ENVISIONING THE VOLUNTARY CARBON MARKET POST- 2020

A Working Group Statement for consultation on the future role and design of the voluntary carbon market to support the goals of the Paris Agreement

Introduction and background

The advent of the Paris Agreement prompted reflection on the role and design of the voluntary carbon market (VCM), specifically:

- How can the VCM optimally contribute to the net zero emissions goals of the Paris Agreement?
- How does the VCM interface with accounting under Articles 4 and 6 of the Paris Agreement and other compliance systems?
- How can organisations be incentivised to finance enhanced levels of climate action, including those beyond their corporate boundaries[1], and claim these contributions credibly?

With support from the German government, a Working Group[2] of civil society organisations, carbon market private sector actors, and standards bodies begins to answer these questions.

Following consultation in June/July 2019 the group puts forward an updated version of the Statement (updates highlighted in yellow). The Statement describes:

- A proposed role and design of the VCM from 1 January 2021 onwards, when the country commitments under the Paris Agreement (i.e., Nationally Determined Contributions or NDCs) officially go into effect;
- An updated characterisation of what a voluntary carbon credit represents;

[1] I.e. outside an organisation's Scope 1, 2 and credible Scope 3 inventories, as defined by the Greenhouse Gas Protocol

[2] Gold Standard convened this group. Experts from the Gold Standard, VERRA, ICROA, WWF, CDP, WRI, The Nature Conservancy, Carbon Market Watch contributed, but we stress that this statement is for consultation and does not represent the formal positions of the individual members of this group. The development of the statement was observed by World Bank (this does not imply endorsement by World Bank).

- ‘Foundational claims’ (see below definitions) that can be made about the purchase and retirement of voluntary carbon credits to finance climate action beyond an organization’s own boundaries--the basis for additional guidance on other claims related to use of the credits (‘usage claims’ - see below) that buyers could make, to be defined in future work by this Working Group);

- A position on double counting in context of the VCM, reflecting how this differs from the Kyoto era; and

- Further proposed work to create a more robust and clearer framework through which organisational-level claims can be incentivised and recognised. This will include a review of what could be appropriate and credible claims associated with the use of voluntary carbon credits, including “carbon neutrality” and “net zero” claims.

The following definitions are applied:

- Foundational claims: These claims focus only on the core attributes that a carbon credit represents. For example, that a carbon credit may represent 1tCO2e avoided or physically removed from the atmosphere.
- Usage claims: These claims relate to how a credit is used/claimed by a buyer, usually at an aggregated level, for example “carbon neutrality.”

It is stressed that usage claims are not discussed in this paper and that no position has been taken on terms such as carbon neutrality. These will be discussed in future phases, see below.

Working Group Statement on the future role and design of the voluntary carbon market to support the goals of the Paris Agreement

The role and value of the VCM in the Paris Agreement

The Working Group stresses that organisations should first reduce internal emissions in line with science (i.e. a Science Based Targets Initiative 1.5C degree trajectory or in line with further guidance from the initiative) which is reflected in the net zero ambition of the Paris Agreement. The Working Group also recognises that the VCM has the potential to provide a complimentary contribution towards the net zero goals of the Paris Agreement by being a vehicle for financing emissions reductions outside organization boundaries. Yet it must be designed to reflect relevant structural differences between Paris Agreement and the Kyoto Protocol.

First, the Kyoto Protocol had limited coverage, introducing commitments for only 37 countries emissions in the second period. Secondly, the Kyoto Protocol had a far lesser ambition—aiming only for an 18% reduction compared to 1990 levels. Thus, the VCM in the Kyoto era operated as a mechanism to unlock voluntary climate action beyond countries' commitments. This therefore required rules to avoid voluntary carbon credits counting toward compliance commitments, or 'double counting'[3].

In contrast, coverage of the Paris Agreement is global, and its ambition introduces global net zero targets (i.e., the balancing of emissions with sinks, in line with science, by 2050 at the latest). However, NDCs currently fall short of this net zero ambition, and even commitments made through the NDCs are not fully financed. Furthermore, there is an urgent need for near-term action to begin bending the emissions curve quickly and avoid locking in carbon-intensive technologies, particularly in developing countries.

