

An aerial photograph showing several white wind turbines in a vast, mountainous landscape. The foreground features a dense green forest, while the background shows rugged, rocky mountains under a blue sky with scattered clouds. The perspective is from a high angle, looking down at the turbines and the terrain.

# **How should the private sector step up climate action?**

**Position paper prepared by South Pole**

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## Acronyms and abbreviations

CA	corresponding adjustment
CDM	Clean Development Mechanism
CO <sub>2</sub>	carbon dioxide
ETF	Enhanced Transparency Framework
GHG	greenhouse gas
ICROA	International Carbon Reduction and Offset Alliance
IPCC	Intergovernmental Panel on Climate Change
LDC	Least Developed Country
NDC	Nationally Determined Contribution
SBTi	Science-Based Targets Initiative
UN	United Nations
UNEP	United Nations Environment Programme
UNFCCC	United Nations Framework Convention on Climate Change
VCM	Voluntary Carbon Market
VCS	Verified Carbon Standard (now VERRA)

### 1 Executive summary

In the void created by government inaction on climate change, leadership by the private sector is imperative to keep global warming from overshooting the 1.5°C climate target of the Paris Agreement.

A shift to climate-friendly business practices the world over is necessary and transformational. Every single industry sector will be affected, and companies who adapt will see great business opportunities while those who lag behind will be at risk. At South Pole, colleagues interact with the private sector on a daily basis and see that companies are ready to scale up climate action to levels that are both unprecedented and required to meet climate targets.

While more and more governments are setting net zero targets, and encouraging signs are coming from the EU and the new administration in the United States, these policy efforts are still wildly insufficient. The Taskforce on Scaling the Voluntary Carbon Market estimates that carbon markets would need to grow by a factor of 15 between now and 2030, and over hundredfold by 2050, in order to stay within the 1.5°C pathway (Taskforce on Scaling the Voluntary Carbon Markets, 2020) – a market size that is unlikely to be accomplished by government action alone, especially at today's level of ambition.

While South Pole welcomes the strong policies and regulatory frameworks put in place by governments to meet the Paris climate targets, the continuing policy gap means that other actors urgently need to step up their climate action efforts. What are the solutions at hand, in the meantime?

The private sector can and should play a key role in accelerating global decarbonisation efforts. It can be part of the solution in several ways: by going beyond current policy mandates to reduce emissions across companies' global operations and value chains, and by deploying capital to support emission reductions outside of these value chains.

**However, private sector climate action remains timid. Why? There are a number of reasons.**

**First** and foremost, the cost of emitting greenhouse gases (GHGs) – in other words, the price of carbon, set by governments – is still too low. At around USD 5–10/tonne, the price of carbon does not accurately reflect the true cost of the damage it incurs, in terms of harm to the environment, health and society (World Bank, nd). One tonne of carbon needs to be priced at more than USD 100 to correctly reflect its true cost (Stiglitz and Stern, 2017). Approximately 1,400 companies are unilaterally setting an internal carbon price as a way to measure the cost of their carbon footprint, with disclosed ranges being between USD 5 and USD 50 (CDP, 2017).

Companies adopting a higher internal carbon price would mean putting in motion a number of other important actions:

- Companies who set net zero targets would realise that the cost of GHG emissions (to their operations) is substantial.
- This would trigger an effort to reduce emissions, both to reach their sustainability milestones and to lower operational costs, and to prepare these companies for potential compliance costs in the future should governments introduce stronger carbon regulation.
- If companies buy carbon credits to compensate and neutralise their emissions that are beyond their target for that year, then they are paying an actual price for their residual emissions. Consequently, the carbon credit price provides the same decarbonisation

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incentive as a traditional price on carbon: the higher the carbon credit price, the more incentive the firm has to reduce its own emissions rather than pay the cost to offset its residual emissions. Firms that are serious about achieving net zero should thus pay a fair price for carbon credits to drive decarbonisation efforts within and beyond their value chains.

**Second**, the flip side to a low price on carbon (which allows companies to emit at a low cost), is that green projects do not attract enough investment finance because the rate of return is too low. Why is that? If the carbon credits these projects generate cannot be sold at more than USD 10/credit, then investors (both international financial institutions and local banks) are not interested in investing in these projects. The business case to support decarbonisation efforts in, for example, the agricultural sector, or carbon capture, utilisation and storage, is not there when the carbon credit price is low.

**Third**, private companies do not see a clear path for action. In the media, carbon finance and the use of carbon credits is criticised by actors who claim that it is 'greenwashing'. They insist that the only credible path for companies is to fully avoid all emissions throughout their operations and value chains. They insist that they should not be allowed to use carbon credits to 'atone for their sins'.

