VCM-SOPA

A SHARE OF PROCEEDS FOR ADAPTATION (SOPA) IN THE VOLUNTARY CARBON MARKET (VCM)

Discussion Note[1]

March 2022

by Benito Müller,[2] with contributions from Hanna-Marie Ahonen,[3] Pedro Moura Costa,[4] Daniel Ortega-Pacheco,[5] Moekti (Kuki) Soejachmoen,[6] and Charlotte Streck.[7]

Table of Contents

---

[1] *The views expressed in this Note do not necessarily reflect the views of the affiliated institutions of the authors and contributors.*

[2] Managing Director, OCP and Director ecbi. Oxford Climate Policy, Linton Road, Oxford OX2 6UD, UK. director@oxfordclimatepolicy.org.

[3] Senior Researcher, Perspectives Climate Research, Helsinki, Finland.

[4] Director, BVRio and Oxford Climate Policy, Oxford, UK.

[5] Director, Center for Public Policy Development - ESPOL Polytechnic University, Guayaquil, Ecuador.

[6] Executive Director, Indonesia Research Institute for Decarbonization (IRID), Jakarta, Indonesia

[7] Co-founder, Climate Focus, Berlin, Germany.

Introduction & Recommendations

Social responsibility is one of the key motivators of voluntary corporate action, and the recent growth of awareness related to voluntary action reflects increased interest in the IPCC, the Paris Agreement (PA), and the UN Sustainable Development Goal (SDGs).

In this context, it is valuable to harness carbon markets to promote multiple co-benefits in addition to mitigation, including adaptation co-benefits, particularly if they promote global equity by generating resources – for example through a *Share of Proceeds for Adaptation* (SOPA) – to support those who suffer most from adverse impacts of climate change while having contributed least to causing it.

Increasing social as well as environmental integrity are among the top governance requirements that have been identified by the Task Force on Scaling Voluntary Carbon Market (TSVCM), a private sector-led initiative working to scale an effective and efficient voluntary carbon market to help meet the PA goals, initiated in September 2020 by Mark Carney, UN Special Envoy for Climate Action and Finance.

Potential buyers are concerned about reputational risks that could arise from purchasing credits. Minimizing these risks is one of the key reasons why market actors have called for the development of oversight efforts with the mission of promoting the integrity, liquidity, and growth of the VCM. In response, the Integrity Council for the Voluntary Carbon Market (ICVCM, successor to the TSVCM) and the Voluntary Carbon Markets Integrity Initiative (VCMI) have been set up with the aim *inter alia* of ensuring the integrity of credits and associated corporate claims. To do so, they have embraced a wide-ranging membership of companies and organizations active in all VCM segments and engaged with industry groups, investor alliances, government agencies, and non-governmental organizations (NGOs) whose members or activities are involved in the market. Furthermore, Nordic stakeholders are co-creating a Nordic Code of Best Practice for voluntary compensation under the Nordic Dialogue on Voluntary Compensation, drawing on and complementing other ongoing initiatives such as the ICVCM and VCMI.

The VCM has thus currently the unique opportunity to explore the value proposition that a SOPA can provide to stakeholders. Given the political buy-in that SOPA can bring about, as observed during the CDM development (see section 1), and the policy need to align with the provisions of the Paris Agreement (PA), ongoing efforts to improve the governance of the VCM (including those of the ICVCM and VCMI) should strive to:

1. encourage standard setters to promote a SOPA;
2. incorporate into VCM regulatory provisions for a SOPA as a key component of good governance and a high-level principle for the market, to ensure environmental and social non-carbon positive impacts;
3. enhance coordination of supply and demand oversight efforts, to foster synergies towards effective SOPA implementation and delivery.

