with buying voluntary carbon credits, prospective buyers will be increasingly reluctant to make purchases

without undertaking thorough due diligence, and project developers and registries should expect to find it difficult to make sales without providing those buyers with the necessary information with which to conduct that.

3.3.3 Ensure that offsetting is secondary to reducing emissions whilst being transparent as to the use of offsetting measures

What has happened

In our 2022 paper, we recognised a common accusation by opponents of the VCM that offsets give an illusion of a "fix" but in effect are just an excuse for inaction resulting in claims of "greenwashing". The reports over the past two years alleging certain carbon projects overstating their emissions reductions have been very detrimental to the VCM (see Chapter 1). Many of the climate activist entities and non-government organisations pursuing greenwashing claims are being driven by concern that carbon offsetting is directing the focus away from – and thereby slowing – the reduction of actual emissions. Whilst potentially an overly simplistic view of the VCM, it does highlight the importance of market participants being transparent about their use of carbon offsets.

To help counter this, VCM initiatives like the Claims Code are seeking to introduce stringent requirements for entities seeking to use carbon offsetting as part of their climate mitigation action plan. For example, under the Claims Code, part of the foundational criteria for making a Silver, Gold or Platinum claim is having SBTi-approved, net zero-aligned targets and being able to demonstrate progress against these

⁴² Verra, 7 December 2023, Verra Announces First Application of Article 6 Authorized Labels to VCU's from a Cookstove Project in Rwanda. Available at: <https://verra.org/program-notice/verra-announces-first-issuance-of-article-6-authorized-labels-for-cookstove-project-in-rwanda/>

goals. This means corporate entities need to be able to demonstrate that they have made considered changes in how they run their businesses to reduce emissions before they can rely on carbon credits.

Going forward

Needless to say, carbon offsetting should remain secondary to reducing emissions at source. The VCM is merely one tool in an arsenal needed to avoid the worst impacts of the climate crisis. At the heart of all climate mitigation must be deep-set, radical shifts in attitude towards the relationship of business to the natural world. Entities seeking to use carbon credits for offsetting purposes must develop transition plans which only rely on credits in the short and mid-term for hard-to-abate emissions. Carbon standards and their governing bodies should also continue to require such efforts by buyers when approving credit-related claims. This is especially important as long as allegations of greenwashing continue to hamper the VCM.

3.3.4 Act in an informed, discerning manner to build market trust and improve the legitimacy and integrity of the VCM

What has happened

Much has already been said about the challenges that the VCM has faced in recent years. Some of this is a direct consequence of participants not acting with integrity or honesty. The impact that this has had on the VCM cannot be understated.

However, there has been some positives. The World Bank Group in its State and Trends of Carbon Pricing: International Carbon Markets 2024⁴³ identifies the increased sophistication of buyers, including a preference for high-quality investment. It reports that buyers are willing to pay large premiums for carbon credits of perceived higher quality and developmental impact. For example, in 2023 projects with certified co-benefits traded at an average price premium of 37% over other projects. Projects with Letters of Authorisations also commanded higher prices. The World Bank Group considers the higher prices could be attributed to their perceived integrity by alignment with the Paris Agreement.

The emergence of different carbon credit labelling tools (including Gold Standard's SDG labels and Verra's Article 6 labels discussed above) are further helping buyers to act in an informed and discernible manner when engaging in carbon offsetting.

Going forward

In the same way that implementing a clear, positive communication strategy around the VCM is so important now, so too is ensuring that market participants are acting in an informed and discernible manner when choosing to rely on carbon offsets. It is hoped that buyers continue to seek out high-quality, high integrity credits. The work by the ICVCM and the VCMI is considered to be helping, but more will be required. Adoption of the various labelling tools recently introduced by the different carbon standards should also assist.



⁴³ World Bank Group, State and Trends of Carbon Pricing 2024: <https://openknowledge.worldbank.org/server/api/core/bitstreams/253e6cdd-9631-4db2-8cc5-1d013956de15/content>

3.4 Government-led action

Governments and government-led action can have an instrumental impact on the VCM. Clear government support for VCM activities can deliver a great deal of confidence in a market of the particular jurisdiction and help to drive market participants (and ultimately climate finance) to those jurisdictions. Of course, express opposition to the VCM from governments will have the opposite effect. For that reason, Governments should recognise that and take care when engaging with the VCM.

Governments also have a fundamental role in finalising the operationalisation of the Paris mechanisms and ensuring they have the necessary domestic legislation in place to enable their countries to participate.

3.4.1 To foster VCM activities, host governments should demonstrate clear support for, and engage strategically in, the VCM

What has happened

The response by governments to the VCM has been mixed over recent years. On one hand, the most prominent display of governmental support for the VCM came from the Biden-Harris administration in the US. In May 2024, the administration released a statement supporting the potential of the VCM to “support decarbonization efforts and...provide myriad co-benefits”. The US Secretary of the Treasury, together with the Department of Agriculture Secretary, Department of Energy Secretary, Senior Advisor

for International Climate Policy, National Economic Advisor and National Climate Advisor published a joint statement titled “Voluntary Carbon Markets Joint Statement and Principles”⁴⁴ designed to enhance its integrity and scalability. The US’s Secretary of the Treasury has also publicly endorsed the work of the VCMI and ICVCM in raising integrity standards, as have ministers from countries including the UK, Ghana, Japan and Finland. The US’s apparent support for the VCM could however significantly change under the Trump administration.

