18 December 2020

Carbon Market Watch response to the Consultation of the Taskforce on Scaling Voluntary Carbon Markets

Summary:

The proposition of a Taskforce on scaling voluntary carbon markets represents an opportunity to encourage all parts of the carbon market value chain to boost their commitment towards the goals of the Paris Agreement.

However, Carbon Market Watch underlines that the Taskforce should **prioritize** the reduction or avoidance of absolute emissions, guaranteeing that only entities able to prove their science-based attitude to mitigation, can cover projects in the voluntary markets. At the same time, industry collaboration to promote higher standards and innovate regulatory framework - not to suspend or hamper them - should be strongly **encouraged**. Furthermore, the Taskforce should aim to attract strong, well-resourced, independent and non-commercial entities aimed to supervise the markets' compliance with standard criteria (transparency, permanence, efficiency etc) to participate in the voluntary markets

It is important to first **clarify** why scaling up markets is necessary and who should or should not participate in them. Currently neither the Taskforce nor the topics that it covers explain whether, why and how the market should be scaled up. The Taskforce seems to primarily aim to drive trading, rather than emission reductions. It doesn't acknowledge the fact that the financial sector's involvement in a scaled-up voluntary market might simply lead to increases in the volume of trading, but not necessarily in the volume of emission reductions.

In addition, the Taskforce should put more emphasis on **certifying** the market's qualitative approach towards emission reduction or avoidance (rather than just reporting the quantitative increase in market volume). Although the Taskforce consultation document addresses the need for 'transparent, verifiable, robust' voluntary market carbon credits, guidelines on quality concerns are lacking, especially in the supply and standard areas. These would be key to **guaranteeing** markets' integrity and projects' efficiency, transparency and durability, while avoiding double-counting.

Carbon Market Watch considers that the above core carbon principles should ensure integrity

and quality of those standards that are currently lacking in voluntary carbon credits. To achieve this, a governance body working independently from sectoral and political interests is needed.

Furthermore, Carbon Market Watch advocates for the voluntary carbon market to **ban** all projects that use fossil fuels or any other GHG source. They should also **exclude** biological carbon sinks (given their vulnerable and non-durable nature) and derivative and secondary markets (given their lack of transparency, their speculation and "bubble" risks). Biological carbon sinks could be supported through providing results-based finance, related, for instance, to carbon farming. Also, project selection criteria should take into account the starting date of the project's first crediting period, and exclude certain projects or methodologies considered "vintage" (emission reductions should not be older than five years when they are used for compensation), as a consequence, a minimum year should be set as a core principle and the year in which a given emission reduction took place should be specified as a further attribute.

Finally, to avoid "greenwashing" and reduce the risks related to "offset" claims by those who did not fulfil several climate-relevant criteria, the markets should **require** rigid advertisement and sales parameters on offsets.

Feedback:

To support the scale-up of the voluntary carbon markets, the Taskforce has identified six key topics for action, spanning the entire value chain. The six topics for action are:

I. Core carbon principles and attribute taxonomy

II. Core carbon reference contracts

III. Infrastructure: Trade, post-trade, financing, and data

IV. Consensus on the legitimacy of offsetting

V. Market integrity assurance

VI. Demand signals

Do you agree that the implementation of these six topics for action would significantly help to scale voluntary carbon markets?
Answer: Somewhat Agree

Is there anything not covered by these topics for action that we should consider?
These topics effectively cover the question of how to scale up the voluntary market. However, they do not address the more fundamental question of whether, why and how the market should be scaled up. The report conflates emission reductions and carbon credits. The vision for scaling up the VCM at times implies that this is the only way of driving emission reductions from the private sector. One key concern following from the identification of these 6 topics as priority topics is that they primarily aim to drive trades, rather than emission reductions. There is an implicit assumption that more financial sector participation will drive more emission reductions. However, there is no detailed discussion to assess whether this hypothesis is likely to be true or not. The possibility that the financial sector's involvement in a scaled-up voluntary market might simply lead to increases in the volume of trades, but not necessarily in the volume of emission reductions - e.g. because a single credit is traded multiple times, or because trades are based on derivatives - is not acknowledged. This is a more fundamental problem of this initiative. Before assessing how to scale up the market, it should discuss why this is necessary, and who should participate in it.

Topic for action I is focused on the Core Carbon Principles and taxonomy of attributes. Please refer to pages 11 -12 in the Consultation Document.

Do you agree with the recommended actions we have outlined in "topic for action I"?

