

Carbon Markets Rules for the Kingdom of Bhutan 2023

National Environment Commission

Royal Government of Bhutan

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Preface

The Kingdom of Bhutan has always emphasized conservation and protection of our rich natural environment and biodiversity. At the 15th Conference of Parties to United Nations Framework Convention on Climate Change (UNFCCC), Bhutan pledged to remain carbon neutral for all times. However, Bhutan as a fragile mountainous country remains highly vulnerable to impacts of climate change. As a Least Developed Country, we are highly constrained by lack of financial, technological and human resource capabilities in achieving our goals of carbon neutral and climate resilient development.

We recognize that carbon market mechanisms under Article 6 of the Paris Agreement will play a crucial role in accelerating the transition towards a low carbon economy. It will have an important part in incentivizing and promoting emission reductions by providing an additional source of revenue against the transfer of mitigation outcomes; enabling transfer of technology and building national capacity for implementation; and trigger innovation and knowledge generation.

We acknowledge the need for rules and safeguards to ensure environmental integrity and transparency of carbon market mechanisms under Article 6, including ensuring that commitments of our Nationally Determined Contributions are met; authorizing units to transfer under Article 6 and perform corresponding adjustments for internationally transferred mitigation outcomes (ITMOs); seek avenues to enhance ambitions of our successive NDCs; and assist in identification of investment needs for climate change mitigation and building resilience to impacts of climate change.

In light of the above considerations, the 56th National Environment Commission Meeting held on 27th March 2023 adopted the “Carbon Market Rules for the Kingdom of Bhutan, 2023” as a foundation for robust, transparent, and effective participation in the carbon market mechanisms that contribute to achievement of our climate goals of pursuing a carbon neutral and climate resilient development while promoting sustainable development to achieve environmental, social and economic benefits.

A handwritten signature in black ink, appearing to read 'Tandin Dorji', is written over a horizontal line. The signature is stylized and includes a vertical stroke that extends downwards from the line.

Tandin Dorji
Minister for Foreign Affairs and External Trade
Chairperson, National Environment Commission

1. Rationale for Carbon Market Rules

At the meeting of the Conference of Parties (COP26) at Glasgow, Parties agreed on the modalities, procedures, and rules for the implementation of carbon markets under Article 6. Article 6 of the Paris Agreement recognizes voluntary cooperation among Parties for the implementation of their nationally determined contributions (NDC) to allow for higher ambition in their mitigation and adaptation actions and to promote sustainable development and environmental integrity. This is seen as providing the basis for trading emission reductions across countries. Markets under Article 6 are a form of international “compliance” markets, i.e., governed by international climate treaties and authorized by governments. In parallel, voluntary carbon markets also offer an avenue for monetizing carbon credits.

Carbon markets under Article 6 can support Bhutan’s long-term goal of remaining carbon neutral by providing an additional source of revenue against the transfer of mitigation outcomes. Eligible programs could potentially cover emissions avoidance, reductions, and removals. In its 2nd NDC, Bhutan stated the intention to participate in Article 6 mechanisms as a way to cover some of the costs of implementing its NDC.

The Paris Agreement supports a bottom-up approach to carbon markets, requiring considerably higher levels of engagement and oversight from participating countries. Specifically, the decisions on how to quantify, monitor, verify, authorize, and report emission reductions under Article 6.2 are largely up to the participating countries, provided they are consistent with the guidance adopted by the Conference of the Parties at the meeting of the Parties to the Paris Agreement. Countries that host cooperative activities will need robust policy and regulations along with strong institutional arrangements and procedures to:

- Ensure current nationally determined contributions (NDC) commitments are met;
- Authorize units to transfer under Article 6 and perform corresponding adjustment for internationally transferred mitigation outcomes (ITMOs);
- Seek avenues for further mitigation to enhance ambition for future NDC update; and
- Additionally, identify investment needs for climate mitigation and resilience among other activities (present and future).

