The Voluntary Carbon Market and Climate Ambition under the Paris Agreement

Final report and next steps

8 March 2021

Trove Research

Contents

1. Introduction

This document summarises the state of the consultation process being convened by Trove Research on the interaction between the Voluntary Carbon Market and national commitments under the Paris Agreement, and clarifies the next steps.

The project commenced in October 2020 with funding from the Children's Investment Fund Foundation (CIFF), and to date has undertaken the following tasks:

- Wide-ranging interviews with market participants and experts during October, November and December 2020.
- Creation of a project website where relevant documents have been posted. [1]
- Drafting of a discussion/consultation document published at the end of December 2020. [2]
- Creation and hosting of three consultation workshops on 19th January, 3rd February and 26th February 2021 comprising 50, 30 and 25 attendees respectively.
- Formation of a Framing Group with representatives from both sides of the debate. This group comprised: Jonathan Shopley (ICROA/Natural Capital Partners), Gilles Dufrasne (Carbon Market Watch), Chris Zink (Swedish Energy Agency), Leslie Durschinger (Terra Global) and Jamey Mulligan (Amazon). Participants generally act in a personal capacity due to their subject matter experience, and do not necessarily represent their organisations. Trove Research expresses sincere thanks to these individuals.
- Recognition in the TSVCM of the relevance of this initiative.

The December 2020 Consultation Document examined the potential impact of applying Corresponding Adjustments on emissions mitigation incentives, and suggested a potential solution space that might meet the needs of various participants. This framework was proposed as a potential way of thinking about the issues and trade-offs, and is summarized in Appendix 1. *The thinking in this group has since developed as a result of the debate and contributions throughout the workshops and via continued bilateral discussions.* The recommendations in Section 3 replace this initial solution space.

It is also worth noting recent developments from other initiatives in the accounting treatment of voluntary carbon market transfers.

Mobilizing Voluntary Carbon Markets to Drive Climate Action - EDF / Engie / High Tide, December 2020

This year-long consultation exercise run by Environmental Defense Fund in partnership with the High Tide Foundation and expert input from Engie Impact, examined a broad remit of issues around role of voluntary carbon markets in meeting the goals of the Paris Agreement.

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[1] www.globalcarbonoffsets.com

[2] https://globalcarbonoffsets.com/wp-content/uploads/2021/01/VCM-and-Article-6-interaction-6-Jan-2021-1.pdf

The potential application of Corresponding Adjustments to the accounting of credit transfers was examined as part of this work. The work drew four main conclusions:

- Urgent action should not be delayed – ensuring ongoing investment in high quality carbon credits.
- Facilitate the Transition – encouraging companies, standard setting bodies, developers, international organisations and civil society to work together.
- Alignment and continuous improvement over time – ensuring coordination with host governments as they develop their NDCs under the Paris Agreement
- Clarity and Review – standard setting bodies to make sure which credits are associated with Corresponding Adjustments.

Treatment of Double Counting and Corresponding Adjustments in Voluntary Carbon Markets – Gold Standard 18 February 2021 [3]

The position paper from Gold Standard (GS) proposes that Corresponding Adjustments will need to be applied to credits registered on the GS registry for voluntary market transactions. The paper links to a parallel GS paper on Integrity for Scale: Aligning Gold Standard-Certified Projects with the Paris Agreement. [4]

New and existing projects in developed countries would need to have Letters of Approval from the host country that Corresponding Adjustments will be carried out with issuance vintages starting from January and May 2021 respectively. For projects in developing countries besides Least Developed Countries (LDCs), Landlocked Developing Countries (LLDCs)and Small Island Developing States (SIDS) and conflict zones the vintage dates for applying CAs are slightly later at January 2023. For LDCs, LLDCs, SIDS and conflict zones CAs will be applied to credit vintages from January 2025.

3 https://www.goldstandard.org/sites/default/files/documents/gs_guidance_correspondingadjustments_feb2021.pdf

4 https://www.goldstandard.org/sites/default/files/documents/integrity_for_scale_aligning_gs_certified_projects_with_the_paris_agreement.pdf

2. Summary of Consultation Workshops

The workshops held to date have identified the key areas of agreement and disagreement, and have proposed a draft solution space. This has generated considerable correspondence.