1. Why a SOPA?

1.1. SOPA in multilateral carbon markets: A Brief History

The notion of a 'share of proceeds' first appeared in the multilateral climate change discourse during the negotiations of the Kyoto Protocol (KP) in the context of the negotiations of the Clean Development Mechanism (CDM) that led to paragraph 12.8 stating that the governing body of the KP:

- "shall ensure that a share of the proceeds from certified project activities is used to cover administrative expenses as well as *to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation*." [emphasis added]

The origin of the CDM lies in a proposal by Brazil which "sought to impose quantified emissions limitation and reduction objectives – binding emission caps on the Annex I countries' GHG [greenhouse gas] emissions – on the basis of historical responsibility, rather than on the basis of each country's current emissions. [The Brazilian proposal] included a Clean Development Fund, which was to be funded by fines paid by Annex I countries that exceeded their emissions caps. The proceeds of the Clean Development Fund were to be distributed among GHG emission reduction projects in developing countries, with preference given to countries with greater projected (1990–2010) GHG emissions."[Cole (2012) pp.42-3][8]

Box 1.1. *Genesis of the CDM: the original policymaking goals of the 1997 Brazilian proposal and their evolution in the Kyoto protocol negotiations into the CDM*

by John C. Cole, *International Environmental Agreements* (2012), 12. p.52

"This article argues [Brazil] believed that the mere existence of a project mitigating GHG emissions below an appropriate baseline comprised sufficient sustainable development [...]. This does not mean that Brazil ignored the interests of other developing countries. On the contrary, Brazil supported the inclusion of a sustainable development prong to ensure that developing countries could implement their priorities; however, the timeframe between Brazil's agreement with the US on the CDM and the Kyoto negotiations was such that it was not possible to canvass the positions of other developing countries extensively outside the informal working group chaired by Brazil under the Committee on the Whole at the Kyoto conference of parties.

In interviews the Brazilian CDM architects recalled that they addressed their objective of achieving consensus among the G-77 and China by designing the CDM to be a mechanism benefiting developing countries that had not contributed to climate change in any meaningful way, but will nevertheless suffer its consequences, both in terms of mitigation and adaptation. The Brazilian Proposal had addressed adaptation through the adaptation fund."

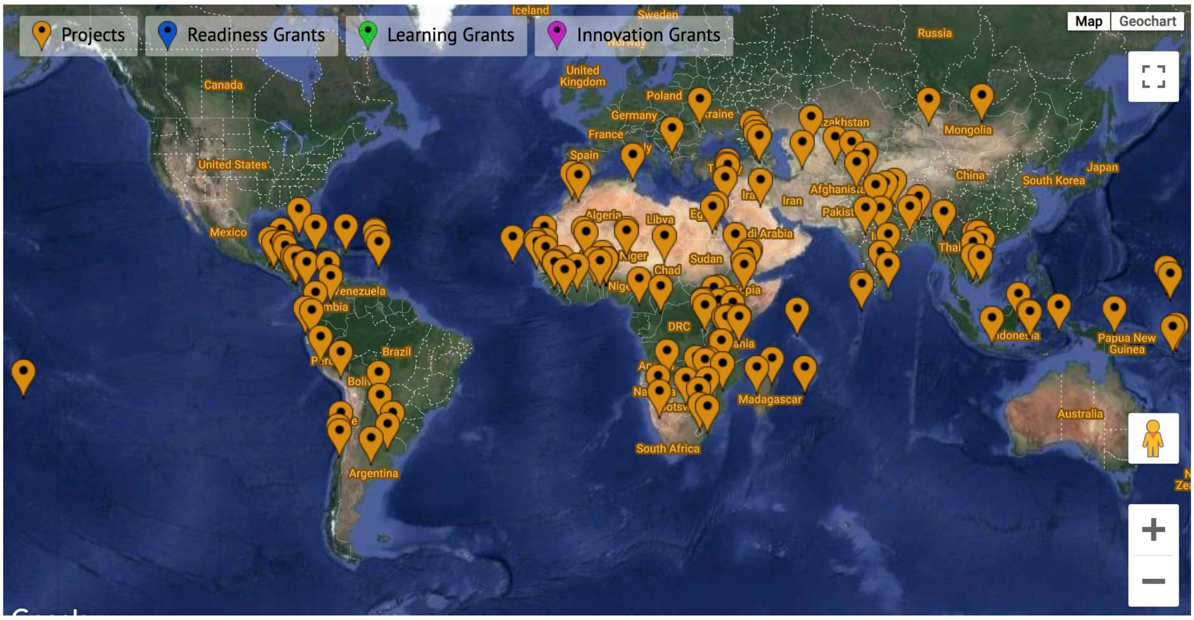
The KP defined the purpose of the CDM, *inter alia*, as assisting developing countries "in *achieving sustainable development* and in contributing to the ultimate objective of the Convention" [Art. 12.2, emphasis added] which has led to considerable controversy as to whether this has actually been achieved. The answer is, as so often: that depends on what you mean by 'sustainable development'. Cole argues (see Box 1.1) that the original conception was rather narrow, assuming "the CDM project's existence, alone, would comprise sufficient sustainable development to achieve the CDM's sustainable development goal."[*ibid*] It is also worth noting that in the resource allocation proposed for the Clean Development Fund, large developing country emitters were meant to get the lion's

