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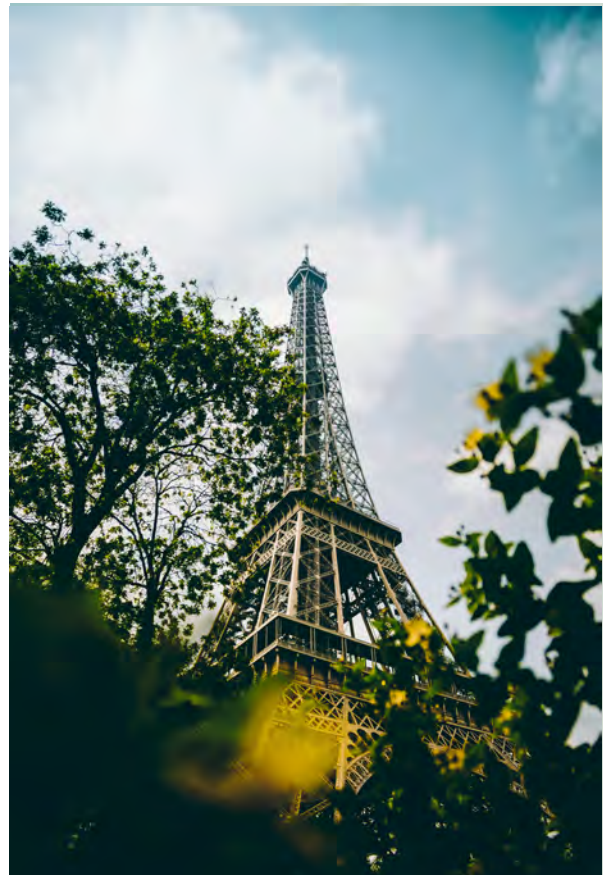
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Chapter 3



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

The crediting of greenhouse gas (GHG) emission reductions and removals in the voluntary carbon market (VCM) is governed by private **carbon standards**. National regulatory bodies can define rules for VCM activities, but they are not involved in the certification of GHG emission reductions and removals or the issuance of **carbon credits**. VCM activities can support countries in achieving their commitments under the Paris Agreement.

To avoid double claiming of GHG emission reductions and removals, some market actors seek approval of VCM activities under Article 6 of the Paris Agreement. In that case, VCM activities need to comply with the Paris Agreement Article 6 rules that are being developed by the United Nations Framework Convention on Climate Change (UNFCCC).

What is 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 Nationally Determined Contributions (NDCs) “to allow for higher ambition in their mitigation and adaptation actions” (**Article 6.1**

Paris Agreement). This includes engaging with the VCM. The rules that govern this voluntary cooperation open the door to carbon market transactions under the Paris Agreement that may overlap, integrate, or, in the case of Article 6.4, compete with VCM activities. Article 6.2 of the Paris Agreement provides modalities and guidance to ensure that activities that transfer GHG emission reductions and removals (‘mitigation outcomes’) do not result in the double counting of GHG emission reductions and removals under more than one NDC. A host country can authorize the use of GHG emission reductions and removals generated by a VCM activity towards the NDC of another country, other international mitigation, or other purposes. In this case the activity will need to comply with the Paris Agreement Article 6.2 implementation guidance. GHG emission reductions and removals can also be authorized to count towards the NDC of another country, other international mitigation commitments or other purposes. In that case, the country where the mitigation action took place (the “host country”) needs to ensure that the authorized GHG emission reductions and removals are not counted towards its own NDC.

Article 6.4 of the Paris Agreement defines a mechanism that can be understood as a revised, modified and ‘improved’ version of the Clean Development Mechanism (CDM). The rules and modalities that govern Article 6.4 mechanism are still being developed. Once they are operational, the Article 6.4 supervisory body will register projects, and countries will be able to approve and authorize activities under Article 6.4. It is unlikely that VCM activities will seek approval under Article 6.4. Instead, Article 6.4 directly competes with standards that offer the certification of VCM projects. Companies may choose to invest in activities approved under Article 6 rather than in VCM carbon credits.

The results of activities that remove or reduce GHG emissions are referred to as “mitigation outcomes” under Article 6.2 and as “emission reductions and removals” under Article 6.4 (abbreviated as Art.6.4ERs).

How do the VCM and Article 6 interact?

There are a range of different ways that the VCM and Article 6 may interact. Host countries may choose to integrate current and future VCM activities into an Article 6.2 program. Private actors may invest in cooperative approaches that are guided by governments’ Article 6.2 programs. Governments may take an active role in defining which VCM activities will be authorized

under Article 6.2 and steering VCM investments. Or, governments may choose not to link VCM activities to Article 6 and only provide minimal guidelines that ensure VCM activities are aligned with country priorities.

