HOT TOPIC

Sustainability in the US

US supports efforts to improve voluntary carbon markets

May 2024

US government publishes principles to advance the integrity of the voluntary carbon markets.

Source and applicability

- The US Treasury, the Department Secretaries of Agriculture and Energy, the Senior Advisor to the President for International Climate Policy, together with both the National Economic and National Climate Advisors to the President, issued the Voluntary Carbon Markets Joint Policy Statement and Principles.
- The policy is in place immediately and the principles are intended to advance high-integrity voluntary carbon markets (VCMs), thereby increasing private capital available to fund carbon reduction, removal and avoidance projects.

Fast facts, impacts, actions

On May 28, 2024, the Principles for Responsible Participation in the Voluntary Carbon Markets (the ‘Principles’) were released to “inform and support ongoing efforts to address the challenges and opportunities associated with VCMs.” There are seven Principles in three categories, each targeted at different constituents that together make up the market.

	Objective	Main constituents
Supply	Credit integrity and protections regarding climate and environmental justice	Project proponents, registries / programs, validation and verification bodies
Demand	Credible credit use	Buyers of carbon credits
Market	Efficient market participation and lower transaction costs	Policymakers and market participants

VCMs have come under increasing scrutiny in recent years, with a number of high profile cases related to the quality of carbon credits. While the Principles themselves are not prescriptive laws or regulations, we expect them to shape the future development of regulation over VCMs.

Now is the time for supply-side constituents to carefully consider the quality of new credits that are being generated and sold; and for buyers to consider the use of credits in their decarbonization strategies, and the adequacy and appropriateness of their disclosures.

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Background

The Infrastructure Investment and Jobs Act (IIJA) focuses on fixing and upgrading US infrastructure networks, while one of the objectives of the Inflation Reduction Act of 2022 (IRA) is to further support a reduction in carbon emissions through grants and tax credits in domestic energy production and manufacturing. Both of these have drawn private capital into the development of new technologies and investment in projects that are intended to reduce carbon emissions among other activities.

VCMs provide an opportunity for private capital to fund even more of these investments incentivized by the IRA and IIJA. In the voluntary market, a carbon credit's primary purpose is to provide funding for a project that removes or reduces carbon from the atmosphere (a carbon credit project) that would not be pursued absent the revenue from the sale of carbon credits – an incentive to ***supply***.

Conversely, companies may find after achieving their operational and value chain emissions reduction targets that the remaining greenhouse gas (GHG) emissions cannot be eliminated and turn to carbon credits to neutralize (or offset) emissions that cannot be avoided – a ***demand*** incentive.

GHG programs in VCMs may use registries, with unique serial numbers assigned to credits and specific methodologies and frameworks to evaluate and implement projects. The methodologies and frameworks are developed, approved and enforced by the registries. Once generated, a carbon credit may change owners many times with limited transparency of the project and methodologies governing the credit's issuance. Other challenges related to pricing, transparency and a lack of robust reporting practices contribute to questions about the ***market*** integrity of VCMs.

To address integrity challenges in each of these areas – supply, demand and the market – the Principles for Responsible Participation in VCMs were published to reinforce responsible practices. They draw on existing guidance such as the Core Carbon Principles of the Integrity Council for the Voluntary Carbon Market, and concepts from the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).

To learn more about the process by which carbon credits are issued and retired, see Question 10.3.25 in our Handbook, GHG emissions reporting. To understand terminology, see Terminology and resources.

Principles for responsible participation in VCMs

There are seven Principles across three categories.

Principles 1 and 2: Supply integrity

Principles 1 and 2 focus on what characteristics should be present for an issued carbon credit to be of high integrity.

> **Principle 1.** Carbon credits and the activities that generate them should meet credible atmospheric integrity standards and represent real decarbonization.

Under Principle 1, activities that generate credits and the credits themselves should meet core integrity principles, including the following.

- **Additional.** The activity would not have occurred in the absence of the incentives of the crediting mechanism and is not required by law or regulation.
- **Unique.** One credit corresponds to only one tonne of carbon dioxide (or its equivalent) reduced or removed from the atmosphere and is not double-issued.

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- **Real and quantifiable.** Claimed emissions reductions or removals represent genuine atmospheric impact that is determined in a transparent and replicable manner using robust, credible methodologies. Relevant activities are designed to prevent emissions from occurring, being shifted, or intensifying beyond their boundaries as a result of the activity ('leakage').
- **Validation and verification.** Activity design is validated, and results are verified, by a qualified, accredited, independent third party.
- **Permanence of GHG benefits.** The emissions removed or reduced will be kept out of the atmosphere for a specified period of time during which any credited results that are released back into the atmosphere are fully remediated.
- **Robust baselines.** Baselines for emissions reduction and removal activities are based on rigorous methodologies that avoid over-crediting, prioritizing the use of performance benchmarks where applicable, and that evolve over time to reflect advancements in national climate policy, emissions pathways and decarbonization practices and technology.