Recommended action 1: Establish core carbon principles and taxonomy of additional attributes
Answer: Somewhat Disagree
Comment:
1) Creating attributes separate to the core principles gives the impression that these are "nice to have". In fact, some of the things mentioned in the document are crucial elements that determine the quality of a credit.
2) This risks "re-inventing the wheel" and allocating significant resources to the establishment of yet another set of quality criteria. What we need is to re-assess, improve, and enforce the existing standards and methodologies (VCS, GS, CDM, ...), not set up new criteria. General criteria such as additionality, permanence, etc. are already widely accepted. What is problematic is their concrete implementation. How is additionality measured? How long is "permanent"? Etc.

Recommended action 2: Assess adherence to the core carbon principles
Answer: Somewhat Agree
Comment:

An independent organisation should be staffed and resourced to assess the quality of existing methodologies, standards, projects. But not new core principles. This should obviously not be the standards themselves, nor should the standards be tasked with accrediting the entity. There should be no direct link between the standards and the entity assessing quality. This should not be done by a Validation and verification body either. It should be a non-commercial, independent organisation.

Should the "Core Carbon Principles" exclude projects of a certain vintage (Vintage refers to the year of the emissions reduction. For example, CORSIA does not allow project activities that started their first crediting period before 1 January 2016)?
Answer: Yes

Should the "Core Carbon Principles" exclude certain project types, or only allow them with additional safeguards? (independent of project vintage)?
Answer: Yes

Which of the following additional attributes would you want to see available, distinct from core carbon? These will serve as a method to differentiate carbon credit valuations, allowing the market to decide their value. Please also note that the Core Carbon Principles are likely to evolve over time.

Vintage - yes, should be added
Comment: A minimum year should be set as a core principle, and in addition, the year in which a given emission reduction took place should be specified as a further attribute. Emission reductions should not be older than five years when they are used for compensation.

Avoidance / reduction vs. removal /sequestration - yes, should be added
Comment: Removals and sequestration through biological carbon sinks do not meet the “core principle” of permanence and should not be eligible for use as offsets. They are also highly susceptible to baseline gaming.

Project type (e.g., renewables, REDD+, Afforestation) - yes, should be added
Comment: Some project type restrictions should apply, e.g. against projects which prolong the life of any fossil fuel activity, or projects which rely on carbon sequestration in biological carbon sinks.

Location (e.g. South America, Africa) - yes, should be added

Co-benefits (e.g. Biodiversity badge, Social badge, etc.) - yes, should be added
Comment: Minimum sustainable development benefits and safeguards for upholding Human Rights should be part of the core principles and details provided as attributes.

Corresponding adjustment (e.g. yes/no) - no, should not be added
Comment: The application of a CA should be part of the core principles.

Other (please specify in comments) - yes
Comment:
The standard under which the project is registered, crediting period and total potential crediting period (including potential crediting period renewals), the total volume of reductions by the project, benefit-sharing arrangement (e.g. if host country can retain some of the emission reductions), application of an automatic partial cancellation rate to ensure that some of the emission reductions achieved are not used to compensate emissions and rather directly increase the total volume of reductions, the contribution of the project to adaptation finance (see for e.g. CDM contribution to adaptation fund).

Do you have a perspective on the Consultation Documents positioning of avoidance/reduction vs. removal/sequestration?
We believe avoidance/reduction should be a priority in the short term, and should therefore be promoted more clearly as such in the document.

We strongly oppose the inclusion of avoidance/reduction based on biological carbon sinks, e.g. forests or soil. While these can be supported by crediting systems in the form of results-based payments, they should not be used to generate offset credits, because they do not lead to an absolute and permanent reduction in the concentration of greenhouse gases in the atmosphere. They can at most contribute to a "postponement" in emissions, but cannot store carbon on a geological timescale.

In addition, there are massive measurement uncertainties for certain project types (e.g. soil carbon), and most methodologies used today have vast potential to be gamed in order to inflate the number of credits issued.

We note the debate between jurisdictional and nested REDD+ projects, as mentioned in the consultation document, and highlight that neither of them is capable of generating carbon credits suitable for offsetting. Non-nested projects are completely inappropriate because their baselines are by and large not credible. While nested projects can reduce the risks related to the baseline setting, they are not perfect (as the jurisdictional baseline can also be gamed), and they do not address the issue of non-permanence.

We also note that the document mentions that permanence risks are addressed through buffers, and the definition in the appendix requires a “multi-decadal” approach to managing this risk. There is no evidence to support that buffer pools are adequate mechanisms to prevent the non-permanence risk because no buffer pool has existed for long enough to face the type of risks which climate impacts will generate. It is therefore not appropriate to trust these systems to function at scale.