Mitigation actions are associated with a cost. The trading of mitigation outcomes under Article 6 requires countries to provide an “Authorization” or a commitment undertaking to make a “Corresponding Adjustment”, an accounting process that ensures that the traded mitigation outcome is not double counted toward its own NDC. Without informed decisions, countries may have to implement more expensive mitigation activities to meet their NDCs because of Corresponding Adjustment for transfer of Authorized emission reduction credits. The provision of Corresponding Adjustment creates obligation and an associated liability for the host country. The liability to the host country is linked to the associated opportunity cost of meeting the NDC.

To perform the aforesaid roles, the RGOB proposes to charge a levy to finance additional mitigation activities that have to demonstrate achievement of NDC after providing Corresponding Adjustment for ITMOs. Therefore, mitigation outcomes (MOs) with Corresponding Adjustment will entail a two-part payment with the market price (\$m) being paid to the seller and an additional share (\$+) to the RGOB.¹

¹ For transparency, clarity and simplicity, RGOB may decide and specify the charge applicable for the respective NDC period acknowledging the increasing cost of mitigation activities. The additional share may be collected towards a climate fund.

2. Definitions

Activity Participant: Any private and/or public entity that has obtained a Letter of Authorization from the [DNA] and is either listed as a project participant in the relevant MO design document or is otherwise expressly evidenced to the [relevant Ministry or relevant bodies that would be responsible for facilitating and regulating participation in markets].

Approved GHG Program: A GHG program that is accepted and approved under these Carbon Market Rules, and which, among other things, provides the underlying infrastructure to facilitate listing and registering of MO activities, issuing, holding, transferring and retiring MOs, provides records of all MO activities and MOs issued, and provides public access to all MO activities and MOs information.

Article 6.2 Guidance: The relevant decision(s) of the CMA providing guidance on cooperative approaches referred to in Article 6.2, of the Paris Agreement, as may be agreed or subsequently amended from time to time.

Article 6.2 Registration: Formal acceptance and listing of an MO activity as an eligible activity for the purposes of these Carbon Market Rules by the Department of Environment and Climate Change, published in English and made publicly available on the website of the Department of Environment and Climate Change.

Carbon neutral: Refers to a situation where the level of greenhouse gas emissions are levelled with the sequestration provided by the carbon sink.

Climate change coordination committee (C4): A technical committee established through an executive order from the Hon'ble Prime Minister that serves as a forum to discuss and coordinate matters related to climate change in Bhutan and make recommendations for consideration by the National Environment Commission (NEC).

Corresponding Adjustment: An accounting mechanism established under Article 6 of the Paris Agreement intended to ensure that mitigation outcomes are not "double counted", i.e., trading of mitigation outcomes (MO) should not result in more than one country using the same MO to demonstrate achievement of their Nationally Determined Contributions (NDCs).

Cooperative Approach: The arrangements outlined in a bilateral agreement as agreed to and adopted by Bhutan and another Paris Agreement Party under Article 6.2 of the Paris Agreement, in respect of the mutual recognition, acceptance, use of and dealing in MOs including enhancing removals of Sinks and reservoirs/ enhancement of removals (for example, REDD), avoidance of GHGs, involving GHGs that are generated from the specified activity type, involving a specified sectoral scope.

Entities: Entities in the Rules include government agencies, NGOs, private sector, project participant in Bhutan that wish to participate in the carbon market.

DNA: The designated national authority of Bhutan for the purposes of Article 6.2 and Article 6.4 of the Paris Agreement that has been formally designated and registered with the Secretariat as required by the Article 6.2 Guidance. The Department of Environment and Climate Change serves as the DNA for Bhutan.

Greenhouse Gas (GHG): Carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulphur hexafluoride, nitrogen trifluoride, halogenated ethers, trifluoromethyl sulphur pentafluoride, and any other halocarbons subject to the '2019 Refinement to the 2006 IPCC Guidelines for National Greenhouse Gas Inventories' as published by and updated from time to time by the IPCC.

Internationally Transferred Mitigation Outcome (ITMO): An MO arising in respect of an MO activity for which Bhutan has issued a Letter of Authorization and is first transferred outside by Bhutan to a Paris Agreement Party pursuant to a Cooperative Approach in a manner that is consistent with the Paris Agreement and Article 6.2 Guidance.