However, we do not have the technologies at hand at an affordable price to allow all companies to reach zero emissions within their own operations and value chains *today*. And critics do not offer an alternative solution for companies: they insist on either full decarbonisation now, or on not operating at all. This is not realistic for most private firms, who shrug their shoulders and say 'I will not close down my business simply because it emits greenhouse gases, which I cannot avoid at a reasonable cost. What else can I do? I don't want to be accused of greenwashing.'

While we today do not have the technologies in place for a fast transition to a zero-emissions economy, progress is visible and encouraging, albeit slow. Government policies and investments in the Green New Deal provide encouraging signs of industrial transformation that can become sustainable in the long term. Meanwhile, projects that lower emissions around the world are in desperate need of financing. This is why carbon finance through the voluntary carbon markets is critical. As mentioned above, it puts a price on carbon, it attracts funding to eligible and deserving projects, it allows companies to do something (rather than nothing) to support and catalyse more decarbonisation, and in the meantime it develops and supports solutions that will dramatically reduce emissions today.

### Is carbon compensation greenwashing?

It is not greenwashing when companies are setting science-based targets and roadmaps to decarbonise their operations and value chains, and use carbon credits to compensate for residual emissions on their way to net zero.

Using the voluntary carbon markets to funnel financing to projects around the world that lower GHG emissions, certified under the highest quality carbon standards, ensures that these carbon credits drive faster climate action. It is an efficient, cost-effective and transparent way to catalyse global decarbonisation. It is also just one among many tools in the climate toolbox: it is an effective strategy that allows companies to act today, while more climate-friendly technologies are being developed to help them decarbonise as well.

To encourage voluntary action from the private sector, companies must be able to demonstrate and communicate their commitment and impact to customers, investors and employees. Companies should follow the GHG Protocol Corporate Accounting and Reporting Standard, which requires companies to disclose their own emissions, and

separately report the use of carbon credits. Such communication allows companies to demonstrate transparently how they are meeting corporate targets, and to hold themselves to account by decarbonising emissions within and outside their operations and value chains.

Encouraging companies to become climate neutral voluntarily, by setting net zero targets and compensating for *all* residual emissions in their value chain by using third-party certified carbon credits, can also provide governments with more confidence to adopt stronger regulation around carbon pricing, which could send the price signal needed to transform the wider economy.

Finally, ambitious and proactive corporate action can also give companies a headstart when economy-wide climate regulations are introduced. In this way, the private sector can demonstrate the willingness, and urgency, of addressing climate change.

## 2 Climate change – Huge threat, huge opportunity

Climate change is one of the largest and most complex global challenges for our century. Global net GHG emissions caused by humans need to fall by about 45 percent from 2010 levels by 2030, reaching 'net zero' around 2050, according to the Intergovernmental Panel on Climate Change (IPCC, 2019). In absolute terms, this means that, in 2030, the world would need to emit 23 billion fewer tonnes of CO<sub>2</sub> than today (Olivier and Peters, 2019) and reach net zero by 2050. In short, global emissions need to be reduced by 7.6 percent each year between 2020 and 2030 to be on track to avoid increases in global average temperatures by 1.5°C or more (United Nations Environment Programme, or UNEP, 2019).

Reaching this ambition requires investment on an unprecedented scale. For the energy transition alone, the IPCC concludes that “policies in line with limiting warming to 1.5°C would require a marked upscaling of supply-side energy system investments between now and mid-century (...) of about [USD] 3.5 trillion per annum” (IPCC, 2019).

At the same time, the solutions to climate change reveal major investment opportunities. Former Governor of the Bank of England and current UN Special Envoy for Climate Action Mark Carney has said that “[a]chieving net zero emissions will require a whole economy transition – every company, every bank, every insurer and investor will have to adjust their business models. This could turn an existential risk into the greatest commercial opportunity of our time.”

The voluntary carbon markets can play a crucial role in channeling private finance into transformational carbon projects, whose environmental and social impacts can be clearly measured and traced. There are three main challenges for unlocking such finance. For carbon credit suppliers, the lack of a forward demand curve for carbon credits, which would provide suppliers with a signal to invest in new projects to meet that future demand, is a problem.

The second challenge is the persistently low market price for carbon credits, which is caused by a surplus of carbon credits available in the voluntary market, and which undermines the business case for investing in new and high-quality projects to achieve an appropriate rate of return.

On the carbon credit demand-side, many companies are currently unfamiliar with how the voluntary carbon market works and how it can play a role in meeting net zero targets. Industry bodies such as the International Carbon Reduction and Offset Alliance (ICROA), reporting standards such as the Science-Based Targets Initiative (SBTi), and initiatives such as the Taskforce on Scaling the Voluntary Carbon Markets, can help to provide clarity and guidance for companies that are financing voluntary carbon projects, on their way to meeting corporate targets.

