PHILIPLEE

Recent Developments in the Voluntary Carbon Market

The market for carbon credits has seen unprecedented growth in recent years, as increasing numbers of companies have made voluntary climate commitments. The number of corporates that have made such commitments has grown from 23% in 2019 to 42% in 2022 based on research into the climate commitments of the Fortune Global 500.[1]

The Intergovernmental Panel on Climate Change (IPCC) has accepted that carbon reductions alone will not be sufficient to meet Paris Agreement targets and that carbon removals will be essential. Given the scale of this challenge it can be expected that international climate finance, including the voluntary carbon market (**VCM**), will play an increasingly important role in removing greenhouse gases (GHGs) from the atmosphere.

At the same time, it is important that companies can be sure that their contributions to climate action are robust and verifiable. The use of descriptions such as "carbon neutral" and "net zero" have to be supportable and withstand increased scrutiny. Accusations of greenwashing may lead companies to scale back their climate ambitions entirely.

In this article we look at recent developments that aim to build confidence and set standards in the voluntary carbon market, but will likely have an application across the GHG reductions and removals landscape.

1. Verra publishes updates to the Verified Carbon Standard Program (v4.5)

Verra, one of the leading standards for certifying GHG reduction and removal projects, has published updates to its Verified Carbon Standard (VCS) Program. The updates to the Standard aim to increase transparency and integrity, as well as aligning with other carbon market initiatives (including those outlined in sections 2 – 4 of this briefing note). Changes include increased environmental and social safeguards, as well as clarifications to Verra's rules intended to avoid double-counting and double-claiming. Two new market labels have been also introduced for credits issued under the VCS Program (Verified Carbon Units or VCUs), with the aim of increasing marketability of such VCUs.

One of the new labels identifies credits authorised for use under Article 6 of the Paris Agreement. Article 6 of the Paris Agreement provides a framework for countries to cooperate and internationally transfer 'mitigation outcomes' when achieving their Nationally Determined Contributions (NDCs). This framework seeks to avoid situations of double counting that can result in a net increase in emissions. For VCUs to be eligible for an Article 6 label the host country authority must have issued a letter of authorisation (LOA) in respect of those VCUs.

The LOA must include certain information, including the specific use (or uses) for which the mitigation outcomes represented by the VCUs will be authorised. There are three available Article 6 labels - NDC use, other mitigation purposes (e.g. CORSIA) or other purposes (e.g. use towards voluntary emission pledges). The status of VCUs with Article 6 labels can be publicly viewed on Verra's website. Verra will also make available a template LOA on its website to assist project proponents in approaching a host country to request Article 6 authorisation.

2. Voluntary Carbon Market Integrity Initiative (the "VCMI") Claims Code of Practice

Amid a lack of standardisation, it has been difficult for companies buying carbon credits (and for end-consumers) to be sure that a high-integrity offset has been purchased. Recent publicity casting doubt on the integrity of some credits has shaken confidence in the voluntary carbon market. With its recent Claims Code of Practice, the VCMI has sought to build integrity on the demand side by guiding companies and other non-state actors on how they can make voluntary use of carbon credits as part of their climate commitments.

The VCMI is a multi-stakeholder platform aimed at promoting credible and net-zero aligned participation in the voluntary markets for buyers of carbon credits (i.e. the demand side).

The Claims Code of Practice is a rulebook on the credible use of high-quality carbon credits and associated claims. By following the Claims Code, companies can make an enterprise-wide "VCMI Claim" and use that label to demonstrate high-integrity use of carbon credits. The process requires commitment to foundational criteria including setting validated science-based near-term emissions reductions targets (see section on SBTi, below).

Importantly, a company seeking to make a VCMI Claim must purchase and retire carbon credits only after demonstrating progress towards its near-term targets. In other words, all VCMI Claims require the purchase of carbon credits representing mitigation outside the value chain of the company (also defined as "beyond-value-chain mitigation" or BVCM).

The VCMI claims are ambitious as the lowest "tier" Claim (silver) requires the purchase and retirement of high-quality credits representing 20%-60% of a company's remaining emissions, after it has demonstrated progress towards its near-term targets.

In addition to corporate buyers, the VCMI Claim Code is aimed at:

[1] Climate Impact Partners 2022.

- buyers of goods and services who seek to make climate-friendly purchases;
- investors and other stakeholders who want to judge the credibility of a company's climate actions and its broader decarbonisation efforts; and
- governments and regulatory agencies considering how to incentivise non-state use of carbon credits credibly and structure claims through reporting requirements, advertising, and consumer protection standards.

The VCMI also recommends companies refrain from the use of claims such as "carbon neutral". Ultimately, the Claims Code seeks to minimise the risk of greenwashing allegations and litigation in respect of claims made, which serve to reduce vital investment in climate change mitigation.