Throughout Asia, several countries, including the Kingdom of Saudi Arabia, Abu Dhabi and Japan, have sought to establish carbon trading platforms or provide for carbon trading within their existing stock exchanges. Whilst not as explicit as the US, this action nevertheless demonstrates clear support for the VCM in those jurisdictions.

In contrast, in Africa, the focus has been on establishing a domestic regulatory environment to implement Article 6. For example, Kenya, Rwanda, Ghana, Tanzania and Zambia have all introduced new legislative frameworks to align with Article 6 (discussed further below).

However, a degree of governmental involvement in the VCM is important to help identify the opportunities VCM participation can offer a country, and to align approaches to the VCM with existing policy frameworks and goals. The UK’s approach provides a good example of this.

In March 2023, the UK government published its updated Green Finance Strategy and its Nature Markets Framework. Together, the strategy and the framework aim to foster growth in high integrity carbon and nature markets to unlock investment and support development of nature projects across England.

In October 2024, the UK released its Transition Finance Market Review.⁴⁵ The review recognised “*the significant potential and the opportunity that hosting a high integrity VCM could provide, including for scaling transition finance*” and recommended that the government promptly issue its consultation on scaling a high integrity VCM, including providing clarity to the private sector on the role carbon credits should play in transition plans. Fittingly, the review also emphasised the government’s role in “*demonstrating ambition and leadership*” to support greater drive in and application of carbon markets, including as part of UNFCCC negotiations.

Going forward

While the Paris mechanisms continue to develop, it is crucial that global climate action progresses without delay. The VCM will likely play a significant role alongside the Paris mechanisms, even as they become fully operational. Governments should realise the potential for voluntary carbon credits to support companies’ net zero and transition plans, and actively engage in establishing VCM infrastructure now. Doing so will both create an enabling environment for carbon

44 U.S. Department of the Treasury, May 2024. Available at: <https://home.treasury.gov/system/files/136/VCM-Joint-Policy-Statement-and-Principles.pdf>

45 Transition Finance Market Review, October 2024. Available at: <https://www.theglobalcity.uk/PositiveWebsite/media/Research-reports/Scaling-Transition-Finance-Report.pdf>

projects that contribute to governments' net zero and transition plans, and boost the demand-side of the VCM by making voluntary credits readily available to voluntary buyers within each jurisdiction.

3.4.2 Host governments should expressly recognise the ability to internationally trade carbon credits generated within their countries

What has happened

Following publication of Decision 3/CMA.3 and the rules, modalities and procedures for the PACM, several countries, including India, Indonesia, Honduras and Papua New Guinea, introduced moratoria on the issuance of carbon credits and/or international trading of carbon credits pending further clarity on how the VCM and the Paris mechanisms would co-exist, and the role the VCM could play in Parties satisfying their NDC targets. By and large, these moratoria have now been lifted. Whilst not every issue has been settled, evidently, enough progress has been made in clarifying the scope and role of the carbon trading mechanisms for NDC purposes that these once hesitant Parties have lifted their rudimentary bans. In their place, Parties are opting for the imposition of legislative frameworks to establish the boundaries necessary to foster carbon trading whilst protecting their domestic climate action needs.

At a policy level, Parties are also now increasingly willing to recognise the role of international carbon trading activities in their jurisdiction, whether within their NDC or in government statements or policies supporting the same. A broad sweep of countries around the globe has shown implicit support for international trading of carbon credits they generate by

issuing Letters of Authorisation (“LOAs”) in accordance with the Paris mechanisms, most notably Vanuatu, Thailand and Ghana, each of whom have agreed to sell ITMOs they produce to Switzerland.

Going forward

As suggested in our 2022 paper, Parties can deliver certainty to the market by expressly providing for carbon credits generated in jurisdiction to be traded internationally. Establishing the necessary legal frameworks to provide for this will be important. Later in this paper we consider what Parties are doing to deliver this.

3.4.3 Host countries concerned with benefit-sharing arrangements may wish to incorporate express benefit sharing requirements within existing national regulatory frameworks

What has happened

Benefit sharing arrangements have been a concern for many developing countries with regards to the VCM and its interplay with Paris mechanisms. A report by Carbon Market Watch in late 2023⁴⁶ found that comprehensive requirements for benefit sharing arrangements are not yet common practice, and that there is a high degree of variation in the quality of reporting on benefit-sharing. Our 2022 report recommended that governments concerned with benefit-sharing arrangements may wish to incorporate express requirements in national regulatory frameworks. Indeed, we have seen a number of countries do exactly this in recent years, albeit in different forms. For example:

- Following controversy at the Kariba avoided deforestation project in 2023, Zimbabwe implemented temporary statutory instruments entitling the government to 50% of revenue from carbon credit projects, with foreign and local investors receiving 30% and 20%, respectively. In May 2024, Zimbabwe's government sought to codify these measures in legislation, with higher levies for those projects with more significant community impacts. Such levies contribute to a “National Climate Fund” for climate change response actions.
- Kenya's Climate Change (Amendment) Act 2023 came into force in September 2023, requiring project proponents to outline expected benefits and establish community development agreements. These agreements mandate sharing benefits with impacted communities, contributing at least 25% of annual earnings to them. More recently, Kenya has introduced the Climate Change (Carbon Markets) Regulations 2024 to support and detail the 2023 Act, which maintains the 25% contribution for non land-based carbon projects but raises this to 40% for projects which are land-based.
- Papua New Guinea has introduced a national carbon market regulatory framework that enshrines benefit-sharing by mandating that 50-60% of the benefits (which includes community development projects and capacity-building initiatives as well as monetary benefits) from carbon projects must go to local communities. This is overseen by PNG's Climate Change Development Authority, which supports local communities in negotiations with developers to ensure that their community needs are prioritised.

⁴⁶ Carbon Market Watch and Oeko-Institut, November 2023, Assessing the transparency and integrity of benefit sharing arrangements related to voluntary carbon market projects. Available at: <https://carbonmarketwatch.org/wp-content/uploads/2023/11/Assessing-transparency-and-integrity-of-benefit-sharing-arrangements-related-to-voluntary-carbon-market-projects.pdf>

Going forward

Governments wishing to secure benefit arrangements may wish to consider these examples when developing similar arrangements within their own regulatory frameworks. Any benefit-sharing arrangements will need to be carefully considered and should aim to strike an appropriate balance between protecting some of the benefits achieved by the project or programme in question for the host country and its communities, and the need to ensure the countries remains an attractive investment opportunity for project proponents. Getting the balance wrong could drive prospective projects to other jurisdictions with more balanced (or no) benefit-sharing arrangements.

3.4.4 Parties should maintain a clear and well-defined NDC

What has happened

NDCs are at the heart of the Paris Agreement. NDCs represent each Party's pledge to reduce emissions with specific targets, as well as measures the Parties are taking to adapt to climate change including implementation strategies and time frames for achieving these goals.

The first global stocktake of NDCs was undertaken in 2023 and concluded at COP28 in Dubai. The purpose of the global stocktake was to evaluate the collective progress towards meeting the Paris goals and aims to inform the next round of NDCs due to be submitted in 2025. The results of that stocktake were published in March 2024 in Decision 1/CMA.5. In its decision, the CMA acknowledges that all Parties have communicated NDCs that demonstrate progress

towards achieving the Paris Agreement temperature goal and most provide the information necessary to facilitate their clarity, transparency and understanding. However, despite this progress, it was noted with significant concern that global GHG emissions trajectories were not yet in line with the Paris Agreement. Therefore, Parties are encouraged to come forward in their next NDCs with *"ambitious, economy-wide emission reduction targets, covering all GHGs, sectors and categories and aligned with limiting global warming to 1.5°C, as informed by the latest science, in the light of different national circumstances"*. Specifically, Parties are encouraged to communicate in 2025 their NDCs with an end date of 2035.

As to what these NDCs cover, the results of the global stocktake express appreciation that all Parties have demonstrated NDCs that demonstrate progress towards achieving the Paris Agreement temperature goal, noting that most provided the information necessary to facilitate their clarity, transparency and understanding. However, several market commentators have since raised concerns about the "investibility" of these NDCs. That is, while current NDCs provide a useful starting point for assessing countries' overall decarbonisation trajectories, their "investibility" remains difficult to assess. These market commentators raise concerns with the significant variance in quality and granularity of NDCs, the fact they do not have full sectoral coverage and often use different metrics to establish targets, are often submitted late, and generally lack alignment with other supporting documents and plans such as national adaptation plans and national biodiversity strategies and

action plans. Hence, there is clearly significant scope for Parties to improve their NDCs.

Going forward

Enhancing ambition is one of the two pillars of the COP29 vision. A key element of this, as recognised by the COP29 President-Designate in his letter to Parties in July 2024, is *"for the Parties to signal their own determination to act with ambitious, comprehensive, and robust NDCs"*. This reiterates the message from the CMA following the global stocktake of NDCs in 2023. Therefore, we can expect NDCs to be a key focus going into COP29 and beyond, as Parties seek to update and communicate their NDCs in 2025 with an end date of 2035.

In terms of the content of NDCs, the concept of "investable NDCs" has started to emerge. While there is guidance on information to facilitate clarity, transparency and understanding of NDCs, there is little available on what makes an NDC "investable". Market commentators⁴⁷ have suggested that for an NDC to be "investable" it should contain credible information, provide sectoral targets and pathways, quantify investment needs, provide for whole of government engagement, be supported by stable domestic policies and regulatory frameworks, and enhance global harmonisation and consistency across NDCs. If all of this can be achieved, it will be much easier for companies in those sectors to align their transition plans with the NDC whilst delivering certainty for investors and funders to understand where they should direct their finances. Parties should take care to align their NDCs with these broad principles so as to best position

47 Center for Climate and Energy Solutions, 25 July 2024, "What are "Investable" NDCs?" Discussion Paper available at: <https://www.c2es.org/wp-content/uploads/2024/07/20240723-C2ES-Investable-NDCs-FINAL.pdf>. Also see IIGCC, June 2024, "Making NDCs investable" – the investor perspective. Available at: https://www.iigcc.org/hubfs/POLICY/IIGCC_Making%20NDCs%20investable%20-%20the%20investor%20perspective_June2024.pdf

themselves to succeed in their NDC implementation and, where relevant, attract the necessary financial investment for doing so.

