Adaptation finance and Article 6 of the Paris Agreement

- **Submission by Norway**

Greater levels of finance are essential to enable adaptation action in developing countries, in particular for the most vulnerable countries and communities. Norway recognizes that the Paris Agreement calls for a balance between adaptation and mitigation finance and that too little finance has been allocated to adaptation. Innovative financing mechanisms can help in such upscaling if designed properly.

Experiences with share of proceeds (SoP) under the Kyoto Protocol (KP), including the Clean Development Mechanism (CDM), can provide important lessons for the design and expectations related to SoP for the mechanism under Art. 6.4, as well as for the discussions on the proposed SoP for Article 6.2. Lessons relate to volume, timing and predictability of funding. These insights can be helpful in finding ways in which cooperation under Article 6.2 may contribute to financing adaptation efforts.

Norway appreciates that t]he mechanism under the Paris Agreement's Article 6.4 has a provision for SoP, similar to the provisions for the CDM, while there is no similar legal basis for SoP in Art. 6.2, which Norway sees primarily as an accounting framework. The 6.4 mechanism has the potential to raise both ambition in terms of emission reductions and to contribute to adaptation finance. Unfortunately, experience from the CDM tells us that the revenues from such finance mechanisms may not be predictable and substantial.

Features relevant for monetization of SoPs.

Standardized units with multiple users are easier to monetize through a market. The Kyoto Protocol creates a system where units are standardized and more narrowly defined than ITMOs under the Paris Agreement. Certified Emission Reductions (CERs) from the CDM could therefore be traded through i.a. exchanges. Emission reductions from the 6.4 mechanism may get similar properties as the CERs. AAUs have to some extents been traded between countries and other buyers bilaterally, and to some extent been transferred and acquired for accounting purposes without payments, reflecting underlying cooperation in trading schemes.

In comparison, all ITMOs may not necessarily by unitized, nor authorized to be freely tradable in the same way as the CERs, ERUs and AAUs are, but could rather be restricted for use by the cooperating Parties only. There is also a chance that not all ITMOs will apply the same metrics (i.e. be measured by the same CO_2-equivalents).

Experience from the CDM

CDM has generated more than USD 200 million for adaptation finance since 2009[1]. Issuances under the CDM grew until about 2013, and for some years monetization of the

[1] The Adaptation Fund has reported these revenues – volumes sold, prices and holdings of CERs, on p. 48-49 in: FCCC/KP/CMP/2019/4−FCCC/PA/CMA/2019/2 Microsoft Word - 1916244E.docx (unfccc.int).

Certified Emission Reductions (CERs) gave considerable revenues. Prices for the CERs were reasonably high until 2012 and reached a persistent minimum level in 2013. Reflecting the difficulties in the market, a considerable part of the accumulated SoP CERs transferred to the adaptation fund has not been monetized.

Over the years SoP from CDM has generated less than a fourth of the funds of the Adaptation Fund, but the relative importance as a source for finance to the fund has decreased over time.

For comparison, the CDM's SoP for administrative purposes, which is a fixed sum (USD 0.20/CER with some exceptions) paid at issuance, has shown a somewhat different path as prices in the market only indirectly affects the revenue through volume. These SoP have eventually generated some more revenues than the SoP of 2% of CERs for adaptation purposes.

Based on the experience from the CDM, SoP from 6.4 has the potential to generate significant finance for adaptation. However, the revenues cannot be assessed with much certainty as there are major uncertainties both related to the price and issuance of volumes.

Experience from International Emissions Trading under the Kyoto Protocol related to proposals for SoP on Art. 6.2.

There has been no revenue from the 2% SoP agreed in Doha in 2012 (Dec. 1/CMP 8 para 21) on AAUs traded under the International Emissions Trading mechanism, and neither can any substantial revenue be expected from this arrangement. This despite that Norway and other European parties are engaged in emissions trading which will lead to AAU transfers under the Kyoto Protocol that are subject to SoP for the second commitment period. The timing of when the AAU SoP for KP 2 will accrue – in 2022/2023 - has not been affected by the late entry into force of the Doha Amendment.