The paragraph of Article 6 that is most relevant to the VCM is Article 6.2. Under Article 6.2, GHG emission reductions or removals can be transferred between countries as Internationally Transferable Mitigation Outcomes (ITMOs). Transactions under Article 6.2 are referred to as “cooperative approaches.” To be transferred, ITMOs must be authorized by the host country. A country may authorize ITMOs i) for use towards an NDC, ii) for “international mitigation purposes” other than NDC achievement (e.g., to comply with the Carbon Offsetting and Reduction Scheme for International Aviation—CORSIA, 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

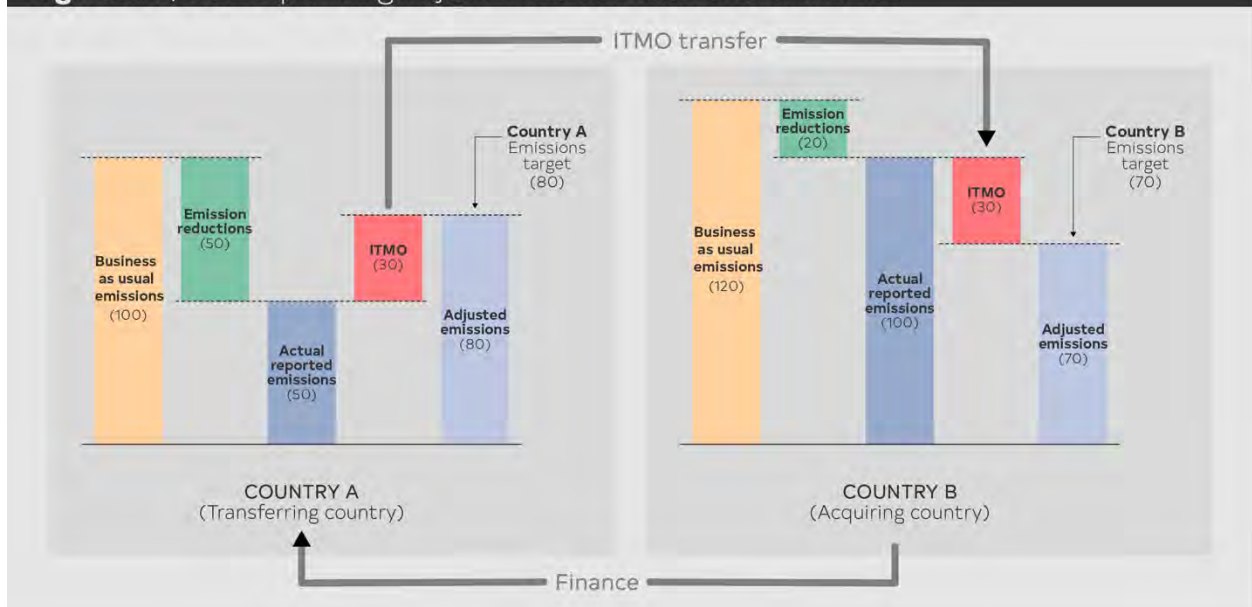
The Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), adopted by the International Civil Aviation Organization (ICAO) in 2016, is a short-to-medium-term strategy (2021-2035) for the aviation industry to achieve carbon neutrality through offsetting while low-emission aviation 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.

Do VCM activities need Article 6 authorization and corresponding adjustments?

VCM activities do not require Article 6 authorization or corresponding

adjustments. A part of the VCM is likely to continue to operate without any reference to or inclusion in Article 6 mechanisms. However, governments and VCM participants may wish to include some VCM activities under Article 6.

Figure 3.1 | Corresponding adjustment between two countries



In some cases, buyers are indicating a preference for credits that have corresponding adjustments. This means that Article 6.2 rules are impacting the VCM.

The VCM and Article 6 will coexist in a variety of modalities (Figure 3.2). This is positive, as different countries will need different approaches depending on their context and priorities.

Host countries have control over whether the GHG emission reductions and removals that are achieved by VCM activities will be authorized as ITMOs or counted towards their NDCs. Countries can decide if all, none, or some VCM activities will be authorized as ITMOs under Article 6.2. If a host country does not authorize VCM credits to be traded as ITMOs, then it can count those VCM GHG emission reductions and removals towards its own NDCs. Mitigation outcomes and Art.6.4ERs without authorization may also be applied to results-based payment schemes,

national carbon pricing systems, or VCM transactions.

Figure 3.3 shows how VCM and Article 6 transactions work under the Article 6 rules. Transactions of mitigation outcomes under Article 6.2, Art.6.4ERs, and VCM credits may be authorized—requiring corresponding adjustments—and then be transacted as ITMOs 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.

Most countries have yet to decide whether and when they will transfer ITMOs. They also have yet to develop the institutional and regulatory requirements they need to host or participate in Article 6 activities. Host countries may offer to include VCM activities under

Figure 3.2 | Different modalities of the VCM and Article 6 coexistence



Article 6.2 cooperative approaches or approve VCM activities under Article 6.4. In those cases, some of the resulting GHG emission reductions or removals may be authorized corresponding adjustments and host countries and VCM activity developers will need to ensure that activities comply with the Article 6 rules to generate ITMOs.