3. Integrity Council for the Voluntary Carbon Market (the "ICVCM") Framework

The ICVCM is an independent governance body for the supply side of the VCM, which aims to assist project developers and other suppliers of credits within the VCM. The ICVCM introduced the long-awaited Core Carbon Principles (**CCPs**) in March 2023 – a set of ten principles defining high-quality credits. (Please see our earlier briefing note: The Core Carbon Principles: implications for market participants.)

To operationalise the CCPs, there will be an Assessment Framework, consisting of (i) a Program Level Assessment Framework, which will assess the integrity of carbon crediting programmes under which credits are issued (e.g. Verra); and (ii) a Category Level Assessment Framework, which will assess the integrity of different types of categories of credit/ types of projects. The criteria that the ICVCM will apply in the Category Level Assessment Framework were published in July 2023. Note that the ICVCM will not assess individual projects, but rather the project categories. This will involve an assessment of the methodologies used for issuing credits for a particular project type.

In order to successfully obtain CCP label approval, credits must fund activities to reduce or remove emissions that are:

- compatible with a transition to net zero;
- permanent;
- additional; and
- robustly quantified.

The activity must also adhere to environmental and social safeguards, respect human rights, mitigate risks to Indigenous Peoples and local communities and contribute to and be consistent with the Sustainable Development Goals.

Carbon-crediting programs can apply for assessment through the ICVCM's application portal. If approved, programs will be able to use the CCP label on specific categories of credits, aimed to be available by the end of 2023. Both new and existing credits issued under methodologies from approved categories will be able to use the CCP label.

For more complex issues, the ICVCM is establishing expert working groups to assess whether different categories will meet the CCP criteria. Some credit types will be automatically ruled out, e.g. mitigation activities leading directly to an increase in fossil fuel extraction.

As the first labels are issued, it will be interesting to see the extent of the premium that CCP-tagged credits command, and any re-negotiation of existing offtake agreements.

4. Science-based Targets Initiative ("SBTi") guidance on Beyond Value Chain Mitigation

The SBTi is a partnership between leading international environmental organisations and the United Nations Global Compact. One of its core objectives is to support companies to set ambitious climate mitigation targets in line with the latest climate science. As of August 2023, over 3,000 companies have had their targets independently validated by SBTi, with thousands more having made a public commitment to set a science-based target within 24 months.

The SBTi recommends that companies go further than their science-based targets and mitigate emissions beyond their value chains, to support global efforts to limit temperature rise to 1.5°C. As noted above, this is described as beyond-value-chain mitigation (**BVCM**) and was introduced by SBTi as part of its Corporate Net-Zero Standard that was launched in 2021.

Such additional action by corporates is considered critical as (among other reasons): (i) there are important sources of emissions outside of corporate value chains, and (ii) government policies are not yet sufficiently ambitious to deliver a 1.5°C future. BVCM is defined as "*Mitigation action or investments that fall outside a company's value chain, including activities that avoid or reduce GHG emissions, or remove and store GHGs from the atmosphere*." A mitigation action was defined by the Intergovernmental Panel on Climate Change (IPCC) as an intervention that results in GHG reductions or removals. Examples include purchasing high-quality jurisdictional REDD+ credits or investing in direct air capture (DAC) and geologic storage.

Most companies surveyed by SBTi agreed that the private sector should go further than abatement of value chain emissions, but gave feedback that they needed guidance on best practice in BVCM and investments. To this end the SBTi is preparing a paper on BVCM and launched a public consultation on BVCM in June 2023.

The SBTi aims to establish:

- which activities and investments companies can count towards their BVCM commitments;
- what steps companies can take when designing and implementing their BVCM strategies;
- which claims companies can make about their BVCM activities and investments and how that influences what activities they finance and support;
- what companies need to report on their BVCM activities and investments;
- what barriers need to be addressed and what new incentive mechanisms could be established to encourage companies to finance and deliver BVCM; and
- the standardisation of terminology.

The public consultation process, which ended 30 July 2023, aims to guide and consult on matters such as:

1. the definition of BVCM;
2. articulate the need for companies to go beyond their near- and long-term science based targets to also invest in BVCM;
3. explore the business case for BVCM;
4. recommendations on:

- Determining a commitment to BVCM;
- Deploying finance and resources across mitigation activities; and
- Claims, transparency and reporting with regards to BVCM, including matters such as double claiming.

The outcome of the public consultation process is expected in the fourth quarter of 2023.

Conclusion

The initiatives discussed are welcome developments, having common goals of harmonising standards and building greater confidence in the market for carbon credits. Recent findings in fact refute the assertion that companies voluntarily buying carbon credits are creating a ‘license to pollute’. Research indicates that the voluntary purchase of carbon credits provides companies with an incentive to accelerate their emission reductions and companies using a “material” amount of credits reduce their emissions faster than those that do not.

The demand for high-integrity carbon credits is predicted to increase sharply in the coming years both in light of the above, and as countries seek to meet their own GHG reduction targets under the Paris Agreement.

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[2] Trove Research, ‘Corporate emission performance and the use of carbon credits’ 1 June 2023.