VCM-SOPA

How to Operationalise a Share of Proceeds for Adaptation for the Voluntary Carbon Market

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Executive Summary

The overall purpose of this ecpi Policy Paper is to analyse how the social integrity of the Voluntary Carbon Market (VCM) could be boosted through a small “Share of Proceeds for Adaptation (SOPA)” to support the poorest and, particularly, the most vulnerable developing countries in adapting to adverse climate impacts. The paper begins by discussing why shoring up the (social) integrity of the VCM is important, and by looking at what is happening in this regard in the work of the Integrity Council of the VCM (IC-VCM). It continues by identifying options of how to operationalise a SOPA, both in terms of collection and transfer to Adaptation Distribution Vehicles (ADVs), that is entities receiving and disbursing SOPA proceeds to adaptation projects.

Conclusions and Recommendations

- To ensure the VCM’s global social integrity, a SOPA must be mandatory, i.e., applied to all credits in the market.
- The SOPA should be applied to all project types, and any exemption should only be contemplated based on the geographical (host country) location of the project, for example in a least developed country (LDC).
- Following existing precedents and procedures, a SOPA could be charged when credits are issued. Carbon standards could also decide to charge the SOPA at the point of retirement, in which case SOPA revenue generation would be delayed but charged – in accordance with the polluter-pays principle – to the end-user of carbon credits.
- The simplest way to charge a SOPA would be in the form of a fixed fee per credit issued, traded, or retired. Alternatively, registry administrators could also deduct a percentage from the credits to be issued or retired.
- The involvement of VCM standards in SOPA collection or monitoring is essential and its success will depend on strong partnerships with VCM standards.
- The Adaptation Fund offers a ready and tested ADV, but other ADVs could be accredited and used by collaborating VCM standards.
1. Introduction

1.1. Background

The Integrity Council of the VCM (IC-VCM) is “an independent governance body for the voluntary carbon market [which aims to] set and enforce a definitive global threshold, drawing on the best science and expertise available, so high-quality carbon credits efficiently mobilise finance towards urgent mitigation and climate resilient development". So far, it has focussed on shoring up the ‘environmental integrity’ of the Voluntary Carbon Market (VCM), that is to make sure that the climate (the ‘global natural environment’) is better (or at least not worse) off with the VCM in place than it would have been without it. However, it fails to fully consider the social integrity of the VCM.

In March 2023, the IC-VCM released the first iteration of its Core Carbon Principles (CCPs) and Assessment Framework, which will determine when credits can be regarded as ‘high-integrity’ carbon credits. Apart from the CCPs, the IC-VCM also offers supplemental tags, known as ‘CCP Attributes’, which “can be used to identify additional features related to the mitigation activity for which the carbon credit has been issued. Such identification enables mitigation activity proponents to showcase the features of the mitigation activity and allows buyers to purchase carbon credits that match their preferences”. Among the attributes listed is a Share of Proceeds for Adaptation (SOPA), which refers to “whether the mitigation activity makes a voluntary contribution to the Adaptation Fund of the UNFCCC”.

As part of a continuous improvement process of the Assessment Framework, the next iteration of the current Framework will include a work programme on a SOPA. The first revision process for the CCPs and Assessment Framework is expected to be launched in 2025 and ready for implementation in 2026.

In the context of aligning the VCM with the Paris Agreement, the IC-VCM work programme for a SOPA should consider (viz. IC-VCM 2023, p.47):

- whether SOPA should be mandatory or voluntary;
- potential exemptions based on mitigation activity type or size based on mitigation and adaptation impacts, and on benefits and revenues to communities participating in mitigation activities/programmes in developing countries;
- the readiness of buyers of carbon credits to make such a contribution;
- the merits of voluntary compared to mandatory approaches;
- the appropriate destination of any carbon credits/revenue; and
- the impact on market participants and incentives created.

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1 IC-VCM (2023); Core Carbon Principles, Assessment Framework and Assessment Procedure; Section E: Continuous Improvement of the Assessment Framework, p. 47, 27 July 2023
2 The Adaptation Fund was established in 2001 “to finance concrete adaptation projects and programmes in developing country Parties to the Kyoto Protocol that are particularly vulnerable to the adverse effects of climate change”.
This paper seeks, for one, to feed into this SOPA work programme, but given the timeline for revised IC-VCM guidelines, it also advocates for a SOPA directly with VCM standard programmes.

