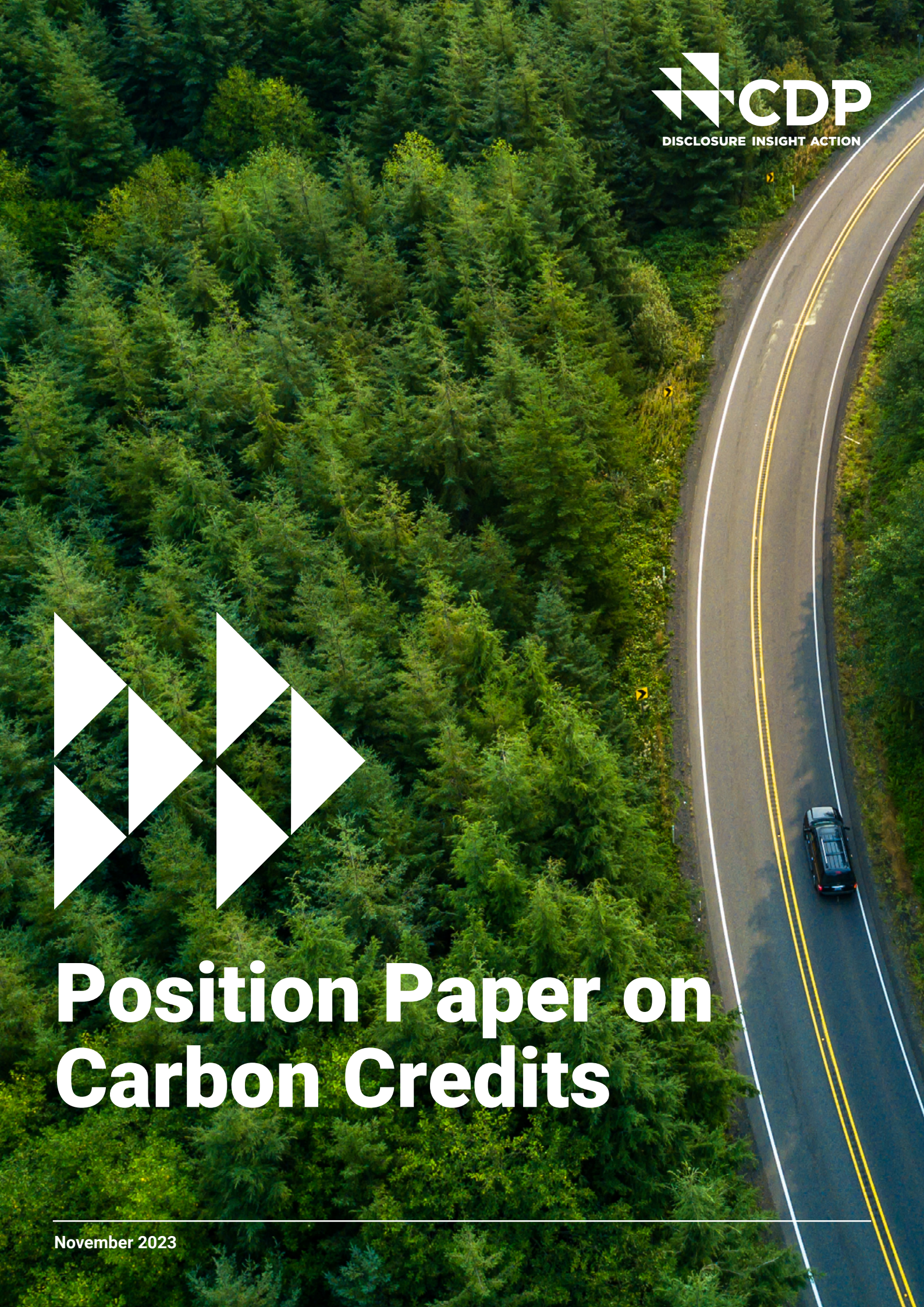
