

Carbon markets

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COP26 carbon market rules

Howie Lee
Economist
+65 6530 1778
howielee@ocbc.com

What is the Paris Agreement Article 6?

Article 6 pertains to international carbon markets. Notably, there are two parts to Article 6:

- a) **Article 6.2** allows for a bilateral/multilateral arrangement between countries for an international emissions trading scheme framework. A country that has overachieved its climate pledge under its Nationally Determined Contributions (NDCs) can sell its excess emission savings to another country.
- b) **Article 6.4 allows for the creation of an international carbon offset market**, where projects such as afforestation, renewable energy plants, etc generate emission credits. These credits can be bought by states, private entities and individuals.

COP26 international carbon market agreements

The table below summarises the main agreements clinched on international carbon markets at COP26.

Achievement Level	Overarching topic	Deal struck	Issue going into COP26	Comments
Big Win	Double-counting	No double-counting. The country that generates the credit will decide whether to authorise it for sale to other nations or to count towards their climate targets.	Countries like Brazil were adamant that carbon offset credits producers should be allowed to <u>both</u> authorise a sale to buyer countries as well as count the offset credits towards their own NDCs.	A big win. We thought if the likes of Brazil – whose previous insistence on double-counting torpedoed carbon market talks at COP25 – could agree on a five-year phasing out of double counting, it would have been regarded as a triumph for the integrity of international carbon offset markets. For an agreement reached by all Parties to only count a carbon offset credit once is beyond our most optimistic expectations.

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Decent Win	Adaptation Fund	5% of all traded proceeds will be channelled to the UN Adaptation Fund.	In the Kyoto era, a levy on CDM trades were placed and proceeds were channelled towards the Adaptation Fund, which aids vulnerable countries in combating climate change. This pertains to Article 6.4.	This policy officially formalises expectations of support towards vulnerable countries via the Adaptation Fund, which has been highly expected prior to the summit. What was disappointing (although expected) was the continued objection from wealthier nations to pay levies on country-emissions trading (Article 6.2). On a net basis, both were expected, and the formalisation of the 5% offset proceeds should be regarded as a decent win.
Decent Win	Overall mitigation in global emissions (OMGE)	2% of offset credit projects will be cancelled to provide a net-positive climate impact.	Offset credits have been criticised as a net-zero tool, which contradicts the goal of OMGE.	Going into COP26, countries were in broad agreement for the need of OMGE via offset markets, but Parties were divided on its mechanics. Applying a 2% haircut on projects under Article 6.4 provides a clear framework on how to achieve OMGE through carbon markets.
Disappointment	Carryover of all Kyoto Protocol credits	Only vintage credits beginning 2013 and newer can be brought forward into the Paris Agreement, which is estimated at about 320 million offset credits.	The World Bank estimates old and existing carbon offset credits from the Kyoto Protocol under the Central Development Mechanism (CDM) at a total of about 4 billion credits. Allowing all 4 billion to transit into the new market system under the Paris Agreement would almost certainly dwarf demand for offset credits, depressing prices and turning the carbon market into a lame duck.	We had used ICAO’s goalpost of recognising only vintages from 2016 towards CORSIA requirements as the benchmark, so dating credits from 2013 was a disappointment in our opinion.

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Overall thoughts: Stronger international carbon market from COP26

Considering how previous carbon market talks in prior COPs went up in smoke, COP26 provided a strong rulebook for how international carbon markets should and could function. The biggest takeaway is the clarity present in major announcements – quantifiable proceeds towards the Adaptation Fund and OMGE as well as a clear consensus on double-counting. Even the disappointing recognition of offset credits from 2013 is well-defined, as a consolation. It is still not perfect and far from ideal, but the international carbon market integrity now looks more solid compared to pre-COP26. Going forward, the focus shifts to enhancing enforcement, transparency and accountability in upholding these rules.

Treasury Research & Strategy

Macro Research

Selena Ling*Head of Research & Strategy*LingSSSelena@ocbc.com**Tommy Xie Dongming***Head of Greater China Research*XieD@ocbc.com**Wellian Wiranto***Malaysia & Indonesia*WellianWiranto@ocbc.com**Howie Lee***Commodities*HowieLee@ocbc.com**Herbert Wong***Hong Kong & Macau*herberthywtong@ocbcwh.com

FX/Rates Strategy

Frances Cheung*Rates Strategist*FrancesCheung@ocbc.com**Terence Wu***FX Strategist*TerenceWu@ocbc.com

Credit Research

Andrew Wong*Credit Research Analyst*WongVKAM@ocbc.com**Ezien Hoo***Credit Research Analyst*EzienHoo@ocbc.com**Wong Hong Wei***Credit Research Analyst*WongHongWei@ocbc.com

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