
Navigating the Risks of Greenwashing in the Voluntary Carbon Market

INTRODUCTION

Well-functioning, high-integrity carbon markets are essential to delivering an economically efficient energy transition. Analysis by the National Academies of Science, Engineering, and Medicine projects that over 10 billion tons of CO₂ must be removed from the atmosphere every year to meet the 1.5°C warming threshold outlined in the Paris Agreement¹. In addition, the Glasgow Financial Alliance for Net Zero estimates that \$125 trillion of investment is required to achieve the net zero transition, 70% of which will need to be supplied from the private sector².

Markets for project-based carbon credits are widely regarded as a potent private-sector financing mechanism, with the potential to accelerate the decarbonization of the global economy at the lowest cost. Failing to achieve cost-effective decarbonization will likely compromise the speed and effectiveness of the energy transition.

The carbon market is composed of increasingly intertwined compliance-based and voluntary activities. Compliance-based activities comprise governments and private-sector actors purchasing and surrendering carbon credits against their actual carbon emissions to discharge a legal obligation imposed by the state or under international treaty.

Compliance market credits are typically issued by governments, although credits purchased from project-based activities are also eligible in some systems. The focus of this paper is on voluntary activities, including where private-sector actors voluntarily announce a publicly stated commitment to match their reported greenhouse gas (GHG) emissions with verified carbon credits (VCCs) from the voluntary carbon market (VCM). These carbon credits are produced voluntarily from project-based activities.

VCMs offer an important market mechanism that allows firms to efficiently abate their emissions by following the cost curve to net zero on a collective basis among private-sector actors. By utilizing the VCM, firms can buy VCCs from carbon projects that have a lower marginal cost of abatement, allowing firms to decarbonize more efficiently. For example, if a corporate is faced with a cost of \$100 per ton of CO₂ abatement of its own footprint or supply chain, having the option to pay a VCC project to make the same reduction for less allows the corporate to abate its emissions more cost effectively.

This efficiency may lead to firms decarbonizing their operations more quickly and further than they would otherwise do on a voluntary basis, and there have been multiple reported market studies of this correlation³. Using VCCs allows corporates to set higher levels of ambition than would otherwise be possible if they were only allowed to make reductions in their own Scope 1, 2 and 3 emissions.

It follows that the integrity of VCCs is fundamental to maintaining confidence in VCMs as a mechanism, allowing scaled investment in carbon-removing technology and low carbon energy, and preserving and enhancing natural carbon sinks (among other things). These are important initiatives to achieve the Paris Agreement ambition of net zero emissions by 2050.

¹ Negative Emissions Technologies and Reliable Sequestration: A Research Agenda, The National Academies Press, <https://nap.nationalacademies.org/catalog/25259/negative-emissions-technologies-and-reliable-sequestration-a-research-agenda>

² Financing Roadmaps (gfanzero.com), www.gfanzero.com/netzerofinancing/

³ For example MSCI Carbon, www.msci.com/documents/1296102/Using+Carbon+Credits+to+Meet+Corp+Climate+Targets_Nov+2023.pdf; Ecosystem Marketplace, www.ecosystemmarketplace.com/articles/new-research-carbon-credits-are-associated-with-businesses-decarbonizing-faster/; and World Business Council for Sustainable Development, collaboration with Bain & Company, www.wbcsd.org/Imperatives/Climate-Action/Resources/The-Case-for-Beyond-Value-Chain-Actions

One of the main obstacles in delivering the lowest cost abatement through VCCs and liquid transparent VCMs is the perceived risk of greenwashing and its associated reputational and regulatory risks. This paper will: (1) provide an overview of VCCs; (2) explain greenwashing; (3) describe the origin, causes and risks of nature- and technology-based VCC methodologies at both the credit and system level; (4) discuss the effects of greenwashing on primary and secondary carbon markets; (5) highlight market reforms to minimize the risk of greenwashing (both regulatory and industry-led efforts); and (6) provide recommendations.

WHAT ARE VERIFIED CARBON CREDITS?

VCCs are produced when a project or activity removes or reduces GHG emissions relative to a baseline counterfactual scenario. To produce a VCC:

- Projects must follow strict methodologies and practices outlined by carbon-crediting programs (carbon standard setters). These entities only approve projects and issue credits that can be shown to meet their protocols and requirements.
- A project must demonstrate using a baseline counterfactual that the reductions or removals would not have otherwise occurred.
- The project's claims must be verified by an independent third-party validation body to confirm the credits meet the carbon-crediting programs' methodologies.