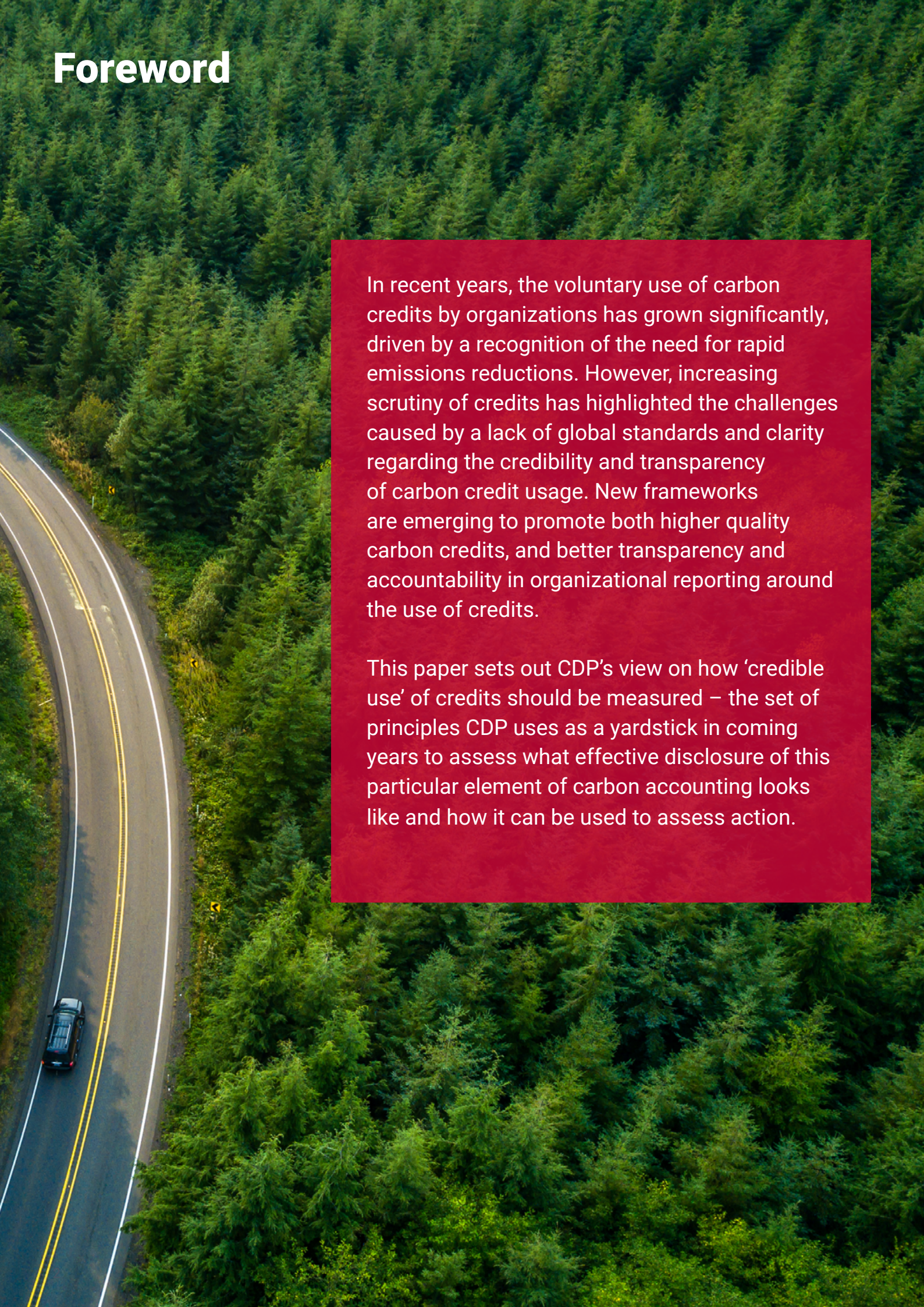