Letter of Authorization (LOA): The letter through which the DNA authorizes the relevant Activity Participant's participation in the proposed MO activity for the purposes of any Cooperative Approach.

Mitigation: A reduction in the anthropogenic emission of GHG to reduce global warming.

Mitigation Outcome (MO): One or more of the following outcomes resulting in emission reductions or removals, including mitigation co-benefits resulting from adaptation actions and/or economic diversification plans, or the means to achieve them and which are capable in being represented in a form of a unit of measure.

Mitigation Outcome activity or MO activity: Eligible mitigation activity, action, project or groups of activities that lead to the achievement of an MO, including joint projects with other countries and projects from non-government entities.

MRV: Monitoring, Reporting, and Verification refers to the process of measuring the amount of GHG emissions avoided, reduced, or removed by a specific mitigation activity over a period of time, and independently verifying the results to ensure robustness and accuracy.

National Climate Change Committee (NCCC): The highest body for decision making on matters related to climate change in Bhutan. The National Environment Commission acts as the NCCC.

NDC: The Nationally Determined Contribution of a Paris Agreement Party, as prepared, communicated and maintained from time to time in accordance with Article 4.2 of the Paris Agreement and Decision 4/CMA.1.

NDC Implementation Period: The period of time within a specific NDC Period.

NDC Period: The five-year period specified in Article 4.9 of the Paris Agreement, Decision 1/CP.21 and any relevant decisions of the CMA, during which the Paris Agreement Parties shall achieve their respective NDC.

Other international mitigation purposes: A purpose for the use of an ITMO that is other than the achievement of a Paris Agreement Party's NDC, as determined by a Paris Agreement Party [including a delivery of overall mitigation/voluntary cancellation].

Paris Agreement Party/Parties: A country/Countries that is/are signatory/signatories to the Paris Agreement and who has deposited their instrument of ratification, acceptance, approval or accession to the Secretary-General of the United Nations in the capacity of depository of the Paris Agreement. For the avoidance of doubt, a country that has withdrawn from the Paris Agreement shall no longer be considered a Paris Agreement Party after its withdrawal takes effect pursuant to Article 28(2) of the Paris Agreement.

Paris Agreement: The agreement adopted by the parties to the UNFCCC at its 21st meeting in Paris as reflected in Decision 1/CP.21 (Adoption of the Paris Agreement).

Sink: Any process, activity or mechanism that removes a GHG, an aerosol or a precursor of a GHG from the atmosphere. "tCO₂e" means an amount of carbon dioxide emission measured in metric tons that would cause the same integrated radiative forcing or temperature change, over a given time horizon, as an emitted amount of a GHG or a mixture of GHGs.

3. Rules

3.1 Purpose

The Kingdom of Bhutan is a Party to the United Nations Framework Convention on Climate Change (UNFCCC) and ratified the Paris Agreement on 19 September 2017. Bhutan submitted its Intended Nationally Determined Contribution (NDC) on 30 September 2015, in which it committed to remain carbon neutral. In its second NDC, submitted on 5 June 2021, Bhutan reaffirmed this commitment.

The Royal Government of Bhutan (RGOB) wishes to operationalize, at the national level, the provisions of Article 6.2, 6.4, and 6.8 of the Paris Agreement and its applicable guidance. These Carbon Market Rules (“Rules”) set out the elements of how Bhutan will, inter alia, facilitate participation in cooperative approaches under Article 6.2 of the Paris Agreement with other Paris Agreement Parties, in order to allow for higher ambition in mitigation and adaptation actions. Bhutan wishes to promote sustainable development and ensure environmental integrity and transparency in pursuing cooperative approaches. These Rules build on the Climate Change Policy of the Kingdom of Bhutan 2020² and the National Environment Protection Act of 2007³ to provide guidance for participation in international voluntary or compliance carbon markets for activities in Bhutan.