After verification, credits are typically issued into a database known as a registry, where they are then bought, sold or retired. VCC status and ownership is tracked on that database. Credits are retired when they are used toward an entity's mitigation goal and are removed from circulation, ensuring they are only used once within that registry. VCMs already utilize a variety of practices and mechanisms to help ensure the claimed benefits of projects occur in the real world.

WHAT IS GREENWASHING?

Greenwashing occurs when an organization presents an environmentally responsible image that is deceiving or misleading. The threat of climate change and the opportunity to engage with customers and employees on this issue may incentivize firms to appear more environmentally sustainable than they are by overstating the positive environmental impacts of their actions.

In the context of the VCM, this can manifest in two ways. First, as an overstatement of the positive effects of VCCs in meeting mitigation outcomes, which is referred to as ‘system-level risks’ in this paper. As an example, a US meat producer made claims in relation to being net zero by 2040 by using offsets, which is alleged to not be feasible, making the announcement misleading⁴.

The second form of greenwashing is an overstatement of the positive effects of the activities that give rise to any individual VCC, called ‘credit-level risks’. As an example, allegations have been made against carbon credit developer South Pole, which sold carbon credits from projects that claimed carbon savings from protecting trees from being felled. An exposé by *The Guardian* newspaper suggested there was very weak evidence of an actual risk of deforestation either in the short or long term⁵. This latter category predominantly comprises both broad conceptual concerns about the methodologies used and specific concerns about certain methodologies and projects.

Greenwashing allegations relating to VCCs and VCMs are being pursued with vigor by environmental non-government organizations for a variety of reasons. These include a fear that carbon offsetting, if used too extensively, will slow efforts to reduce absolute emissions and fears that some of the methodologies approved by carbon standard setters are insufficiently rigorous and therefore could lead to companies claiming to have reduced their reported unabated GHG emissions without having effectively done so. In addition, the economic waste of capital spent on effective abatement is a concern of both corporates and non-governmental organizations (NGOs).

Consequently, greenwashing poses reputational, litigation and regulatory risks to all participants in the carbon market. It is critical to understand the causes and factors that contribute to greenwashing in the VCM so they can be addressed at a system and carbon standard-setter level and can be risk managed by the corporates involved.

⁴ Attorney General James Sues World’s Largest Beef Producer for Misrepresenting Environmental Impact of Their Products, <https://ag.ny.gov/press-release/2024/attorney-general-james-sues-worlds-largest-beef-producer-misrepresenting>

⁵ <https://news.bloomberglaw.com/esg/faulty-credits-tarnish-billion-dollar-carbon-offset-seller>

ORIGIN, CAUSE AND RISKS OF GREENWASHING FOR VCC METHODOLOGIES

To better understand the origins, causes and risks of greenwashing for VCC methodologies, it is important to review some of the different approaches used to demonstrate an emission reduction or removal.

A removal requires the extraction of GHGs (almost always CO₂) from the atmosphere, either through mechanical or natural processes, with the net amount of removals credited in the form of VCCs. For example, the process of photosynthesis fixes CO₂ from the atmosphere in the cells of plants in the form of sugar and carbohydrates, which are then permanently stored until the plants are cut down or consumed. Even then, carbon in those plants may remain fixed in soil or products manufactured from those plants, providing a further opportunity to keep that CO₂ from returning to the atmosphere.

Equally, it is possible to extract CO₂ from the atmosphere using proven technology extensively used in industry and to store it in geological reservoirs. These carbon capture technologies are proven to be effective in permanently fixing CO₂ from the atmosphere.

Both photosynthesis and direct air capture are examples of activities that may result in removal-based VCCs. Technology-based removals often have less reversal risk compared to nature-based credits because the carbon storage methods are typically more certain.

For example, Climeworks direct air capture projects use permanent underground storage to prevent the release of carbon for thousands of years⁶. Many technology-based credits, or credits that use a combination of nature and technology (ie, biochar or biomass burial), are explicitly designed to minimize the risk of reversal. All the same, diligent monitoring of projects is important to ensure the carbon stays locked away.

Removal VCCs are typically the highest integrity credits and represent the highest cost of abatement. Significant investment in removal VCCs is required to scale production and reduce costs. Typically, removal projects will be solely reliant on carbon-market-based revenues.