### 3 Paris Agreement: Transformational ambition, but insufficient action

The Paris Agreement is the biggest success in global climate policy thus far. With the adoption of the Paris Agreement, governments established climate ambition on a transformational scale by setting a goal of limiting global warming to “well below 2°C and to pursue efforts to limit the temperature increase to 1.5°C above pre industrial levels” (United Nations Framework Convention on Climate Change, or UNFCCC, 2016).

The framework that is supposed to translate this ambition into reality is the Nationally Determined Contribution (NDC), where each government is asked to pledge a target to reduce emissions and to increase its ambitions over time. Unfortunately, the concept of NDCs today still has significant shortcomings:

1. **NDCs are not formulated in a consistent or easily comparable way.** NDCs can include both quantitative targets and more qualitative goals. Even quantitative targets can differ: in terms of how emission reductions are measured (absolute or emissions-intensive reductions); in terms of the baseline year against which reductions are measured; whether the NDC is economy-wide or sector-specific; and whether it covers all GHGs or just carbon dioxide (CO<sub>2</sub>). This makes it difficult to take stock globally of progress towards the Paris targets. It also makes it difficult to understand how “voluntary offset markets might eventually dock into international accounting and transparency systems under the Paris Agreement” (EDF, 2020).
2. **Many NDCs have two or more ambition levels: one level that the government pledges to fulfil on its own (referred to as ‘unconditional targets’), and another with a higher ambition level, if additional international climate financing is provided (referred to as ‘conditional targets’).** The consequences are unclear: can international financing only come in *after* the government has fulfilled its own NDC target? If not, what is the appropriate way to account impact between the fulfillment of unconditional and conditional targets?
3. **NDCs are neither legally binding nor enforceable.** While the Paris Agreement encourages Parties to increase their climate ambition when they update their NDCs every five years, a government can opt to adjust its NDC upwards or downwards without facing any major retributive consequences. A key reason for this unfortunate situation was that the entire Paris Agreement had to be designed in such a way that it would not create new legal obligations – as otherwise the US administration would not have been able to ratify the Paris Agreement in 2016 without the approval of Congress. However, as the example of the past US administration has shown, a government can simply decide to leave the Paris Agreement altogether, without any consequences.
4. **NDCs are not implemented consistently.** Some governments have started to implement secondary binding domestic legislation to achieve emission reductions. Others have not done so, and some have even enacted policies that are fundamentally at odds with their own NDC pledges. A 2018 report comparing NDC targets with domestic legislation showed that out of the 157 Parties who submitted economy-wide targets in their NDCs, only 58 adopted economy-wide targets in their domestic laws, with only 17 of these Parties showing domestic targets consistent with the targets set in

their NDCs (Nachmany and Mangan, 2018). The credibility of implementing NDC targets is cast into doubt when such targets are not reflected in domestic policies.

These shortcomings point to the difficulties of relying solely on governments to set ambitious NDC targets backed by credible climate policies and action. The UN Emissions Gap report (2020) clearly shows that we are not on track to achieve the Paris Agreement targets, even with the conditional pledges of NDCs, as shown in Figure 1 below.