It is worth noting that the World Resources Institute's Climate Watch platform has launched an interactive NDC Tracker ahead of COP29. This will enable users to track and analyse new NDC submissions. With tools such as this becoming available, we expect the level of public scrutiny of Parties' NDCs to increase over time.

3.4.5 Host governments should consider G2G and/or B2G arrangements to make clear their positions with respect to Paris mechanisms and the VCM in order to support greater investment activity

What has happened

Government-led cooperative approaches sit at the core of the Paris mechanisms. In our 2022 paper, we suggested governments should consider government-to-government ("G2G") or business-to-government ("B2G") arrangements to make clear their position on the Paris mechanisms and the VCM. In the years since, G2G agreements laying the groundwork for Article 6.2 implementation have taken off, but are being driven by only a handful of countries. (See above recommendations to project proponents for more information on B2G arrangements.)

- Singapore has entered into MoUs with more than twenty countries including Bhutan, Cambodia, Chile, Fiji, Mongolia, Kenya, Rwanda and Vietnam to collaborate on carbon credits. These agreements create a framework for cooperation and outline the criteria for recognising the international transfer of mitigation outcomes by the treaty

parties. They also provide a legal foundation for commercial contracts between buyers and sellers of these ITMOs.

- Switzerland has signed bilateral agreements with Peru, Ghana, Senegal, Georgia, Dominica and Vanuatu to offset its emissions. Most recently, however, Switzerland completed the first bilateral transaction under Article 6.2 with Thailand, whereby Switzerland purchased 1,961 credits from Thailand's Energy Absolute with the funds used to support the replacement of petrol-fuelled buses in Bangkok with electric ones.
- Ghana has engaged in five G2G bilateral cooperative approaches. The participating Parties, with Ghana being the host country, include, Sweden, Singapore, South Korea and Liechtenstein.
- Japan has also run a Joint Crediting Mechanism for many years, whereby it partners with developing countries and facilitates their implementation of systems to decarbonise and contribute to sustainable developments, generating credits that Japan uses towards its NDC. As of February 2024, Japan had bilateral agreements with 29 countries, and in July its MoU with Thailand was updated to include references to carbon credits generated under the Paris Agreement and Thailand's Premium voluntary emissions reduction scheme.

The MoUs seen so far evidence a range of project types, from solar power installations to clean cookstoves to biogas. They typically cover an agreement for Parties to work together towards legally binding Implementation Agreements, to share best practices and knowledge of carbon market mechanisms to develop capacity, and identify potential Article

6.2-compliant mitigation projects that are most suitable for the Parties concerned. So far, Singapore's MoUs with Bhutan, Ghana, and Papua New Guinea have progressed to Implementation Agreements,

Notably these MoUs are not focused on the role of the voluntary carbon market and whilst the generic nature of some of their provisions could include VCM projects they seem focused on the Paris mechanisms.

Alongside these efforts, governments have been channelling their efforts into developing the necessary legislative and policy frameworks, such as creating an Article 6.2 registry, to encourage carbon activities generally within their jurisdiction rather than focusing on one or two carbon projects.

Going forward

G2G arrangements remain an option for delivering greater certainty to the VCM. Formal arrangements such as MoUs between Parties can provide clarity on carbon project and/or programme eligibility, whether certain emission reductions are within scope of a Party's NDC, and use authorisations and the need for corresponding adjustments - all whilst enhancing cooperation within the global community.

Governments should also be open to B2G arrangements with private market participants, such as investors, project developers or buyers. They could also be used for sector groups. Although not as scalable as G2G arrangements, B2G agreements can nevertheless offer certainty to support investment and financing. They can also be used to tie in at sectoral level to NDCs.

To be effective in promoting clarity and investment, a high level of detail in MoUs is desirable. Governments should be willing to share information about the types of carbon projects authorised for trading, whether under the Paris mechanisms or the VCM, the volumes of carbon credits intended for trade, any restrictions, and how accounting obligations, including corresponding adjustments, will be met. Transparency in governments publicly sharing the fact of their entry into MoUs and their details will also be important in encouraging a broader selection of governments to consider and enter into similar agreements to specify their intended approach to engaging with the Paris mechanisms and VCM.

3.4.6 Establish clear parameters for the granting of, and a standard form for, use authorisations.

What has happened

There are three categories of use authorisation for ITMOs recognised by the Paris mechanisms:

- Authorisation for use towards an NDC pursuant to Article 6.3;
- Authorisation for international mitigation purposes other than achieving an NDC (i.e., global compliance markets); and
- Authorisation for “other purposes” as determined by the first transferring participating Party. This is widely accepted to include voluntary offsetting purposes.

The use authorisation attributed to an ITMO has significant implications on the future application of those ITMOs. It

brings those ITMOs within the accounting that Parties must carry out when determining whether they have met their emission targets set out in the NDCs and will inform whether corresponding adjustments are required.

