

04

Legal and institutional matters

Who should be included in these discussions? Responsible ministry legal departments, Ministry of Justice, legal experts, institutions that may be tasked with the implementation of carbon market activities, relevant stakeholders in public consultations. Stakeholders include, but are not limited to, private landowners, organizations that have already developed VCM activities, indigenous peoples (IPs) and local communities (LCs), local government institutions, and civil society organizations. Relevant local communities must be involved in project and investment decisions; all relevant political stakeholders should be consulted in legislative processes.

Once a host country has developed a financing plan to achieve national climate goals and identified the funding instruments it will use, the host country needs to ensure that the relevant legal frameworks are in place to facilitate the deployment of finance. If carbon markets are among the funding instruments identified, there are important legal and institutional issues to address.

4.1 Clarify carbon rights

Carbon rights determine who can participate in and benefit from carbon market activities. Carbon rights¹ assign to the holder the right to benefit from greenhouse gas (GHG) emission reductions and removals. Carbon rights define the underlying entitlement to benefit from GHG emission reductions and removals associated with an asset (e.g., land or forest) or activity (e.g., the sustainable management of forests). Carbon rights are distinct from tradable carbon credits, which represent GHG emission reductions or removals verified and issued in accordance with the rules of a particular carbon standard.

Tradable carbon credits are standardized certified GHG emission reductions and removals. GHG emission reductions and removals that are issued as carbon credits under carbon standards or crediting programs are, first and foremost, units representing one tonne of CO₂ equivalents (tCO₂e) sequestered or not emitted. GHG emission reductions or removals in the form of carbon credits are also tradable instruments that are transferable among entities participating in carbon markets.

Carbon rights refer to the right to participate in and benefit from carbon transactions. In the case of carbon crediting programs and standards, rights to

¹ Carbon rights are almost exclusively referred to in the plural form of multiple rights.

participate in markets and monetize GHG emission reductions and removals are often lumped under the concept of carbon rights. Since most carbon credit programs do not define or systematically describe carbon rights, the right to benefit from carbon transactions often needs to be clarified through contractual arrangements.

Carbon rights are often relatively easy to establish in energy and industry-related emission reduction projects. In the context of energy and industry projects, there is a limited number of actors with clearly defined rights and contractual arrangements. Whether it is the owner of an installation, the installation's operator, or an investor, typically there are clear arrangements as to who can claim the emission reductions under investment agreements.

In land-use and nature-based solutions projects, establishing carbon rights can be significantly more complicated and politically sensitive. This is because there are often several actors associated with a given project, and it may not be immediately clear who holds the rights to receive carbon credits or payments once the mitigation action has been verified under a carbon standard.

Land or resource ownership is often contested. Legal constructs such as land or tree ownership, customary or ancestral rights, or the ability to provide ecosystem services are often used to create a link from a carbon right to a carbon credit. Complexity in establishing carbon rights arises due to unclear and overlapping land titles, land grabbing, encroachment, and legacies of land seizure and forced expulsion by the state or holders of state-sanctioned concessions. Even where legal clarifications exist, the rights to benefit from GHG emission reductions and removals need to be calibrated equitably – not solely based

on statutory ownership currently recognized by the government.

Host countries can clarify distribution of carbon rights by defining allocation of land tenure rights and by establishing rules for benefit-sharing arrangements.

In the absence of official guidelines – and considering overlapping claims to benefits that flow from GHG emission reductions and removals – the only remedy to avoid conflict relating to land-based activities is to secure rights via local land and service agreements. See Table 1 for an overview of carbon rights systems in examples of land ownership scenarios.

Benefit-sharing arrangements are a means to recognize carbon rights, including of Indigenous peoples (IPs) and local communities (LCs). Benefit-sharing arrangements must consider who manages the forest or land base, who holds land titles, and who invests in GHG emission reductions and removals activities. In addition, vulnerable communities that live in proximity to land-based mitigation activities need to be included in fair benefit-sharing arrangements. Inclusivity is crucial to ensure the long-term sustainability of VCM activities. Titles to carbon should account for the customary and ancestral land tenure rights of IPs and LCs.²

Options for clarifying the legal nature of carbon credits in host countries can be as straightforward as confirming that carbon credits shall be treated as intangible property via an existing legislative instrument. This could be supported by further legislation or policy that sets out the precise tax, accounting and regulatory requirements that must be applied to carbon credits³ Securing such legal certainty would help attract carbon finance to a jurisdiction.