The definitions are similar to those found in the quality criteria of other standards and frameworks, and many of these concepts under the GHG Protocol are explained in section 10.2 of our Handbook, GHG emissions reporting.

Principle 1 goes further to also hold the (independent) verification or crediting bodies and their practices to certain standards – e.g. requiring robust measurement, monitoring, reporting and verification, and requiring the use of a registry and publicly available information on crediting activities.

The issuance of a carbon credit requires a methodology that supports the validity of the amount for which it was issued. Scientific knowledge about emissions reduction and removal continues to deepen and the technology to monitor the performance of projects advances – each providing better data that informs improvements to carbon crediting methodologies, necessitating good governance policies and procedures of the crediting bodies.

Principle 2. Credit-generating activities should avoid environmental and social harm and should, where applicable, support co-benefits and transparent and inclusive benefits-sharing.

Principle 2 takes the responsibilities of the credit-generating activities of the project and program developers one step further:

- requiring that they understand and seek to avoid negative impacts on the communities in which they operate; and
- encouraging the identification and delivery of verified co-benefits associated with credit-generating projects and programs – e.g. supporting economic development, sustaining livelihoods of local communities.

Principles 3 to 5: Demand integrity

Principles 3 to 5 focus on responsible practices for the credible use of carbon credits, with 3 and 5 in particular addressing the buyer's integrity in employing credits in a GHG reduction strategy.

Principle 3. Corporate buyers that use credits should prioritize measurable emissions reductions within their own value chains.

Principle 4. Credit users should publicly disclose the nature of purchased and retired credits.

Principle 5. Public claims by credit users should accurately reflect the climate impact of retired credits and should only rely on credits that meet high integrity standards.

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Recent laws attempt to fill the existing market information and transparency gap (Principle 4) by requiring disclosures about the purchase and use of carbon credits. The following are examples.

- California's Voluntary carbon market disclosures Act (AB-1305) requires detailed disclosures about carbon credits and the related programs by companies that 'operate' in California or that market or sell voluntary carbon credits in California. To learn more, read our Hot Topic, California imposes climate disclosures and assurance.
- If carbon credits have been used as a material component of a registrant's plan to achieve its disclosed climate-related targets or goals, the SEC's climate rule (now stayed) would require disclosures about the credits and the underlying projects. To learn more about the climate rule, read our Top 10 Q&As, Understanding the SEC's climate rule.

Principles 6 and 7: Market integrity

Principles 6 and 7 focus on supporting participation in the market and enabling the lowering of transaction costs.

Principle 6. Market participants should contribute to efforts that improve market integrity.

Principle 7. Policymakers and market participants should facilitate efficient market participation and seek to lower transaction costs.

Principle 6 expands on the need for transparency and publicly available data to, for example, prevent fraud and manipulation by bad-faith actors – enabling market infrastructure and reporting that supports robust participation in the VCM.

In our experience, there is a wide spectrum of buyer activity, ranging from short-term purchases at a point in time to long-term agreements to provide capital and off-take carbon credits generated by a project. Principle 7 speaks to policymakers and buyers to be open to structures that provide certainty to would-be participants.

What to consider as a market participant

The issuance of the Principles reinforces the existing practices developed to improve integrity of VCMs – communicating a consistent message regarding the need to address challenges inhibiting or discouraging market participation.

Participants in VCMs should consider their respective roles and how these Principles may align or guide their existing standards and procedures for:

- evaluating projects to issue credits;
- buying and selling credits; and
- disclosing adequate and appropriate information about VCM participation.

Further, the Principles communicate a responsibility to support ongoing efforts to improve the infrastructure that will enable more market participation.

Be prepared to adapt as changes are implemented across verification bodies.

Be aware of the implicit expectations of stakeholders that the use of carbon credits accompanies an earnest effort to reduce emissions in the value chain.

Consider making longer-term capital commitments for certain suppliers to increase their market participation and decrease uncertainty about the revenue stream from carbon credits.

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Terminology and resources

In this Hot Topic, we refer to 'carbon credits', consistent with the Principles and the SEC's stayed climate rule. California's AB-1305 refers to 'carbon offsets' but acknowledges that other terms are used, and the GHG Protocol refers to 'offset credits'. The Principles transcend the exact naming convention used and, at a basic level, are instruments in VCMs that represent carbon dioxide (or its equivalent) reduced or removed from the atmosphere.

To learn more about carbon credits, see our resources:

- GHG accounting in chapter 10 of our Handbook, GHG emissions reporting, which includes comparisons to European Sustainability Reporting Standards and IFRS Sustainability Disclosure Standards
- Financial accounting in chapter 13 of our Handbook, Climate risk in the financial statements, and our web article, FASB project on environmental credit programs
- Decarbonization strategies, Defining your decarbonization pathway
- Overview and opportunities, Infrastructure Investment and Jobs Act.

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