Topic for action II is focused on exchange-traded core carbon reference contracts. Please refer to pages 12-13 in the Consultation Document.

Do you agree with the recommended actions we have outlined in "topic for action II"?

Recommended action 3: Introduce core carbon spot and futures contracts
Answer: Disagree
Comment:
We strongly disagree with this as we see it as a new asset developed by and for the financial sector, at the expense of actual real-world impacts and transparency. This will work against the Taskforce’s stated objective of improving transparency. It will create a financial asset which can be traded with no clear underlying “real world” asset. This will make the market even more non-transparent. It will not be clear which projects/credits are backed by these core contracts. This is already seen with CORSIA-compliant credits which are traded, without public information about the actual underlying projects. This will make the market more complicated and more opaque. It will allow large investors to trade large volumes, shielded from public scrutiny by high complexity. Carbon markets are already difficult to track, this will only add an extra layer of opacity. Finally, it is unclear how some of the elements proposed would benefit *the climate* rather than financial institutions, e.g. the possibility to financially settle any Futures contracts, without the delivery of an actual carbon credit. In this scenario, money transacts between two financial players, but never reaches an actual mitigation project.

Recommended action 4: Establish an active secondary market
Answer: Somewhat disagree
Comment:
The document states that secondary trading helps to manage risk and support long-term investments, but it does not specify why and how. While liquidity is important in a compliance

market, where companies face a regulatory risk if they cannot purchase allowances in time, this is not the case on the voluntary market. The VCM should not aim to drive *trades*, it should aim to drive *emission reductions*. The secondary trades create financial value but have no impact on the actual project. Secondary trading will not help project developers, it will open the door for speculation. It is unclear why a high level of liquidity is needed. If the market was in a situation where demand exceeds supply, this will drive prices up, and make new projects viable, hence driving emission reductions. This will not have a negative impact on buyers, since their commitments are voluntary. At most, it will put more pressure on buyers to reduce their internal emissions, which is a good thing. Secondary trading also opens the door to fraud and lack of clarity, e.g. as some stakeholders could attempt to sell credits which have already been cancelled to unassuming buyers.

For reference contracts, should we move towards more standardized or more customized contracts versus the Taskforce recommendation? Keep in mind that standardization allows for easier financing of project developers through the formation of liquid markets, while customization better satisfies current buyer demand.

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Topic for action III is focused on infrastructure required in the voluntary carbon market. Please refer to pages 13-15 in the Consultation Document.

Do you agree with the recommended actions we have outlined in "topic for action III"?

Recommended action 5: Build or utilize existing high-volume trade infrastructure
Answer: Somewhat agree
Comment:
It would be beneficial to centralise data in one place and, crucially, make trading information public. However, most existing financial platforms provide limited public data, and specialist data providers must be paid to access useful information. This would not improve market transparency. The focus should be on improving transparency, not on developing new assets that can be traded in very large volumes and primarily benefit the financial sector.

Recommended action 6: Create or utilize existing resilient post-trade infrastructure
Answer: Neutral
Comment:
It would be useful to have a meta-registry to centralise all information, but this must be very

transparent. Clearinghouses can be useful but they should work very transparently, including by publishing the transactions costs and/or fees they receive on each trade.

Recommended action 7: Implement advanced data infrastructure
Answer: Somewhat agree
Comment:
Provision of detailed data is useful, but easily interpretable information should be free and readily accessible from trading platforms and/or a meta-registry. The provision of detailed data analysis as a commercial business should not serve as a reason for failing to provide useful and comprehensive public information on trades.

Recommended action 8: Catalyze structured finance
Answer: Somewhat disagree
Comment:
While creating ways to provide upfront capital to project developers is important, this recommended action also carries significant risks. Providing loans collateralized by carbon credits, and proposing that banks which enter this market be labelled as "green financiers" opens the door to both widespread greenwashing and the development of uncontrolled derivatives. Not unlike the subprime mortgage crisis, institutions could package loans to high-risk projects, and develop hard-to-trace derivatives based on these loans. The credits backing these loans could be overestimated in value (as prices are difficult to estimate on the VCM) and in volume (as actual issuance is often very different from expected issuance). The assets used as collateral are therefore themselves very risky. This would also allow for greenwashing as banks could finance a few (potentially low-quality) carbon offset projects, and claim the "green financier" label while continuing to finance e.g. fossil fuel extraction activities.

Topic for action IV is focused on the consensus for the legitimacy of offsetting. Please refer to pages 15-16 in the Consultation Document.