Achieving net zero by 2050 therefore requires filling 1) the **emissions gap** (the estimated amount of emissions that the current NDCs are deviating from what climate science requires), 2) the **finance gap** (the amount of financial capital required to meet and exceed the current NDCs), and 3) the **time gap** that prioritises climate action taken sooner versus later.

The role of voluntary purchases and retirements should therefore shift from an instrument to go beyond compliance targets to an instrument to accelerate the global transition towards net zero emissions by helping close the emissions gap, the finance gap and the time gap.

Practically, this includes:

[3] For example, through cancellation of allowances prior to issuance of voluntary credits

- Financing actions beyond organisational boundaries that lead to a reduction in the concentration of greenhouse gases in the atmosphere in a way that is real, additional, verifiable, and permanent.

- Targeting actions (such as emerging technologies) that raise ambition and accelerate the transition towards the goal of net zero emissions.

<u>What voluntary purchases and retirements of carbon credits represent post-2020</u>

Post-2020, organisations and individuals may make voluntary contributions to the net zero goals of the Paris Agreement by financing emission reductions through the purchase and retirement of carbon credits. Credits may be units that are reported in the host country NDC accounting or may be beyond (for example, because they are in a sector not captured under the host country NDC or the host country makes an adjustment to their accounting in relation to the credit).

Dependent on whether the credit is reported under the host country NDC this may imply either 1) that the credit contributes to host country efforts and overall goals of the Paris Agreement or 2) contributes to the goals of the Paris Agreement only. The voluntary purchase and retirement of a carbon credit post-2020 may therefore represent the **financing** of an emission reduction; the emission reduction itself and its impact may be accounted for by the host country.

The foundational claim for credits used for voluntary purposes are described below. It is acknowledged that negotiations concerning Article 6 of the Paris Agreement are ongoing and this may necessitate revisiting the claims described.

<u>Foundational, best practice claims about carbon credits post-2020</u>

As best practice, an organisation or individual could make the following unique (i.e. have sole claim to ownership of the credit) foundational claims about the voluntary purchase and retirement of carbon credits. The sections in parentheses are relevant only to organisations:

> *Company X has purchased and retired YY carbon credits through the voluntary carbon market and has thus financed the reduction of YY tons of CO2e [outside its organisational boundaries], representing a tangible contribution to the climate mitigation goals of the host country and the Paris Agreement.*

In this way it is possible to retain much of the infrastructure of the VCM (unit issuance and serialisation, registry of units, transfers and retirements) and leverage its strengths as a way to channel finance to projects that reduce emissions, while adjusting the claim of the retiring organisation to reflect the new era of the Paris Agreement. Subject to the outcomes of negotiations concerning Article 6, it is potentially possible to retire Article 6 units in this context.

Implications for use in offsetting

While the above Foundational Claims may be applied by any voluntary buyer at any time it is acknowledged that the predominant use of the VCM is currently for offsetting; with credit purchases used to compensate, for example, an organisation's residual emissions.

As part of the further work envisaged, the role of credits in offsetting will be further explored. In particular this will focus on what further provisions the credits may require in order to be used in the context of offsetting. This will be informed by a consideration of the impact of offsetting on the ambition of both host-country and offsetting organisation, as well as the role and definition of claims such as Carbon Neutrality.

To facilitate this work, the group will engage with and discuss options with a range of stakeholders, including host country governments.

In addition to the above, the group will also assess the need for transition periods to implement any such provisions while protecting existing VCM projects.

Implications for double counting

During the Kyoto era, the VCM addressed emissions reductions that were beyond compliance targets. Practically, this meant that units could only be issued from countries without a compliance target or with a corresponding cancellation/retirement of allowances in countries with a target.

National greenhouse gas inventories as reported to the UN do not account for the voluntary use of market-based instruments to compensate for national emissions. Countries that host emission reduction projects will be able to report lower actual emissions in their national inventory that is reported to the UN. Therefore, assuming no further agreement between countries, emission reduction activities delivered through the voluntary purchase and retirement of carbon credits should be counted only once at the UN level—by the country that hosts the emission reduction project that gave rise to the carbon credits.