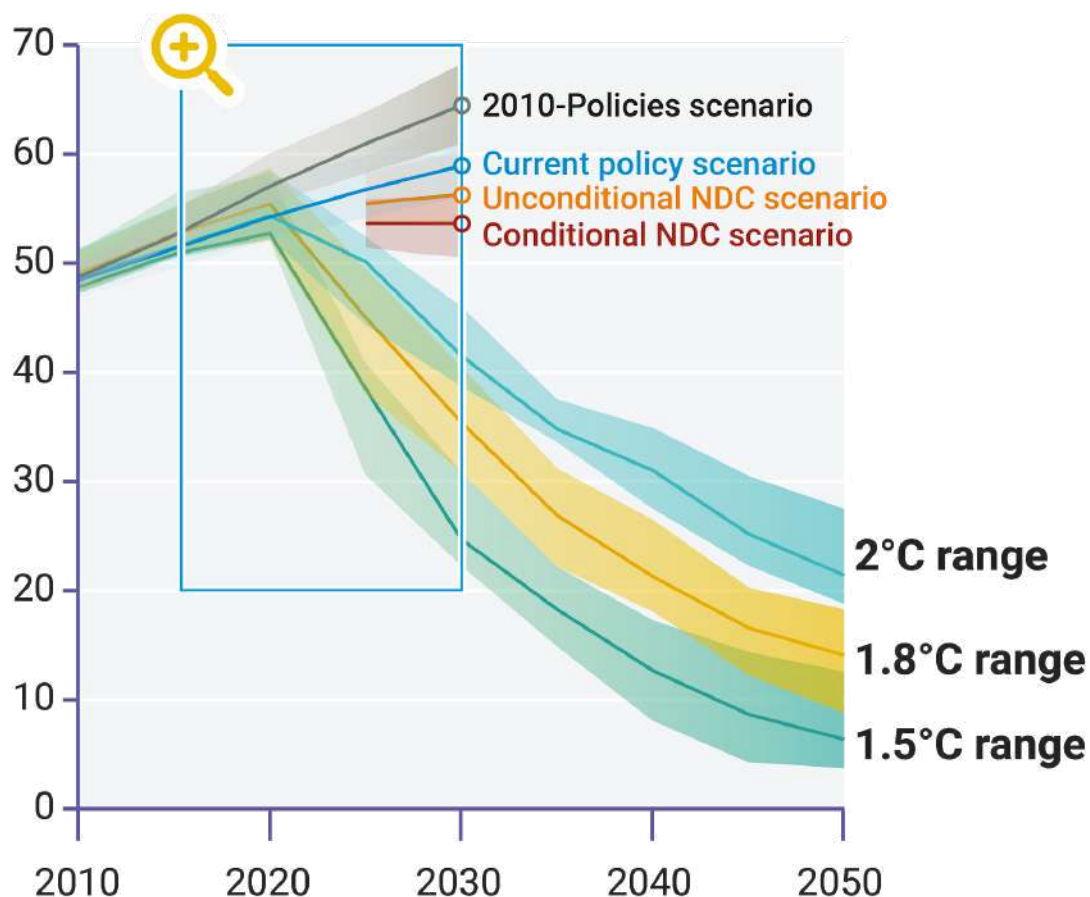


Figure 1: Trajectory to meet Paris targets of limiting emissions to the Paris targets 1.5 or 2°C (Source: [UNEP 2020](#))

## 4 Private sector financing is key to jump-starting climate action

The role of the private sector in ramping up climate finance is absolutely essential, particularly in light of the highly insufficient action by governments to implement the Paris Agreement. Driven by demand from investors, customers and employees, most of the world's largest listed companies have committed to bold climate action. Recently, pledges to achieve "net-zero emissions" have been issued by a number of high-profile companies. What does this mean? The SBTi recently clarified how an ambitious net-zero target should unfold (CDP, 2020).

A company should:

- set a net zero target based on climate science, with interim milestones to reach this no later than 2050, consistent with a 1.5°C mitigation pathway.



- show how it can reduce emissions across its operations and value chain in line with climate science.
- while reducing its emissions, take climate action now by financing and accelerating reduction, avoidance and removal activities via compensation outside of its value chain as it transitions towards a state of net zero emissions.
- neutralise its residual emissions using CO<sub>2</sub> removals to reach net zero.
- report progress to achieving corporate targets by following the GHG Protocol Corporate Accounting and Reporting Standard, which requires corporates to separately disclose emission reductions achieved by corporations within their operations and value chains, and the use of carbon credits in the corporate accounting of its carbon footprint.

To ensure the transparency and ambition of voluntary corporate action, reporting standards such as the SBTi have emerged, which pushes companies to adopt science-based targets and decarbonisation plans to reach net zero emissions, validated by an external standard which provides transparency, credibility and accountability.

It also requires companies to develop a long-term roadmap for how they are to achieve their net zero targets, by identifying options to reduce emissions internally *first*, before using carbon credits to compensate and neutralise emissions that are difficult for the corporation to avoid in that year. As such, reporting standards such as the SBTi can ensure that companies do not use carbon credits as a way to greenwash, but as a complementary solution, compensating and neutralising residual emissions as part of their long-term corporate strategy to reduce their emissions.

These reporting standards are important in ensuring that companies reduce their emissions across their value chain and disclose their progress towards meeting their targets. As such, they increase the transparency and accountability of voluntary corporate action. So far, over 1,000 companies have had targets validated under the SBTi, with 360 committing to a 1.5°C reduction pathway.

## 5 Achieving net zero by corporates in the context of the Paris Agreement

In recent years, a debate has emerged around whether voluntary climate action can co-exist with the Paris Agreement. The question is, in essence, whether the presence of NDCs, by definition, makes any emission reductions in the same scope “non-additional”, as each tonne of CO<sub>2</sub> reduced by private financing brings the government one tonne of CO<sub>2</sub> closer to reaching its NDC.

The view of ICROA with respect to the Voluntary Carbon Market (VCM) is as follows (ICROA, 2020):

1. “No export: Carbon reductions financed by the VCM post-2020 will not be exported from the Host Country. They are accounted for by the Host Country and can contribute to or go beyond that Country’s efforts.
2. “Additionality: Carbon Standards will be required to ensure baselines and methodologies are updated and adapted over time to maintain additionality by ensuring carbon reductions over-and-above business-as-usual and regulatory requirements.