The paper further seeks to encourage the International Civil Aviation Organization (ICAO) to include a SOPA as one of the eligibility criteria for its Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) eligible emissions units. By May 2023, ICAO had approved nine standards and programmes to issue CORSIA-eligible units for the pilot phase (until 2023) and two for the first compliance phase (2024-2026). While the overall demand for offsets from the aviation industry may still be limited, eligibility of a unit under CORSIA is one of the few quality thresholds in an otherwise mostly unregulated market. As such it serves as a reference for quality in the VCM more generally, beyond the compliance obligations of the aviation industry. If, for future approvals or the renewal of such approvals, ICAO included SOPA as one eligibility criteria for standards and programmes (together referred to as “standards” in this paper), such standards would be forced to make provisions for SOPA collection.

1.2. A SOPA to shore up the VCM’s ‘Global Social Integrity’

‘Social integrity’, in this context, refers to the VCM not sidelining the poorest and most vulnerable countries, so that they (also) benefit from the VCM and are better off with it in place than they would have been without it. The VCM has ‘global social integrity’ if it benefits the globally poorest and most vulnerable, particularly LDCs and the most vulnerable Small Island Developing States (SIDS).

Lack of global social integrity is an issue afflicting any credit-generating carbon market mechanism with a market-driven allocation of projects. In the case of the Clean Development Mechanism (CDM) of the Kyoto Protocol (KP) and the mechanism defined in Article 6.4 of the Paris Agreement, this is addressed through the introduction of a SOPA, without which these mechanisms would not have been acceptable to many developing countries nor would they have been adopted.

Indeed, the notion of a ‘share of proceeds’ first appeared during the negotiations of the KP in the context of the CDM. This led to KP Article 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.” 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].

The market-based allocation of projects under the CDM led to a very uneven geographic distribution, resulting in over 85% of issued certified emission reductions (CERs) originating
in Brazil, China, and India. This “crowding out the most vulnerable countries to climate change, like SIDS and LDCs”,⁹ [Qui. 2018, p.10] was viewed as deeply unfair. This situation was addressed with the introduction of the SOPA which enabled countries that did not benefit from hosting projects to reap at least some sustainable development benefits from the CDM, provided SOPA resources did indeed reach them. This was ensured by channelling the SOPA resources through a new tailor-made dedicated Adaptation Fund explicitly “established to finance concrete adaptation projects and programmes in developing countries that ... are particularly vulnerable to the adverse effects of climate change”.

**Figure 1: Global Distribution of VCM Projects**

The idea of a SOPA for multilateral emissions trading schemes was validated when it was also introduced into Article 6.6 of the Paris Agreement, *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”.

The geographical location of VCM projects (see Table 1.1) may not be as concentrated as was the case with the CDM, but it clearly exists, thus exposing the VCM to the reputational risk of being perceived as benefiting only large emitters (corporates or countries), while excluding those who are most vulnerable to but least responsible for the

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Source: VCM Primer; Chapter 1
adverse impacts of climate change.

Numerous voices have expressed support for a VCM-SOPA as a CCP, particularly the Climate Vulnerable Forum, an international forum which currently consists of 58 developing countries most threatened by climate change and that represent 1.5 billion people:

- Voluntary Carbon Markets’ Credibility in Question Over Support for Adaptation: Adopting a Share of Proceeds for Adaptation as part of the Integrity Council for the Voluntary Carbon Markets’ Core Carbon Principles

In addition, while inclusion of a SOPA in the public consultation on the IC-VCM CCPs was welcome, including in the press, the VCM remains vulnerable to accusations it lacks social integrity until it is included in the CCPs.

1.3. Should the SOPA be mandatory or voluntary?

A key reason for concerned end-users to purchase credits in a VCM is to do good (and be recognised for doing so). If the market in question is tainted, then its credits are devalued. Safeguarding its reputation, particularly regarding ‘integrity’ must, therefore, be of paramount importance to all concerned VCM participants.
So far, the focus of the IC-VCM CCPs is on shoring up the ‘environmental integrity’ of the VCM. More precisely, current IC-VCM efforts are primarily aimed at shoring up the systemic integrity of the VCM as a whole, not just some of its components (standards, categories, credits). This necessitates mandatory requirements, including in the programme-level CCPs, as ensuring that only some programmes/categories/credits are of ‘high-integrity’ is not sufficient. The presence of some “bad apples” will almost inevitably have significant negative reputational consequences on the VCM as a whole. This is not just the case for the market’s ‘environmental integrity’ but also for what has been referred to as its ‘social integrity’.