First consultation workshop (19th January 2021)

Comments have been received from 22 organisations through bilateral conversations, and during the first workshop. Respondents by type of organisation is shown in table 1.

Table 1. Respondents by type of organisation from first workshop

Respondents	No.	%
Government [5]	1	5%
Intergovernmental Org	2	9%
Philanthropy	1	5%
Trading association	1	5%
VCM registry	2	9%
NGO	5	23%
Project developer	4	18%
Corporate	1	5%
Consultancy/Institute	5	23%
Total	**22**	**100%**

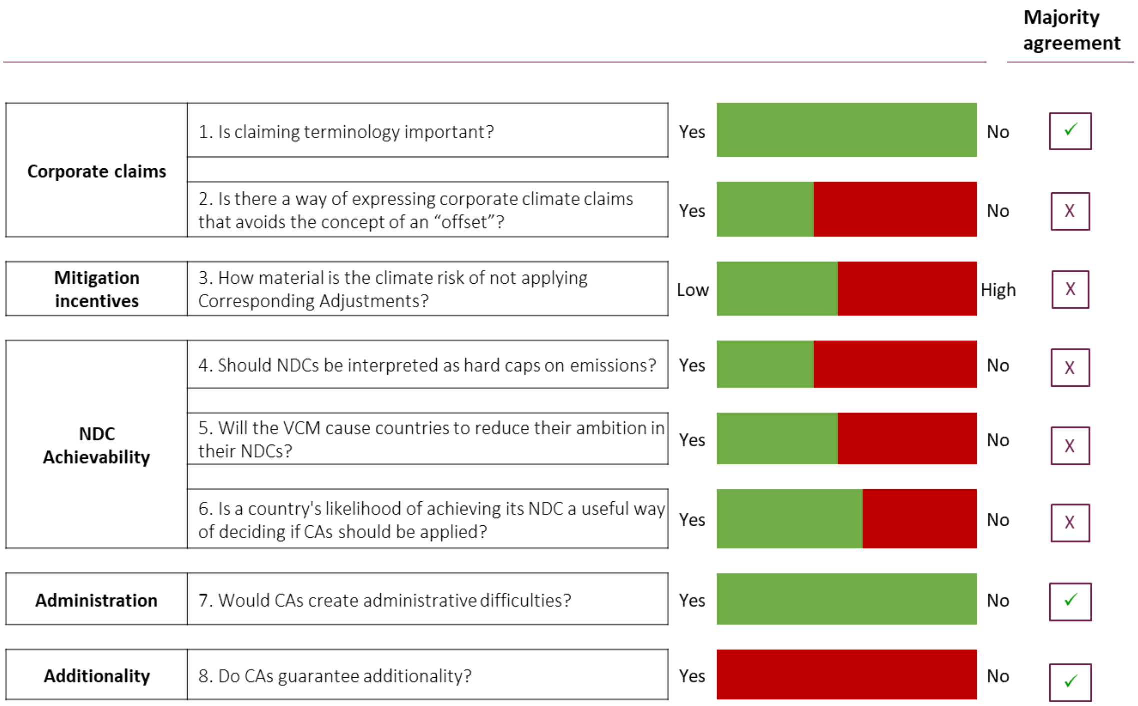
The discussion during the workshops has focussed on 5 key topics:

- Corporate claims
- Mitigation incentives
- NDC achievability
- Administrative implications
- Additionality & Corresponding Adjustments

Within these five topic areas we have identified a number of sub-issues, creating a total of eight specific issues. All the comments received through the first workshop and have been codified against each of these issues. The balance of opinion is shown below in Figure 1.

[5] The project group acknowledges that for this issue to be progressed successfully greater government involvement will be necessary.

Figure 1. Summary of consultation responses after the first workshop



As shown in Figure 1, agreement was difficult to achieve on all but the least contentious topics, notably:

- That the nature of corporate claims is an important consideration in considering accounting treatment of carbon credits. [6]
- That the application of Corresponding Adjustments would create administrative difficulties.
- Even if Corresponding Adjustments are applied, they do not necessarily guarantee additionality of the carbon credits.

The other issues remained contentious amongst the workshop participants.