3. “No corresponding adjustments: As carbon reductions are not exported from the Host Country, no corresponding adjustments are needed. Carbon finance through the VCM does not undermine ambition, it simply becomes one of a number of sources of finance to increase ambition.
4. “No double counting: Voluntary activity does not lead to double counting at the UN level because carbon reductions are recorded only once by the Country hosting the mitigation activity.
5. “Claiming carbon reductions: When emissions are balanced by a combination of internal abatement and verified carbon reductions outside the boundary of an organisation, carbon neutrality can be claimed.”

A second question is whether increased private sector financing of climate action inside the scope of an NDC might undermine government ambition and action. These claims are difficult to substantiate in practice. It is more likely that other factors play a role in explaining why governments have not increased their ambition and action. Governments may, for example, not fully know the costs of achieving higher decarbonisation targets, and are therefore unwilling to raise ambition until those costs become clearer. For example, they may wish to act on climate change, but feel that action on health takes priority, particularly with limited fiscal budgets.

Voluntary carbon projects can actually help governments measure and understand the costs of reducing emissions through different strategies – for example, renewable energy, biomass, reforestation, climate-smart agriculture – by collecting on-the-ground project data that can help to measure, verify and report the volume of emissions that are achieved by projects through the carbon certification process. Carbon projects can thus calculate the real costs of emission reductions, and build local capacity through the implementation of projects.

Indeed, evidence from previous experiences in project finance indicates that voluntary climate action *increases* government ambition, by showing the social, economic and environmental benefits of low-carbon interventions, and in some cases, by removing barriers to action. Voluntary carbon projects can thus act as pilot projects to provide real data on application within the country context, demonstrating which projects are within the engagement capabilities of the government and its citizens, and which projects continue to need external financing and support.

Thus, voluntary carbon markets and the financing of emission reduction projects by the private sector not only remains fully possible within the context of the Paris Agreement, it is even imperative that the private sector acts quickly and boldly, not least to encourage governments to turn their non-binding NDCs into tangible domestic regulation. Of course, this is only valid under the condition that, when using voluntary carbon markets, companies certify carbon projects under the highest possible standards with regards to additionality, transparency and environmental integrity.

In summary, it is clear that these two questions around voluntary action do not hold water: “Net zero” action by the private sector not only continues to be additional and legitimate, but also should be boosted exponentially across the globe to help finance the climate transition right now. This, in fact, may even catalyse government action.

## 6 “Corresponding adjustments” are currently not the solution

Another suggestion proposed in recent publications is the concept that voluntary climate action should make use of so-called “Corresponding Adjustments” (CAs) (Kreibich and Hermwille,

2020). The idea is that, for every tonne of CO<sub>2</sub> reduced within a country's NDC by the private sector, the government should "adjust" its ambition level upwards in its NDC by the same tonne of CO<sub>2</sub>.

If fully operational, and applied in a fair and predictable way by governments, this concept could indeed create more transparency because – as was the case under the Clean Development Mechanism (CDM)<sup>1</sup> – a host country would officially recognise emission reductions generated by voluntary projects, and would clearly state that these efforts happened beyond its own ambition. A few countries are currently trying to take their first steps towards operationalising this concept on a bilateral basis. One of the most encouraging examples is the cooperation between Switzerland and Peru (KLIK, 2019).

Unfortunately, this concept is still in its infancy and has been the sticking point of Article 6 negotiations. Therefore, CAs face, amongst other problems, the following issues:

1. **CAs are difficult to make when targets amongst countries are not communicated in a standardised way and are subject to change.** As shown in Section 3 above, NDCs are heterogeneous; few of them state absolute emission reduction targets. Moreover, NDCs are non-binding, and can be adjusted at any time (not just in the five-year updates), and as such have no direct legal implications for the country. Moreover, as discussed, many NDCs have different ambition levels (including/not including international finance), which exacerbates the risk that a government will be unwilling to do a CA if it realises it has made insufficient progress to meeting its own NDC target. Therefore, the CA concept cannot work for a target that is not defined in a quantitative and absolute way, and which could be changed by governments without consequence.
2. **Requiring the voluntary carbon market to use CAs without a coherent system in place could delay faster climate action.** Even if NDCs were binding and formulated in an absolute way, which is not currently the case, a *globally* functioning system of CAs would take years, if not decades, to establish. Even within five years of signing the Paris Agreement, governments cannot agree on the final rules to implement Article 6. Though there is certainly progress towards bilateral agreements between countries under Article 6.2, to build the structures upon which an internationally traded carbon market which would include more countries, as envisioned under Article 6.4, would require: (1) the rules around CAs to be finalised, and (2) all countries to have the capacity to implement these rules in terms of harmonising their individual accounting systems and their infrastructure to allow for trading between multiple countries. This international system would be needed particularly for multinational corporations, as CAs would need to be executed between the accounting systems of countries it buys the voluntary carbon credits from and the countries in which emissions are released from its operations and value chains.
3. **Moreover, even if all hurdles could be overcome, it is not necessarily clear that the concept of CAs would indeed enhance environmental integrity if certain seller countries' accounting systems were not robust enough to uphold the**