Regarding the IC-VCM’s work, a ‘mandatory’ SOPA could be understood to require a programme-level CCP while a ‘voluntary’ SOPA would merely be linked to a CCP Attribute. In the SOPA context, the function of a CCP Attribute would not be to tag credits with some IC-VCM-certified, high-quality trait enabling buyers to purchase carbon credits that match their preferences. Rather, buyers who wish to be seen as adhering to a SOPA can always pay the SOPA directly to the chosen ADV – i.e., a project delivering adaptation benefits or an institution such as the Adaptation Fund delivering such projects – without the need for an IC-VCM quality endorsement. The function of a SOPA CCP Attribute would be to label credits as the SOPA having been paid in the same way in which there are cases of ‘duty-paid’ labels attached to commodities to signify that a specific duty has indeed been paid. Thus, a SOPA CCP Attribute only makes sense if standard programmes are required to apply the Attribute correctly. In other words, having a SOPA CCP Attribute necessitates a programme-level SOPA CCP requiring the correct tagging and tracking of the ‘SOPA-paid’ label/tag.

Of course, if a SOPA was ‘mandatory’ in the sense of requiring programmes to ensure that a SOPA payment applies to all credits in their registries, then a SOPA Attribute is, strictly speaking, no longer required. The point here is simply to emphasise that a VCM-SOPA, whether ‘mandatory’ or ‘voluntary’, will require the introduction of some general requirements on standard programmes, i.e., a form of programme-level SOPA CCP.

We believe that to be effective, a SOPA must be mandatory, i.e., applied to all credits in the market. This could eventually be achieved by adopting a programme-level SOPA CCP. However, a SOPA should be promoted without further delay, for application by carbon standards irrespective of an IC-VCM requirement.

Following this introductory discussion of why a mandatory SOPA should be introduced, we now turn, in the following two sections, to discuss some concrete options of how a SOPA for the VCM could be operationalised, both in terms of collection and transfer to ADVs. They are not intended to be an exhaustive description of all possible options, but merely a discussion of the main factors to consider in designing such a mechanism.
2. Applying the SOPA to the VCM

2.1. Should there be exceptions?

From a practical perspective, requesting carbon standards to levy a SOPA to all credits from all VCM projects makes sense. However, applying it to credits from all projects may ultimately undermine the main purpose of a VCM SOPA, namely, to support adaptation in the poorest and most vulnerable countries. Therefore, exemptions to a general application of a SOPA may be contemplated.

For example, under the CDM, projects in LDCs were exempt from the SOPA. Small-scale projects also enjoyed some benefits, for instance, by obtaining a 50 percent reduction of the share of proceeds for administrative costs for the first 15,000 CDM CER credits issued within a year. These benefits were meant to lower barriers for CDM engagement in LDCs and encourage small-scale activities. The benefits, together with other reforms, increased the share of small-scale activities as well as CDM projects in LDCs (Espelage et al., 2021).

A similar scheme could be applied to a SOPA from the VCM so that credits generated from projects in the poorest/most vulnerable countries and from certain types of projects are exempted from paying a SOPA. In the case of the former, the CDM example could be followed by applying exemptions to LDCs. Projects in these countries are assumed to directly contribute to sustainable development as they are more likely to benefit poorer and more vulnerable communities. Limiting the host-country exemption to a well-defined category of countries, such as LDCs, would simplify application of the exemption considerably.

Exempting specific project types, such as those with significant adaptation co-benefits, may also sound appealing. Yet this could lead to adaptation benefits being directed to wealthier countries where such projects are hosted and may not redistribute such benefits to poor vulnerable countries.

In conclusion, we suggest that if an exemption is made, it should only be with respect to the geographical location of the project. To fulfil the purpose of levying the SOPA, there should not be any exemptions based on project type.