Because the proposed Foundational claim is to have financed a contribution towards the Paris Agreement (not one that is beyond compliance targets as in the Kyoto era), this is not considered to represent double counting of emission reductions between host country and voluntary buyer. Rather, the emissions reduction impact could be potentially (i.e. unless it is outside the NDC scope or has been adjusted for) reported by the host country in the national inventory, and the retiring organisation can claim to have financed the reduction and to have contributed to goals of the Paris Agreement.

It is, therefore, not proposed to require all VCM projects to seek letters of approval (LOAs) or corresponding adjustments (CAs), as no redress is required in this "finance claim" scenario as it would be for use of credits in a compliance context such as CORSIA[4] As noted above, the Working Group will explore what further provisions are required for credits used in the context of offsetting.

In all cases, however, international independent standards must safeguard against double counting (including double issuance or double use, which are not discussed in this document).

Implications for additionality

While detailed requirements for additionality are not described in this paper, it is acknowledged that credits should be demonstrated as being 'additional'. The test for additionality should be updated to reflect Paris Agreement definitions.

Summary & Conclusions

The global coverage and net zero ambition of the Paris Agreement prompt changes to the role and design of the VCM, positioning it as a tool to address the emissions gap, the finance gap and the time gap.

Key implications of this Statement include:

- A shift from an instrument to go beyond compliance commitments to an instrument allowing voluntary carbon credit buyers to finance climate action beyond their boundaries that contribute to both the host country goals and that accelerate the global transition to net zero emissions. Because of this difference, projects would not necessarily require Letters of Approval or Corresponding Adjustments for purely voluntary action to be able to make foundational claims described in this document.
- For the above bullets to be relevant all carbon credits should be additional.
- A need for development of further guidance on provisions for offsetting, target setting and usage claims, endorsed by key civil society actors and integrated with other relevant initiatives or protocols.

In this context and leading into further developments, the Working Group acknowledges that while the financing claim is available for any organisation or individual to use ,for the position outlined in this Statement to be valid, organisations should reduce internal emissions in line with science (i.e. a Science Based Targets Initiative 1.5C degree trajectory or in line with further guidance from the initiative) which is reflected in the net zero ambition of the Paris Agreement. Without this, the retiring/purchasing organisation could not credibly claim to be on a "net zero pathway". Financing beyond boundaries without reducing sufficiently within boundaries will not lead to a global balance of emissions and sinks, i.e., achieve the goals of the Paris Agreement. Rather, this requires all organisations to balance internal emissions and sinks in line with science within the required timeframe.

[4] Any claims associated with compliance targets, for example airlines seeking to use the VCM towards ICAO CORSIA offsetting obligations would require LOA and CA. Similarly, a voluntary actor that opts to follow a compliance target pathway under Article 6, which should not be prevented by voluntary standards bodies nor the Parties to the Paris Agreement, would also require an LOA and CA.

It is recognised that other uses of the claims may be applicable--for example, for individual users addressing their personal climate footprint, for events and products; and for SMEs.

Further work

This paper sets out the overarching position of the Working Group towards aligning the VCM with the goals of the Paris Agreement and increasing the incentives for organisations and individuals to finance change. In Phase 2, this work will set out provisions for credits to be used in the context of offsetting and further to provide a framework of guidance that further defines preconditions for legitimacy like target setting, credible usage claims, and best practices for financing beyond boundaries.

It is noted that this may have implications on the use of claims commonly made by buyers in the VCM, including but not limited to “carbon neutrality” and “net zero” claims. Phase 2 work may include recommendations for a “dual target” – one for reducing emissions within organisational boundaries in line with science; the second for financing beyond boundaries.

The Working Group will focus on these issues in greater detail in Phase 2, setting out a framework through which the VCM can be an instrument that organisations and individuals can use to be recognised for their contribution to the goals of the Paris Agreement. This may ultimately take the form of guidance or a reporting protocol that works within or alongside other industry reporting protocols, with the endorsement of key civil society partners.