[8] The main reason why the original Brazilian Proposal was rejected is the idea of imposing penalties on non-compliance.

share of the funding and thus most of the sustainable development benefits, as interpreted in this narrow conception. However, as elaborated in Cole (2012) (see Box 1.1), this would not have been acceptable to the majority of the poorest and most vulnerable countries, who typically are not large emitters, and it is only through the introduction of a share of proceeds for them to address their adaptation needs that consensus could be achieved in Kyoto.

The adoption of a market-based allocation of projects under the CDM followed the CDF rationale, and it was to be expected, indeed arguably intended, that the geographic distribution of projects would be uneven, ending up with over 85% of issued *Certified Emission Reductions* (CERs) originating in Brazil, China, and India. Any unfairness of "effectively crowding out the most vulnerable countries to climate change, like SIDS and LDCs"[9][Qui (2018) p.10] in the sustainable development benefits of the CDM was meant to be addressed by the share of proceeds for adaptation, provided that this is actually reach the most vulnerable, which would obviously not be the case if the additional benefits were limited to host countries.

In the case of the CDM SOPA, this was achieved by channelling the SOPA resources through a new dedicated Adaptation Fund (AF) explicitly "established to finance concrete adaptation projects and programmes in developing countries that … are particularly vulnerable to the adverse effects of climate change"[AF website] as reflected in the geographical spread of its projects:



Source: AF Website

The idea of a SOPA for multilateral emission trading schemes was validated when it was introduced into Art. 6.6 of the PA, *inter alia* again "to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation."

It should be noted in this context that developing countries fought hard to have the SOPA extended beyond the Art. 6.4 mechanism, to the collaborative approaches under Art. 6.2.[10]

[9] SIDS: Small Island Developing States; LDCs: Least Developed Countries.
[10] Art.6.2. "Parties shall, where engaging on a voluntary basis in cooperative approaches that involve the use of internationally transferred mitigation outcomes towards nationally determined contributions, promote sustainable development and ensure environmental integrity and transparency, … ".

1.2. VCM-SOPA: Why?

a. VCM Project Benefits

The benefits associated with VCM projects can be divided into those that are 'local' – meaning that they can only be enjoyed by those living in the vicinity of the project location – and those that are not.

Non-local benefits include the benefits associated with the core product of the projects (namely emission reduction credits), be that as sales revenue (to the project owner), or as compliance/public relations benefits (to the 'end-user'). If the project generates a genuine emission reduction (which is not the case if the relevant credits are used as offsets to justify additional emissions), then there are global benefits, including a reduction in the need to adapt.