Position Paper on Carbon Credits

November 2023

Foreword



In recent years, the voluntary use of carbon credits by organizations has grown significantly, driven by a recognition of the need for rapid emissions reductions. However, increasing scrutiny of credits has highlighted the challenges caused by a lack of global standards and clarity regarding the credibility and transparency of carbon credit usage. New frameworks are emerging to promote both higher quality carbon credits, and better transparency and accountability in organizational reporting around the use of credits.

This paper sets out CDP's view on how 'credible use' of credits should be measured – the set of principles CDP uses as a yardstick in coming years to assess what effective disclosure of this particular element of carbon accounting looks like and how it can be used to assess action.

Introduction

Rapid emissions reductions across all sectors by almost 50% by 2030 are necessary to limit the rise of global temperature to 1.5°C. In recent years, the voluntary use of carbon credits by organizations has grown significantly, driven by a recognition of necessity. The voluntary use of carbon credits[1] has existed since the implementation of the Clean Development Mechanism under the Kyoto protocol which operationalizes the United Nations Framework Convention on Climate Change (UNFCCC). In theory, the use of credits allows those for whom emissions reductions are more cost effective to sell their reductions to those for whom reductions are expensive, decreasing the overall cost of emissions mitigations. This serves a dual purpose of facilitating mitigation and transferring finance from the global north to the global south, as a reflection both of responsibility and capacity.

However, the implementation of markets for carbon credits has been much more complex than this and there is a lack of a clear global guidance and accounting on what constitutes a 'credible' carbon credit and regulatory standards for operationalizing such markets, with a proliferation of credit registries and crediting programs. Increased voluntary uptake of carbon credits without a lack of a standardized approach to their quality and usage hinders transparency and assessment of whether efforts towards deep decarbonization are falling far short of where they need to be. If the use and reporting of carbon credits is not credible, comparable and consistent, it risks damaging the integrity of emissions accounting more widely. There are still no clear guidelines on when credits should be used, what kind of credits should be used and how they should be accounted for by organizations.

The voluntary use of carbon credits is expanding and is predicted to continue to grow even more rapidly. The value of the voluntary carbon market is expected to grow from US$2 billion in 2021 to between US$5 and US$50 billion. Voluntary offsetting is the primary use of credits of organizations responding to the 2023 CDP Climate Change Questionnaire, with over 90% reporting they use their purchased credits for voluntary purposes[2].

One of several risks, therefore, of the lack of global standards on usage is voluntary usage by organizations as an alternative to cutting their emissions. For example, it is possible for organizations to include the

[1] A tradeable intangible instrument that is issued by a carbon-crediting program, representing a GHG emission reduction to, or removal from, the atmosphere equivalent to one metric tonne of carbon dioxide equivalent. (ICVCM)
[2] In 2023, question C11.2a.

emissions savings the credit represents as part of their own emissions inventory in reporting net emissions - a practice known as carbon offsetting.

This paper sets out CDP's view on corporate best practice for the use of carbon credits – addressing questions of 'when', 'what kind', and 'how' - outlining three high-level requirements ('principles') that companies must consider if deciding to use carbon credits. CDP's corporate questionnaire uniquely enables the collection of data regarding organizations' usage of carbon credits and offers a centralized platform for these organizations to publicly report this information. The paper will serve as the basis for future technical papers around what data is required to allow for credible use of credits which do not undermine global environmental ambition. The principles outlined will be the yardstick used to assess what practices need to be reflected and incentivized.

Principle 1 – Prioritize ambitious emissions reductions

The first measure of best practice when using carbon credits is to undertake ambitious emissions reductions before even considering what credits to purchase (ie Principle 2). Significant emissions reductions by all actors are a necessary part of meeting climate goals and advancing action, particularly in this critical decade of action. The necessary emissions reductions to achieve net-zero by 2050 cannot be covered by carbon credits alone.

Credits should only be used when companies have made progress with emissions reductions, indicated by being on track to meet a Science Based Targets initiative (SBTi)-validated 1.5-degree aligned near-term target or equivalent.

The SBTi's Net-Zero Standard embodies this idea in its core concept of the mitigation hierarchy. Under the Net-Zero Standard, the first priority for companies is to set science-based targets in the near- and long-term and implementing strategies to achieve them. Only once this is done should companies undertake actions outside their value chains, including the use of carbon credits.

The broader carbon credits landscape is beginning to adopt this stance, including the Oxford Offsetting Principles, the Voluntary Carbon Markets Integrity Initiative (VCMI), and by the UN High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities (UN HLEG).

The Oxford Offsetting Principles guides the use of carbon credits as part of an overall net-zero strategy. A key part of their first principle is to prioritize reducing an organization's own emissions, minimizing the need for carbon credits to achieve net-zero. Companies should maximize the emissions reduction opportunities they have available, before considering the use of credits as part of a net-zero strategy.