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<sup>1</sup>The CDM refers to the market-based mechanism established under the Kyoto Protocol that allows developed countries (identified as Annex 1 countries) to offset their emissions by funding emission-reductions in developing countries (non-Annex 1 countries). Emission reductions certified under the CDM standard can now also be purchased by corporates for voluntary carbon market purchases.

### **requirements of the Enhanced Transparency Framework (ETF) of the UNFCCC.**

These ETF requirements include ensuring the environmental integrity of national accounting systems, such as how to accurately reflect CAs. Requiring CAs on the sale of voluntary carbon credits in these countries would delay investment in carbon projects. Companies will need to wait until the countries have robust accounting systems in place to ensure that CAs from these countries satisfy the requirements of environmental integrity. As many of the countries are least developed countries (LDCs), imposing the CA requirement would mean that they would not be able to benefit from carbon financing – despite being countries who would need these investments the most.

It is thus important to keep to the current solution for private sector climate action while the systems for corresponding adjustments are developed, so as not to delay carbon investment. We support the development of a Technical Advisory Body to provide clarity and guidance on how this interim solution could be implemented to uphold the environmental integrity of the global carbon market. This Technical Advisory Body should consist of members who are transparent about their position on the role of the voluntary carbon market under the Paris Agreement.

## **7 “Climate Neutral” claims are more robust than “climate contribution” claims**

Another recent proposal revolves around the replacement of “climate neutral” claims with “climate contribution” claims. The difference between the two concepts is that the former measures the amount of emission reductions financed through purchase of carbon credits, while the latter just signals the amount of financing provided towards carbon projects. For example, if you were to imagine a company whose unavoidable emissions are 10,000 tonnes of CO<sub>2</sub> per year: instead of purchasing a number of carbon credits equal to the same 10,000 tonnes and claiming climate neutrality, this company could pledge to contribute USD 50,000 to financing climate action. Companies could include measurements and key performance indicators to track their progress towards their investments; however, this does not currently have the same governance architecture as emission reductions, which are *certified* once they are achieved. The idea behind claiming a “contribution” to climate finance in a host country, rather than “climate neutrality”, avoids any discussion of the legitimacy of voluntary climate action under the Paris Agreement (as discussed in Sections 5 and 6).

While such claims might initially seem to solve the issues discussed, on reflection, this concept runs the risk of opening the doors to greenwashing. Instead of a proper accounting of a company’s GHG emissions, and taking responsibility for negative impacts by compensating for them through the purchase of carbon credits, the company could instead simply “buy its way out”, donating an arbitrary amount of money to a worthy cause, without any reduction to its own carbon footprint. Such “contribution claims” are thus dangerous as they distract companies from embarking on a path of actually reducing emissions from their internal operations, value chains and beyond.

The superiority of a climate-neutral claim over a contribution is that the purchase of carbon credits to reach neutrality is equivalent to the volume of a company’s emissions, literally revealing the monetary value – i.e. cost – of its emissions. In doing so, the company puts a price on carbon. The higher the cost of achieving climate neutrality (through the purchase of carbon credits), the greater the incentive for the company to reduce emissions within its value chain.



In contrast, climate contributions do not force companies to take action on a scale that is linked to their carbon footprint. It is unclear whether a company would be overpaying or underpaying for the size of its carbon footprint – the latter is more likely.

Finally, a “climate contribution” claim will not work for products, as it is important to reassure customers that the carbon footprint of products has been fully measured and addressed. Climate-neutral products are a key way for companies to address their Scope 3 emissions.

## **8 Companies going climate neutral are also more likely to have strong climate goals**

A frequently heard myth is that offsetting emissions is a way for companies to ‘atone for their sins’ and an excuse not to reduce emissions, implying that carbon offsetting could hold companies back from ambitious climate action.

Research has shown that the opposite is true. A study by Ecosystems Marketplace (Tucker, 2019) shows that, of the businesses tracked in EM’s 2016 buyers’ report, 88% of voluntary offset buyers and 92% of compliance buyers formally adopted emission reduction targets. This percentage is much higher than that seen among big emitters: a recent study by Climate Action 100+ recorded that only 43% of the biggest emitters have set a net zero target (Climate Action 100+, 2020). In fact, companies that include offsetting in their carbon management strategy typically spend around 10 times more on fighting climate change than a company that doesn’t offset.

