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Mr. Richard Stanislaus Muyungi,
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c/o UNFCCC Secretariat
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Dear Mr. Stanislaus Muyungi:

I write to you on behalf of the International Emissions Trading Association (IETA) in response to the call for input issued at COP 18/CMP 8 on the framework for various approaches (FVA) and the new market mechanism (NMM).

First and foremost, it should be noted that IETA and its +150 members are dedicated to:

- The objectives of the United Nations Framework Convention on Climate Change and ultimately climate protection;
- Establishing effective market-based trading systems for the management of greenhouse gas emissions by businesses that are demonstrably fair, open, efficient, accountable and consistent across national boundaries;
- Maintaining societal equity and environmental integrity while establishing these systems.

IETA greatly appreciates the opportunity to provide our input on this issue. Please do not hesitate to contact IETA's Director for International Policy, Jeff Swartz (swartz@ieta.org) should you have any questions regarding this input.

Thank you for your consideration.

Dirk Forrister

President and CEO, IETA

The Framework for Various Approaches and New Market Mechanisms (FVA/NMM) in a post-Doha context: IETA's Perspective

1. *Background*

IETA views the Framework for Various Approaches (FVA) as a pillar of multilateral efforts for establishing a quantifiable, long-term trajectory for greenhouse gas (GHG) emissions management. Markets should be at the core of an FVA, providing an international network for different policies to interact.

Further to this, many countries that are signatories to the UNFCCC are already establishing an explicit carbon price within part or all their economies. They already recognize that a carbon price in their energy system is the most efficient, lowest cost approach to lowering emissions. Numerous paths to establishing a carbon price are being developed, with many based on the use of tradable instruments.

By allowing these and other approaches to link, over time a global carbon market can be created. Such a market has the potential to deliver the necessary financing to transform the global energy system over this century, ensuring that the climate issue is contained as energy needs are met.

From a business perspective, a new framework that facilitates the further development of market-based instruments and allows linking of those that already exist must be attractive to all key actors: developing countries, developed countries, and investors. The design will have an important impact on the ability of the FVA to achieve this.

The FVA now under discussion, in combination with plans for a New Market Mechanism (NMM) under the Convention, offers the opportunity to deliver such a global market that could then sit at the heart of the new agreement negotiated under the ADP. IETA believes that not pursing such a goal at this time would be a major lost opportunity for the UNFCCC and could ultimately undermine its attempts to limit global emissions.

IETA strongly encourages Parties to come to a decision on both the FVA and NMM at COP 19 in Warsaw.

2. *The Framework for Various Approaches (FVA)*

The FVA should act as a basic framework with a broad, flexible scope that provides structure to emerging carbon markets. IETA believes that a global carbon market is the most efficient way for governments to achieve the necessary emissions reductions in the long-term. The FVA is a step in this direction due to its inclusiveness, but should also transition from current structures to allow for long-term continuity and stability.

Reflecting the discussions held in Durban and Doha on the FVA/NMM, IETA suggests Parties move forward on the FVA with the following elements:

- Clear and consistent methodologies for monitoring, reporting and verification (MRV) of emissions, including offsets;
- Allowing for emission reduction efforts to be converted into tradable carbon price instruments that are internationally fungible. This will enable linking across different policies, thereby increasing the cost effectiveness of the global mitigation effort;
- Establishing a clear relationship between market-based approaches, voluntary international offset programs and national commitments e.g. through national reduction or limitation targets, or international allowance allocations, equivalent to the explicit or implicit 'carbon budget' or cap for a given national or sub-national mitigation programme. This relationship should consider a time horizon to 2050 that would allow for a longer term economic and energy perspective.
- Establishing or making available market infrastructure, such that Parties may use common (or as similar as feasibly possible) issuance procedures, registry, auction mechanisms, etc. Standardization underpins the use of fungible carbon price instruments and builds a common understanding of how markets operate. For the business community, it is essential that registries provide a level of confidence and assurance to private sector actors, a role that the Assigned Amount Unit (AAU) and the International Transaction Log (ITL) plays under the Kyoto Protocol. The ITL could be re-designed in such a way that it would also allow for unit tracking between different national and subnational mechanisms.
- A harmonised set of cost-containment measures, including geographical measures (offsets), and temporal measures (e.g banking and borrowing of credits).
- A conversion mechanism, to allow countries to use international trading mechanisms even though their respective environmental products may be of different denominations/expressed in different units.
- Providing assistance to developing countries to build the capacity necessary for market implementation, particularly in the area of Monitoring, Reporting and Verification (MRV) that poses the first fundamental challenge in the development of emissions trading/carbon market infrastructure. This includes the institutions required for efficient market operations, linkage of domestic markets to a global trading system, and for other market-related functions.

Currently some Parties lack emissions data and management expertise. Targeted assistance is needed to allow all nations to be able to be engaged in the FVA.

3. The New Market Mechanism

A market mechanism describes a process by which a market solves a problem of allocating resources, especially that of deciding how much of a good or service should be produced, but other such problems as well. The market mechanism is an alternative, for example, to having such decisions made by government. Rather, it represents the interaction of supply, demand and prices.

