

Market-based mechanism

AWG-LCA 15

Switzerland welcomes the opportunity to provide input on the work programme to elaborate modalities and procedures for the market mechanism defined under the guidance and authority of the COP (paragraphs 83-85 of the AWG-LCA decision [-/CP.17]).

The following submission briefly outlines Switzerland's views on 1) experiences and lessons learned with existing approaches and mechanisms, 2) the elaboration of modalities and procedures regarding the role of the COP in terms of guidance for the mechanism and the standards that the market mechanism must meet, 3) the definition of the conditions for the use of the market mechanism to meet mitigation targets under the COP, 4) next steps for the work programme to structure and organise negotiations with a view to recommend draft decisions to COP18.

Since the market-based mechanism is one part of the topic "various approaches", consisting in a market-based mechanism and non-market-based approaches, we present here our views in a similar way as in our submission entitled "Framework for various approaches" (dated 05.03.2012).

1) Experiences and lessons learned with existing approaches and mechanisms

Lessons learned and information sharing are stepping stones to allow further developments and adjustments of policies and approaches. We present here two examples of market-based mechanisms, both in Switzerland and on the international level.

Swiss experience with a market-based instrument - the Swiss Emissions Trading Scheme (ETS)¹:

This market approach has been useful for encouraging Swiss companies to implement measures to reduce efficiently their emissions. Our experience with an ETS over the period 2008-12 has shown that this instrument is efficient but that its current design in Switzerland can be further improved. First, because the Swiss ETS is small and has little liquidity, an extension of its scope would improve its functioning. In this regard, linking of ETSs is a promising development. Secondly, because of difficulties for allocating allowances mainly based on historic data, a benchmark approach will be used for the 2013-20 period for allocating emission allowances. Thus, taking into account its past experiences, Switzerland will continue and improve its ETS for the period 2013-20. Such national experiences with market-based instruments are useful to take into account when designing the new market mechanism.

International experience with a market-based instrument - the Clean Development Mechanism (CDM):

The CDM has proven to be a useful instrument to encourage the reduction of global GHG emissions and to support sustainable development. It has brought positive co-benefits such as technology transfer and access to cleaner energy services. The CDM is facing some

¹ <http://www.bafu.admin.ch/emissionshandel/index.html?lang=en>

challenges, in particular regarding additionality, the design of specific methodologies and the geographical distribution of the CDM. The concept of additionality is under review, methodologies are being improved and efforts for promoting the equitable distribution of the CDM have to be maintained, for example through the continued targeted support for CDM capacity-building under the Carbon Finance Assist program of the World Bank. All these current improvements of the CDM are well underway and should continue.

2) Elaboration of modalities and procedures regarding the role of the COP in terms of guidance for the mechanism and the standards that the market mechanism must meet

The new market mechanism was defined in paragraph 80 of decision 1/CP.16 with a set of principles, and in paragraph 83 of decision [-/CP.17] under the guidance and authority of the COP, with modalities and procedures to be elaborated for a decision at COP18.

Objectives of the standards: Principles for the market-based mechanism were defined in decision 1/CP.16, such as safeguarding environmental integrity, ensuring a net decrease/avoidance of global GHG emissions and ensuring robust market functioning. In Switzerland's view, the standards that the new market mechanism must meet, as mentioned in decision [-/CP.17], have to operationalise the principles of decision 1/CP.16 by fulfilling the following functions:

- ensuring that the activities under the mechanism are of comparable quality
- fostering the coherence of the carbon market and fungibility of units
- providing security to the private sector about the acceptance and recognition of the activities under the mechanism

Scope of the standards: Establishing standards does not mean that all aspects of the activities under the market mechanism have to be regulated under the UNFCCC. Indeed, some elements do not need to be regulated under the COP and can take into account national circumstances (e.g. Parties can choose which of their sectors/policies they would like to include in the mechanism, what kind of incentives for the private sector they would like to provide, monitoring and reporting of emission reductions).

In addition, a procedure for revising the standards is needed, in order to take into account future developments.

Elements to be elaborated as standards:

In Switzerland's view, the standards we need to define for the market mechanism include:

- Rules for the functioning of the trading and crediting mechanisms
- Rules to define sectors or sub-sectors, policies and measures, technologies or other mitigation actions, as well as gases that can be part of the mechanism
- Timeframe of the crediting and trading mechanisms
- Rules for avoiding double-counting
- Methods for calculating baselines, crediting thresholds (for the crediting mechanism) and area targets (for the trading mechanism)
- Rules for reviewing and approving baselines, crediting thresholds and area targets at the international level
- Rules for the measurement, reporting and verification (in coordination with the relevant processes under the UNFCCC)
- Rules for ensuring permanency of the emission reductions and the net decrease of global GHG emissions (rules for crediting so that a part of the emission reductions is considered as a unilateral NAMA; and rules for trading so that the cap leads to a significant deviation from the BAU)
- Rules for the issuance of *ex ante* units (trading mechanism) and *ex post* credits (crediting mechanism)
- Rules for tracking units

Compliance with the standards:

The standards must be robust and clear, so that they can provide confidence in the mechanism and their use for meeting mitigation commitments. Therefore, in addition to defining standards, a process for evaluating if the standards are met is necessary. Such a process may take the form of a peer-reviewed evaluation of the proposed activities under the market mechanism, possibly through the SBI or with support of a new executive committee composed of technical experts and with light structure and working procedures.

3) Definition of the conditions for the use of the market mechanism to meet mitigation targets under the COP

The use of the new market mechanism should be open to all Parties under the Convention, since the mechanism is defined under the Convention. Switzerland does not see any conditions to be defined for the use of the market mechanism.

4) Next steps for the work programme to structure and organise negotiations with a view to recommend draft decisions to COP18

As decided in Durban, the work programme will be carried out under the AWG-LCA. For further work needed after COP18 (e.g. for the review and approval of the baselines, crediting thresholds and area targets, and for regular updates of the standards), the AWG-LCA should decide to defer these aspects to the SBI by establishing a process for accompanying the market mechanism.