Given the implications of use authorisations, we recommended in our 2022 paper that clear parameters for the granting of, and a standard form for, use authorisations should be considered to ensure a consistent approach is taken by all Parties. Those that have emerged have all taken slightly different forms and styles; nevertheless, they all contain the same basic information and confirmations. At the time of writing, early form template LoAs were emerging from various industry bodies including the World Bank Group and Global Carbon Council.

More recently, several leading carbon standards including Verra and Gold Standard have also published their own template LOAs⁴⁸. In both cases, these LOA also inform certain “Article 6 labels” that the carbon standards have made available to projects. Verra describes implementation of these labels as bringing the voluntary carbon standard into alignment with how Parties are to account for their climate action.

One particular area of contention is whether a host Party should be able to revoke or amend an LOA after it has been issued. Some developing countries (e.g. India and China) insist that their sovereign rights should not be impinged by UNFCCC decisions and guidance, whereas others including the UK and Singapore, are pushing for clear, firm rules on revocation (given the impact that such uncertainties could have from an investment perspective).



⁴⁸ See for example: <https://globalgoals.goldstandard.org/501-letter-of-authorisation-for-use-under-article-6-template/>

As for actual LOAs by Parties, the interim CARP set up by the UNFCCC manages a register of LOAs. So far, only the following two have been recorded:

- an LOA by Suriname dated 29 May 2024 authorising that the GHG emission reductions and/or removals as verified under Article 5.2 and posted on the UNFCCC REDD_ Information Hub may be issued as ITMOs and used towards NDCs pursuant to Article 6.3 or for other international mitigation purposes; and
- an LOA by Guyana dated 22 February 2024. Pursuant to this LOA, the designated national authority authorises the REDD+ emissions reductions or removals from specified Programme Activities (details of which are not contained within the letter; an attachment has not been made available), issued as “ART Credits”, may be used for one or more of the following purposes: NDC purposes; international mitigation purposes; or other purposes.

Whilst only two LoAs have been recorded on the official CARP platform, 28 have been issued⁴⁹, both between governments (LoAs have been issued by each hosts Vanuatu, Thailand, and Ghana, in each case to Switzerland), and between governments and businesses. Rwanda and Madagascar have been most active in the latter type of arrangement, issuing four letters of authorisation each (the recipient being project developers DelAgua, Korea Carbon Mgt, and atmosfair).

Going forward

The lack of CMA decisions fully operationalising the Paris mechanisms has meant that the uptake of use authorisations has been slow, however, things appear to be moving in the right direction. If the relevant decisions are made by CMA, we expect that as more Parties become familiar with the mechanisms of use authorisations and the advantages these offer, more Parties will be willing to issue LOAs for carbon projects or programmes within their jurisdiction.

As for the form of LOAs, those issued so far provide a rudimentary understanding of their scope, but it remains to be seen whether they provide sufficient certainty to attract meaningful climate action and/or market participants to those jurisdictions. As such, opinions are still divided on whether the UNFCCC should draft a template for authorisations and whether such a template should be mandatory. More broadly, there is also no consensus yet on whether all authorisation elements should be consolidated into a single process or kept separate.

To this end, use authorisations are expected to be a key topic of discussion at COP29, where the Parties will be urged to try to agree guidelines on use authorisations, the focus being on agreeing standard procedures, forms and templates, the timing of authorisations, and setting clear rules around changes and revocation to authorisations.

3.4.7 Establish a registry for the tracking of ITMOs and, possibly, VCM activities

What has happened

Carbon registries serve both an accounting and transactional function. Transparent, fully functioning and interoperable registries are critical to the success of the Paris mechanisms (and the VCM if it is to grow and possibly integrate with the Paris mechanisms market). Hence, readying the necessary infrastructure to support the Paris mechanisms (and the VCM) is hugely important.

That the creation of an international registry for Article 6 transactions has become a major stumbling block in the Article 6 negotiations indicates it has taken on greater political significance than it perhaps merits, stoked by fears that it represents a threat to national sovereignty. There appears to be no major impediment from a legal or technical perspective to operationalising the registry if the Parties can agree upon its role.

At the UN level, the digital infrastructure needed to support the Paris mechanisms is progressing. This comprises the international registry administered by the UNFCCC Secretariat for participating Parties that do not have, or do not have access to, a registry (Decision 2/CMA.3, annex, para 30), the Article 6 database (to record and compile the quantitative annual information on ITMOs submitted by the Parties) (Decision 2/CMA.3, annex, para 32) and the centralised accounting and reporting platform (i.e., the CARP) (Decision 2/CMA.3, annex, para 35).

⁴⁹ See IETA's Letter of Authorisation Tracker available at: <https://www.ieta.org/resources/visualising-article-6-implementation/>

Conceptually, the international registry and the Article 6 database will be integrated parts of the CARP and are being developed, and will be maintained, by the Secretariat. Decision 6/CMA.4 requested the Secretariat to implement the international registry and make it available to Parties no later than end-2024 and to develop and make available the interim CARP and Article 6 database by June 2024 (a test version only) with a view to them being finalised by June 2025. The interim CARP is now operational and supports submission of initial reports, updated initial reports, and annual information pursuant to Decision 2/CMA.3. We understand that the international registry remains under development. However, a document published at the SBSTA 58 suggests December 2024 remains the targeted date for its rollout.