2.2. Who to collect from and when?

There are three different options on the point of levying the SOPA – at issuance of credits, at retirement/cancellation of credits, or at transfer of credits (either at first transfer or at each transfer).

a. At issuance of credits

The SOPA could be collected at the point of issuance of carbon credits, in which case it would be charged to the account holder who receives the credits at first issuance, which in
many cases is the project developer. The advantage of this is that it is administratively simple and easy to track, as a deduction or charge can easily be made by a VCM standard registry when issuing credits, together with other charges levied at the point of issuance (e.g., administrative fees or fees associated with the use of methodologies). This is the preferred option for many VCM standard registries. In both the CDM and the Article 6.4 Mechanism under the Paris Agreement, the SOPA is levied at the point of issuance. Under the CDM, the SOPA was levied upon issuance of CERs, which was then transferred to a holding account of the Adaptation Fund. The Article 6.4 rules, procedures, and modalities similarly provide for a SOPA levy on Article 6.4 emission reductions (A6.4ERs) at issuance.

Levying SOPA at issuance, however, increases the financial risk for project developers as buyers may be unwilling to assume additional costs related to the generation of credits. A recognition by buyers to consider the costs of project implementation and credit generation instead of referring to an average market price would help mitigate that risk by enabling project developers to pass the costs of a SOPA onto buyers. For instance, the Gold Standard has noted that “organisations and individuals have an opportunity to consider longer-term environmental and social impacts of their investment decision and consider both the costs and true value of project outcomes”. The Fairtrade minimum carbon pricing model suggests a minimum price which ensures that average project costs are covered. Several examples of carbon credit buyers and investors also consider project costs when establishing the price per credit they are disposed to pay.

However, prices in the VCM depend on market dynamics. Considering the volatility of carbon market prices, project developers, especially those selling credits in spot markets, may not be able to recover the additional costs from a SOPA.

b. At retirement of credits

Taking into consideration the polluter-pays principle, SOPA could be levied on end-users upon the retirement of carbon credits. End-users of carbon credits (such as corporates using credits as offsets) are likely to be financially capable GHG-emitting entities that seek to offset emissions in a cost-effective manner by using carbon credits. Levying a SOPA at the point of retirement also limits financial risks for the project developer and shifts costs to those who can cushion themselves. Therefore, end-users bearing the SOPA costs seems appropriate.

In terms of administration, charging the SOPA at retirement rather than at issuance is slightly more complex. While VCM standards registries typically track the retirement and end-users of carbon credits, they do not charge a fee at the point of retirement or cancellation. Registries require that carbon credit users notify them when credits are retired so the credits can be permanently removed from circulation. If charging the SOPA at the point of retirement, registries would have to set up an additional accounting procedure. Aside from the case of issuance, where registries already levy a range of fees, registry account holders retire credits without the involvement of registry administrators and the
registries are only notified of such retirement. If standards decide to levy the SOPA at the point of retirement, the registry administrator would have to approve the requests for retirement and confirm payment of the SOPA fee or deduct SOPA credits before the retirement can be carried out.

Another downside of this approach is that the availability of adaptation finance from the SOPA would become directly dependent on the timing of the end-use of carbon credits, which may be years after the original issuance.

c. **At transfer of credits**

Another option would be to levy SOPA at the point of each credit transfer, which would in turn become a transaction charge that would likely significantly increase the amount of SOPA levied. The more liquid and active the market, the higher the eventual SOPA revenue. The SOPA would become an indicator of market activity, mostly burdening traders, rather than imposing costs on project developers and credit users.

However, levying the SOPA at the point of trade is significantly more onerous and complex than charging the SOPA at the beginning or end of its active circulation. VCM registries do not track trades in the way they track credit issuances and retirements and are likely to resist any trade charge. This option would increase the costs of administering a SOPA, by having to apply it to and track the many transactions.

d. **Concluding remarks**

Following existing precedents and procedures, levying the SOPA at the point of issuance makes the most sense. Carbon standards could also decide to charge the SOPA at the point of retirement, in which case SOPA revenue generation would be delayed but charged—in accordance with the polluter-pays principle—to the end-user of carbon credits.

2.3. What to Collect

Another key consideration when designing a SOPA is whether to collect: (a) a monetary contribution per carbon credit issued, retired, or transferred; (b) a share of credits issued, retired, or transferred (in-kind contributions); or (c) a combination of both.

a. **Monetary contributions**

A SOPA could be levied as a monetary contribution per carbon credit issued, retired, or transferred (depending on the point of collection). In theory, the monetary SOPA could be levied as a fixed fee or as a flexible fee tagged to carbon credit prices. The latter option is, however, more complex and difficult to implement. One of the difficulties would be determining the carbon credit prices on which to base the SOPA rate. Most VCM credits are currently transacted through forward contracts and, thus, credit prices are not publicly available. Even if the rate were to be based on a spot price, no such price for VCM credits currently exists. A fixed monetary fee levied at credit issuance provides a predictable and stable source of income irrespective of market trends and demand. Given the current state
of the market, it therefore seems more feasible to collect the SOPA, if the decision is to charge a monetary contribution, as a fixed fee per credit issued, retired, or transferred.