Second consultation workshop (3rd February 2021)

The second consultation workshop explored each of these areas in more depth, in particular (i) the direction and magnitude of mitigation incentives, and (ii) the interaction of the VCM and NDCs. Participant polls were run on six question as follows:

[6] This does necessarily imply that Corresponding Adjustments address all the issues associated with the relationship between corporate claims and the net impact on the atmosphere.

Direction and magnitude of mitigation incentives

Question 1: Would the application of CAs increase or decrease host country climate ambition?

Question 2: Would the application of CAs increase or decrease buying company climate ambition?

Question 3: Would the application of CAs increase or decrease individual climate ambition?

Interaction of the VCM and NDCs

Would the application of a Corresponding Adjustment be required if…

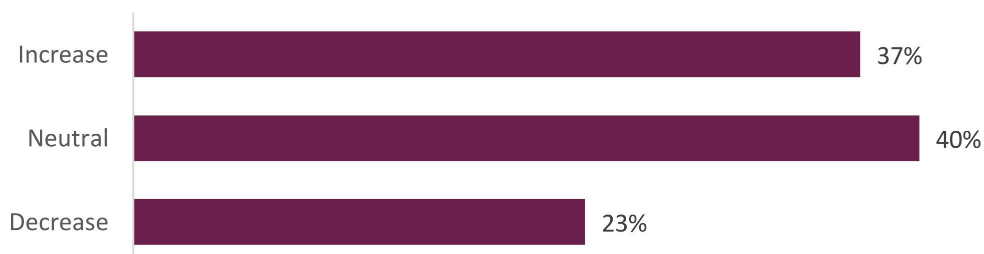
Question 4: The project is in the same country as the corporate buyer?

Question 5: The project is outside a host country's scope of NDC?

Question 6: The project is in an NDC but outside a host country's NDC "register"? [7]

The results from the polls are presented below, however the conclusions were broadly inconclusive. There was comparatively little difference between increase/decrease/neutral for questions 1-3 and a split of yes/no for questions 4-6. From the discussion during the workshop, it was apparent that participants interpreted the questions in different ways, reflecting a broadly equal split between answers. Overall, it was not possible to draw meaningful conclusions from the results.

Question 1. Would the application of CAs increase or decrease host country climate ambition?

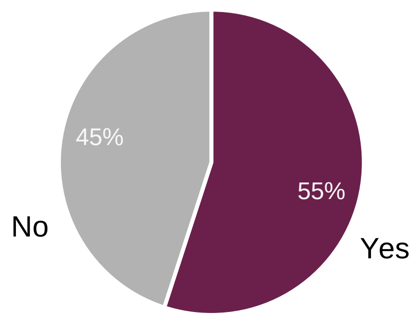


[7] This question addresses the situation where a project may be captured under a country's NDC but is not included within a list of activities (registry) that have been by earmarked by the host government as part of the NDC delivery plan.

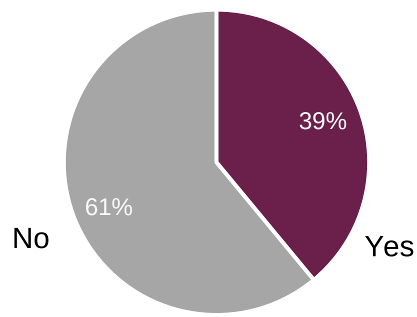
Question 2. Would the application of CAs increase or decrease company climate ambition?

Question 3. Would the application of CAs increase or decrease individual climate ambition?

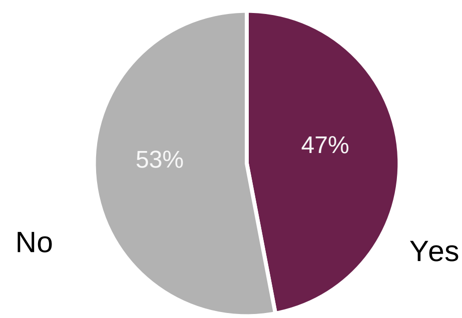
Question 4. Would a CA still be required if the project is the same country as the corporate buyer?



Question 5. Would a CA still be required if the project is outside a host country's scope of NDC?



Question 6. Would a CA still be required if the project is in an NDC but outside a host country's NDC "register"?