Local benefits (often referred to as 'co-benefits') can be due to the project's mitigation itself – such as in the case of health benefits due to a reduction of pollutants being associated with the emissions that are being reduced – or they can be due to other project-related features – such as adaptation benefits due to project activities that have the added benefit of increasing the resilience of the local population of the 'host country', that is the country where the project is carried out.

b. VCM and SDG support

The validation of a SOPA in the PA does not necessarily mean that it would also be a good idea in the context of the VCMs, but it does give pause for thought. To find out whether a SOPA could be useful in the context of VCMs, it is important to highlight that sustainable development benefits are an important consideration for VCM actors, and moreover not only in the narrow sense of accruing directly from the credit-generating mitigation activities, but also in the wider sense of providing co-benefits that go beyond the direct mitigation benefits. Indeed, according to the Climate Focus *VCM Primer* "the inclusion of co-benefits such as contributions to Sustainable Development Goals (SDGs)"[Ch.1] can increase the quality of credits and "drive higher prices" (see Box 1.2).

Box 1.2. Additional certifications can drive higher prices.

Projects that have achieved additional certifications of broader sustainability benefits demand higher prices. For example, the Climate, Community, and Biodiversity Standard confirms the environmental and social benefits of forest carbon projects. Under Verra's Sustainable Development Verified Impact Standard (SD VISta) or the Gold Standard for the Global Goals (GS4GG), project developers can certify contributions to Sustainable Development Goals (SDGs). Certified sustainable development contributions give buyers the assurance that such benefits are real and likely to generate positive environmental and social impacts in addition to GHG emission reductions and removals.

GS4GG and SDVISta certify positive environmental or social attributes for VCM projects, or – for project developers that wish to go a step further – independently tradable sustainable development assets, which can be priced independently of carbon credits of the underlying project.

Source: VCM Primer; Chapter 5

The final report of the VCM Global Dialogue,[11] in Section 3 ("Carbon credit buyers and investors should prioritize transformational VCM investments with broader development benefits and verified SDG contributions"), makes a number of *Recommendations on how to drive finance towards transformational projects and those with high SDG impacts* including:

[11] "The Voluntary Carbon Market as a Catalyst of Climate Ambition in Developing Countries: Vision and Action Agenda" © 2021 Verra.

- *Buyers and investors should prioritize projects with positive GHG spillovers. … Buyer behaviour will be driven by rules created by the likes of VCMI, SBTi, IC-VCM.*
- *Projects that certify SDG contributions* [for example under SD VISta or GS4GG] *are likely to have positive social and environmental impacts beyond GHG mitigation.*

Of the 17 SDGs, clearly the most directly linked to the sort of projects that generate VCM credits is No. 13. *Climate Action: Take urgent action to combat climate change and its impacts.*

It is important to keep in mind that the 'action' referred to covers both mitigation and adaptation. As concerns VCM support for SDG13, adaptation benefits are currently generated through mitigation projects with adaptation co-benefits (sometimes referred to as 'mit-ad-projects'). 'Pure' adaptation projects are not seen as VCM projects, as they lack the capacity to generate VCM credits. However, the introduction of a VCM-SOPA would mean that the VCM could also claim pure the benefits of adaptation projects among its co-benefits. A key advantage of this would be that VCM adaptation benefits could be directed explicitly to the most vulnerable countries without having to interfere with the market-based project allocation of the VCM.

c. Supporting the most vulnerable

One issue with potential reputational implications that has been raised in the context of both the CDM and the VCM, is the balance between benefits for the corporate sector (such as project developers, end-users of VCM credits) and benefits for the project hosts, in particular, vulnerable communities located in the vicinity of where the VCM credits are being generated. Indeed, one of the recommendations of the VCMI Roadmap is that high-quality carbon credits must be from activities that ensure social safeguards, promote global equity and promote sustainable development, particularly by supporting the UN Sustainable Development Goals (SDGs).

Given that SDGs relate to countries, the question about a just distribution of benefits not only to vulnerable communities but also to vulnerable countries arises inevitably and it is important for the reputation of the VCM that countries that are 'particularly vulnerable to the adverse effects of climate change', such as LDCs and SIDS, are not being crowded out. While the current geographical distribution of the VCM projects (see Box 1.3) is not quite as skewed as it was under the CDM – with a overwhelming concentration of projects in large emerging economies (see Section 1.1), particularly China (which led detractors sometimes to refer to it as the 'China Development Mechanism') – neglecting LDCs and SIDS which are particularly in need of adaptation support poses a potentially significant reputational risk for the VCM: VCM credit end-users may well be willing to pay a premium for local co-benefits associated with credits, but their customers may not be too impressed if LDCs and SIDS are being neglected as SDG13 beneficiaries.[12] It just does not create a favourable impression of the VCM itself.