Under the CDM, a share of proceeds in the form of a monetary charge for administrative expenses (USD 0.10 per CERs for the first 15k of CO2e, and USD 0.20 per CER in excess of 15k of CO2e for issuance requested in any given year) is levied as an advance payment at project registration and the remainder at issuance. The amount is then deposited in a bank account administered in the name of the CDM Executive Board (EB) and project participants must show proof of payment when requesting that CERs be forwarded to a holding account. The CDM monetary administrative charge led to significant revenues for the CDM EB, much more than the actual administrative costs. For instance, by June 2012, the CDM Trust Fund had accumulated a surplus of USD 131.2 million, which was three times higher than the annual expenditure for administering the CDM (Michaelowa et al., 2019). Another advantage of a monetary charge (as opposed to in-kind contributions) is that administrative costs are much lower and administration less complex. The monetary fee collected can be directly transferred to ADVs without the need for additional infrastructure to hold and monetise the credits.

While the CDM experience shows the advantage of a fixed monetary SOPA in providing a stable revenue source, it also shows that the level of the monetary rate needs to be monitored and possibly adapted to market dynamics. In the case of the CDM, when CER prices crashed, the CDM EB continued to levy the high administrative charge—in fact, the CDM EB tightened the rules to levy the SOPA before issuance of credits because project developers were no longer requesting that the issued credits be forwarded to their accounts. This led to a heavier financial burden when the markets were low, thus penalising project developers. In a volatile market like the VCM, a fixed monetary fee may end up being punitive if prices go down or may end up being a tiny percentage of the carbon credits if prices go up. Therefore, when a SOPA is a fixed monetary fee, a mechanism to review and adjust the rate should be in place, especially when the price suffers from high volatility.

b. In-kind contribution of credits
A SOPA could also be in the form of a percentage or share of carbon credits issued, retired, or transferred, depending on the point of levying (in-kind contribution). The in-kind contribution could lead to higher revenues compared to a fixed monetary SOPA, when prices and demand for VCM credits increase. In fact, several studies forecast that the demand for voluntary credits will continue to increase. For instance, a report by Trove Research estimates that VCM demand could grow by 5-10 times by 2030, 8-20 times by 2040, and 10-30 times by 2050. This would result in driving prices higher in the coming years.

\footnote{At issuance, CERs are transferred to a pending account. Project participants then request that the CERs be forwarded to a holding account. At the point of requesting the forwarding of CERs, participants must have already paid the share of proceeds for administrative expenses. See CDM Registry Guidance expenses.}
(from a weighted average of USD 3-5/tCO$_2$e in 2021 to an estimated USD 20-50/tCO$_2$e by 2030). The Taskforce on Scaling VCM (now IC-VCM) estimates that demand for carbon credits could increase by a factor of 15 or more by 2030. An assessment by Climate Focus also estimates an aggregated demand of 5.8 – 11.7 billion tonnes between 2023 and 2030, with annual demand expected to reach 1-2 billion tonnes by 2030 (see Figure 2). With such an expected increase in demand for carbon credits and in turn prices, an in-kind SOPA contribution carries the (speculative) potential for higher revenues in the coming years compared to a fixed-monetary SOPA. This is because in-kind SOPA contributions would benefit from the increase in both quantity of credits and price, while a fixed-monetary SOPA would only benefit from an increase in quantity of credits.

**Figure 2: Expected Corporate Demand for Carbon Credits**

Source: Climate Focus analysis

Lessons from the CDM, however, show that in-kind contributions are beneficial when prices are high but bear significant risks. If the market were to crash, carbon credit reserves resulting from SOPA in-kind collection would lose considerable value, which could in turn lead to significantly lower revenues depending on when the credits are monetised. This was the case for the CDM, where Adaptation Fund revenues fell considerably when CER prices crashed and failed to recover. Looking at the VCM, credit prices are quite volatile. For instance, the price of VCM credits from nature-based solutions has dropped significantly in the first months of 2023, to less than 50 percent compared to the same months in 2022 (see Carbon Credits.com) (see Figure 3). This price volatility highlights the unpredictability of revenues that could crash with an in-kind contribution SOPA.