There is clearly a connection between offsetting and other ambitious climate action. Contrary to the ‘greenwashing’ narrative, it appears as though using carbon credits is the hallmark of a company that is leading climate action rather than bringing up the rear. As mentioned earlier, a plausible explanation for why companies that offset actually spend more on fighting climate change is because committing to climate neutrality automatically creates a tangible cost of emissions for the company, based on the price of carbon credits. Companies have to make a real choice between spending internal budgets on carbon credits for residual emissions or using that same budget towards reducing their own emissions. Companies are more likely to prefer spending this budget internally to reduce emissions for various reasons, including control, saving resources, and as an opportunity for PR. However, in the absence of low-carbon technologies and the processes that can help them to avoid releasing emissions, they have to buy carbon credits to maintain a climate-neutral claim.

This is yet another reason why it is so important to have higher carbon credit prices than the current market signals. A higher price provides companies with a higher cost incentive to use internal budgets towards reducing as much of their internal emissions as possible and to buy carbon credits only for those emissions that are currently difficult to avoid.

A higher carbon credit price thus acts as a de facto carbon price for a company that wants to claim climate neutrality. It forces companies to pay for their emissions, both in the short and long term. A higher carbon credit price can also channel financing towards carbon projects that are costly but transformational, thereby enabling faster climate action at a global level.

### 9 Emission reduction projects satisfy the highest standard for impact quantification

Recently, some stakeholders have called into question the quality of projects that reduce GHG emissions and earn carbon credits, arguing that a) some of such projects might not be additional, b) their certificates might be at risk of double-counting, or c) the entire certification process is not transparent.

The mechanisms and standards to validate projects and certify emission reductions were established between 2001 and 2005, starting with the UNFCCC Marrakesh Accords, which created the modalities and procedures of the CDM (UNFCCC, 2001). The Gold Standard (Gold Standard, 2021) was created in 2003 by WWF and other NGOs, followed by the Verified Carbon Standard (VCS, today named VERRA) established in 2005. The VCS was created by the International Emissions Trading Association (IETA), the Climate Group and the World Economic Forum (Verra, 2021). The World Business Council of Sustainable Development joined immediately after the creation. This means a very significant group of the largest climate organisations worldwide stands behind VERRA.

Jointly, these three standards have been responsible for the vast majority of verified and certified carbon credits to date, both under the Kyoto Protocol and in the voluntary sector.

While in the early years, these standards developed their products and procedures and learned from their mistakes, in the past 15 years an exceptionally robust framework of impact quantification has evolved, which until now is unparalleled in terms of its stringency, transparency and robustness.

Its key elements include:

- **Transparency:** all standards operate publicly accessible registries, allowing anyone to track all projects and trace the ownership transfer and retirement of carbon credits to end buyers.
- **No double-counting:** registries provide each certificate with a unique serial number. Double counting is therefore impossible.
- **Additionality:** since the beginning, all three standards adhere to the Additionality Tool provided by the UNFCCC (UNFCCC, 2012). Every project, before being considered, has to show proof that it has been implemented above and beyond business as usual.
- **Calculation methodologies:** all three standards make use of a comprehensive set of reviewed and approved emission reduction calculation methodologies, all of which are transparently accessible to everyone (UNFCCC, 2021). For the vast majority of project types, all three standards make use of the same approved methodologies.
- **Several layers of certification:** all three standards adhere to an exceptionally comprehensive certification process, which consists of five levels:
  1. Project validation: performed by a third-party certification company like TÜV Süd or SGS, confirming that the project meets all quality criteria;
  2. Host-country approval (only CDM): approval by the host government that the project is in line with its sustainability goals;
  3. Project registration: performed by the standard itself;

4. Project monitoring and verification of the reduced emissions: performed annually by a third party certification company like TÜV Süd or SGS, confirming that the project is operating according to plan, and that the emission reductions claimed did indeed occur;
5. Certificates issuance: performed by the standard itself.

We agree that the transparency, accountability and robustness of the voluntary markets can and should always be improved in order to uphold the environmental integrity of the carbon market – particularly as national policies change or as digital innovation provides greater scope for real-time verification. Nevertheless, we are not aware of any other impact monitoring and reporting framework in the world that comes close to the standards and procedures used to certify and enable the tracing of carbon credits.

One caveat to conclude: recently a number of new NGOs and companies have appeared, promoting “climate neutrality” but without basing such claims on verified carbon credits as described above. It is important to note that the quality of a carbon credit, and thus of a climate neutral claim, can only be guaranteed if ICROA quality assurance criteria (ICROA, 2018) are followed.

