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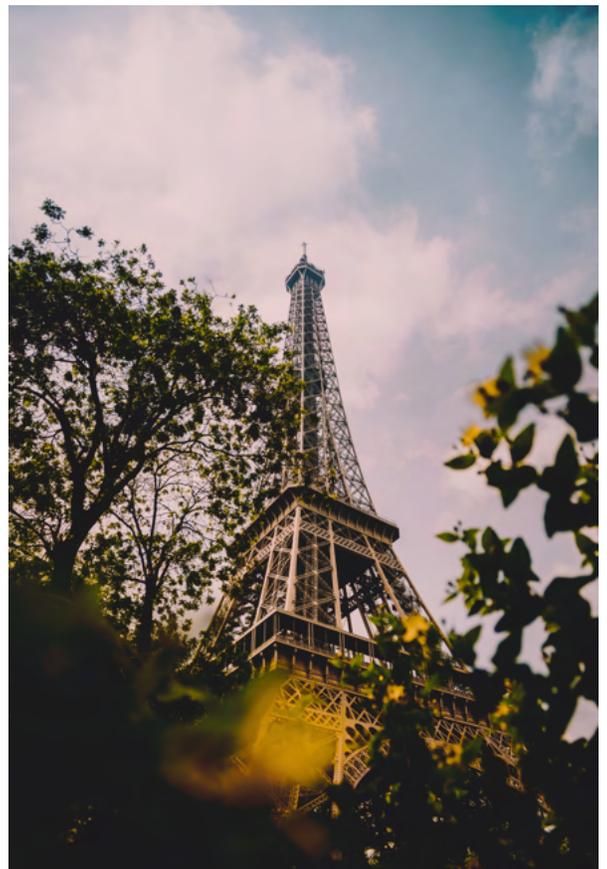
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Chapter 3: How does the voluntary carbon market link to the Paris Agreement and Article 6?

The voluntary carbon market (VCM) is governed by private standards and not by international or national regulatory bodies. However, projects and programs developed under the VCM may support countries in achieving their commitments under the Paris Agreement. To do so, VCM activities will need to comply with the Paris Agreement Article 6 rules that were finalized in November 2021.

What is the link between the VCM and the Paris Agreement?

The generation of carbon credits under the VCM is governed by greenhouse gas (GHG) protocols, programs, and methodologies that are administered by private standards. The Paris Agreement with its governing bodies has no **jurisdiction over the VCM**. However, the VCM is not disconnected from the international climate regime: GHG emission reductions or removals achieved through VCM projects and programs are captured by national GHG inventories, and VCM activities can assist countries to meet their Nationally Determined Contributions (NDCs) under the Paris Agreement.

What is the link between the VCM and Article 6 of the Paris Agreement?

Article 6 of the Paris Agreement provides flexibility to governments to engage in voluntary cooperation in the implementation of NDCs “to allow for higher ambition in their mitigation and

adaptation actions” (**Article 6.1 Paris Agreement**). The rules that govern such cooperation open the door to carbon market transactions under the Paris Agreement that may overlap, integrate, or compete with VCM activities. The clarification of rules for “cooperative approaches” under Paris Agreement Article 6.2 and for the “Article 6.4 mechanism” are of particular relevance to the VCM. Under Article 6.2, GHG emission reductions or removals can be transferred between countries as Internationally Transferable Mitigation Outcomes (ITMOs). A country may authorize ITMOs i) for use towards an NDC, ii) for “international mitigation purposes” other than NDC-achievement (e.g., comply with the Carbon Offsetting and Reduction Scheme for International Aviation—CORSA, see Box 3.1), or iii) for “other purposes.” Authorization for “other purposes” is not defined, but generally understood to refer to the use of ITMOs towards corporate and other voluntary climate commitments.

Article 6.2 implementation guidelines require “corresponding adjustments” for all authorized mitigation outcomes—that is, for all ITMOs. A corresponding adjustment is applied to balance the accounting under the Paris Agreement: an emission reduction is removed from the accounts of the selling country and added to the accounts of the buying country. Corresponding adjustments ensure that governments reporting under the Paris Agreement meet good accounting principles and that no GHG reduction or removal is accounted for twice. Figure 3.1 shows a corresponding adjustment between two countries.