The entity monetising the credits from an in-kind SOPA collection, therefore, requires flexibility in its monetisation strategy, to allow it to monitor markets and monetise credits when prices are highest. The CDM’s failure to generate the expected revenues from SOPA has been attributed to, among others, the monetisation strategy of the Adaptation Fund’s
SOPA monetiser, the World Bank (Adaptation Fund trustee), which built up a CER reserve over a long period of time rather than selling the CERs at times when higher prices would have increased revenues. The reserve was ultimately affected by the price crash, which led to much lower revenue. This provides some lessons on a marketing strategy for the credits reserve, as it may make sense to sell the credits more regularly rather than holding large reserves.

Another downside of the in-kind contribution is that it comes with a higher administrative cost and is more complex to administer compared to a monetary fee. An entity or team would need to monetise the credits as well and infrastructure would be necessary to hold and market the credits. If the SOPA is contributed to the Adaptation Fund, then monetising the VCM SOPA together with the Art. 6.4, SOPA could be an option.

*Figure 3: Prices of VCM credits in USD*

### Nature Based Carbon Offset

The simplest way to charge a SOPA would be in the form of a fixed fee per credit issued, traded, or retired. Alternatively, registry administrators could also deduct a percentage of the credits to be issued or retired. As a third option, the SOPA could be designed as a mix of in-kind and monetary contributions. Art. 6.4 rules and procedures, for instance, provide for a combination of both, i.e., 5 percent of issued A6.4ERs and a monetary contribution to be set by the UNFCCC Subsidiary Body for Implementation based on the scale of the activity or number of A6.4ERs issued. The same approach could be applied in the VCM where a
percentage of the issued, retired, or transferred credits (depending on the point of levy) as well as a monetary fee could be levied on VCM credits. This solution would take advantage of the predictable and stable income as well as the benefits from potentially higher carbon credit prices. However, this solution is significantly more complex. A structure to review and adjust the rates would also be needed, depending on the market activities, to ensure it does not become a burden to market actors and disincentivize investment in carbon market activities.

2.4. Who collects and monitors?

Another question is how to collect the SOPA, i.e., whether to partner with VCM registry standards or rely on a decentralised (and less controlled) system of direct contribution of carbon credit recipients or users.

a. VCM standards
Carbon standards are well placed to monitor and, indeed, collect the SOPA, whether it is collected at issuance, retirement, or transfer, and whether the SOPA is a monetary fee or in-kind contribution. They not only issue the credits, but they also have the means to track the transfers and retirement of credits.

When SOPA is an in-kind contribution, the standards could have a dedicated SOPA account in their registries. They could hold back credits at issuance or deduct the SOPA during transfer and, thereafter, transfer the credits to the SOPA account within their registries. If levied at transfer or retirement, traders or users could be required to transfer SOPA credits to a dedicated registry of accounts. The role of the standards in this case would be limited to “SOPA collectors”. The monetisation of the credits could be undertaken by another entity, such as the World Bank for the Adaptation Fund or another entity dedicated to the monetisation and distribution of credits.

Where the SOPA is a monetary fee, the standards can still act as the SOPA collectors. At the point of issuance, transfer, or retirement, the standards could require that the project developer, buyer, or end-user pay the SOPA fee. When the SOPA is collected at issuance, the collection of the SOPA could be bundled together with that of the issuance levy that standards typically charge. For instance, Verra levies an issuance fee of USD 0.20 per credit. As an example, Verra could add a USD 0.10 SOPA charge to the issuance fee and ultimately charge a combined issuance fee and SOPA levy of USD 0.30 per credit issued.