² World Resources Institute & Climate Focus. (2022). *Sink or swim: How Indigenous and community lands can make or break nationally determined contributions* (p. 22). Available at: <https://forestdeclaration.org/resources/sink-or-swim/> (Accessed 23rd April 2023).

³ The City of London Corporation & Clifford Chance LLP (2022). *Enabling the voluntary carbon market in the context of the Paris Agreement* (p60). Available at: <https://www.theglobalcity.uk/PositiveWebsite/media/Research-reports/Enabling-the-voluntary-carbon-market-2022.pdf> (Accessed 23rd April 2023)

Table 1: Overview of carbon rights systems⁴

Land ownership	Carbon rights	Ability of non-state entities to engage in carbon offset activities	Examples
All land is owned by the government	Carbon rights follow the right to the land and are owned by the host country	Carbon rights can be transferred to private and public entities via concession or license	The Democratic Republic of Congo, Mozambique, Vietnam
Diverse land ownership, often with weak titles and limited titled land	Carbon rights (or rights to ecosystem services) are centralized and managed at the level of the national government	Private projects or transactions involving GHG emission reductions and removals are not permitted	Madagascar, Ecuador
Diverse land ownership, often with weak titles and limited titled land	Carbon rights are regulated and special rules apply	Private entities are free to participate in voluntary carbon market projects subject to restrictions	Mexico (limiting private GHG emission reductions and removals to activities resulting in carbon removals), Peru (requiring activity and tenure)
Diverse land ownership with strong private titles	Carbon rights pertain to land holders	Private entities are free to participate in voluntary carbon market projects within the limits of the law regarding land use and safeguards	Chile, Costa Rica

⁴ Streck, C., (2020). *Who Owns REDD+? Carbon Markets, Carbon Rights and Entitlements to REDD+ Finance, Forests* 2020, 11, 959. Available at: <https://www.mdpi.com/1999-4907/11/9/959>. (Accessed on 23rd April 2023)

4.2 Address institutional and regulatory issues

Once countries have defined their strategic priorities for engaging with VCMs and Article 6 transactions (as described in decision sheets 2 and 3), they must consider the regulatory and institutional implications. Governments need to adopt rules for approvals and authorizations, corresponding adjustments, reporting requirements, and safeguards. Implementation of a carbon market strategy requires institutional coordination and assignment of regulatory and oversight responsibilities.

a. Institutional coordination and capacity

Host countries need to build strong internal institutional coordination.

Issues in the implementation of carbon market policies are often related to lack of communication and common understanding across public entities at various levels – such as ministries, agencies, municipalities, and regions. Governments need to develop internal procedures and guidelines to ensure clear, consistent, and effective implementation.

This may include:

1. Ensuring full understanding across all horizontal (different ministries and agencies) and vertical (local, departmental, state, national) entities on how carbon markets work and their potential for the country's sustainable development
2. Formulating the procedures to apply to a wide range of cases, while being sufficiently detailed and specific to provide clear guidance to implementation agencies and staff
3. Providing continuity and full integration of the carbon market strategy into the

existing legal framework and avoiding the need to change the procedures for each carbon market activity, donor, or carbon crediting program.

A key question when deciding on carbon market approaches is whether the outcomes justify the costs of implementation.

Investment in new institutions and regulatory frameworks is justified if it leads to benefits comparable to the resources expended. Governments need to carefully evaluate which carbon market activities are likely to lead to positive returns.

Host countries need to identify which public institutions are best equipped to fulfil certain market functions and where private sector entities can effectively engage.

Host countries should conduct assessments to identify the ability of relevant institutions and ministries to implement carbon market policies. This includes assessing the set-up, mandates, and capacities of existing institutions to design, implement and track results of planned interventions. Carbon market needs assessments may be relevant for environment and climate change related ministries and specialized agencies; national planning institutions; sectoral and line ministries; and investment agencies.

These assessments are an essential step towards a full capacity development strategy, which may include internally as well as externally supported activities. Such assessments can inform a country's requests for donor support and funding.

b. Approvals and authorizations

For any government or private sector engagement in Article 6 transactions, host countries are required to have certain arrangements in place.

Host countries must put arrangements in place to provide approvals and authorizations for

cooperative approaches and activities under Articles 6.2 and 6.4 of the Paris Agreement. These rules also apply to VCM projects that seek corresponding adjustments for carbon credits, since they must meet the formal requirements of Article 6.2 or Article 6.4. Host countries are also bound by certain requirements if choosing to issue unauthorised credits under 6.4. Tables 4 and 5 set out the list of host country requirements at different stages of the crediting cycle.