At a domestic level, states have a variety of options for securing the necessary infrastructure to support carbon activities within their jurisdiction. In our 2022 paper, we suggested host Parties with the resources to do so should consider implementing their own registries to allow complete oversight and control over the activities within their countries. A number of countries in Asia have been ahead of the curve in this respect having had some form of national registry or repository for climate change mitigation information in place for a number of years (for example, Indonesia, since 2016, and Singapore, since 2018). However, the structure and scope of these registries has evolved considerably in response to the VCM and the emerging Paris mechanisms. More recently, several countries in Africa have taken steps to establish their own registries. Zimbabwe, for example, has introduced a single, all-encompassing carbon registry for all

carbon trading information relating to both the VCM and compliance markets. Similarly in Kenya, regulations which came into force in May 2024 make provision for the establishment of a national carbon registry to keep, maintain and update registries of carbon market projects. Rwanda and Ghana are two other African countries that have set up their own registries for tracking the trade of mitigation outcomes.

Many other States are still considering their options. Those who do not have the capacity or resources to develop their own, or simply do not wish to, may rely on the international registry. Additionally, several international carbon standards and other organisations, including Xpansiv⁵⁰, S&P's IHS Markit carbon registry⁵¹, EcoRegistry⁵², and EcoConsortium⁵³, maintain their own registries. These could also may develop ITMO capacity to support States with no domestic registry.

Going forward

Developing the core infrastructure needed to support the Paris mechanisms and the VCM is crucial for achieving the operationalisation of these mechanisms and should remain a top priority. The unequivocal directions by the CMA to the Secretariat in Decision 6/CMA.4 to prioritise these workstreams is clearly garnering results, and we suspect many Parties are awaiting the rollout of the international registry to determine whether there is a need to develop their own. The focus should nevertheless remain on ensuring interoperability and technological innovation and Parties should seek out opportunities for shared learning from each other.

3.4.8 Establish a legal framework to operationalise the Article 6.4 mechanism at a domestic level

What has happened

In our 2022 paper, we recognised that host Parties would need to incorporate the Paris mechanisms into their legislative framework, in particular to provide a clear route for carbon projects (and market participants) into the PACM. Over the past two years, a significant number of jurisdictions have in fact implemented or begun implementing new legal frameworks, not necessarily specific to the PACM, but relating to carbon market activities more generally within their jurisdictions.

A number of initiatives have emerged which bring attention to these legislative developments with the aim of improving the understanding and transparency of carbon market regulations. In June 2024, Gold Standard released its Carbon Market Regulation Tracker which provides summaries (and links) to actual and proposed regulations concerning baseline and crediting market activities within the VCM and those under Article 6 (but excluding carbon tax policies or emission trading systems). The World Bank Group also maintains a State and Trends of Carbon Pricing Dashboard which is an interactive tool aimed at policymakers, businesses and resources to supply information on existing and emerging direct carbon pricing initiatives around the world.

Unsurprisingly, the form of legislative frameworks being introduced, and the extent of regulation imposed, varies

50 Xpansiv, <https://xpansiv.com/carbon/>; Xpansiv, 30 January 2024, Xpansiv Goes Live with Meta-Registry. Available at: <https://xpansiv.com/xpansiv-goes-live-with-meta-registry-integration-of-evidents-i-rec-registry/>.

51 QCI, 5 April 2024, S&P plans major carbon registry expansion in 2024. Available at: <https://www.qcintel.com/carbon/article/s-p-plans-major-carbon-registry-expansion-in-2024-23227.html>

52 Available here: <https://www.ecoregistry.io/>. Also see: QCI, 11 July 2023, ACX links up with Cercarbono, EcoRegistry to host credits. Available at: <https://www.qcintel.com/carbon/article/acx-links-up-with-cercarbono-ecoregistry-to-host-credits-15309.html>

53 QCI, 25 May 2023, EcoRegistry, Verdana create Asia Pacific digital carbon registry. Available at: <https://www.qcintel.com/carbon/article/ecoregistry-verdana-create-asia-pacific-digital-carbon-registry-14122.html>

considerably. However, certain fundamentals are emerging. Common elements of these legal frameworks include:

- the establishment (or designation) of governance or institutional arrangements for carbon activities;
- the delineation of certain basic parameters for the types of projects or activities eligible for carbon credits in that jurisdiction (sometimes also specifying applicable methodologies and crediting mechanisms); and
- basic procedural elements including reporting requirements, use authorisations and occasionally establishment of a national carbon registry (for accounting and/or transactional purposes) (discussed further above).

These core elements are important for ensuring alignment with the Paris mechanisms and should hopefully provide market participants some degree of certainty over carbon activities within the jurisdiction to encourage participation. Where some of the greatest differences lie is in aspects such as fee structures and/or benefit-sharing arrangements, and the procedure for obtaining use authorisations, which is reflective of differences in national circumstances.

Going forward

Operationalisation of the Article 6 mechanisms is a central element of enabling action; one of the two pillars of the vision for COP29. However, just as important will be ensuring the application or integration of these mechanisms at a domestic level. We are seeing considerable progress in this respect and are hopeful that this momentum can continue. Attention should, however, also turn to achieving consistency among

Parties to improve the understanding and operability of these domestic regimes.

