



What is the future of the CDM?

Questions and answers



Introduction

The second commitment period of the Kyoto Protocol (CP2) will come to an end on 31 December 2020, leaving the fate of the Clean Development Mechanism (CDM) uncertain. The focus and attention has now shifted to the Paris Agreement. Countries will begin to implement their Nationally Determined Contributions—in which they outline their mitigation and adaptation ambitions—and have already begun negotiating a new rulebook under the Paris regime. This includes guidance for bilateral cooperative approaches between governments (Article 6.2 of the Paris Agreement) and modalities for a new centralised mechanism (Article 6.4 of the Paris Agreement).

While the CDM has no expiration date and could, in theory, remain operational indefinitely, a number of developments may impact on its operational status after 2020. For instance, Parties to the Kyoto Protocol may decide to formally discontinue the CDM after 2020. In the current negotiations, a number of Parties agree that it would not be efficient to have the CDM running

indefinitely and in parallel with the Article 6.4 mechanism, especially if both mechanisms have similar objectives and scope. At the same time, several Parties understand that the CDM should continue in one way or another and might not agree to formally discontinue the CDM before a suitable alternative is agreed.

The CDM may also stop as a result of a declining interest in the mechanism going forward. For instance, Parties could eventually cease to nominate members to the CDM Executive Board, essentially leaving it non-operational. External financial factors may also play a role, with the CDM possibly running out of resources to keep its full support structure functioning.

Another option is that Parties may allow the CDM to continue under Kyoto, but restricted to certain types of CDM operations and transactions. For instance, Parties may decide that a pure offsetting mechanism would not be aligned with the spirit of the Paris Agreement, but that the CDM would remain instrumental as tool for delivering results-based mitigation (using, among others, its voluntary cancellation feature).

Finally, a group of countries has also been active in promoting the transition of the CDM—or the migration of its key elements—into Article 6.4 or Article 6.2. In fact, a number of countries' formal submissions in the context of Article 6 have emphasised the need of ensuring a smooth and simple transition of the CDM, giving market predictability for CDM participants and allowing the rapid scale-up of existing mitigation activities.

Against this backdrop, CDM project developers need to carefully consider all possible scenarios affecting the availability of the CDM beyond 31 December 2020 and how these scenarios may impact their mitigation activities and the issuance of Certified Emission Reductions (CERs). This briefing aims to shed light on the discussion through a set of questions and answers addressing key concerns CDM project developers will face as the CP2 period enters its final years.

Pre-2020 CDM activities and CERs

What could happen to registered CDM activities after 2020?

It is still undecided what will happen with registered CDM activities after 2020. The CDM is not directly recognised by the Paris Agreement, therefore CDM activities are not automatically acceptable under the Paris regime. However, Parties to the Paris Agreement are currently negotiating guidance and rules for Article 6 and countries could eventually agree to some form of recognition of registered CDM activities under Paris (please refer to question 2 below).

In addition, other schemes may continue to recognise existing CDM activities including the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) implemented by the International Civil Aviation Organization, and bilateral programs that make use of results-based climate finance.

Could registered CDM activities become recognised under the Paris Agreement?

In the negotiations related to Article 6 of the Paris Agreement, countries are currently discussing the possibility of migrating registered CDM activities into the new regime. Although Party positioning can vary substantially in the details, two broad trends can be identified.

Some Parties are in favour of migrating all registered CDM activities directly as these activities have already been vetted by the UNFCCC and should continue without any interference or additional procedures.

Most Parties, however, condition migration of CDM activities on meeting Article 6.4 requirements. How this would work has yet to be determined. It is possible that a fast-track process or another dedicated transition arrangement is established for registered CDM activities. Successful migration into the Paris Agreement could, for instance, be conditioned upon changes to the baseline and a review of the additionality argument in light of the host country's Nationally Determined Contribution pledges.

Moreover, some Parties are exploring if project developers could be given reassurance on the kind of requirements that are going to emerge to allow for early action. Other Parties, however, do not think this is feasible and that doing so could raise false expectations. It is unlikely that Parties will agree to a clear pathway for the transition before 2018.

Could CP2 CERs be recognised under the Paris Agreement?

Recognising CP2 CERs under the Paris Agreement appears more difficult and less likely than the recognition of CDM activities. Several countries have already voiced their concerns in allowing pre-2020 emission reductions to achieve Nationally Determined Contributions (as this could negatively impact mitigation ambition under the Paris Agreement). This said, transition of CP2 CERs remains a remote possibility. It could occur via a transition criteria that limits the volume of CP2 CERs that could migrate and/or only allow migration of CP2 CERs from a narrowly defined set of activities.

It is noteworthy that other regimes may also become a source of demand for these CERs. This may include the CORSIA as well as certain domestic regimes (e.g. domestic emissions trading or carbon taxes). Rules defining eligibility of emissions units under CORSIA are expected by 2018.

Could registered CDM activities continue under the Kyoto Protocol?

Even with the Paris Agreement in place, it is likely that registered CDM activities could continue under Kyoto until at least mid-2023, when the true-up period is expected to end (see 'Box: True up period' on page 3 for an explanation). After the true-up period it becomes riskier for registered CDM activities to rely on the availability of the CDM.

Emission reductions occurring during the second commitment period (i.e. pre-2020) are presumed to remain valid after 2020 until at least the end of the true-up period. During this period, these emission reductions could continue being issued as CP2 CERs, as well as being forwarded, traded and used for Kyoto compliance purposes.

However, based on experiences with the first commitment period of the Kyoto Protocol, trading and retiring of CP2 CERs would probably be prohibited after the true-up period. In the absence of a third commitment period, carry-over of CP2 CERs under Kyoto would probably also not be possible.