A universal VCM-SOPA, adopted by the VCM meta-principles currently being developed by the IC-VCM and VCMI and suitably targeted to adaptation activities in these most vulnerable countries, could help in mitigating this risk. Moreover, it could do so without interfering in the market-led choices of VCM projects, and the environmental integrity of the credits they generate.

[12] No matter how deserving the local community of a Chinese VCM project may be, supporting China's adaptation effort (and excluding that of Burundi) is not going to be a selling point for the VCM.

Box 1.3

Figure 1.3 | VCM credits issuance and registered projects (VCS, GS, ACR, CAR)

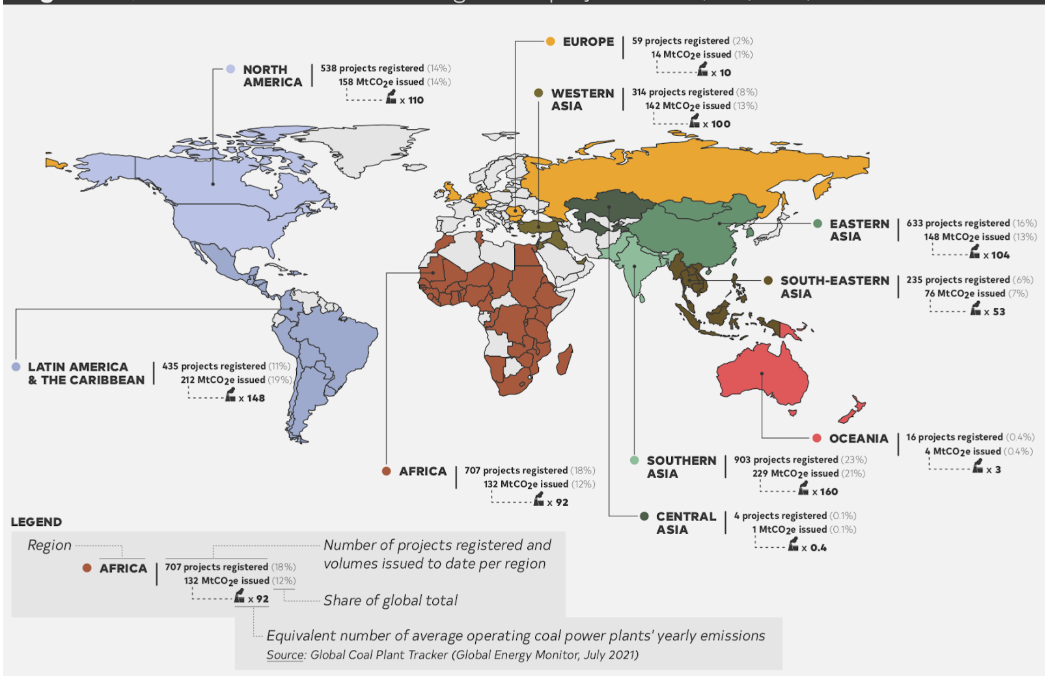


Table 1.1. VCM Distribution					
	Projects	***Credits***		***Projects***	***Credits***
Africa	18%	12%	**Asia**	**53%**	**54%**
Oceania	0%	0%	West	8%	13%
Europe	2%	1%	East	16%	13%
North America	14%	14%	Southeast	6%	7%
LAC	11%	19%	South	23%	21%

Source: VCM Primer; Chapter 1

1.3. Lesson: Safeguarding Social Integrity in the VCM

There are many reasons why an alignment with the multilateral trading schemes, including their having SOPA the VCM, can be beneficial for the VCM, not just because it is required for the fungibility of the traded credits with Paris-compliant regimes.[13] Indeed, this section aimed to demonstrate that the main reason for introducing a SOPA in the multilateral emission trading mechanisms (CDM and A6.4M[14]) – namely to ensure that the most vulnerable countries are not completely left out (which is not a matter of market efficiency but of global justice) – is also valid for the VCM. A SOPA will help the VCM to push back against accusations that it only benefits large emitters (corporates or countries) and excludes those who are most vulnerable to the adverse impacts of climate change and least responsible for them, which could become a serious reputational risk for the VCM.