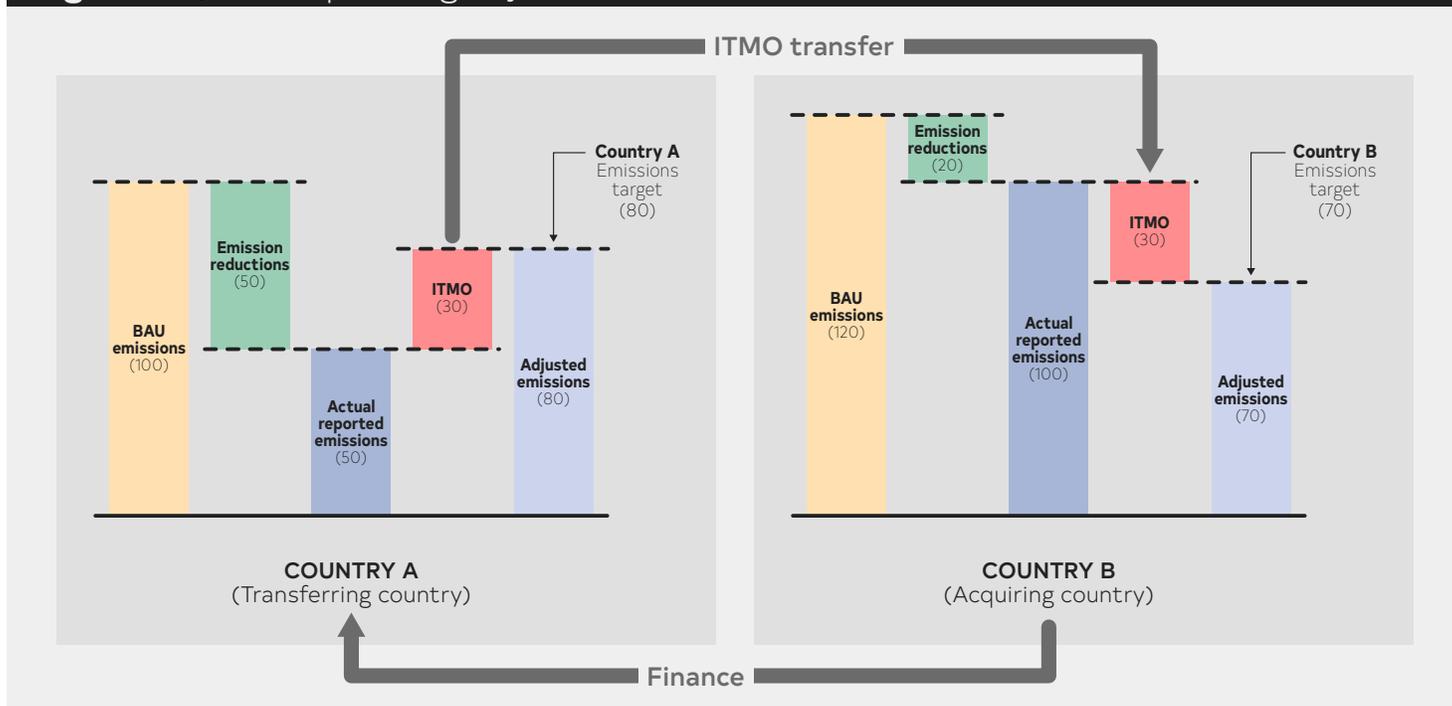
Box 3.1: CORSIA, a special case for corresponding adjustments

The Carbon Offsetting and Reduction Scheme for International Aviation (**CORSIA**), adopted by the International Civil Aviation Organization (ICAO) in 2016, is a short-to-medium-term strategy (2021-2035) for the aviation industry to achieve carbon neutrality through offsetting while low-emission aviation technology is being scaled up. CORSIA is a **compliance mechanism** that allows the use of **VCM carbon credits** to meet compliance obligations. CORSIA covers flights from all countries that have volunteered to participate until 2027, at which point about 90% of flights will be covered, excepting only those from Least Developed Countries and Small Island Developing States. To ensure the environmental integrity of offsets used for compliance, **CORSIA requires corresponding adjustments for VCM transactions** and credits are restricted to those from GHG emission reduction or removal activities approved by the ICAO council.

Article 6.4 defines a mechanism that can be understood as a revised, modified and ‘improved’ version of the Clean Development Mechanism (CDM). Countries have to approve Article 6.4 mechanism activities. Once GHG emission reductions and removals are certified, they generate Article 6.4 Emission Reductions (Art.6.4ERs). Similar to Article 6.2 cooperative approaches, under Article 6.4 host governments have the ability to authorize the use of Art.6.4ERs for NDC achievement, international mitigation purposes, and other purposes. Authorized Art.6.4ERs fall under the definition of ITMOs and, thus, corresponding adjustments must accompany the transfer of Art.6.4ER units.