Any activity needs three types of approvals and authorizations:

1. The project activity must be *approved* under Article 6.4, or *reviewed* under Article 6.2 by the host country. In the case of Article 6.2 the host country must also include more detailed information on the project in its Initial Report to the UNFCCC
2. All public or private entities participating in an activity must be *authorized* by a participating host country to be able to take part in an Article 6.2/Article 6.4 activity
3. The GHG emission reductions or removals (Article 6.4) or Mitigation Outcomes (Article 6.2) must be *authorized* for use against the NDC of another Party or another international mitigation purpose. The host country is responsible for deciding whether to issue authorized or unauthorized credits (Article 6 can also be used a mechanism to finance the achievement of the host country's NDC). Where authorization takes place the host country must make a *corresponding adjustment* to its national accounts to ensure that it no longer counts the GHG emission reduction or removal itself. This avoids "double counting" of GHG emission reductions and removals: the seller adds the transferred emissions back into

its national accounts while the buyer subtracts the transferred emissions from its own accounts. GHG inventories remain unchanged.

According to the implementation rules of Article 6.2 cooperative approaches need to be reviewed by the host country and communicated to the UNFCCC secretariat.

Respecting that the participating Parties can define the nature of the "cooperative approaches" that they engage in, the decision on Article 6.2 focuses on ensuring clear, transparent, and robust accounting of GHG emission reductions and removals. The decision establishes that reported information needs to follow certain reporting formats and is reviewed by a "technical expert review team."

Host countries can define VCM activities as cooperative approaches.

Host countries must communicate and describe each cooperative approach to the UNFCCC secretariat through a set reporting process, including VCM activities that the host country defines as a cooperative approach. Host countries must explain, among others, how it ensures that a GHG emission reduction or removal is accounted for through conservative methods (e.g. reference levels and baselines, limiting uncertainties in quantification and potential leakage), how it minimizes the risk of non-permanence and environmental, economic and social impacts, and that it puts in place high-quality accounting and tracking systems.

For VCM activities to be considered Article 6.4 activities, they need to be approved as eligible by the host country

Host countries may approve an activity without authorizing the use of GHG emission reductions or removals under Article 6.4 (Article 6.4 ERs) to achieve another Party's NDC or another international commitment such as CORSIA. These types of non-authorized Article

6.4ERs are referred to as Mitigation Contribution A6.4ERs. These Mitigation Contribution A6.4ERs can be used for other purposes such as results-based climate finance, domestic mitigation pricing schemes, or domestic price-based measures, for the purpose of contributing to the reduction of emission levels in the host Party, in which corresponding adjustments would not be mandatory.

Host countries must authorize private and public entities to participate in Article 6.2 cooperative approaches or Article 6.4 mitigation activities. Only authorized entities can implement and participate in these activities and transfer internationally transferred mitigation outcomes (ITMOs). The authorization of public or private entities to participate in these activities does not replace the authorization of specific use of mitigation outcomes or A6.4ERs.

Entities participating in either Article 6.2 cooperative approaches or Article 6.4 mitigation activities can seek additional “use authorizations” from the host country.

ITMOs can be authorized by a Party:

- for use towards an NDC,
- for use for international mitigation purposes other than NDC-achievement, or
- other purposes.

Whenever ITMOs are to be used toward NDC achievement, the host country (or first transferring Party) must provide its authorization before the first international transfer. Conversely, a host country may or may not provide its authorization for ITMOs that are to be used for other “international mitigation purposes”⁵ or “other purposes”.

⁵ Note that corresponding adjustments for “other international mitigation purposes” are mandatory for authorized A6.4ERs, carbon credits generated by approved Article 6.4 activities and authorized for other mitigation purposes.

Table 2: Art. 6.2 participation, authorization and reporting requirements.