## 10 Conclusion and key recommendations

In an optimal world, every single tonne of GHG emissions from human-related activities would have a carbon price that is reflective of the climate damage it generates, now and for generations to come.

In the absence of governments being willing or politically able to put in place ambitious climate regulation that puts a real and sufficiently high price on carbon, makes emitting GHG costly, and catalyses change, the private sector needs to take the lead.

In this reality, what is needed to enable companies to step up their climate action?

Currently, what is missing is the financing and ambition for a transformational scale-up of climate action that can stop global average temperatures from increasing more than 1.5°C.

Private companies are increasingly realising that climate change poses an existential threat to their operations, in terms of physical impact, climate policy, climate regulation, and investor and consumer pressures. They are taking a hard look at the risks and opportunities, and in many cases developing a more robust sustainability strategy, including setting long-term net zero targets. In notable cases, companies recognise that they can increase their bottom line by showing climate leadership by adopting a climate neutrality strategy.

Setting ambitious targets and plans to reduce GHG emissions both within and beyond their immediate operations and value chains is key to combating climate change. As a complement to such proactive and ambitious climate action, the private sector should use the voluntary carbon market to compensate for their unavoidable emissions today and enable faster climate action.

The voluntary carbon market is an important tool in catalysing a global transformation to a low-carbon economy. It is in itself efficient and cost-effective, but for it to make the necessary impact, it needs to be exponentially scaled up as well. It should be used as a complement to other climate action, such as reducing and avoiding GHG emissions by all actors, big and small, private and public.



## How should the private sector step up climate action?

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Dismissing the voluntary carbon market as ‘murky’ or as a tool that companies use for greenwashing is not only unhelpful but also distracting. There are solutions for ensuring corporate action is transparent and real. Businesses voluntarily setting science-based targets and decarbonisation plans that are validated and verified by external standards, such as the SBTi, substantiate corporate commitments to reducing emissions within their operations and value chains *first, and then* use carbon credits to compensate and neutralise residual emissions to reach net zero targets. Ensuring that companies buy carbon credits that are certified under high quality standards and that they pay a fair price ensures that they commit to driving climate action outside of their value chains as well.

However, the real obstacle to large-scale climate action is the lack of a robust carbon price imposed by governments to drive the necessary investments. While there are always improvements to be made – no free market of any kind is perfect – the solution is not to do away with carbon finance but rather to scale it up. With a larger market, financing will flow, interest from regulators and international financial institutions will grow, and policy advisory/supervisory bodies will be formed. We saw this happening after the Kyoto Protocol was ratified in 2005 and it will happen again if the voluntary carbon market grows substantially.

Using a market-based mechanism to offset emissions and funnel funds to green projects around the world is the most transparent and effective way to get money to deserving and additional carbon projects. The reality is that the current lack of climate-ready and affordable technologies to reduce emissions to zero means that companies will continue to release emissions that are difficult to avoid in the interim. Thus, allowing companies to buy voluntary carbon credits to compensate for their emissions provides the only practical and cost-effective financing mechanism to enable fast climate action, which is sorely needed. Such emission reductions would otherwise be inaccessible due to a lack of financing, knowledge and government policies. It is therefore important to urge companies today to set carbon emission reduction targets in line with climate science.

Until adequate government regulation is in place across all countries to deliver the goals of the Paris Agreement, there is a real and urgent need for increased voluntary action to fund mitigation that will otherwise not happen, and to provide assistance to countries to increase their mitigation efforts. The voluntary carbon market provides a solution for this challenge. We need to stop fighting over the question of whether internal carbon reduction or compensation is better. If we want to stand any chance to get to net zero by 2050, it is not ‘either, or’, but ‘both, and’.

### Key recommendations

To scale up corporate climate ambition, we need:

1. more companies to adopt an internal price on carbon and a net zero target in line with climate science. With the real cost of emissions clear, this would incentivise companies to:
  - a. measure, disclose and reduce emissions across their value chain;
  - b. finance compensation for unavoidable emissions on their journey to net zero emissions; and
  - c. neutralise residual emissions through removal credits.

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2. to reinforce the ICROA quality guidelines for carbon credits, in order to ensure climate neutrality claims meet the highest standards in terms of environmental integrity.
3. increased clarity around and guidance provided to the private sector on how carbon finance works and which carbon credits achieve the highest environmental integrity by being certified under credible standards, such as those recognised by ICROA.
4. greater cooperation between stakeholders to develop interim solutions that ensure immediate and scaled-up faster climate action is not delayed due to a lack of resolution on outstanding issues. Such outstanding issues include: the credibility of governments to implement policies and legislation to meet NDC targets; the nexus between corporate and host country accounting systems in claiming emission reductions; and the readiness to undertake CAs.

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