VCCs issued for activities that result in less GHGs being emitted are more controversial because they do not reduce the absolute amount of greenhouse gas in the atmosphere relative to the position prior to that activity taking place (or not taking place). Some consider the VCCs arising from these reductions are not acceptable as a mitigation activity for this reason.

Advocates make the case that crediting reductions with VCCs can be a legitimate way of funding mitigation activities, provided certain safeguards are in place to prevent overgenerous issuance and responsible use. They argue these mechanisms are essential to achieve the lowest cost abatement. Without them, support for the extensive emissions reductions needed to maintain the 1.5°C threshold will not be achieved, as moving through the cost curve of abatement activities becomes inefficient and market leaders will reduce ambition due to the high cost of abatement within their own Scope 1, 2 and 3 emissions.

⁶ <https://climeworks.com/carbon-removal-technology>

Credit-level Risks

Additionality

A credit must be ‘additional’ to be validated and issued as a VCC. This ensures project developers are not earning income for emission mitigation that was already happening or would happen irrespective of the project’s development and associated VCC-derived revenues. Lack of additionality poses material greenwashing risk and must therefore be diligently evidenced and verified during the project approval process.

VCCs from nature-based removals or reductions have been subject to particular scrutiny on additionality. These VCCs can be generated from a wide range of activities, including reductions in GHGs from the conservation of a forest, mangrove or wetland, and removals of GHGs from their restoration and expansion.

Nature-based projects have been subject to scrutiny in part because the co-benefits of nature-based VCCs are an additional attraction to investors and corporates, with the possibility of achieving positive outcomes for nature, biodiversity and indigenous peoples alongside the abatement of GHG emissions. It is logical for NGOs to have focused on these VCCs, as the benefits of greenwashing for the corporate are more egregious and the impact from the NGO undermining those claims is correspondingly greater than for VCCs that do not have those co-benefits. It is therefore useful to focus on these projects as an example of greenwashing risk, but the concept could equally apply to other projects.

VCCs are vulnerable to lacking additionality if either: (i) the risk to natural carbon sinks is overstated; or (ii) there is baseline manipulation.

i) Baseline-related Risk and Overstating Risks to Natural Carbon Sinks

Baseline-related risks arise due to inaccurate project baseline assumptions or modeling. When a project is developed, a baseline scenario needs to be modeled to act as a point of comparison. This modeled baseline represents the business-as-usual scenario, meaning the state of the world if the project was not enacted. Modeling is critical to project development because it is cost prohibitive to directly measure carbon impact.

Some nature-based VCCs have been issued from projects that utilize as their counterfactual baseline the risk that a forest or other natural carbon sink will be damaged if not for the protection that the revenues from the sale of VCCs provides. These so-called reduced deforestation or REDD projects have been a particular focus for NGOs and journalists. The concern lies in being able to demonstrate that the threat to the forest or other carbon sink is both sufficiently real and would have been likely to manifest within a time frame that is consistent with issuing VCCs from the start of the project.

ii) Baseline-related Risk

Modeling also allows developers to estimate the project’s impact to determine the number of credits that can be issued. Modeling is necessary to enable large projects to be effectively developed and deployed, but assumptions need to be tested and data points need to be sufficient to ensure accuracy.

Modeling involves using assumptions to extrapolate data points to give an estimate of the benefits derived from the project. If the baseline's assumptions or data points are insufficient or incorrect, then the impacts of the project can be overstated, meaning not all the VCCs issued in respect of the project are additional.

Baseline-related risk affects non-nature-based credits as well. For example, it can be difficult to establish whether existing market subsidies are sufficient to allow a project to overcome economic and logistical barriers and whether the addition of carbon credits revenues, while making the activity more profitable, would have allowed the project to go ahead when it otherwise would not have done. For this reason, some carbon standard setters have avoided crediting renewable energy projects in certain jurisdictions.

Baseline-related risks can also be unintentional due to the complexity of modeling carbon in the natural world.

There are several strategies that carbon standard setters employ to mitigate the risk of non-additionality. One is to apply dynamic baselines that are periodically updated to maintain accurate modeling of the real carbon impacts⁷. Another strategy is employing robust buffer pools. These are pools of credits held by a carbon-crediting program that act as an insurance mechanism, enabling the carbon-crediting program to retire pooled credits to compensate for reversal or retroactive evidence of mistakes in baseline methodologies and/or monitoring outcomes.