---

[13] Indeed, it is very difficult to see how VCM credits could be accepted as A6.4ERs (Article 6.4 Emission Reduction units) without being subject to a SOPA equivalent to the one adopted in Glasgow for the Art. 6.4 Mechanism.

[14] Article 6.4 Mechanism.

2. SOPA Options for the VCM

In this part, certain options of how a VCM-SOPA could be operationalized are outlined. It is not intended to be a compendium of all possible options, but merely an exposition of the options we find most plausible.

2.1. What 'proceeds' and how to collect them?

There are essentially two possible interpretations of the notion of 'share of proceeds' as used in the current context, namely a volume interpretation (shares of issued credits) and a monetary interpretation (such as a share of revenue raised in the sale of credits).

In the CDM, the SOPA was defined exclusively in volume terms, namely: 2% of CERs issued (with LDC-hosted project activities exempted).[15] The Art 6 Rulebook,[16] completed in Glasgow, adopts a dual approach levying both a 5% share of issued credits (A6.4ERs) and a monetary levy in proportion to the issued credits.[17]

In principle, 'proceeds' could also be interpreted as sales proceeds, but given the potential problems in getting the relevant information (such as commercial confidentiality) and the general issues associated with transaction taxes, this would be tricky, if not practically impossible, to implement.

The simplest interpretation is the original volume-based one of a share of the credits being issued which, for simplicity's sake, this Note will focus on (without prejudice to other possible interpretations that could be envisaged for other reasons).

The collection of such a 'volume-SOPA' is very simple. In the case of the CDM, and *mutatis mutandis* in the context of the Art. 6.4 Mechanism, credits (CERs, A6.4ERs) are issued by the relevant executive body, with a percentage (2% and 5%, respectively) being registered in a dedicated SOPA account of the mechanism registry, and the rest in the relevant activity (project developer) account.

In the case of the VCM, where the credits are issued by the 'standards' (the standard holder organisations managing the different VCM standards) and registered in their respective registry, each standard could apply the same process: set up a SOPA account in their registry to receive the SOPA share of credits issued by that standard.

2.2. Monetizing and Distributing the SOPA

a. The CDM and A6.4M

The CDM, and its successor the Article 6.4 Mechanism, are using the KP/PA Adaptation Fund (AF) both to monetize their SOPA and as an Adaptation Distribution Vehicle (ADV) to distribute

[15] Para 15.a of Decision 17/CP.7 ("Modalities and procedures for a clean development mechanism as defined in Article 12 of the Kyoto Protocol")
[16] Para 67 "*The share of proceeds to assist developing country Parties that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation shall be comprised of:*
(a) A levy of 5 per cent of A6.4ERs at issuance;
(b) A monetary contribution related to the scale of the [Art. 6.4] *activity or to the number of A6.4ERs issued, to be set by the Supervisory Body;*"
[17] It is not clear how exactly the unit price of the monetary levy (para. 67.b) is to be set (fixed, or proportional to the prevailing market price).

adaptation benefits. Indeed, as mentioned above, the AF was purpose-built for this role after the introduction of a CDM SOPA in the KP.

The AF provides funding for projects that protect the livelihoods of the world's poorest and most vulnerable people against the adverse impacts of climate change. Its activities closely align to a range of *SDGs* including, but not limited to (see Box 2.1), SDG13.1: "Enhanced adaptive capacity, strengthened resilience, and reduced vulnerability of people, livelihoods and ecosystems to climate change".