Countries can decide to support cooperative approaches and Article 6.4 mechanism activities without authorizing (all) mitigation outcomes (Article 6.2) or Art.6.4ERs (Article 6.4) for corresponding adjustments. In that case, the resulting GHG emission reductions

Figure 3.1 | Corresponding adjustment between two countries



and removals are counted towards the host country's NDC. Mitigation outcomes and Art.6.4ERs without authorization may be applied to results-based payment schemes, national carbon pricing systems, or VCM transactions.

VCM projects and programs can continue without any reference to and inclusion in Article 6 modalities. In the future, host countries may offer to include VCM activities in an Article 6.2 cooperative approach or approve VCM activities under Article 6.4. In that case, some of the resulting GHG emission reductions or removals may be authorized for corresponding adjustments. However, countries will meet a number of institutional and regulatory requirements before they can host or participate in Article 6 activities.

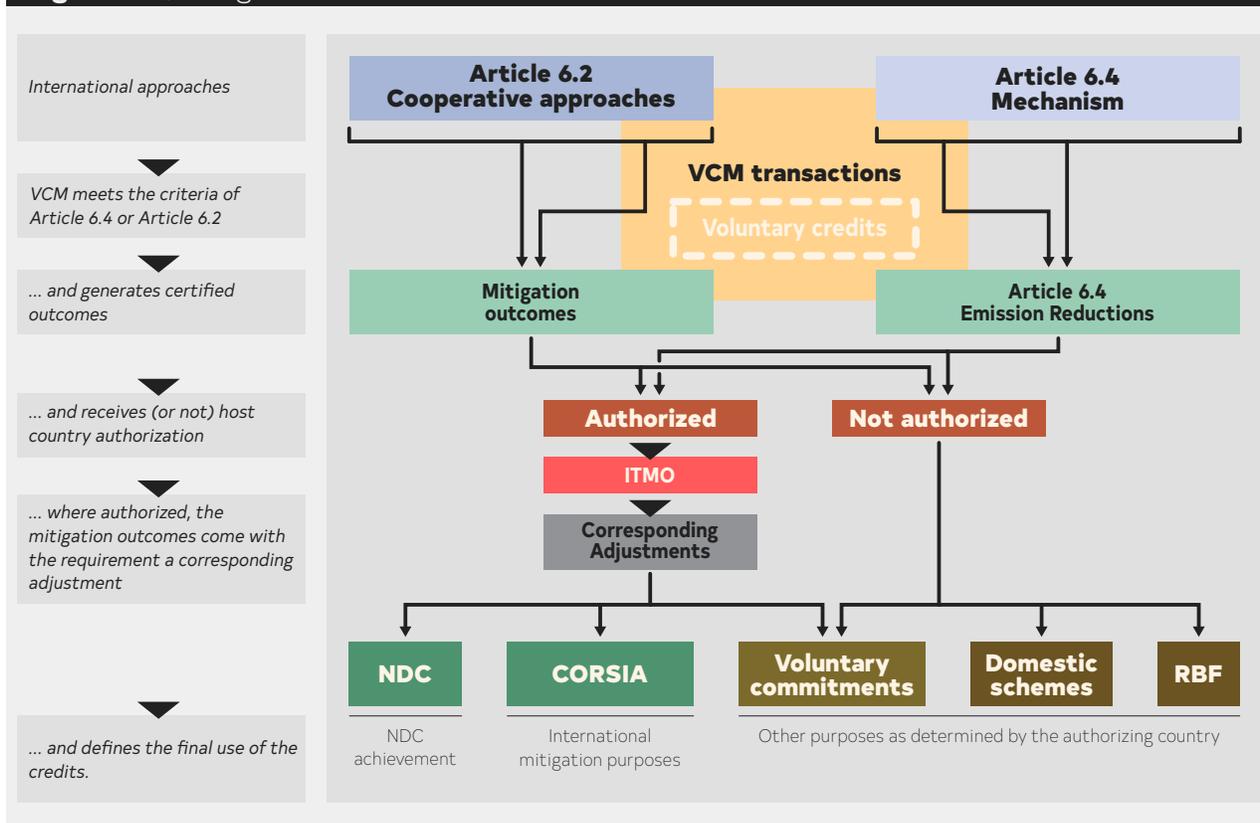
Figure 3.2 shows how VCM and Article 6 transactions work under the rules

established at COP26. Authorized transactions of mitigation outcomes under Article 6.2, Art.6.4ERs, and VCM credits may be authorized—requiring corresponding adjustments—for use toward NDCs, CORSIA compliance, and voluntary transactions. Not authorized outcomes, emission reductions, or credits do not require corresponding adjustments and may be used toward “other purposes” determined by the host country, which may include voluntary transactions, domestic schemes, and results-based finance (RBF) schemes.