The main reason for the difficulty in obtaining consensus on these issues is a fundamental difference in philosophy in regard to the role of voluntary commitments. This situation is characterised in Figure 3, which summarises the main arguments for and against applying Corresponding Adjustments to carbon credit transfers.

Figure 3. Arguments for and against Corresponding Adjustments for carbon credit transfers

Anti - CAs	Pro - CAs
• Progress against global emissions targets are monitored at the national level under UN emission inventories - corporate emission accounts are separate to the national emission accounts. • All additional projects that help a country reduce its emissions are beneficial. Governments benefit from a huge range of emission projects already taking place in their countries. • Additionality is key for environmental integrity and CAs do not necessarily ensure this. • Part of a government's ambition is to attract climate finance to meet their NDCs. CAs for VCM transactions might disincentivise this.	• Without a CA, an emission reduction from a project would be claimed twice: once by the company, once by the host government. This would give a false sense of achievement in tackling climate change. • Countries made a commitment to reduce emissions in their NDCs. If further help is provided the NDC is easier to achieve and the extra resources could be used to create further emission reductions. *ie there would be a displacement of national climate ambition*. • CAs make it more likely that the emission reductions are only claimed once.

Put more simply, those against the use of CAs argue that the priority should be to “ensure the finance gets flowing and real projects are developed - accounting and claiming can be sorted out later”, whereas those arguing for the use of CAs believe it is important to “get the accounting and claiming as right as possible upfront, otherwise the finance flows risk being shut off if it is shown that the system lacks integrity”.

From the second workshop it became clear that finding a consensus on contentious topics is unlikely to be possible in the context of large web-based discussion group.

For this reason, a Framing Group meeting was held on 10th February to revisit the core questions and approach of the project. The output and recommendations from this meeting are described in the following section.

Third consultation workshop (3rd February 2021)

The third and final workshop of the series presented the conclusions of the framing group and recommendations for next steps as described in this document. In spite of agreement on the overall aims of voluntary carbon market transactions, there were still strong differences of opinion on if, and how, Corresponding Adjustments should be applied to carbon credit transactions.

In view of this difference of opinion, and the unilateral actions being taken by the main registries, Verra and Gold Standard, it raised the question of whether there was merit in continuing to work to resolve the outstanding issues.

The following direct question was put to the workshop group:

Q: “Should work continue to try and clarify the message to corporates on the accounting treatment of carbon credit transactions”. The response was:

Yes 81%

No 19%

This indicates that whilst there remain differences in how accounting treatments should be applied, there is an even stronger view that corporates need clarity. Anecdotal interactions with companies looking to set decarbonisation targets also shows that uncertainty on future accounting decisions for the use of carbon credits is limiting confidence in the market.

3. Framing Group recommendations

Aims

Parties continue to have different approaches to the accounting treatment of carbon credit transactions in the voluntary market and under NDCs as part of the Paris Agreement. Whilst Voluntary Carbon Market participants are under no regulatory obligations, the lack of clarity on whether Corresponding Adjustments might be required at some future date is limiting confidence in the market and investment in emissions mitigation projects.

The purpose of this initiative is to reduce the volume and confusion in the debate, and provide clarity on when and how CAs might be used (if at all). This will give greater confidence to the integrity and effectiveness of the voluntary carbon market.

Through conversations with key stakeholders from both sides of the CA debate, it appears that there is agreement on the overall principle:

"The purpose of the Voluntary Carbon Market and the accounting treatment of carbon credit transfers should lead to the greatest possible reduction in emissions."

To this extent there is some common ground to work from. Disagreement on the accounting treatment arises because of differences of opinion in how to achieve this aim.

Approach

It has been proposed that achieving the aim above should be approached in a way that defines the problem and then works through options for solving that problem. This would involve a four-step process:

- Agree the problem statement (the risk statement).
- Assess the materiality of the risks.
- Identify options for dealing with the risks.
- Assess and recommend solutions/actions.

These steps are described in more detail below:

1. Problem statement

The primary issue at stake from the point of view of accounting for emission reductions can be phrased as follows:

"Emission reduction projects funded voluntarily, may risk displacing national climate mitigation ambition. Carbon credits acquired for offsetting purposes may also risk displacing corporate climate ambition"

Displacement of national ambition might arise because governments do less than they originally set out to achieve in their NDCs due to the emission reduction contribution of projects developed by voluntary corporate actions. High integrity buyers of carbon credits would not want to buy credits if the result would mean that governments would reduce their ambition.