There are resources available seeking to drive greater consistency among jurisdictions. The World Bank Group, together with Climate Warehouse, has published the “Country Policy Framework for Cooperative Approaches under Article 6.2”⁵⁴, which aims to identify a minimum legal foundation required to give Parties (including private sector entities) the necessary certainty with respect to cooperative approaches including their rights and obligations as participants and the ability to enforce cross-border contractual arrangements. Parties should draw from these resources, and each other, as far as possible, to help reduce fragmentation among Parties and enable effective engagement in carbon markets.

3.4.9 Formalise the legal nature of, and ownership rights over, carbon credits

What has happened

In our 2022 paper, we recognised that one way to attract additional investment in the VCM, particularly a secondary market, would be to codify the legal nature of, and ownership rights over, carbon credits. In practice, this has not happened in a consistent market-wide approach. However, a number of countries have sought to set out the status of carbon credits in their jurisdictions (as part of the legislation implementing the Paris mechanisms). Therefore, the legal nature of carbon credits continues to be debated, with varying views on whether carbon credits should be treated as documentary intangibles, personal property, financial instruments or commodities.



⁵⁴ Available at: <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/478601631780001402/country-policy-framework-for-cooperative-approaches-under-article-6-2>

Notwithstanding, certain trends have emerged among Parties. From an ownership and security perspective, the prevailing view appears to be that carbon credits are intangible property. From a financial perspective, an increasing number of countries appear to be amending their capital market laws and/or financial regulations to recognise carbon credits as financial instruments, thereby seeking to regulate carbon trading activities. Some argue that clear contractual provisions between market participants can inject enough certainty into the market for it to successfully operate regardless of the legal nature that any given jurisdiction ascribes to credits. For example, initiatives such as ISDA's Verified Carbon Credit Transactions Definitions⁵⁵ offer some standardised core terms for emission reduction purchase agreements. Some consider that this is enough to achieve sufficient clarity and consensus as to the legal nature of, and ownership rights over, carbon credits to enabling meaningful transactions, without jurisdictional or regulatory intervention to provide precise definition.

However, there are still those who consider that greater certainty is needed, particularly if a meaningful secondary market for carbon credits is to develop. To this end, the International Institute for the Unification of Private Law ("**UNIDROIT**"), in collaboration with the World Bank Group, has undertaken a project to analysis and define the legal nature of voluntary carbon credits. So far, three working groups have been held, with two more due in 2025. The key objective is to produce an international instrument providing guidance on voluntary carbon credits including, inter alia, the typical life cycle of a voluntary carbon credit, general principles surrounding carbon credits, transfer and/or retirement of voluntary carbon credits, custody and security.

The ultimate goal is to enhance confidence in the VCM and ultimately help establish a legal framework for the trading of voluntary carbon credits.

Going forward

We recognise that clear contracting can deliver sufficient certainty for many engaging in VCM transactions (evidenced by the volume of VCM transactions that have occurred to date). However, we also recognise that providing greater certainty has the potential to open the VCM to a broader pool of participants. Therefore, we remain of the view that addressing legal uncertainties about the nature and ownership of carbon credits remains important. For many investors and would-be participants, clarifying these aspects is a necessary precursor to their willingness to fully participate in the VCM. Not only would such clarity provide legal certainty with regards to ownership and transferability, but that certainty would enable financial security mechanisms which would, in turn, support development of a mature secondary market.

3.4.10 Consider the role that financial regulators could play in the VCM going forward

What has happened

The role that financial regulators could play in the VCM was largely untested at the time of our 2022 paper. We had recommended that this was worthwhile exploring as a means of promoting greater market integrity. Since then, there has been a noticeable shift in countries seeking to utilise their existing financial regulatory frameworks to provide for and, in a sense, regulate carbon trading activities in their jurisdiction. Egypt, for example, amended its capital market executive regulations to recognise and define carbon credits as tradable

financial instruments. In Abu Dhabi, the government has developed a new regulatory framework to treat carbon as a commodity and regulate carbon credits as an "environmental instrument" (being a new form of financial instrument). In Australia, "Australian carbon credit units" are classified as tradable financial instruments for the purposes of Australia's corporation laws (and personal property for property law purposes – see the discussion above about the legal nature of carbon credits). There is clearly a recognition among States that financial regulators can have a role in regulating, and promoting integrity within, voluntary carbon markets.

In our 2022 paper we also noted that the International Organization of Securities Commissions ("**IOSCO**") was at the time seeking to advance discussions about the role that financial regulators could play in promoting standardised operating principles and a robust underlying infrastructure for the VCM. At COP28, IOSCO released a consultation report⁵⁶ outlining 21 good practices to promote fair, efficient, stable and transparent markets. The suggested good practices focus on four key areas where financial regulators can have a positive role in developing market integrity, being:

- regulatory frameworks, by promoting consistency and cooperation between domestic and international regulators;
- primary market issuance, by promoting transparency, disclosure and accuracy in registries;
- secondary market trading, by promoting market functioning and transparency; and
- helping to ensure carbon credits are used and disclosed appropriately.