3.2 Scope

The Rules apply to all activities in Bhutan seeking participation in compliance or voluntary carbon markets for the issuance of a Letter of Authorization for the purpose of undertaking Corresponding Adjustment consistent with Article 6 of the Paris Agreement.

The RGOB also welcomes private sector investment in climate change through voluntary carbon markets. Where no Letter of Authorization is sought for participation in voluntary carbon markets, entities are not required to seek RGOB approval since these activities have no implications for RGOB’s international climate commitments.

Existing arrangements for the sharing of credits across countries under other agreements will remain in force.

3.3 Institutional Arrangements

National Climate Change Committee (NCCC): The National Environment Commission (NEC) functions as the high-level National Climate Change Committee (NCCC) and is chaired by the Hon’ble Prime Minister or his nominee. It is the highest cross-sectoral environmental policy and regulatory body responsible for coordinating all the matters relating to the protection, conservation and improvement of the environment. The NEC derives its mandate from the National Environment Protection Act of 2007.

Accordingly, the NCCC will be responsible for rulemaking and oversight functions related to participation in carbon markets. This includes:

- Set out overall scope of Article 6 engagement, including eligible sectors {such as hydropower, forestry}, and positive list of targeted sectors and technologies for priority action technologies, project types, and methodologies;
- Agree on allocation of functions to relevant institutions within the country;
- Approve fees for corresponding adjustments; and
- Guide and oversee Article 6 program implementation in the country.

² <https://www.gnhc.gov.bt/en/wp-content/uploads/2020/02/Climate-Change-Policy.pdf>

³ <http://www.nec.gov.bt/publications/legislations>

Climate Change Coordination Committee (C4): The C4, chaired by the Director General of the Department of Environment and Climate Change, is the technical body that serves as a forum for discussion and coordination on matters of climate change in Bhutan, comprised of high-level representation from stakeholder agencies and organizations. For the purposes of these Carbon Market Rules, consultations through the C4 will include line ministries for relevant sectors/designation of sectors. The C4 derives its mandate from the Executive Order of the Prime Minister of October 16, 2016. The Climate Change Division of the NECS supports the implementation of the mandate of the C4. The C4 will be responsible for technical advisory functions, including:

- Review international methodologies, technical guidelines, default factors, etc. and oversee the development of new methodologies;
- Propose a positive list of activities for participation in carbon markets for approval by the NCCC;
- Approve technical standards, guidelines, accreditation rules for third-party auditors, NDC-related parameters to be used in emission reduction calculations, and the carbon asset development process
- Define criteria for the certification and issuance of emission reduction credits;
- Approve [recognition of] accreditation of auditors [of an existing carbon standard];
- Approve authorization of projects and activity participants to generate and transact ITMOs;
- Provide analysis on the impact of potential projects/transfers on NDC; and
- Address grievances and appeals.

Department of Environment and Climate Change (DECC): The NCCC is supported in implementing its mandates and functions through the Department of Environment and Climate Change. The DECC will be responsible for implementation activities, including:

- Set out the carbon asset development process;
- Propose accreditation of auditors as per existing carbon standard[s] to carry out validation and verification;
- Review and register eligible projects;
- Certify and issue/authorize issue an existing carbon standard[s] emission reductions based on criteria defined by the NEC;
- Propose authorization of projects and activity participants to generate and transact ITMOs;
- Propose fees for corresponding adjustments;
- Execute transfer of Article 6 units;
- Maintain/designate a registry of projects and emission reductions, including links with international registries, where required;
- Implement corresponding adjustments; and
- Report on projects, MOs, and transfers in Biennial Transfer Reports (BTRs) for Article 6 Technical Expert Review.

3.4 Process

Entities that wish to participate in carbon markets whether voluntary or compliance may seek a Letter of Authorization from the DECC in respect of an MO activity that has been carried out within Bhutan and validated or verified using the procedures set out by the NEC.

Any Letter of Authorization granted by the DECC will be made publicly available on the DECC website.

Upon obtaining a Letter of Authorization, Activity Participant(s) will be authorized to represent the MO activity and are authorized by Bhutan to deal in, including to sell and transfer, any MOs arising from the MO activity, subject to any conditions specified in the Letter of Authorization.