In the context of emissions mitigation, the trading structure within the Kyoto Protocol illustrates the part played by the market mechanism. Within its design, the functioning market mechanism is the Assigned Amount Unit (AAU). The AAU establishes the need for trade and creates basic supply and demand through the allocation process against national targets relative to actual emissions. This gives value to the AAU, which in turn creates demand and value for CERs under the Clean Development Mechanism (CDM). Without the AAU, the CER and similar instruments have no value and could not exist in a meaningful sense.

The New Market Mechanism should be modeled on such a design, in effect replicating the role of the AAU under the Kyoto Protocol, but operating in a world of bottom up pledges, nationally designed trading systems and NAMAs – in other words, a series of various approaches operating within a common framework (the Framework for Various Approaches or FVA). This design for the core NMM instrument would give renewed value to the CER and allow the development of additional crediting mechanisms within a new framework (See Section 5).

Such an approach will scale-up beyond existing crediting mechanisms, such as the Clean Development Mechanism (CDM) and Joint Implementation (JI) to generate impact across entire sectors. This will provide a new avenue for private investment in reducing emissions and meeting overall emissions goals in a more cost effective way. The NMM must take on board the experience gained from the pioneering AAU, CDM, JI and voluntary market mechanisms to improve infrastructure while still maintaining the confidence of the private sector that has generated over $200 billion in developing country investment since 2005.

The NMM will enable countries and regions to transition from project-based crediting to real carbon pricing and economy-wide trading of GHG emission reductions, by promoting mitigation across one or more sectors or sub-sectors. As such, NMMs will embody a commitment to reduce emissions by the host country that reflects some level of aspiration across a sector or sub-sector. Importantly, as countries begin to unveil plans for market based systems, there could be an opportunity to establish an international expert review of each system under design as a way to ensure best practice and commonality are achieved.

4. *The FVA and NMM – a framework for a global carbon market*

IETA proposes a stepwise approach to the goal of a global carbon market, through an arrangement that allows linkage between approaches within the FVA, utilizing existing market approaches and the New Market Mechanism to establish both initial supply and demand for carbon pricing units. A national, sub-national or sectoral level approach recognized under the FVA may choose multilateral participation in the developing global carbon market by accepting a fixed carbon emissions budget for a given future period in the form of tradable international allowances (an FVA unit, or FVU). The budget arises from the goals of the specific policy program(s) as a contribution to the global effort. The budget is fixed (i.e. absolute), irrespective of the nature of the mitigation programme operating within the economy. This is best illustrated by way examples:

Example 1: A developed country has a cap-and-trade system in the national power sector.

The cap-and-trade system is set to reduce emissions in the power sector from 800 million tonnes per year (tpa) in 2020 to 600 million tpa by 2030. The system has its own national allowance unit which is deemed equivalent to an FVU for the sake of international trade. The government takes an FVU allocation of 7 billion units for the period that matches the cap-and-trade allocation.

Example 2: A major emerging economy has a national intensity based system for emissions in the industrial sector.

The system projects emissions in the sector growing as production doubles over the period 2020 to 2030. The initial emissions are 100 million tonnes and the system is designed to limit emissions to 150 million tonnes, but this may vary depending on actual production. The credits within the baseline and credit system are deemed equivalent to an FVU, such that the sector can trade internationally. But the government underwrites an absolute change, taking an FVU allocation of 1.25 billion units over the ten years. Should the sector grow faster than expected but still meet its emissions intensity, the national government may need to purchase FVUs to balance the system.

For approaches in which domestic units are not expressed in CO_2-e, the national government could still accept a comparable FVU allocation, which then serves as a route for conversion of the domestic unit to a tradable international carbon unit. Such a conversion mechanism provides additional fungibility by facilitating linking beyond emissions trading to include Renewable Energy Certificates (RECs) and other trading approaches not explicitly denominated in CO_2-e.

Example 3: The power sector in a certain economy has a renewable energy target. A percentage of the electricity generated must come from renewable

energy. The companies involved seek some flexibility in meeting their goals.

The sector is expected to double in size over 10 years, with the fraction of renewable energy rising to 30%, governed by Renewable Energy Certificates (RECs). Emissions start at 100 million tonnes per annum and are expected to grow to 150 million tonnes, significantly less than "business as usual". The national government accepts an FVU allocation of 1.25 billion units. The underlying emissions reduction for a given amount of renewable energy substitution sets the conversion ratio for RECs to FVUs and vice versa, giving the power generators flexibility in meeting their target.

Under this approach, governments would take the risk of any conversion of units that are not measured in CO_2e. Such a conversion mechanism would always exist under the authority of a national government and it would be responsible for recognizing what types of units could be transferred in and out of a national system. Governments would maintain and administer any conversion 'risks' associated between units not denominated in CO_2e (e.g. renewable energy certificates-REC's) and FVU's.

Any conversion to FVU's would also need to be agreed upon at the international level through the body recognizing FVA submissions when each Party submits its scheme (see below).