Corporate climate ambition - and the impact on real emission reductions - might also be affected by the use of carbon offsets. Offsets are typically cheaper than reducing scope 1, 2 or 3 emissions, and whilst there is pressure on firms to only use carbon offsets after emissions have been reduced, some companies may see the use of carbon offsets as an alternative to real emission reductions. Reducing emissions, rather than purchasing offsets, is the priority in addressing climate change.

There are also a number of other risks that accounting adjustments might create. For example, the application of CAs to VCM transactions might limit the ability of the host country to attract climate finance from a voluntary buyer. In turn this might reduce the ability of a country to deliver on its NDC emission reduction targets.

Questions on the use of Corresponding Adjustments should apply irrespective of the location of the corporate credit buyer and the location of the project, ie the risks described above apply if the project is in the same country as the corporate buyer, or in different countries.

2. Assessing materiality

Having established the risks, the next step is understanding how significant these risks are. In the December consultation document, we proposed a framework for discussing these risks.[8] A report by the New Climate Institute in November 2020 also proposed a framework for assessing risks associated with the interaction between the VCM and national targets under the Paris Agreement. [9]

Both these assessments are highly qualitative, and more work needs to be done to determine the materiality of these issues. This might include:

- *Assess future demand for carbon credits* - Trove Research is currently completing analysis of the demand for voluntary carbon offsets and this will be published shortly. However, more work may be needed to model the breakdown of demand over time, and whether there are preferences for different types of projects.
- *Review which countries are likely to be the main recipients of carbon credit purchases*. Scenarios would be developed but this would likely be prioritised by REDD+ and Afforestation projects.

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[8] The potential effects of adding Corresponding Adjustments to carbon credit transfers on mitigation incentives is shown in Appendix 1.

[9] https://newclimate.org/wp-content/uploads/2020/11/NewClimate_Future_role_for_voluntary_carbon_markets_Nov_2020.pdf

- *Assess the quality / completeness / credibility /governance of a country's NDC*. Other initiatives such as WRI, ICAP and Climate Action Tracker, as well as various academic institutes (eg LSE) are also looking at this area.
- *Compare these carbon credit volumes against NDCs*. This would show the proportional impact of carbon credits on NDC ambition if CAs are not applied. Segmental analysis would be applied, eg advanced economies with strong NDCs incorporating domestic offsetting schemes (US) through to least developing economies with high need/ low capacity to deliver mitigation.
- *Conduct a survey of companies to determine the risk of carbon offsets displacing company mitigation incentives.* This will help fill a gap in the knowledge of how carbon offsets might affect company climate ambition. The survey would seek to understand whether access to lower cost carbon credits might increase corporate climate ambition (because it allows more emission reductions to be achieved for the same cost), or decrease the effectiveness of targets already set (because carbon offsets displace internal abatement).

3. Develop options set

All options for solving or mitigating these risks should be considered. These could include:

- *Clarifying the implications for accounting treatment produced from the differences between "contribution" and "offset" claims.* Contribution claims refer to financial support for low carbon technologies or projects. These differ from offset claims that measure carbon emission reductions that are used to offset a carbon footprint. Contribution claims do not claim the emission reduction and avoid the double-claiming issue.
- *Positive project lists/national project registers for NDCs that clearly require outside assistance to achieve*. Projects lists and registers can be used to identify which projects are designated towards a country's NDC and which may lie outside this scope.
- *Modifications to additionality tests at the project level*. The fundamental risk of displacing national ambition could be partly addressed by tightening project level additionality tests. This might be achieved by extending definitions around regulatory barriers to current and future policies.
- Corresponding Adjustments (and variants thereof). Corresponding Adjustments adjust the emissions in the host country for any export of the carbon credit.
- *Disclosures on the part of corporate buyers (ie credits may be used by host governments towards their NDCs)*. This option would at least allow stakeholders of corporates claiming the use offsets to understand the potential impacts on national climate targets.

- *Conditional NDCs and variants thereof.* Other options might achieve the same aim, such by requiring host countries to show how they intend to leverage the exported VCM credit volume to achieve more, rather than less mitigation.