Do you agree with the recommended actions we have outlined in "topic for action IV"?

Recommended action 9: Establish principles on the use of offsets
Answer: Neutral
Comment:
There is a clear need for more consistency - and integrity - in the way offsets are used. However, it is unclear how the proposed principles complement - or duplicate - existing

initiatives. Principle 3 encourages companies to offset, without discussing alternative ways through which companies could finance mitigation projects. This principle could have the effect of encouraging companies to “green” their image while selling more polluting products. The principles are generally vague, and the Taskforce should rely on existing initiatives, such as the Science Based Targets Initiative, rather than creating new principles.

Recommended action 10: Align guidance on offsetting in corporate claims
Answer: Somewhat agree
Comment:
It is unclear what the document suggests. If it is to continue the work on “claims” through the SBTI and other initiatives, we agree. See comment above, we do not see value in duplicating these efforts in another forum.

Topic for action V is focused on market integrity assurance. Please refer to pages 16-17 in the Consultation Document.

Do you agree with the recommended actions we have outlined in "topic for action V"?

Recommended action 11: Institute efficient and accelerated verification
Answer: Somewhat disagree
Comment:
While it is clear how this would increase speed and lower costs, it is less clear how it would improve the integrity of credits, as stated in the document. A major challenge with MRV today is not just the lack of efficiency, but also the lack of effectiveness. The former cannot be improved before the latter is fully addressed. The “automatic” verification proposed (e.g. in exhibit 32) could work for some projects for which detailed “hard data” can be provided. However, it might not always be the case (e.g. lack of precise satellite imagery), and some aspects, such as sustainable development benefits and upholding human rights, cannot be measured through automated systems. In addition, a key responsibility of external validators/verifiers is in checking that hypotheses used are correct, e.g. in setting the baseline. This cannot be automated. Any approach to deal with improving the work of external verifiers should also directly address the obvious conflicts of interests between verifiers and project developers.

Recommended action 12: Develop global anti-money laundering (AML)/know-your-customer (KYC) guidelines
Answer: Agree

Recommended action 13: Institute governance for market participants and market functioning
Answer: Somewhat agree
Comment:
We believe that the first dimension is - and should be - addressed elsewhere than through the work of this Taskforce. However, we support the other two dimensions proposed here.

Topic for action VI is focused on demand signals. Please refer to pages 19-20 in the Consultation Document.

Do you agree with the recommended actions we have outlined in "topic for action VI"?

Recommended action 14: Offer consistent investor guidance on offsetting
Answer: Agree
Comment:
This guidance should focus on the importance of internal reductions, and on alternative uses of carbon credits - e.g. for contribution purposes - in ways that reduce the opportunities for aggressive “green” advertising through offsets.

Recommended action 15: Enhance consumer product offerings, including at Point-of-Sale (POS).
Answer: Somewhat disagree
Comment:
While we support the idea of enabling individuals to contribute to climate mitigation projects, existing POS offerings have significant shortcomings. This includes giving a false impression that a good or service (e.g. flying) has no impact on the climate and allowing a company to brand its own activities as “green” using offsets financed by their customers.
We agree that clear and consistent carbon claims, together with transparent labels would be beneficial. We also see a need for clear regulations on advertising, to ensure consistency and truthfulness in the way products are presented. These regulations should be enforceable and their application should be monitored, e.g. by national advertising regulatory bodies.
These are not elements to accompany the development of POS offerings, but rather are pre-conditions which must be met before POS offerings can be increased.

Recommended action 16: Increase industry collaboration and commitments
Answer: Disagree
Comment:
We strongly disagree with this point and see it as an open door for greenwashing. Offsetting is not an objective in itself, but merely a last resort option which might be pursued on a voluntary basis. Public policies based on offsetting do not set a sufficient incentive to achieve internal emission reductions. We support increased industry collaborations and commitment to the development of effective climate policies. Several companies, including some with net-zero targets, and members of this task force, seem to promote the use of offsets as an alternative to more stringent regulations, such as the EU ETS. This is counterproductive to the goal of increasing climate action and would be encouraged by industry-wide collaboration to develop commitments based on offsetting. There is a real risk, already materialising today in certain sectors, of using the purchase of offsets as an argument against more stringent regulations. In addition, industries should not be in charge of determining the standards governing the use of offsets, as this should be regulated by independent entities.

We also strongly disagree with the statement in the executive summary that industries should set ambitious goals ahead of regulation. If regulations are deemed too lax, then industries should collaborate to support more ambitious regulations. Industry opposition is most often the single largest element that prevents the adoption of more ambitious regulations and it would be hypocritical for companies to lobby against climate policies and then coordinate a sector-wide voluntary commitment initiative.