Where the SOPA monetary fee is collected at transfer or retirement, the VCM standards could require payment of the fee before a transfer can be carried out from a seller to a buyer’s account. This would require that the registry administrator confirm payment of the SOPA fee before issuance, transfer, or retirement.
After collection of the monetary SOPA, standards could then automatically transfer the collection to an ADV. Alternatively, the standards could transfer the collection periodically, e.g., every quarter, and account for the collections.

b. Contribution directly to the beneficiary
Another option would be for the SOPA liable entity (e.g., carbon credit recipients at issuance or final users) to directly transfer the SOPA to the beneficiaries or an ADV (e.g., the Adaptation Fund). Direct transfers to beneficiaries would require a system or guidelines to identify beneficiaries, mode of distribution, and tracking of SOPA payments. Otherwise, the system may end up being skewed and transfers made to beneficiaries may not be in poor and vulnerable countries, as intended. In this case, transfer of monetary or in-kind contributions to one or several ADVs may be the better option to ensure proper distribution of the SOPA.

The downside of such direct transfers is that they are hard to control and monitor, and even harder to enforce. Unless the SOPA contribution is voluntary, direct contribution may still require the involvement of standards to ensure compliance. For instance, if the project developer indicates contribution of a SOPA fee to an ADV, the standards may need to confirm this before issuance of credits. The standards would, thus, act as “SOPA monitors”. Even where an in-kind contribution is transferred to an account held by an adaptation vehicle, an entity must be checking compliance with the share of credits transferred. The direct contribution option, therefore, seems more appropriate when the SOPA is voluntary.

c. Concluding remarks
The involvement of VCM standards in SOPA collection or monitoring seems inevitable, especially when the SOPA is mandatory. The success of SOPA will, therefore, depend on strong partnerships with VCM standards.

2.5. How much?
Determining the level of a SOPA fee requires balancing adaptation needs vis-à-vis the financial burden on market actors. The goal should be to maximise on the SOPA revenues for adaptation finance without placing an undue financial burden on market participants. Therefore, the SOPA fee level should not discourage market participants from engaging in the VCM. At the same time, it should be high enough to contribute to meaningful adaptation finance.

The fee level can depend on the point of levy, which in turn determines who is liable to pay. For instance, if levied at retirement, it will likely be levied on credit users who are financially more capable. Therefore, the rate may be higher when levied at retirement compared to when levied at issuance. If levied at the point of transfer, having a lower rate than at retirement and issuance might make more sense, since it will be levied at each transfer of a credit, i.e., possibly multiple times before the credit is being retired.
One thing to consider when determining the SOPA rate is the project costs that different market actors already incur in project and carbon asset development, including the fees levied by VCM standards. For instance, in addition to project development costs, Verra and Gold Standard levy the fees shown in Table 2 below.

Table 2: Examples of fees levied by VCM standards

<table>
<thead>
<tr>
<th></th>
<th>Verra</th>
<th>Gold Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Account opening: USD 500</td>
<td>Annual registry account fee: USD 1,000 per account</td>
</tr>
<tr>
<td></td>
<td>Account maintenance: USD 500 per year</td>
<td>VER certification project design review: USD 0.15 per credit</td>
</tr>
<tr>
<td></td>
<td>Pipeline listing request: USD 1,000 for each request</td>
<td>Performance review: USD 1000 for VERs</td>
</tr>
<tr>
<td></td>
<td>Project registration request review: USD 2,500 for each registration</td>
<td>Issuance fee for first year of VER issuance: USD 0.15 per credit minus</td>
</tr>
<tr>
<td></td>
<td>request</td>
<td>performance review fee paid (for SustainCERT review)</td>
</tr>
<tr>
<td></td>
<td>Issuance levy: USD 0.20 per VCU</td>
<td>Issuance fee for subsequent VER issuances: USD 0.30 per credit minus</td>
</tr>
<tr>
<td></td>
<td></td>
<td>performance review fee paid</td>
</tr>
</tbody>
</table>

Sources: Verra Fee Schedule and Gold Standard Fee Schedule

In addition to standards, some countries also levy fees on projects. For instance, in Ghana, VCM projects that do not require authorisation of VCM credits still must incur a fee to open an account within the country’s registry, obtain a unique identification number, and register a carbon offset in the registry. VCM credits that require Article 6 authorisation incur additional fees, e.g., authorisation and corresponding adjustment fees. Several other host countries are either considering or have started regulating VCM and, in turn, introducing fees for VCM projects. However, considering how diverse and different countries’ fees can be, it might be difficult to consider these fees when setting the appropriate SOPA rate. Nevertheless, the overall cost burden of projects should be kept in mind when establishing the SOPA fee level.