4. Assess options

Having developed a full option set, criteria would be developed that would be used to assess the risk mitigation options. These criteria may include:

- Impact on emission outcomes
- Impact on market integrity
- Impact on availability of supply
- Impact on corporate willingness to engage with VCM
- Impact on price of carbon credits
- Impact on administrative costs
- Impact on the communities and land tenure holders who are producing the emission reductions for voluntary buyers
- Practice implications – eg timing of accounting adjustments

These criteria may also consider who is responsible for implementing the risk mitigation option. For example, if there is a risk of a country reducing its ambition relative to its original NDC, is this best dealt with by the voluntary investor, the standards applying the additionality tests of the UN as the overseeing body of national commitments under the Paris Agreement. These would be assessed qualitatively, and quantitatively where possible.

5. Produce guidelines and recommendations

The output of the work would be a set of guidelines on strategies for mitigating the identified risks, including the use of Corresponding Adjustments and other potential options.

Government Engagement

Governments are critical actors in the potential application of Corresponding Adjustments to voluntary carbon credit transfers. We note that the World Bank has engaged with ICROA on country perspectives on the voluntary market interface, but more work needs to be done to bring out their views on this issue.

It is also noted that issues concerning the interaction of the VCM and national accounting under the Paris Agreement is likely to be influenced by decisions made through the UN negotiations on Article 6.

4. Next Steps

4.1 Objectives of further work

The principle at the centre of this project is that differences of opinion on whether carbon credits should carry Corresponding Adjustments reduce confidence in the voluntary market. In turn this is likely to reduce voluntary commitments to invest in carbon reductions outside the scope of a company's carbon footprint.

On the basis that aligned collective action to reduce emissions is more effective than disparate individual actions, climate mitigation efforts would be best served by increasing corporate confidence in the voluntary carbon market. To do this, requires a consistent message to corporates on how to approach the potential risks outlined in Section 3.

Moreover, as CAs would only come into effect after 2030 (the true-up period for performance against NDCs), it is important that recommendations on good practice for voluntary buyers and host governments provides clarity in the short term.

The aim of further work in the area should be to:

"***clarify guidance to corporates on how the potential risks associated with the VCM affecting climate ambition, at the national and corporate level, should be managed".***

A solution space could involve a revision or expansion of the conditions presented in Figure 1, that describe where CAs or other measures might or might not be required. Ultimately the aim should be to provide simpler and clearer guidance to corporates. This aim alone is in the interests of all those that see the voluntary carbon market as a useful tool in addressing climate change.

4.2 Operating team and governance structure

Governance

Given the strength of opinion on the potential application of Corresponding Adjustments, it appears that an intra-industry group - such as that process convened during this project - is unlikely to achieve the desired outcome. A higher level body is likely to be required to provide the authority and influence.

Conversation have been held with a number of potential bodies that could act in this capacity, for example the TSVCM and SBTi/CDP. Neither of these bodies is well-positioned to take on the oversight of this issue. The TSVCM is precluded from addressing issues that potentially affect international Paris Agreement negotiations, particularly in relation to Article 6, and the SBTi/CDP is focussed on driving mitigation action from corporates for Scope 1, 2 and 3.

Ongoing work by the Oeko Institute, EDF and WWF, on the "*Methodology for assessing the quality of carbon credits – Phase 2 of the Carbon Credit Guidance for Buyers*" project is also a relevant parallel project. The work formulates a methodology where a rating system grades the quality of a credit on multiple criteria. In this context Corresponding Adjustments applied to a carbon credit are thought to increase the quality rating of the carbon credit, other things being equal. That said, it leaves open the question of whether Corresponding Adjustments are required or not, effectively trading off different quality attributes.

If the implications of the VCM for national climate mitigation is deemed important for the voluntary carbon market to resolve, then in our opinion an alternative initiative that promotes high quality corporate action on climate mitigation would be needed.

A suitable option could be the proposed ***HADA-VCM (High Ambition Demand Accelerator for the VCM)***. This initiative will focus on a range of issues to drive high quality in the voluntary carbon market and continuation of this consultation process could form the basis of a subsequent workstream under HADA-VCM.