Recommended action 17: Create mechanisms for demand signaling
Answer: Somewhat agree
Comment:
We support the idea of buyers making long term commitments to support mitigation projects. However, this should be carefully considered to avoid that long term commitments lead to companies not reducing their own emissions because they made a long term commitment. For example, if a company discovers a new emission reduction technology, but does not use it because it is already meeting its targets through the long term commitments it entered. Therefore, these commitments should be framed in terms of supporting mitigation projects, rather than purchasing offsetting credits. The support could later come in other forms, e.g. Technical assistance, or financial contributions not used for compensation.

Voluntary carbon market governance

Governance bodies to ensure integrity of carbon credits

Do you agree with the need for a governance body to:

Establish, host, and curate the Core Carbon Principles (CCPs) and the definition of additional attributes: This body would set the quality standards at the credit level and keep these up to date over time. It would develop guidance for any required guardrails or exclusions of project types, as technologies mature and as new information becomes available. At the project level, standard and methodology setters should continue to develop methodologies that adhere to these evolving CCPs.
Answer: Somewhat disagree

Do you agree with the need for a governance body to
Assess adherence to the CCPs: This body will assess both past and current standard setters and methodologies against the CCPs. It should also be empowered to assess the validity of projects and credits against the methodologies, including conducting spot checks. This body could be the same as or a different body to the one that establishes, hosts and curates the CCPs. It is also possible that these assessments could be undertaken on behalf of the assessment body, by separate expert verification agencies, which would have to be accredited by the independent body.
Answer: Agree

Governance bodies to ensure integrity of market participants and market functioning

Do you agree with the need for a governance body to:
Establish principles for participant eligibility: Setting the principles for what buyers, suppliers and intermediaries must adhere to in order to participate in voluntary carbon markets, similar to know-your-customer rules applied in the banking industry.
Answer: Agree

Do you agree with the need for a governance body to:
Ensure participant oversight: Accredit the validation and verification bodies (VVBs) that assess projects and methodologies. Provide oversight of these VVBs through audit & spot checks. Develop principles that validation and verification bodies must adhere to, an example of these principles could be that the same organization cannot carry out both validation and verification.
Answer: Agree

Do you agree with the need for a governance body to
Oversee market functioning: Develop principles to prevent fraud, including money laundering.
Answer: Agree

We aim to build on the work already existing or emerging. Please reference the appendix for the list of organizations whose initiatives on the voluntary carbon market we are already tracking. If there are other groups or initiatives that we should be aware of, please let us know.

Are there any parallel initiatives you are aware of that we have not mentioned?
Answer: Yes

For each initiative that you think the Taskforce should engage, please provide website(s)
Answer: Carbon 4: Net-zero initiative

Is there anything else in the report you would like to comment on (e.g. second- and third-order effects that we may not have anticipated in market scaling)? If you have specific edits please specify on which page, line and the proposed change
The first priority for the VCM today is to increase its environmental integrity and through this its credibility. While businesses and financial institutions aim to grow the market, there is no clear social license to do this. Aiming to scale the market without first addressing the integrity and credibility concerns will either fail or result in a financial market driven by speculation but failing to create the real positive change required to tackle the climate crisis.

The "core principles" of offsets are already clear, e.g. credits must be real, permanent, verifiable, additional, etc. What is crucially missing is independent and reliable policing of how these principles are 1) operationalized in methodologies and 2) respected by project developers. We fully support the need for new governance levels to examine the real-world impacts of all existing projects and methodologies. While this is a significant task, it is necessary, as the market cannot be credible without such a "cleanup".

Too many low-quality projects have accumulated on the market, and this Taskforce risks scaling up a dysfunctional system. This might simply increase the size of the problem, and in the worst case lead to a net increase in global greenhouse gas emissions while destabilizing financial markets.

Accurate measurement of the impacts of mitigation projects, and providing a clear channel for private sector financing of climate action are clear benefits of the VCM. But it will need to 1) exclude all low-quality projects and improve existing methodologies, and 2) ensure that claims are used consistently across industries, and that offsets are not used to fuel aggressive and misleading advertisements that would promote a continued "business as usual" way of life. The voluntary market should lead by example and set stringent rules to inspire future regulations. Instead, this initiative risks creating a lowest common denominator (the core carbon principles contract), reducing transparency, and opening the door for greenwashing.

Would you endorse the blueprint?
Answer: No