Box 2.1. The Adaptation Fund SDG alignment
The activities of the AF work through four cross-cutting themes:

- Engaging, empowering and benefiting the most vulnerable communities and social groups, including women, youth, and marginalized communities (SDG1, 5, 10, 13).
- Advancing gender equality and the empowerment of women and girls in adaptation planning (SDG5).
- Strengthening long-term institutional and technical capacity for effective adaptation in developing countries, including through North–South, South–South, and triangular cooperation (SDG13b, 16, 17).
- Building complementarity and coherence with other climate finance delivery channels (SDG13a, 17).

Having allocated over US$532 million to projects with 5.8 million beneficiaries throughout the developing world, it has a proven track record. All AF projects must satisfy strong environmental and social standards, including protecting human rights, empowering marginalized and vulnerable groups, fostering biodiversity conservation, protection of natural habitats, and land and soil conservation.

Last, but by no means least, the AF has shown an appetite to embrace unique innovative ideas, making it, for developing countries, the most cherished of all multilateral (climate) funds:

- **Resource mobilization**: The AF not only monetizes the CDM SOPA, but has also introduced an online crowdfunding engine.
- **Access modalities**: It has also been the first climate fund to operationalize what has become known as Enhanced Direct Access, in which funding is allocated through programmes with funding decisions delegated by the AF Board to local entities – by far the most effective way to fund activities at the local level, which is after all where adaptation happens.
- **Governance**: It is the only multilateral (climate) fund with a majority of developing country Board members,

The biggest drawback to using the AF in the same functions (namely as SOPA-monetizer and ADV) for the VCA is an aversion in some private sector quarters to public sector management, be that by governments or the UN, seen as inefficient and overly bureaucratic. The only way to overcome this obstacle to using the AF is by publicising the fact that was independently evaluated as "an effective institution capable of achieving its ambitious objective … ***good value for money***."[18]

[18] Adaptation Fund, Medium-Term Strategy 2018-22, p.15.

b. The VCM

While the IC-VCM and VCMI could and should make recommendations as to how the VCM-SOPA is to be monetized and used, it stands to reason that the ultimate decision on this will lie with the VCM standards.

Given that, according to the recommendation in the previous section, each standard would most likely use a dedicated account in its own registry to collect its SOPA, one way to monetize these SOPA credits is by the standards themselves. The distribution of SOPA adaptation benefits would then be based on monetary contributions by the VCM standards to the chosen ADV(s). Alternatively, the standards could transfer the SOPA credits to the chosen ADV(s) to be monetized by them, following the CDM/Art6.4M model with the AF monetizing the SOPA credits.

The question then is what ADV(s) should be used. There is, of course, a plethora of entities that could be used, ranging from the international to the local level, and from existing institutions delivering adaptation projects to ones that could be set up by the standards specifically for the purpose. Three things ought to be kept in mind when designing this adaptation delivery architecture:

1. Given the difficulties in carrying out good local adaptation projects, it would be desirable to use ADVs with a proven track record.

2. There needs to be some form of coordination to achieve the desired overall geographical distribution of adaptation benefits, with a focus on two groups of most-vulnerable countries: LDCs and SIDS.

3. These two groups should endorse the way in which the VCM-SOPA benefits are distributed. They need to be given a voice in this.

Given its track record, and the fact that not only do developing countries have a majority on its governing Board, but both LDCs and SIDS have a dedicated seat of their own, coordination achieved by channelling most, if not all, VCM-SOPA funds through the AF would seem to do the job.

This is not to say that over the longer-term other arrangements should not be taken into consideration, but at the outset of a VCM-SOPA scheme, the use of the AF as ADV (and where needed as credit monetizer) seems to be the most sensible and pragmatic choice.

2.3. Lesson: Build on Tried and Tested Best Practice

As is to be expected, there are a number of options for operationalizing a VCM-SOPA. This Section looked into some of the more promising ones and concludes that the tried and tested modalities used in the multilateral trading schemes – in other words, the collection of SOPA credits at issuance and channelling of the proceeds through the UN Adaptation Fund (to ensure the buy-in of the most vulnerable countries) – would be the most practical and effective at least initially (other modalities could, of course, be developed, tested, and deployed over time should these start up ones prove to be sub-optimal).