Nature of the obligation	Requirements	Art. 6.2 guidance
Participation requirements	<p>Party has (and maintains)</p> <ul style="list-style-type: none"> – ratified the Paris Agreement – an NDC in place – arrangement in place to authorize ITMOs – arrangement in place to track ITMOs – submitted the most recent national inventory report <p>Its participation in cooperative approaches contributes to the implementation of its NDC.</p>	Annex, para. 4
Approvals and authorizations	Parties have to authorize ITMOs for use against the NDC of another Party, for international mitigation purposes other than achievement of an NDC, or for other purposes	Annex, para. 1
Reporting requirements	<p>Initial report</p> <p>The Party has to submit an initial report that</p> <ul style="list-style-type: none"> – provides evidence that the participation requirements are met – provides a description of its NDC (decision 18/CMA.1 para 64) including relevant mitigation information (in tCO₂eq or another metric) – communicates the ITMO metrics and method for applying corresponding adjustments 	Annex, para. 18-19
	<p>For each cooperative approach</p> <ul style="list-style-type: none"> – A copy of authorizations by participating parties, a description of the approach, its duration, the expected mitigation for each year of its duration, the involved parties and authorized entities. – A description on how each cooperative approach ensures environmental integrity (conservative measurements, permanence, leakage, safeguards, etc) 	Annex, para. 18
	<p>Annual information</p> <ul style="list-style-type: none"> – Authorization of ITMOs for the use towards achievements of NDCs or other international mitigation purposes – Relevant information on the cooperative approaches, other international mitigation purposes, the first transferring Party, the using Party or authorized entity or entities, the year in the which the mitigation occurred, sectors, activity types, and unique identifiers 	Annex, para. 20
	<p>Regular information in biennial transparency reports</p> <ul style="list-style-type: none"> – Continuous information on participation requirements – Updates on the initial report – Authorizations of the use of ITMOs – Corresponding adjustments undertaken in the last reporting period – Assurances against double use of ITMOs – Information on each cooperative approach (how it contributes to the Party's NDC and a confirmation of its environmental integrity) – A summary of emissions, including ITMOs first transferred, authorized mitigation outcomes, and use of ITMOs 	Annex, para. 21

Institutional requirements	A registry that can track ITMOs (first transfer, transfer, use, etc) The secretariat offers the services of an international registry for Parties that do not have a registry. And the Party has to make corresponding adjustments for authorized ITMOs.	Annex, para. 29 and 30
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Table 3: Art. 6.4 participation, approval, authorization and reporting requirements.

Nature of the obligation	Requirements	Art. 6.4 rules, modalities and procedures
Participation requirements	Party has (and maintains) <ul style="list-style-type: none"> – ratified the Paris Agreement – an NDC in place – designated a national authority for the Article 6.4 mechanisms – indicated how its participation in the mechanism contributes to its sustainable development – indicated how the activities under Article 6.4 would contribute to its NDC <p>The Party may indicate methodologies and crediting periods applied to Article 6.4 mechanism activities that it intends to host.</p>	Annex, para 26 & 27
Approvals and authorizations	<ol style="list-style-type: none"> 1. The host Party has to approve project activities it hosts. The approval includes information on how the activity supports the sustainable development of the host country, approval of potential renewal of the crediting periods, and explanation on how the activity relates to the implementation of its NDC 2. The host Party has to authorize activity participants 3. The host Party has to authorize the use of A6.4ERs for NDCs or other international mitigation purposes. 	Annex, para 40-44
Reporting requirements	Where corresponding adjustments are made, the reporting requirements of the Article. 6.2 decisions [are most likely to] apply.	Annex, para 71
Institutional requirements	And the Party has to make corresponding adjustments for authorized A6.4ERs consistent with the Article 6.2 decision.	Annex, para 71

c. Reporting requirements

Host countries may adopt rules that require VCM activity developers to periodically report on their mitigation activity and generated GHG emission reductions and removals. VCMs

suffer from a lack of transparency and governments may know little about the VCM activities in their territories.

Considering the impact that VCMs could have on nationally determined contributions (NDCs), governments may decide to require carbon market project sponsors to provide the government with design information about the project and projected GHG emission reductions and removals yields. Such ex-ante reporting can be complemented by requirements to transmit periodic (e.g., annual) monitoring data to the government. This information can be stored and made available in a national GHG and carbon market registry. The Art. 6.4 Supervisory Body is in the process of developing project reporting requirements.

Governments may take inspiration from these requirements when regulating the VCM. Only where corresponding adjustments are made on credits do the reporting requirements of Art. 6.2 apply (as outlined in Tables 2 and 3).

d. Safeguards

Host countries have the prerogative to adopt additional safeguarding requirements where existing environmental and social guidelines for investment projects do not sufficiently address carbon market-related risks.

Approvals and authorizations can be made contingent on projects and programs proving that they meet safeguard requirements. Safeguard requirements can be checked periodically in environmental and social compliance checks.

In the broader context of national safeguards, governments can also adopt rules for fair benefit sharing with local communities.

The Voluntary Carbon Markets Integrity Initiative is a multistakeholder platform to drive credible, net zero-aligned participation in voluntary carbon markets.

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