The VCMI provides guidance on how credits can be used as a core part of its mission. Similarly, before credits are used and any claims are made, companies are required to publicly commit to achieving net-zero emissions by 2050, and publicly disclose validated, science-based near-term targets to reduce emissions. To make any claims under the VCMI's claims code, companies also must demonstrate that they are on track to meet their targets by publicly disclosing the percentage of total GHG emissions reductions achieved.

The UN HLEG recognizes the critical importance of guidance, and that a framework is needed to "ensure credits are only used once a non-

The necessary emissions reductions to achieve net-zero by 2050 cannot be covered by carbon credits alone.

state actor's own mitigation efforts are in line with science". In other words, emissions reductions should be in line with pathways that limit warming to 1.5°C with no or limited overshoot before the use of credits is considered.

CDP already has data on when in their decarbonization journey organizations are choosing to use carbon credits. CDP's Climate Change Questionnaire captures the extent to which companies are on track to meet a 1.5°C-aligned near-term target, requesting details on absolute and intensity emissions targets and progress made against these[3]. In addition, companies can disclose details of carbon credits cancelled[4] in the reported year[5].

If companies are on track with their SBTi-approved targets, there are two additional principles that companies need to follow to meet best practice use of carbon credits.

[3] In 2023, questions C4.1a and C4.1b.
[4] "Cancelling" a credit means that the credit cannot be used again, and the exact term used may vary, e.g. retired, surrendered, claimed or used.
[5] In 2023, questions C11.2 and C11.2a

Principle 2 – Ensure purchased credits are high quality

The second principle is to ensure purchased credits are of high quality. High quality credits ensure that any emissions mitigations and other benefits that a project claims to generate have both the scientific and factual basis in terms of impact on the atmosphere. The use of poor-quality credits will overstate emissions mitigations, with negative implications as outlined above.

CDP supports efforts by the Integrity Council for the Voluntary Carbon Market (ICVCM) to create a single standard that acts as an indicator of high-quality credits. Once available for a project type, companies should only use Core Carbon Principles-approved credits. Beyond selecting credits issued under reputable standards, companies should additionally perform due diligence on the projects they are purchasing credits from to ensure they have positive environmental, economic and social impacts.

The ICVMC is an independent governance body for the voluntary carbon market. Their Core Carbon Principles are designed to ensure the high quality of carbon credits. The 10 principles are structured around requirements for the governance of carbon-crediting programmes, the emissions impact of the mitigation activity and ensuring positive sustainable development impacts and contributions to net-zero.

The existing landscape of carbon crediting programme standards is fragmented, but several common elements emerge which can be considered minimum requirements for a good quality credit. Several of these have been incorporated into CDP's climate change questionnaire with respect to information of carbon credits cancelled in the reporting year.

First and foremost, the additionality[6] of projects should be assessed to ensure the project activity would not have occurred in the absence of revenue from carbon credits. If the emissions mitigation would have occurred regardless, then the sale and use of credits will not bring additional benefits. Next, projects should have a mechanism in place to address any reversal risks[7] inherent to the activity. In the event of a reversal event, the mitigation impact of a project is undone if the appropriate mechanisms have not been put in place. When quantifying emissions reductions or removals from the project activity, projects

[6] i.e. the GHG emission reductions or removals would not have occurred in the absence of the incentive created by carbon credit revenues. (ICVCM).
[7] The risk that achieved GHG emissions reductions or removals may be reversed or undone in the future.

The existing landscape of carbon crediting programme standards is fragmented, but several common elements emerge which can be considered minimum requirements for a good quality credit.

should thoroughly account for potential sources of leakage[8]. Even if a project successfully mitigates emissions, it and any associated credits will not have any impact if an equivalent increase in emissions takes place elsewhere. Finally, projects should avoid negative environmental, economic, and social impacts. Even if projects do have an emissions mitigation impact, pursuing them may not be worthwhile if their other impacts on local environments and communities are severely negative.

There is variation between the standards even on the coverage of the above aspect, leading to significant variation in credit quality. Some standards do not cover every requirement above, while others go significantly further – for instance, requiring projects to demonstrate co-benefits beyond emissions mitigations.