⁵⁵ Available at: <https://www.isda.org/book/2022-isda-verified-carbon-credit-transaction-definitions/>

⁵⁶ IOSCO, December 2023. Available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf>

The consultation closed in March 2024. IOSCO is now considering feedback and expects to issue a final report on the VCM in Q4 2024. It will be interesting to see whether IOSCO's findings encourage even more Parties to explore the role that financial regulators can have in carbon trading activities.

Going forward

As recognised throughout this paper, national regulations can have an important role to play in addressing some of the core criticisms of the VCM. If undertaken correctly, these can deliver a great deal of clarity and certainty which, as the market has demonstrated, are crucial to its success.

For many States, their existing financial regulators are in a prime position to assume this regulatory role (or at least in part). Classifying carbon credits as a financial instrument, for example, achieves a certain degree of oversight in respect of such activities which can improve market transparency and integrity. It creates the opportunity for the trading of these carbon-related financial instruments to take place on established and regulated exchanges or platforms (for example, a country's existing stock exchange, as is the case in Egypt, Abu Dhabi and Japan (among others)); that, in turn brings another layer of regulatory oversight. Parties should consider whether there is scope to expand their existing capital markets laws to recognise and provide for carbon credits as a financial instrument and carbon trading as a regulated activity.

A certain degree of financial regulation or oversight can also help to drive a meaningful secondary market by providing the foundation for derivative products linked to carbon credits to evolve. In its consultation report, IOSCO identifies a growth in such derivatives products, noting that several trading platforms have become more active as venues for these products (i.e., both spot instruments and their derivatives). The more widespread this becomes, the greater the market access and the more liquidity in the market, which in turn means a more active, efficient and transparent VCM.

Naturally, care must be taken not to over-regulate carbon trading activities which could inadvertently undermine the agility and flexibility that sits at the core of the VCM. Any such financial regulatory regime would also need to tie into the Party's broader climate change mitigation workstreams. As noted above, many Parties have introduced or are introducing legislative frameworks specifically for carbon-related activities. Where this is the case, it will be important that the different regulatory arms are aligned.





CHAPTER FOUR: CONCLUDING COMMENTS

4. CONCLUDING COMMENTS

While progress has been made against our 2022 recommendations, albeit in varying degrees, the issues they covered remain as relevant as ever. Until the Paris mechanisms are fully operationalised, the full potential of carbon markets to deliver critical funding for climate mitigation is not being realised. Our recommendations demonstrate the particularly significant role that governments and the CMA have in finalising both the Article 6.2 and 6.4 mechanisms, and the focus areas that remain unresolved. To this end, it is hoped that COP29 delivers on its two key pillars of enhancing ambition and enabling action but most pertinent, its commitment to finalise the operationalisation of Article 6.

Nevertheless, we expect the VCM to remain highly relevant including post-operationalisation of the Paris mechanisms, especially as an accessible means for non-governmental actors to buy, trade, and retire carbon credits against their hard-to-abate emissions. However, for the VCM to have a secure future, it is critically important that lingering concerns over integrity are addressed. That is why integrity underpins many of our updated recommendations, from the need for governing bodies to implement a communications strategy, to market participants engaging in more transparent information sharing, to governments utilising the existing frameworks and expertise of financial regulators. Integrity is truly the concept at the heart of a well-functioning carbon market. To the project developers and communities involved on the ground on the sell side of the market, integrity means that funds from credit sales reach meaningful and effective climate mitigation and sustainable development projects that are a lifeline for the planet's future. To corporates, governments, and other entities on the buy side of the market, integrity is what enables them to make valid claims about offsetting the emissions they produce. Without integrity, carbon credit sales

are open to criticisms that they are a pass for polluting entities to continue business-as-usual. Entities engaging in the Paris mechanisms and the VCM must keep the need for the highest standards of integrity at the forefront of their minds.

Our recommendations also demonstrate the need for a cooperative and collaborative approach to resolving the outstanding issues in the Paris mechanisms and the VCM. Few of our recommendations can be fully actioned by one stakeholder group alone. For example: meaningful knowledge-sharing initiatives require feed-in from a combination of market participants, governing bodies and carbon standards; resolving the continued controversy and confusion plaguing REDD+ will need significant input from both VCM governing bodies and the CMA; and governments implementing national legislative frameworks to support the Paris mechanisms will need to be conscious of regulating in a way that does not create further fragmentation or conflict with CMA guidance or best practice in the VCM. Collaboration is crucial for steering the constructive development of carbon markets and facilitating standardisation and interoperability

between mechanisms. The examples of collaboration throughout our recommendations illustrate the multifaceted approach needed to advance the global carbon market effectively.

Finally, our recommendations highlight the need to ensure that efforts to promote integrity, transparency, and certainty ultimately serve the development of carbon markets in a manner that draws greater investment. Early engagement between host governments and project proponents, G2G and/or B2G agreements, better and more granular detail in NDCs, and certainty with respect to the legal nature of carbon credits are areas ripe for improvement which, if delivered, will help to facilitate greater confidence in, and consequently more investment to support, such markets.

It is hoped that the global community continues to stand together and strives for the shared goal of combating climate change, and that the collective resolve of nations prevails, leading to actionable agreements that advance the operationalisation of the Paris mechanisms and bolster the integrity and effectiveness of carbon markets worldwide.

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