Participation in this model is not mandatory, but once in, participants must fulfill their commitments and meet their agreed emission budgets through the surrender of FVUs. Participation would always be dependent on a review of the carbon budget submission by an oversight body. Any such body, while having a critical role to play in providing guidance and recommendations, will need to fit the realities of international governance, where nations will retain much of their existing authority over capital flows and broader trade policies. The oversight body could either fall under the UNFCCC, or be independent of the UNFCCC (i.e. a Board elected by countries participating in the market ensuring a balance of representation from developed and developing countries).

Such a body would perform the following functions:

a) Establishing the framework within which projects and national programs can link.
b) Creating the global carbon-trading instruments that will underpin the linkage process and issuing those instruments in response to submitted projects and programs (as per Assigned Amount Units (AAU) and CERs within the Kyoto Protocol).
c) Developing measurement, reporting and verification rules associated with the issuance of instruments and the later step of annual reconciliation.

d) Developing and issuing guidelines for the basic structure of national programs. Programs designed along similar lines will facilitate linkage.
e) Developing and operating the necessary international registries for linking (e.g., an expansion of the current International Transaction Log - ITL).
f) Governing the overall framework, including periodic reconciliation.
g) Assessing submissions for inclusion in the international framework.
h) Expanding and operating the project mechanism(s).

To avoid double counting, the FVA should ideally manage a centralized tracking system, through an international transaction log (ITL) or similar centralized registry. Governments participating in the carbon market under the FVA need to ensure they have robust domestic registries and GHG accounting systems in place. The mitigation approaches proposed, even if not designed as an absolute reduction or limitation of GHG emissions at a national level, should result in a fixed carbon emissions budget for a given future period in the form of tradable international allowances. Parties may wish to explore criteria on scarcity of allowances in order to allow for a clear price signal to develop over time. The budget would stem from the goals of the specific policy or program. As noted, this budget would be exchanged for an equivalent international allowance allocation, held by the national government, and recognized in the international centralized registry. The national government would then ensure that sufficient allowances are in the international registry to cover the agreed emissions budget.

Key steps to participation in the NMM under the FVA are as follows:

a) National governments begin the task (or continue the task) of designing policy measures to manage emissions in their own economies, but with the specific goal of a tangible national contribution to the global goal (e.g 2°C).
b) Industry sectors affected by such policy measures look for the flexibility to manage emissions more widely and in particular seek access to reduction opportunities outside their national borders. This can only be realized through some form of international trading.
c) A national government seeks to be included in the international market and proposes that a sector covered by specific policy architecture (e.g., cap-and-trade) is allowed to participate. The budget (or cap) for the sector is exchanged for an equivalent international allowance allocation.
d) The international allocation is held by the national government, but an equivalent tradable instrument within the industry sector program is recognized on the international registry.
e) The national government recognizes any flow from the international registry as compliance units within its industry program.

f) At the periodic reconciliation for the international agreement, the national government ensures that sufficient allowances are in the international registry to cover the agreed emissions budget.

5. New Developing Country Project and Sector Crediting Mechanisms (NCM)

With a core carbon market established between developed and major emerging economies, the opportunity then exists to introduce new scale to crediting mechanisms for the use of other countries. The NCM will offer tools to enable countries to transition from project-based to economy-wide crediting of GHG emission reductions, by promoting mitigation across one or more sectors or sub-sectors. As such, NCMs will embody a commitment to reduce emissions by the host country that reflects some level of aspiration across a sector or sub-sector, as well as performance beyond the indicated country threshold. Performance beyond the threshold, or benchmark, would enable the creation of tradable units.

For some countries, the CDM may remain the preferred mitigation tool due to their national circumstances, and they should be allowed to use that mechanism alongside a new crediting mechanism if needed.

While the CDM provides an important foundation for crediting mechanisms of the future, voluntary markets in many ways have additionally been the test beds of climate innovation and should also serve in a similar role as a crediting mechanism alongside the CDM--including REDD+ and frameworks for crediting REDD at both the jurisdictional and project levels; and the development and use of performance methods for crediting individual firm performance within a sectoral context.

All new crediting mechanisms should build on the experience garnered through the CDM, including its MRV and standards.

Any new crediting mechanism will have its inherent risks. In order to mitigate such risks, the mechanism should include a tool that provides a guarantee to private sector investors, at least in the mechanism's early stages, against unacceptable risks. This could come in the form of an international body that provides a financial guarantee that such a system is safeguarded from policy and economic risks. A case can be made that the Green Climate Fund (GCF)—and/or the World Bank—could provide guarantees or insurance, or provide incentives to support pilot projects and investments, in order to attract and lead private sector investors into sectoral credit projects or other crediting mechanisms as they are introduced. Under certain circumstances, however, the host country could provide the guarantee. Pilot projects and real experiments are key to progress towards new crediting mechanisms. Also we expect that the GCF will provide incentives to various mitigation and adaptation projects- depending on the amount and scale of public and private financial commitments.