In addition, there remains a chance that countries could agree to keep certain key CDM functionalities available even after the true-up period. In this case, CP2 CERs could potentially be allowed to remain in a CDM registry account and CP2 CERs could also be subject to voluntary cancellations.

What is the relevance of the true-up period?

The existence of the true-up period has direct relevance for registered CDM activities and pre-2020 CERs, as during this period it is likely that the CDM will remain fully operational. This means that during the true-up period, the CDM Executive Board is likely to continue with its regular supervisory functions and the CDM registry will still be able to perform all transaction types concerning CP2 CERs.

Once the true-up period is over, however, there would be fewer incentives for Kyoto Parties to keep the CDM. Therefore, the risk that the CDM is no longer operational or becomes somewhat restricted increases after the end of the true-up period. It may be that a lack of attention and interest in the mechanism leads to the CDM running out of resources to maintain its operations. If so, CDM project developers managing activities with crediting periods spanning beyond 2020 could be negatively affected.

That said, it is still possible that countries will agree to maintain the CDM as it is, or, at least agree to keep certain key functionalities ongoing. This could include, for example, the opening of holding accounts, and issuance and voluntary cancellation of CERs for results-based climate finance purposes.

Box: True-up period

The 'true-up period' refers to the additional period of 100 days that Annex 1 countries to the Kyoto Protocol (i.e. those with commitments to reduce their greenhouse gas emissions) may use to fulfil their respective commitments if they have not yet done so. During this period, all transactions that involve trading of Kyoto units continue to be possible.

The precise date on which the true-up period begins is not fixed in advance. It is defined by the Parties to the Kyoto Protocol (COP/MOP) as a function of the centralised review of countries' emissions inventory. The second commitment period will end on 31 December 2020 and the last inventory reports should be submitted by countries by 15 April 2022. Given the experience with review procedures during the first commitment period, it is likely that the review process for the second commitment period will be concluded by mid-2023.

Post-2020 CDM activities and emission reductions

What could happen to CDM emission reductions occurring after 31 December 2020?

Except for the possibility of applying the CDM as a tool for other uses such as voluntary cancellations, issuance and trading of emission reductions occurring after 31 December 2020 (e.g. as 'post-2020 CERs'), it is unlikely to be possible under the Kyoto Protocol. As of 1 January 2020, accounting for emissions and emission reductions will be governed by the Paris Agreement, and a number of countries are not in favour of having the CDM operating indefinitely as a pure offsetting mechanism.

If a CDM transitional arrangement to migrate existing CDM activities into the Paris Agreement is agreed, eligible activities which successfully undergo this transitional process would then be able to have their CDM emission reductions recognised under the Paris Agreement (for instance, for the purposes of transfer and use to achieve National Determined Contribution pledges). The migration date could be used to determine which emission reductions are valid under the Paris Agreement.

In the absence of CDM transitional arrangements, or for CDM activities that do not qualify for a possible transitional arrangement, project developers could apply anew to have their activities recognised under the Paris Agreement as either an Article 6.4 market mechanism or as a bilateral cooperative approach between two governments under Article 6.2. This new application would have to follow the specific set of rules or guidance still to be agreed under the Paris Agreement (and potentially bilaterally by countries).

Could CDM activities be registered by the Executive Board after 2020?

There is a risk that Kyoto Parties decide to halt registration of new CDM activities by 2020 or shortly thereafter.

On the other hand, it is worth noting that the CDM Executive Board is engaged in promoting the CDM as a tool for other uses (other than offsetting), including assisting host countries in achieving their Nationally Determined Contributions. It is therefore possible that the CDM Executive Board continues to register activities after 2020 and, for example, makes available an enhanced online platform for voluntarily cancelling CERs.

In addition, non-registered CDM activities could also apply anew for registration under Article 6.2 or Article 6.4 of the Paris Agreement, respectively as a bilateral cooperative approach between two governments or as market mechanism. Such application would have to follow Paris Agreement rules and guidance, which are still to be agreed upon.

Assuming it would be possible to issue CERs post-2020, would host countries promote them?

Under the Paris Agreement all countries put forward mitigation contributions and/or pledges, so host countries are likely to pay more attention to which emission reductions are used towards the country's own mitigation pledge, and which ones can be used for other purposes.

If post-2020 CERs become possible, a host country would probably be more careful with authorising trading of post-2020 CERs which stem from activities that fall within the country's Nationally Determined Contribution scope. The host-country would likely want to make sure that the CDM activity's baseline is duly aligned with its Nationally Determined Contribution target.

In addition, the host country would also have greater incentive to make sure CERs are truly additional and properly captured in their emissions inventory. Finally, host-countries may also prefer to keep cheaper emission reductions at home and authorise only the transfer of those that are derived from more costly abatement opportunities.

Staying ahead

While the negotiations on cooperative approaches between governments and modalities for a new market mechanism under the Paris Agreement are well underway, countries still have to decide upon nearly all aspects of Article 6, including the fate of the CDM. This briefing aims to shed light on ongoing discussions and provide an insight into key concerns for CDM project developers, by presenting possible scenarios and their consequences for CDM activities and their emission reductions.

As a pioneering international advisory company on carbon markets and climate finance, Climate Focus supports public and private CDM project developers in keeping up with the new international climate regime and devising optimal emissions management and carbon asset strategies.

This briefing note draws on key insights from a transition report that was developed for the **World Bank's Carbon Initiative for Development (Ci-Dev) as well as from the **CDM Transition Initiative** led by Climate Focus and Koru Climate. The initiative fosters solutions for the CDM after 2020 and explores technical options for migrating elements of the CDM into the Paris Agreement. A detailed options report of the CDM Transition Initiative is available at:**

www.climatefocus.com/publications

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