In the beginning, it might be worth linking the SOPA rate to existing international precedents, such as the SOPA under Art. 6.4. Participants in Art. 6.4 transactions will be subject to a 5 percent SOPA; a similar SOPA rate could be applied to the VCM. Lessons from the CDM, however, show that a periodic review of SOPA rates in the case of a fixed monetary contribution might be necessary.

3. Using the SOPA

To be effective, SOPA benefits must reach the intended recipients, namely the world’s poorest and most vulnerable countries and communities. In addition to considering how a
SOPA might be collected and monitored (Section 2.4.), identifying suitable ADVs is, therefore, important.

3.1. The CDM and Article 6.4 Mechanism

The CDM and its successor, the Article 6.4 Mechanism, are using the Adaptation Fund to monetise the in-kind contributions to SOPA and as an ADV to distribute adaptation benefits. Indeed, as mentioned above, the Adaptation Fund was purpose-built for this role after the introduction of a CDM SOPA in the KP.

The Adaptation Fund 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 are closely aligned with a range of Sustainable Development Goals (SDGs), including, but not limited to (see Box 3.1) SDG Target 13.1: “Enhanced adaptive capacity, strengthened resilience, and reduced vulnerability of people, livelihoods and ecosystems to climate change”. The Adaptation Fund, therefore, has by design the desired global reach to the poorest and most vulnerable countries and communities.

**Box 2: Adaptation Fund-SDG Alignment**

The activities of the Adaptation Fund work through four cross-cutting themes.

- Engaging, empowering, and benefiting the most vulnerable communities and social groups, including women, youth, and marginalized communities (SDGs 1, 5, 10, 13).
- Advancing gender equality and the empowerment of women and girls in adaptation planning (SDG 5).
- Strengthening long-term institutional and technical capacity for effective adaptation in developing countries, including through North–South, South–South, and triangular cooperation (SDG 13.b, 16, 17).
- Building complementarity and coherence with other climate finance delivery channels (SDGs 13.a, 17).

Having allocated over USD 532 million to projects with 5.8 million beneficiaries throughout the developing world, the Adaptation Fund has a proven track record and was independently evaluated as being efficient and providing ‘good value for the money’.4

All Adaptation Fund projects must satisfy strong environmental and social standards, including protecting human rights, empowering marginalised and vulnerable groups, fostering biodiversity conservation, protecting natural habitats, and conserving land and soil.

Last, but by no means least, the Adaptation Fund has shown an appetite to embrace unique innovative ideas, making it, for developing countries, the favourite multilateral (climate) fund.

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• **Resource mobilisation**: The Adaptation Fund not only monetises the CDM SOPA, but it has also introduced an online crowdfunding engine.

• **Access modalities**: It was also the first climate fund to operationalise what has become known as Enhanced Direct Access, in which funding is allocated through programmes with funding decisions delegated by the Adaptation Fund Board to local entities – by far the most effective way to fund activities at the local level, which is after all where adaptation takes place.

• **Governance**: It is the only multilateral (climate) fund with a majority of developing country Board members.

### 3.2. The VCM

While the IC-VCM and other initiatives could make recommendations regarding how to monetise and use the VCM SOPA, the ultimate decision on the use of proceeds is likely to lie with the VCM standards.

Given that, according to the recommendation in the previous Chapter, each standard would most likely use a dedicated account in its own registry to collect its SOPA, one way to monetise 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 monetised, following the CDM/Art. 6.4 Mechanism model with the Adaptation Fund monetising the SOPA credits.

The question then is which ADVs should be used. A range of entities could be chosen, from those at the international to the those at the local level, and from existing institutions delivering adaptation projects to ones that could be established by standards specifically for the purpose. Three things ought to be kept in mind when designing this adaptation delivery architecture, namely:

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

2. Some form of coordination is needed to achieve the desired overall geographical distribution of adaptation benefits, with a focus on two of the most vulnerable groups of countries: LDCs and SIDS.

3. These two groups should endorse the way in which the VCM SOPA benefits are distributed and must be given a voice in this process.

Given the Adaptation Fund’s track record, and the fact that developing countries have a majority on its governing Board, with a dedicated seat for both LDCs and SIDS, coordination
achieved by channelling most, if not all, VCM SOPA funds through the Fund seems like the best option.

This is not to say that over the longer-term other arrangements should not be considered; however, at the outset of a VCM-SOPA scheme, use of the Adaptation Fund as an ADV (and where needed as a credit monetiser) seems to be the most sensible and pragmatic choice.