Carbon Market Watch reply to the TSVCM's second public consultation

June, 2021

***Carbon Market Watch** welcomes the opportunity to provide feedback to the second phase documents published by the TSVCM.*

1. **Overarching comments on the TSVCM and its objectives**

1.1 Scaling up the market

Scaling up climate finance from the *private* sector is important today. It is likely to play a critical complementary role to *public* finance in enabling the rapid transition to the low carbon, and eventually zero carbon, economies that almost all governments have committed to in the Paris Agreement. However, the question of whether the voluntary carbon market (hereafter VCM) is the right instrument to do so and how it may interact with other approaches has neither been sufficiently evaluated, nor substantiated, in the context of the TSVCM's work. While we do not oppose the scale-up of the VCM *per se*, we do not think that scaling up should be the objective. The market should not exist (and grow) for its own sake. It **is foremost an instrument to channel climate finance to mitigation projects which otherwise lack commercial appeal, especially in developing countries, and should be developed in a way that effectively delivers this goal without crowding out or disincentivizing climate action outside of this market.** A more detailed explanation of why the TSVCM believes that the VCM is the ideal channel to scale up private sector climate finance is needed.

There has also not been a detailed discussion of why the existence of a secondary market, as well as financial products such as carbon index funds, would benefit the climate. It is important to not take it for granted that more money (and liquidity) means greater impact in addressing climate change. Exchanging carbon credits between financial speculators does not benefit the climate, and can create price volatility which will in fact be *detrimental* to investments in mitigation action. This does not mean that there is no role for financial intermediaries, but **the TSVCM has not sufficiently focused on distinguishing between the positive and negative ways in which financial intermediaries can participate**. One example is the promotion of financially-settled Futures contracts. It is unclear how a purely financial transaction between actors will benefit the climate in any way, given that no money ends up being channeled to project developers when contracts are financially settled.

1.1 Governance

Furthermore, we note that the TSVCM work has identified, but not resolved, a number of fundamental issues with the VCM. The Taskforce is yet to come to clear conclusions and recommendations on key aspects such as project type or vintage restrictions, the permanence of emission reductions, as well as rules on the avoidance of double counting and, in particular, double claiming. Whilst we recognise the urgency of scaling climate finance, moving ahead at pace to scale the VCM without addressing elements fundamental to the overall impact of the market on global emissions risks undermining any renewed credibility that the work of the Taskforce aims to deliver. We see this as a result of the high level of representation of actors with interests vested more in the *scale* of the market than its *quality*, and we highlight the **crucial importance of not reproducing this dynamic within the governance body**. Only a truly independent governance body can have credibility and legitimacy in regulating the VCM. The current sub-optimal state of the VCM is the result of 15 years of self-regulation marred by conflicts of interest. A clear break from this must be marked. Whilst engagement with relevant stakeholders from across all elements of the market is valuable, industry associations, such as IETA and ICROA, should not play any role in the governance body of the TSVCM.

Finally, we note that the decision of the Taskforce to ignore the debates regarding claims and double counting of emission reduction outcomes risks undermining the overall credibility of the work. It will likely create confusion as to what a high-quality credit truly is. If credits are used for compensation/offsetting such that they support a claim to neutralize actual emissions, then the application of a corresponding adjustment to national reporting of emissions against committed targets is critical and should not be considered an “added co benefit” or optional “attribute”.

Given the status of discussions, and the large uncertainties which remain regarding both the composition and the impact and credibility of the governance body, we find the proposed annual budget of $10 million a very risky use of funds which could be better deployed elsewhere in efforts to tackle climate change. The Taskforce work has now reached a good basis for setting the direction of its future efforts and prioritising next steps. However, some of these steps – for example establishing detailed contract and product infrastructure – should not move ahead prematurely whilst fundamental concerns remain unresolved with the robustness of the underlying product. **It would be preferable to initially finance a smaller-scale process, e.g. to establish the expert panel and allow some initial work on defining the CCPs more clearly.** Once the detailed CCPs are established, and the experts selected, it will be clearer to what extent the TSVCM can truly go beyond existing practices and deliver added value to the VCM.

In addition to this, we note that, contrary to what is suggested in the consultation documents, a truly independent board does not necessarily follow from requiring the combined number of independent board members to total a simple majority within the overall board. The founding partners are essentially purchasing the right to sit on the board, and their views would only be balanced by the independent members *if* the independent members all share the same view (or at least if there is a very large majority among the independent members). Decision-making that is independent of vested interests and biases, facilitated through majority voting, typically benefits from a diversity of perspectives and, in certain cases, positions on matters of subjective judgement. **It is critical that ALL members of the board act independently of any financial, or other, interests they either hold individually, or which may accrue to the organisations they represent.**

2. **Establishment and functioning of the TSVCM body**

A strong and independent governance body will be crucial to the integrity of the TSVCM. We therefore support the establishment of such a body. In establishing the governance body, we strongly support the rule excluding participation from active market participants, or any stakeholder who was a market participant at any point in time during the 2 years preceding its application to the governance body. However, the definition of "market participation" should be more clearly defined, and should ensure that stakeholders which have been active within inter alia standard bodies, validation and verification bodies (VVBs), project developers, carbon credit brokers, financial trading companies, be excluded. We highlight again that it would be inappropriate for existing trade associations to form part of the governance body.