In addition, the Integrity Council for the Voluntary Carbon Market's (ICVCM) Core Carbon Principles (CCPs), one of the prominent industry initiatives for credit quality, provides guidance to address additionality. This includes requiring conservative default values, which entails developers using conservative assumptions of impact when modeling the effect of credits. The ICVCM also highlights the importance of buffer pools⁸.

However, the challenge of more conservative modeling is making sure the project remains commercially viable. The market is increasingly making more conservative assumptions on baselines or increasing monitoring obligations to improve integrity, but this does not feed into pricing in a way that compensates for fewer VCCs being issued, which affects margins and returns for investors and the viability of projects.

Leakage

Leakage occurs when a VCC project displaces the activities that create the emissions to another area outside the project's boundaries – for example, if a forest was protected from clear cutting by a lumber company under an offset program, only to have a nearby forest clear cut by the same lumber company 100 miles away. In this case, leakage occurred because the emissions were moved, not removed. Leakage is often unintentional and is critical to address for real emission impact.

Carbon-crediting programs can combat leakage through modeling and taking steps to minimize its occurrence. The ICVCM CCPs highlight the importance of accurate quantification of material sources of leakage and the need to model leakage using conservative estimates due to uncertainty⁹. Carbon markets have sought to address this risk through economy-wide programs and conservative baselines. However, leakage in forestry-based projects is an ongoing challenge and is an acute greenwashing risk.

⁷ General Assessment of the Role of Agriculture and Forestry in US Carbon Markets (usda.gov), <https://www.usda.gov/sites/default/files/documents/USDA-General-Assessment-of-the-Role-of-Agriculture-and-Forestry-in-US-Carbon-Markets.pdf>

⁸ www.icvcm.org

⁹ www.icvcm.org

Physical Reversal

Physical reversal occurs when the carbon that was stored via a project implemented due to additional VCC income is re-released into the atmosphere. A common example is a forest fire. If a forest planted using VCC revenue burns, most of the carbon that was stored is released. Therefore, any emission-mitigating claim based on those VCCs could be challenged. While some level of forest loss through wildfire or disease will necessarily be built into the baseline, catastrophic loss will not. This needs to be addressed through risk sharing across the project type to ensure these reversals do not result in claims being made that are greater than the total amount of emissions stored or reduced. One benefit of certain technology-based projects like carbon capture and storage is that carbon can be stored geologically for thousands of years, greatly reducing the risk of reversal.

The ICVCM CCPs outline several solutions to address the risk of reversal across credit types, including long-term monitoring, reporting and verification of projects to confirm the permanence of storage, as well as appropriate compensation for reversal and availability of pooled buffer reserves that help counteract the risk of natural phenomenon reversing mitigation activities¹⁰.

Provided buffer reserves are not exceeded, they can provide effective mitigations. Beyond buffer reserves, it may be necessary to consider insurance products to provide further coverage to adequately mitigate but not extinguish the risk.

Monitoring Risk

Monitoring risk throughout a project's operation is an important component in ensuring projects are delivering the carbon-related results they claim. Methodologies rely on modeling to extrapolate the impact of a given project based on a data-driven counterfactual. Although this strategy is mathematically legitimate and these modeling practices are widely accepted by the scientific community, there has been a large degree of negative press directed at the practice. The criticism centers on when the counterfactual and/or evidence of performance is based on weak data, resulting in difficult-to-substantiate baselines or achieved reductions and removals. In response to the negative press, carbon standard Verra (the world's largest carbon-crediting program) has updated the monitoring requirements for forest-based methodologies¹¹.

The result of these adjustments has been a more conservative application of these techniques, resulting in fewer VCCs being issued. This isn't because it has been proved that fewer reductions have occurred. Rather, it is a result of more conservative assumptions that move the baseline upwards. The ICVCM highlights the importance of constructing models with conservative baselines. Given this, the effect on the viability of projects needs to be considered to ensure nature-based solutions are not prejudiced compared to other technologies.

Conservative baselines are not the only way of managing this risk. The ICVCM CCPs require 40 years of monitoring to ensure projects are delivering results as claimed. When reversals occur, the ICVCM CCPs also require compensation via pooled buffer reserves and refraining from issuing new credits until the reversal has been compensated for¹².