Even among requirements such as additionality, there are differences in the stringency of these requirements. Projects which meet the additionality requirements of one standard may not meet the requirements of another. Further, even the best quality credit does not fully remove issues of uncertainty in mitigation outcomes nor does it resolve fundamental open questions around what activities qualify as credits (eg with avoidance).

There are additional considerations associated with certain project types, especially nature-based solutions. Forests credits are a key example: ICVCM has in many cases separate and additional requirements around REDD+ activities. This is significant as forests hold the main biodiversity and carbon sinks on land. Implemented well, forests credits can have numerous co-benefits ranging from landscape conservation and enhancement of biodiversity to the improvement of food security.

Equally, there are challenges specific to forests credits related to accounting, permanence, political pressures and land use change which bring with them additional governance and planning requirements. For example, inaccurate methodologies, including the lack of solid baseline scenarios, are a key challenge to enabling a more accurate creation of credits. Methodologies requiring dynamic approaches to assess achieved carbon reductions, instead of more static approaches, strengthen accuracy and transparency. In many cases, there are indigenous and local communities which depend on forests and hold systemic knowledge and practices that must be

[8] When a carbon crediting project or program does not halt emission-generating activities, but instead displaces them outside the project or program boundary. (VCMI)

considered in programme design to ensure forest carbon credits do not cause negative environmental, economic and social impacts.

These differences between standards and the need to account for issues specific to project types highlight the need for additional due diligence by companies purchasing credits. Various options exist, ranging from free tools, carbon credit rating agencies and third party due diligence providers, to companies conducting their own independent due diligence. Due diligence should cover at least the minimum requirements identified above but could be expanded to cover additional aspects such as whether the project contributes to international commitments or national policies, whether it engages with nature-related priorities and initiatives at a sub-national scale, and whether it promotes social, ecological and legal integrity.

CDP has also begun to request details on the quality of the credits organizations are using, regardless of the standard the credits have been verified under. In the CDP climate change questionnaire, C11.2a requests details of carbon credits cancelled in the reporting year. Added in 2023, columns request companies to detail how additionality has been assessed, how reversal risk has been addressed, how potential sources of leakage have been assessed, and any other issues such as avoiding negative environmental, economic, and social impacts, have been addressed. Where possible, the dropdowns in the question align with the ICVCM.

Data from 2022 highlights how varied the field of carbon credits is, with companies reporting nearly 300 different types of projects verified by nearly 400 different standards.

Principle 3 – Account for credits with credibility and transparency

The final principle is that credits need to be accounted for and cancelled in a credible and transparent way. Even if organizations are using high quality credits, the climate benefit will still be diluted if multiple parties can claim the same credit for themselves, or the same party can claim for competing causes.

It is important for companies to only use credits issued by or accounted for in a carbon crediting programme with a robust and transparent credit registry. In creating accounting requirements for carbon-crediting programs, the ICVCM breaks their accounting requirements around double counting down into three parts. In their core carbon principles are requirements for programs to avoid double issuance, double use and double claiming of credits.

Double issuance occurs when multiple credits are issued for the same emissions reduction or removal. Double use occurs when a single credit is claimed multiple times. Double claiming occurs when a credit is issued for a reduction or removal which is already covered by a domestic compulsory mitigation scheme. Again, the requirements for this among standards vary.

Organizations should report on the use of credits in a transparent way, with credits accounted for in robust accounting systems preventing double counting. Organizations should always report credits separate to their gross GHG emissions inventories. For the credits they use, companies should disclose the key information on retired credits requested in the VCMI Claims Code of Practice.

These details can already be reported in CDP's climate change questionnaire, but CDP intends to update the questionnaire to request these details more explicitly.

Conclusion

Taken together, these three principles constitute CDP's view of best practice in the voluntary use of carbon credits.

Before using credits, companies must take ambitious action in their own value chains by setting and being on track to meet SBTi-approved 1.5-degree aligned near-term targets or equivalent.

If companies do decide to use credits, they should ensure these are of a high quality by only using CCP-approved credits once these are available and performing their own due diligence on the projects they are purchasing credits from.

Finally, the credits they use should be accounted for in a transparent way that is reported separately from the GHG inventory and includes the necessary details for transparent and robust accounting. CDP corporate questionnaires can offer a single place to identify which organizations are following best practice in their use of carbon credits.