How can the VCM support achieving and exceeding Nationally Determined Contributions?

To mobilize the full mitigation potential of the VCM, it is important to establish a common understanding of when and how activities that generate carbon credits under the VCM contribute to

Figure 3.2 | The generation and use of carbon credits after COP26



Graph modified from Perspectives Climate Research gGmbH

host countries' NDCs. How and to what extent VCM projects and programs support national climate goals depends on the type of VCM project or program, whether the project or program is in a sector that is covered by host countries' NDC targets, whether those targets are conditional or unconditional, whether the project or program is in an activity type or sector that the country is authorizing under Article 6 for corresponding adjustments, and whether the right to claim associated climate benefits is traded out of the country along with the carbon credits.

While the VCM can directly or indirectly support countries in achieving or exceeding their NDC targets, there is a fear that VCM activities may undermine the achievement of NDCs. Specifically, there is concern that the VCM could displace company abatement actions or that governments could become overly reliant on private actions and VCM credits. However, the displacement risk may be minimized when VCM activities complement government action by complying with all requirements to be authorized and backed by corresponding adjustments, by contributing to sectors covered by conditional NDC targets, or by operating in areas not covered by NDCs or public policy.

Governments can act proactively to mitigate the risk that VCM activities would undermine NDC achievement and to encourage VCM activities that are complementary to public action. They can clarify how VCM projects and programs—and Article 6 activities—complement public policies and specifically identify sectors in which VCM investments are welcome. VCM projects can also continue to attract investments while governments

establish the institutions and regulations necessary to operationalize Article 6 activities and authorize or approve projects under Article 6.2 or 6.4. Governments can clarify how they will define “other purposes,” which types of VCM activities they will authorize under Article 6 to be backed by corresponding adjustments, and which activities they will approve but not authorize under Article 6.4. Governments can encourage investments in carbon projects in priority sectors—e.g., those sectors that are not covered by the NDC—where government regulation is not expected to be sufficient to incentivize behavior change or where mitigation benefits are expected to be technically complicated or costly to achieve.

Carbon projects or programs can complement public efforts by generating carbon finance that allows countries to meet conditional NDC targets. The host country could account for the GHG emission reductions and removals from VCM activities under its conditional NDC targets. Similarly, when VCM projects or programs are developed in sectors, for activities or for types of GHGs that are not covered by NDCs, the finance from the sale of these carbon credits may be able to support host countries in achieving additional mitigation benefits. In both cases, host countries could decide to authorize VCM emission reductions and removals and back them with corresponding adjustments. However, even if there are no corresponding adjustments, in these cases, the risk that VCM activities displace public action is limited.

When VCM activities are in a sector covered by an unconditional NDC target, they directly assist host governments to achieve this target—like any other domestic, voluntary effort to reduce or

remove GHG emissions. In this case, the VCM and Article 6 activities could be integrated into public policies and used to achieve NDC targets. If there is a high number of VCM transactions channeling large amounts of finance, governments may be disincentivized from adopting additional and potentially more ambitious climate policies and NDCs that cover more sectors. This would lead to a displacement of public action. In these cases, authorizing the use of internationally-transferred VCM carbon credits for offsetting by adding corresponding adjustments would ensure environmental integrity. When **the trade of carbon credits** in the VCM is not backed by corresponding adjustments, the host country retains the right to apply the climate benefits associated with VCM projects or programs in its jurisdiction towards its NDC targets.

Further Reading

1. Howard, A., & Greiner, S. (2021). *Accounting Approaches for the Voluntary Carbon Market*. *Voluntary Carbon Markets Global Dialogue*.
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2. Marcu, A. (2021). *Article 6 rule book: A post COP26 assessment*. *Roundtable on Climate Change and Sustainable Transition (ERCST)*. <https://ercst.org/post/cop26assessment/>

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