¹⁰ www.icvcm.org

¹¹ Verra makes major changes to methodology of forest-based carbon offsets | S&P Global Commodity Insights (spglobal.com), www.spglobal.com/commodityinsights/en/market-insights/latest-news/agriculture/042023-verra-makes-major-changes-to-methodology-of-forest-based-carbon-offsets

¹² www.icvcm.org

System-level Risk – Across Methodologies and VCCs

System-level greenwashing risks relate to the use and verification of credits.

Double Counting

Double counting is a broad term referring to the inappropriate use of a single VCC or underlying reduction or removal towards more than one mitigation goal. It is sometimes confused with the multiple benefits that can legitimately accrue, including to different parties, from a mitigation action.

Some mitigation activities will require multiple sources of subsidy to make them economic, which may involve the generation of multiple environmental attributes from the same reduction that may be eligible for use in multiple schemes. For example, a VCC project may store carbon through the afforestation of a section of rainforest and, in doing so, promote and enhance biodiversity. Both attributes can be monetized without double counting. True double counting arises when a single mitigation action is used or credited in a way that results in a doubling of the mitigation benefit within the same carbon accounting inventory or system.

Double counting can occur in two forms: (i) double use; and (ii) double issuance.

Double use is when the credits are counted toward more than one entity's mitigation goal within the same accounting system. For example, if Company A and Company B purchase the same carbon credit, and both use the credit toward their Scope 1 and 2 net zero ambitions, the credit representing one ton of CO₂ is claimed to offset two tons of CO₂ within the same inventory. This causes the companies' net zero claims to be greenwashing because the mitigation impact is overstated by a factor of two. Double use can also occur if one credit is counted twice by one entity.

Double issuance occurs when more than one credit is issued based on one underlying emission removal or reduction – for example, if a project is registered to more than one carbon standard or a single credit is listed on more than one registry. Double issuance can occur if there is overlap between projects – in which case, only a portion of a given project is double counting. While double issuances must be monitored closely across carbon-crediting programs, this risk is very small due to procedures (like ISO 14064-2) put in place by carbon standards, including Verra and Gold Standard.

To minimize double counting, it is important that a registry has clear and transparent rules. As noted in *Voluntary Carbon Markets: Analysis of Regulatory Oversight in the US*, governmental authorities may have a role in improving transparency of registries¹³. The ICVCM CCPs also highlight the importance of transparent tracking for registries, emphasizing the importance of using secure platforms to track credits¹⁴.

Fragmented Standards and Methodologies

Industry-wide consensus on acceptable methodologies and modeling requirements has the potential to reduce greenwashing risks and increase transparency and trust in VCMs. The current lack of consistency may be harming confidence in VCMs, leading to ambiguity on what constitutes a high-integrity credit, heightening uncertainty for market participants. The ICVCM CCPs provide a promising step toward greater standardization for developers, carbon-crediting programs and registries. This greater degree of consensus may increase VCC quality and reduce the risks of greenwashing.

¹³ <https://www.isda.org/a/93WgE/Voluntary-Carbon-Markets-Analysis-of-Regulatory-Oversight-in-the-US.pdf>

¹⁴ www.icvcm.org

IMPACT OF GREENWASHING IN VCMS AND SECONDARY MARKETS

The desire by companies to meet net zero objectives drives demand in VCMS. However, retirement of credits on Verra fell 3% from 2021 to 2022, a notable decrease when considering retirements grew almost 50% between 2019 and 2020¹⁵. Although such a decline cannot be exclusively contributed to instances of greenwashing, it remains one of key deterrents to market participants using VCMS, causing VCMS to lose momentum if greenwashing is not addressed.

In the secondary markets, exchange-traded and over-the-counter (OTC) spot and future contracts have the potential to provide liquidity and long-term funding for projects. The forward curve provides pricing transparency, increasing the bankability of carbon credit projects.

ISDA has drafted the 2022 ISDA Verified Carbon Credit Transactions Definitions for physically settled spot, forward and option transactions to assist the efficiency of derivatives transactions in the VCM. Importantly, secondary markets rely on confidence in the underlying VCCs to facilitate high-frequency trading and optimum price discovery. Without that confidence, efficient and liquid primary markets will not develop and the advantages of standardization in the secondary market will not be realized.