To the extent that Bhutan agrees with another Paris Agreement Party that these Rules form a Cooperative Approach with the Paris Agreement Party, the MOs authorized by the DECC will be converted/deemed, if applicable, ITMOs for the purposes of such a Cooperative Approach.

The DECC will specify, as appropriate, the payment to be made for carrying out Corresponding Adjustment at the time of granting the Letter of Authorization. The payment of Corresponding Adjustment is additional to the payment made for the underlying MOs, and reflects the opportunity cost of Bhutan meeting its NDC. Such payment is to be made directly to the Royal Government of Bhutan/transferred by the Activity Participant to the Royal Government of Bhutan/to the designated fund or account. Payments to the RGOB may be operationalized through a sovereign climate fund to capture the fee associated with corresponding adjustments, which can then be reinvested in climate mitigation and adaptation to ensure achievement of NDC.⁴

Activities carried out in voluntary carbon markets that do not require a Letter of Authorization are required to register their MO activities and issued MOs in the registry designated/maintained by the DECC as the national registry.

Registry

As per Paragraph 29 of Decision 2/CMA 3 “each participating Party shall have, or have access to, a registry for the purpose of tracking”.

The DECC will designate/maintain a registry that will perform the following functions:

- Identify and facilitate the tracking and transfer of unit ownership/holding from issuance to cancellation/retirement;
- Identify unit status, including retirement/cancellation, and issuance status;
- Assign unique serial numbers to issued units;
- Identify the serial numbering of, or designate on a public platform, each unique unit’s country (fixed as Bhutan, in this case), sector of origin, and vintage year.

The registry and its operator would be responsible for:

- Registry use: Utilize an electronic registry to comply with the criterion for unit identification and tracking;
- Unit identification: The registry should be capable of transparently identifying units, in all account types;
- Unit transfer and tracking: The registry should facilitate the transfer of unit ownership and/or holding; and transparently identify unit status, including issuance, cancellation, and issuance status;
- Unique serialization: The registry shall have policies in place requiring the registry to assign to each unit a unique serial number; identify units’ country and sector of origin, vintage, and original (and, if relevant, revised) project registration date;
- Registry administrator conflicts of interest: Avoid administrator conflicts of interest and have policies that prevent the registry administrators from having financial, commercial or fiduciary conflicts of interest in the governance or provision of registry services. Where such conflicts

⁴ The establishment and operation of the Bhutan Climate Fund is not part of the scope of the Rules

arise, and are appropriately declared, should have robust procedures in place to address and isolate the conflict;

- Registry account creation and screening: Have provisions to support opening new accounts for users, establish the KYC process and procedure that includes ensuring the screening of requests for registry accounts; and restricting registry accounts to registered businesses and individuals; and
- Registry security review: Have provisions to ensure the periodic audit or evaluation of registry compliance with security provisions.

These Carbon Market Rules will be amended, as required, to ensure conformity with Article 6.2 Guidance and any relevant decisions of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA).

4. Legislative Compliance

This policy is in compliance with all relevant national laws and international legal instruments in force in the Kingdom of Bhutan at the time of adoption of the policy. The Rules for carbon markets are formulated to respond to provisions in the following legal instruments:

- National Environment Protection Act 2007:** This policy is aligned with the principles of the Act, which sets out the mandate and functions of the NEC and its Secretariat in implementing obligations under multilateral agreements.
- Climate Change Policy 2020:** This policy is aligned with Bhutan's Climate Change Policy, which includes as a policy objective the utilization of relevant mechanisms under the Paris Agreement such as 'cooperative approaches', among measures to contribute to the goal of remaining carbon neutral.
- The Paris Agreement:** The policy is consistent with the Paris Agreement and is intended to facilitate participation in cooperative approaches under Article 6.2 of the Agreement.
- United Nations Framework Convention on Climate Change:** This policy has been formulated to support the implementation of actions by Bhutan to meet the objectives of the UNFCCC.