The trading relevant for KP is derived from the regional European Emissions Trading scheme (ETS). In the first 4 years year traded units (EUAs) in the EU-Norway cooperation also implied transfers of Kyoto AAUs. As of 2012, this trading has for various practical reasons entailed transfers of AAUs after the trading period, on a net basis, as a result of a decision taken earlier. This is also the way such AAU transfers related to ETS will happen for the 2013-2020 period.

The important lesson is that the flow of AAUs between EU and Norway pertaining to our ETS cooperation takes places only once and after the commitment period. For KP 1 a transfer from the EU to Norway occurred in 2015. Similarly, the transfer related to KP 2 could be expected in 2022/2023. These transfers reflect the net position of the Parties involved in the cooperation and not the actual volumes of units (EUAs) that have travelled back and forth between installations in the cooperating countries. Such net figures could be very small even if trade volumes were quite high during the period.

Only in 2022/2023 SoP for KP2 will be sent to the Adaptation Fund at the time of transfer of AAUs. Details of how this transfer will happen is included in the European Registry Regulations as amended in 2019.

There were no monetary payments involved in the KP1 transfer between EU and Norway 2015. The transfer was purely part of an accounting exercise. Similarly, no payments will be involved in the exercise for KP2.

The Adaptation Fund will have to monetize the AAUs from SoP after receiving the 2% of the units transferred/acquired by EU and Norway. We do not to expect high prices for these AAUs from KP2 in 2022/2023. There is a chance that they cannot be sold at all, as the only compliance users would be Annex B Parties to the Protocol.

Under the Paris Agreement, Parties may choose to transfer ITMOs only after the NDC periods (typically in 2032/2033 for the first NDC). Where these transfers reflect schemes like ETS this would likely be the preferred option. Such ITMOs may be less standardized and have more narrow use than the KP units. Consequently, any monetization of the proposed SoP from cooperation on emission reductions under article 6.2 would have encountered similar or bigger difficulties related to timing and predictable funding than the units under the KP. Any SoP ITMOs reflecting mitigation outcomes from pre-2030 may have limited or no monetary value if they were made available only in 2032/2033.

Implications for discussions on SoP for art. 6.

If Parties choose to engage extensively in the Article 6 mechanism giving significant volumes and prices, the 6.4 mechanism can give most welcome adaptation finance. However, the volume and timing of this contribution is hard to predict and maybe a small part of international adaptation finance.

Any SoP applied mechanically to other forms of cooperation, such as 6.2 ITMOs, could not be expected to generate significant revenues. This observation could be valid even if the ITMOs are well defined as units, such as the AAUs were under the KP.

Any application of the proposed SoP in 6.2 pertaining to some forms of cooperation would likely occur after the NDC period. For countries with targets ending in 2030 this could mean 2032/2033. Consequently, any SoP arrangement for 6.2 would likely channel only limited amounts of adaptation finance in the next decade. We realize that some other forms of cooperation under 6.2 could generate flows of ITMOs before the end of the NDC period if Parties so choose.

Further, ITMOs may only be recognized for use by those Parties actually involved in a particular form for cooperation under Article 6.2. It may therefore not be possible to monetize them, and any SoP of such ITMOs may not be meaningful to convert to funds through the market.

End note:

Parties may become involved in many different forms of cooperation that will eventually lead to transfers of ITMOs under Art. 6.2. It will be up to the Parties involved to decide on volumes and timing of ITMO transfer – whether transfers will happen as emissions reductions are verified or only after the NDC periods are over. The cooperative measures underlying the ITMOs, such as ETS, may involve issuance and flows of major assets between countries, as the European ETS does for the international emissions trading in KP2. However, the issuance and transfer of ITMOs themselves may be small, may not occur before after 2030 and SoP may not be possible to monetize.

Unlike for 6.4, the features of the underlying cooperative activities such as crediting schemes or ETSs, resulting in ITMO transfers under 6.2 are not envisaged to be regulated under the Paris Agreement – only the accounting of the outcome in the form of ITMOs (or in some instances MOs). Rather than any mechanically applied SoP, a better and more promising way to generate adaptation finance would therefore be a strong encouragement from the CMA to the Parties using cooperative approaches, to find ways to contribute resources to adaptation to assist developing country Parties that are particularly vulnerable to the adverse effects of the climate change, and a reporting requirement in that respect in the BTRs. This is in line with the proposed compromise provision in Madrid, and it may well merit consideration again.