¹⁵ Independent Group Stakes Out Position as Arbitrer of Carbon-Offset Quality (wsj.com), www.wsj.com/articles/independent-group-stakes-out-position-as-arbitrer-of-carbon-offset-quality-20794a5c?mod=article_inline

MARKET REFORMS TO PROMOTE INTEGRITY

Market reform to promote integrity and build confidence in the VCM is key to minimizing greenwashing and promoting scalability. Importantly, both regulatory authorities and industry-led initiatives have contributed meaningful resources to boost market participants' confidence. This reset should be seen as an opportunity to challenge the validity of some ongoing criticism of VCMs and to emphasize their benefits to economic efficiency of abatement and reduction activities.

Regulatory Efforts

CFTC

The Commodity Futures Trading Commission (CFTC) recently issued proposed guidance on the listing of VCC derivatives contracts to help promote integrity, liquidity, transparency and price discovery in the secondary market¹⁶. The proposed guidance was published to coincide with the 28th session of the Conference of the Parties to the UN Framework Convention on Climate Change. It is a first step to creating a framework that would provide a degree of standardization in the secondary markets. It may also assist participants in the bilateral OTC markets to get clarity on their regulatory obligations and liabilities.

The proposed guidance leverages work conducted by the CFTC through various public initiatives to establish standards for VCC derivatives listed on futures exchanges, and also references work conducted by ISDA, the International Organization of Securities Commissions (IOSCO) and the Futures Industry Association.

The proposed guidance outlines factors for exchanges that list VCC futures to consider on the quality and attributes of the underlying VCCs. This guidance may offer a degree of transparency and certainty in both the primary and secondary markets, bolstering confidence in the VCM. Market participants welcome the CFTC's regulatory initiative as VCC markets have been subject to enhanced regulatory scrutiny in recent years.

IOSCO

IOSCO's recent VCM consultation outlines non-legally binding good practices to promote well-functioning VCMs. Although these practices do not address environmental integrity of credits, they do provide key guidance on sound markets, orderly trading, transparency and data accessibility¹⁷.

IOSCO's initiatives are an important step to increasing consistency in the VCM ecosystem. Several of the report's recommendations address greenwashing and system-level risk in particular. For example, Good Practice 8 highlights the importance of soundness and accuracy of registries, a vital factor in reducing double counting. In addition, the report discusses the importance of transparency and disclosure in the VCM, which can aid and enhance market integrity while minimizing greenwashing.

ISDA welcomes IOSCO's initiatives to foster the development of sound and well-functioning VCMs. Given IOSCO's mandate, its guidance should focus on how financial regulators should use their authority to promote market integrity. It is also important to leverage different stakeholders' work to support market-based standards, like the ICVCM.

¹⁶ CFTC Issues Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts | CFTC, www.cftc.gov/PressRoom/PressReleases/8829-23

¹⁷ www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf

Industry Effort

Standardization – Supply Side

The ICVCM seeks to improve integrity, standardization and transparency in VCMs by building on existing governance, procedures and policies to increase comparability and quality.

The ICVCM CCPs set standards for market participants to identify high-integrity credits by providing consistent science-based criteria. The CCPs also provide a labeling system, helping buyers to identify quality across registries and project types. CCP-labeled credits should be available starting from mid-2024.

To address system-level greenwashing risks, the ICVCM has specific guidance pertaining to carbon-crediting programs and registries to ensure there is effective governance, tracking, transparency policies and robust third-party verification.

ISDA welcomes the ICVCM's efforts to increase the standardization and quality of VCMs. ISDA is also working to increase standardization in the VCM secondary market by developing standardized documentation, which is a cornerstone of safe and efficient derivatives markets. The 2022 ISDA Verified Carbon Credit Transactions Definitions are not specific to a given jurisdiction or carbon crediting program, reflecting the importance of a global, harmonized VCM infrastructure, strengthening the VCM's scale and efficiency.

Standardization – Demand Side

US, EU and industry demand-side standardization efforts are evolving. The European Commission has grown increasingly hawkish toward the VCM, discouraging its use by seeking to ban or restrict certain claims based on VCCs¹⁸.

Industry standardization efforts reflect a more VCC-favorable set of claims guidance. There are several organizations that are fostering standardization on the use of VCCs and the resulting claims market participants can make. The Voluntary Carbon Market Integrity Initiative (VCMI) published the VCMI Claims Code of Practice, which provides credibility to corporate decarbonization efforts through ratings based on clear requirements on credit use and internal emission reductions. In addition, the International Carbon Reduction and Offset Alliance and the International Emissions Trading Association, among others, offer market participants guidance on the use of VCCs and what they can and cannot claim to prevent greenwashing. They also provide guidance on what constitutes a high-integrity credit^{19,20}.