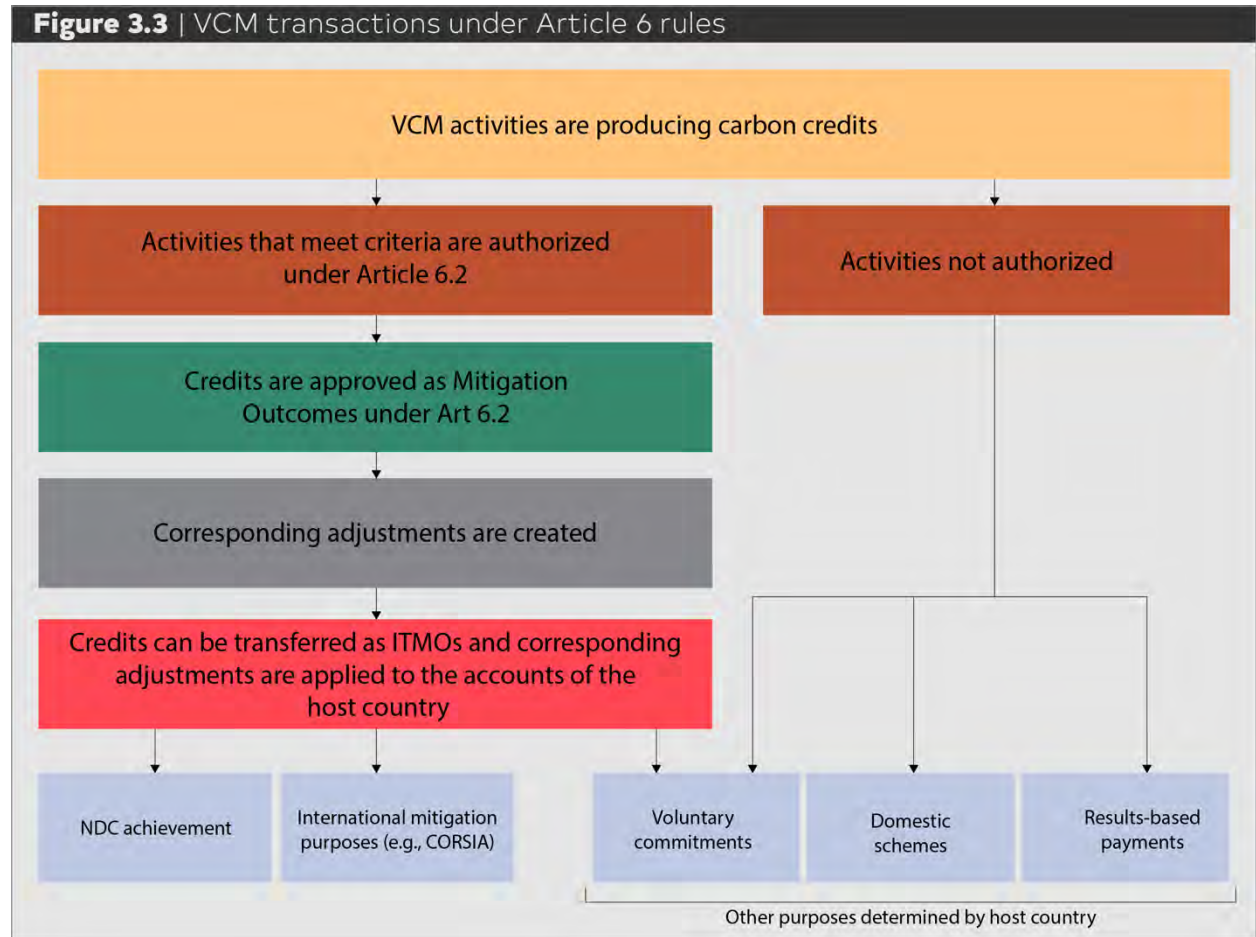
How can the VCM support achieving and exceeding NDCs?

To mobilize the full mitigation potential of the VCM, it is important to establish a common understanding of when and how VCM activities that generate carbon credits contribute to host countries' NDCs. How and to what extent VCM activities support national climate goals depends on the type of VCM activity, whether the activity is in a sector that is covered by host countries' NDC targets, whether those targets are conditional or unconditional, whether the activity 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.

Governments can proactively encourage VCM activities that are complementary to public action. They can clarify how VCM and Article 6 activities complement

public policies and specifically identify sectors in which VCM investments are welcome. VCM activities can also continue to attract investments while governments establish the institutions and regulations necessary to operationalize Article 6 activities and authorize or approve VCM activities 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 activities in priority sectors 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.

VCM activities can complement public efforts by generating carbon finance that allows countries to meet NDC targets. The host country could offer Article 6.2 authorizations for GHG emission reductions and removals generated by VCM activities under its conditional NDC targets. When VCM activities are developed in sectors, for activities, or for types of GHGs that are either covered by the conditional NDCs or not covered by NDCs at all, the finance from the sale of these carbon credits may be able to support host countries in achieving additional mitigation benefits.



Further reading

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