Second, **there should not be a direct link between funding of the governance body and market activity.** While recognizing that this raises practical challenges, it is an important element to ensure the independence of the body. For example, service-based user fees, whereby a fee would be levied on credits issued/transacted/retired, would not be appropriate as it would set an incentive for the governance body to recognize more credits as CCP-compliant.

Finally, the proposed eligibility criteria for members of the governance body are problematic. In particular, **the criteria for experts to serve on the expert panel which requires that they support the positions of the TSVCM is inappropriate for three reasons**. First, these "positions" are not clearly stated. There is simply an "e.g." list which is not exhaustive and largely non-specific. Second, within this non-specific list, the element "need for scaling up VCM" is highly inappropriate. Experts will be tasked with evaluating the quality of methodology types, as well as methodologies and projects to some extent as well. Requiring that these experts also support the "need for scaling the VCM" would put into question their neutrality. Could members of the expert panel be criticized, or even ejected from the panel, if they do not approve enough methodologies, as this would be taken as a sign that they do not agree with the "scaling up" objective of the TSVCM? The third reason why this eligibility criteria is inappropriate is that the governance body should reflect a diversity of views and have a culture of openness to challenging the status quo.

3. **Operationalisation of the CCPs**

One important aspect of the TSVCM's work, and which will require input from the governance body, will be to identify how to deal with supposedly CCP-compliant credits when new information comes to light potentially invalidating these credits. This is particularly important given that the primary assessment level is set at methodology type, which itself includes a wide diversity of projects, some of which might not live up to the standards of the CCPs. **A clear process should be adopted not only to withdraw the "CCP" label from credits if new information invalidates the assessment, but also to replace any retired credits.** One possibility would be for standards that have attributed the CCP label to their credits to be liable for purchasing an equivalent number of CCP compliant credits, and retiring them. This would echo the system currently in place under the California cap-and-trade programme, except that in this programme, it is the buyers who are liable for replacing credits.

This element is important to correct past mistakes. For example, under the CDM, the host country was the only entity able to deregister a project, even if clear violations were brought to light. This cannot be the case with the CCP-label, and **the governance body must have the authority to withdraw the "CCP compliance" label from credits**. More specifically, slide 65 refers to "fraudulent" credits, but does not define "fraudulent". It should be defined as any credit which does not represent a full tonne of CO_2e permanently avoided, removed, or reduced, or any credit that has been issued as a result of illegal activity.

In addition to this, we note that the level of applicability of the CCPs is inappropriate. Aiming to provide a quality assessment for carbon credits by evaluating methodology types is illusory. There is too much heterogeneity between methodologies (within a given methodology type) and especially between projects, even under a given methodology. **At a very minimum, there should be regular spot checks not only of methodologies, but also of projects.** This is proposed in the consultation documents, but there is no clear indication of how many projects will be subject to spot checks.

Slide 52 also suggests that, within a given methodology type, standards will self-assess the CCP-compliance of their methodologies. **Self-assessment is inappropriate, and the assessment by the expert panel should ideally take place at methodology level.**

Finally, on the timing of crediting, we support the exclusion of ex-ante crediting. We also believe that **retroactive crediting should be excluded**, as such crediting opens the door to issuing non-additional credits, i.e. credits for reductions which took place long before the possibility of selling credits was considered. This can happen for example when standards require "proof" of when a project started, and that such proof can easily be created and is unverifiable, e.g. meeting minutes of a kick-off meeting.

4. The CCPs

The adoption of clear CCPs will be a very importance first task for the governance body. The detailed determination of CCPs should follow a highly transparent process.

We support the proposed rule requiring project developers to identify and submit a rotating schedule of VVBs for their project. **Standards must also be able to demonstrate how they manage possible conflicts of interest, inter alia when it comes to approving proposed schedules of VVBs by the project developers.**

We also support the need to demonstrate financial additionality. **Beyond financial additionality, project developers should explain how their project fits within the host country's NDC, and why it is deemed to "go beyond" what the host country would have done anyway in order to meet its NDC objective as well as other relevant targets.** While we understand the difficulty of clearly establishing what is "compatible" or not with the host country NDC, this challenge should not be used as a justification for completely dismissing this question. Clear guidance from initiatives such as the TSVCM can incentivize countries to more clearly and transparently define their own climate commitments as well as the additional needs they have for external financing.

Further to this, it is important that the CCPs include measures to correct existing loopholes in baseline setting, in particular for nature-based solutions. In this regard, we support the proposal that baseline setting is undertaken by third Parties, rather than project developers. We would support this rule for at least all LULUCF project types, and not just for forestry projects. In addition, slide 60 highlights that baselines should be "open to public scrutiny". **This should include making all annexes to project design documents public, including spreadsheets (or other tools) which set out the calculation of baselines.** This is currently not the case, which makes public scrutiny of baselines much more difficult.

Finally, on the question of permanence, we support the adoption of a minimum permanence timeframe by the governance body, i.e. not leaving this up to the standards. We note that this should be at least 100 years and ideally significantly longer. Some of the timeframes for guaranteeing permanence mentioned in the consultation documents (e.g. 10, 30, 40 years) risk the delivery of credits which have no (or very limited) material impact in addressing climate change in the context of the temperature goals of the Paris Agreement. **We also highlight that the "credit permanence period" should go beyond the crediting period, and that there should be clear provisions for continued monitoring of permanence after crediting stops.** The wording in the text - a "reasonable multi-decadal" compensation mechanism - is not enough to support a robust claim that a carbon credit neutralises the impact of actual emissions released into the atmosphere (which themselves are truly permanent).