These initiatives are important steps to help combat greenwashing, ensuring VCC use is consistent with what is claimed. It also may improve liquidity and scale of the VCM by providing more certainty to corporate participants on what is going to be acceptable for the purposes of the claims made.

However, attempts to use regulation of claims as a way of regulating all VCMs out of existence risks losing the economic benefit of using VCMs to lower the cost of abatement and lowering corporate ambition by removing incentives to act on a voluntary basis.

¹⁸ www.europarl.europa.eu/news/en/press-room/20240112IPR16772/meps-adopt-new-law-banning-greenwashing-and-misleading-product-information

¹⁹ <https://vcmintegrity.org/>

²⁰ <https://icroa.org/icroa-code-of-best-practice/>

Transparency

Transparency is important at every level of the VCM. Clarity on carbon crediting protocols, verification methodologies, measurement and monitoring can all help reduce greenwashing risk. Organizations like the Global Carbon Market Utility are aiding transparency by providing trustworthy market infrastructure that improves data transparency, contracts, audits and other key components of safe markets²¹. Transparency is an important consideration in many initiatives, like the ICVCM CCPs and IOSCO's recent VCM consultation report. Rating agencies may also help increase transparency in the VCM by providing clarity on the overall quality and integrity of VCCs from particular projects.

However, there needs to be thought about how to ensure the rating of credits is consistent with the development of liquid markets and the implications of suggesting that VCCs are not representative of actual reductions. If rating agencies can increase the standardization of carbon attributes, promoting the comparability of credits based on risk profile, then the impact would be positive to market confidence.

This could be a valuable service, reassuring market participants about the quality of a given VCC project, building confidence and promoting efficiency and liquidity in the market.

²¹ <https://gcmu.net/>

RECOMMENDATIONS

Companies need to address greenwashing concerns head on and potentially rethink their role in VCMs. Today, companies view purchasing or selling VCCs as transactions in a neutral marketplace. If viewed from this lens, a company secures a certain number of VCCs at the best available price. The company then publicly reports its actions in achieving its climate goals. If the purchaser of the credit doesn't perform its due diligence on the claims being made and the VCCs used to support them, and the environmental benefits turn out to be false or misleading, then the purchaser will bear reputational and legal risk. Companies, therefore, need to adopt measures to protect their reputation and adopt measures to ensure credit integrity is high in the VCM. Some of the measures may include:

- **ICVCM adoption:** A quality baseline is critical to build confidence in the VCM. The CCPs are expected to enhance existing practices, creating more reliability and transparency in the VCM and helping to rebuild trust and confidence. Moving forward, CCP-approved credits will provide an important benchmark of credit quality.
- **Adopting standards on claims** such as the ones developed by the VCMI to ensure integrity in the use of VCCs at a system level.
- **Pooling VCC portfolios:** VCC quality varies based on methodology. To reduce the risks of greenwashing, pooling credits across methodologies and developers can help minimize the risk of making false claims due to low-integrity credits.
- **Enhanced third-party oversight:** To prevent greenwashing and ensure market participants are operating in a way that is consistent with the recommendations, third-party oversight is important. Due diligence on VCCs and protocol quality, including rating programs and advisors, are a promising example of third-party monitoring that may be employed to investigate risk.

CONCLUSION

A robust and ambitious climate strategy calls for full participation of both the government and private sectors. High-integrity VCMs can play a vital role in delivering real, economically efficient emission reductions. VCMs offer an opportunity and business case that enables investment into carbon removing and storing technology, enhancement and expansion of natural carbon stores, and the propagation of low-carbon technology, especially in lower-income countries.

VCMs allow companies to have real emission impacts, giving many firms an opportunity to reduce more emissions than they otherwise could achieve on a voluntary basis with the funding available to them. At a time when trillions of dollars are needed globally to combat climate change, scaled VCMs are an important potential component of the solution. VCC quality and integrity is essential to the efficient functioning of these markets.

Understanding root causes of greenwashing and continuous improvement of methodologies to enable production of high-quality VCCs will ensure that VCMs make a real difference, facilitating the deployment at scale of the private-sector investment needed to combat climate change.

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