An alternative platform could be ***Carbon Pricing Leadership Coalition (CPLP)*** run by the World Bank Group. This initiative is a globally respected initiative that catalyzes action towards the successful implementation of carbon pricing around the world. The CPLC brings together leaders from government, business, civil society and academia to support carbon pricing, share experiences and enhance the global, regional, national and sub-national understanding of carbon pricing implementation. Harmonising rules to facilitate improved climate finance through the voluntary carbon market could fit into this initiative's remit. [10]

Operations

From an operational perspective there would be strong benefits in bringing together the experience of the two recent independent initiatives run by Trove Research and EDF. This would provide a single convening entity together with detailed sector experience, required to resolve residual technical and political issues.

4.3 Timing and Budget Implications

The work conducted under this project was financed by the Children's Investment Fund Foundation up to February 2021. To progress this initiative along the lines suggested in Section 3 would require new funding. Material progress could be made in 2 to 3 months.

[10] https://www.carbonpricingleadership.org/task-force-on-net-zero-goals-and-carbon-pricing

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Appendix 1 – December 2020 consultation document summary

The December consultation document addressed the key factors affecting opinions on the potential use of Corresponding Adjustments for voluntary carbon market transfers.

The potential solution space presented in the consultation document is shown below in Figure A1. The reasoning behind this framework was that the question of whether CAs should be applied to carbon credit transactions could be influenced by the level of economic development of the host country and the type of claim being made by the buyer. In principle, countries with similar levels of income should have similar abilities to achieve climate targets, especially when these targets are set on a voluntary basis.

Alternatively, rather than categorisations based on levels of national income, more specific assessments could made. These could include, the stringency of the NDC, preparedness of national NDC plans and/or the robustness of national accounting frameworks.

The buyers of carbon credits would also have the option of adjusting their claims according to the source of the offset. For example, if a buyer wants to claim the credits for "offsetting" their emissions, and they want to source them from a developed country (or one where policies, financing and enforcement processes are in place), then they might use credits with CAs. If the claim was not for offsetting, but worded in a way that suggested financing or assisting a country in achieving its NDC, then a CA adjustment would not be required. If, however, the buyer intends to use a credit from a least developed country where all financing is helpful to achieving reductions in emissions, a CA would not be required no matter what the claim.

Figure A1. Simplified solution space for application of Corresponding Adjustments for voluntary transactions taking place in NDCs (December 2020 Consultation Document)

Country classification	Nature of corporate claims		
	"Offset"	"Emission reduction"	"Contribution"
Developed country – policies, financing & enforcement in place	CA required	CA required	No CA
Developing country – some policies, financing & enforcement in place	Sector specific assessment required	Sector specific assessment required	No CA
Least developed country – policies, financing & enforcement not in place	No CA	No CA	No CA

The December consultation document also suggested a framework for assessing the mitigation incentives of introducing CAs to carbon credit transactions. This is shown in Figure A2.

Figure A2. Potential impacts on mitigation incentives of VCM transactions – with/without CAs

	Host Country NDC		Corporate Buyer		Consumer / other
	Ambition	Effort	Ambition	Effort	Effort
Without Corresponding Adjustment	+++ Governments incentivised to be more ambitious as they will use all means available to achieve their targets.	- Likely that emission reductions from voluntary project would be seen as contributing to emission targets in NDC, leaving less for government to do.	+ Likely that corporates will seek higher levels of ambition in knowledge that supply of credits is more accessible.	- With the supply of cheaper credits more available, corporates may be incentivised to undertake less abatement internally and rely more on offsets.	- If corporate claims for offsetting emissions are not genuinely additional, consumers risk being misled and potentially consuming more of a product/service.
With Corresponding Adjustment	- - - If governments are required to adjust up their emissions for exports of credits for voluntary purposes they would be incentivised to set more lenient targets in the first place. if they want to access to finance associated with carbon credits.	+ With CAs the effort required to achieve the host country's NDC remains the same, irrespective of emission reductions generated from a project supported voluntarily	- Corporates could seek lower levels of ambition in knowledge that supply of credits might be more restricted.	+ If credit supply is more restricted corporates may be incentivised to undertake more abatement internally than rely on offsets.	+ An offsetting claim backed up by a CA gives consumers reassurance that offsets are additional to what would otherwise occurred.