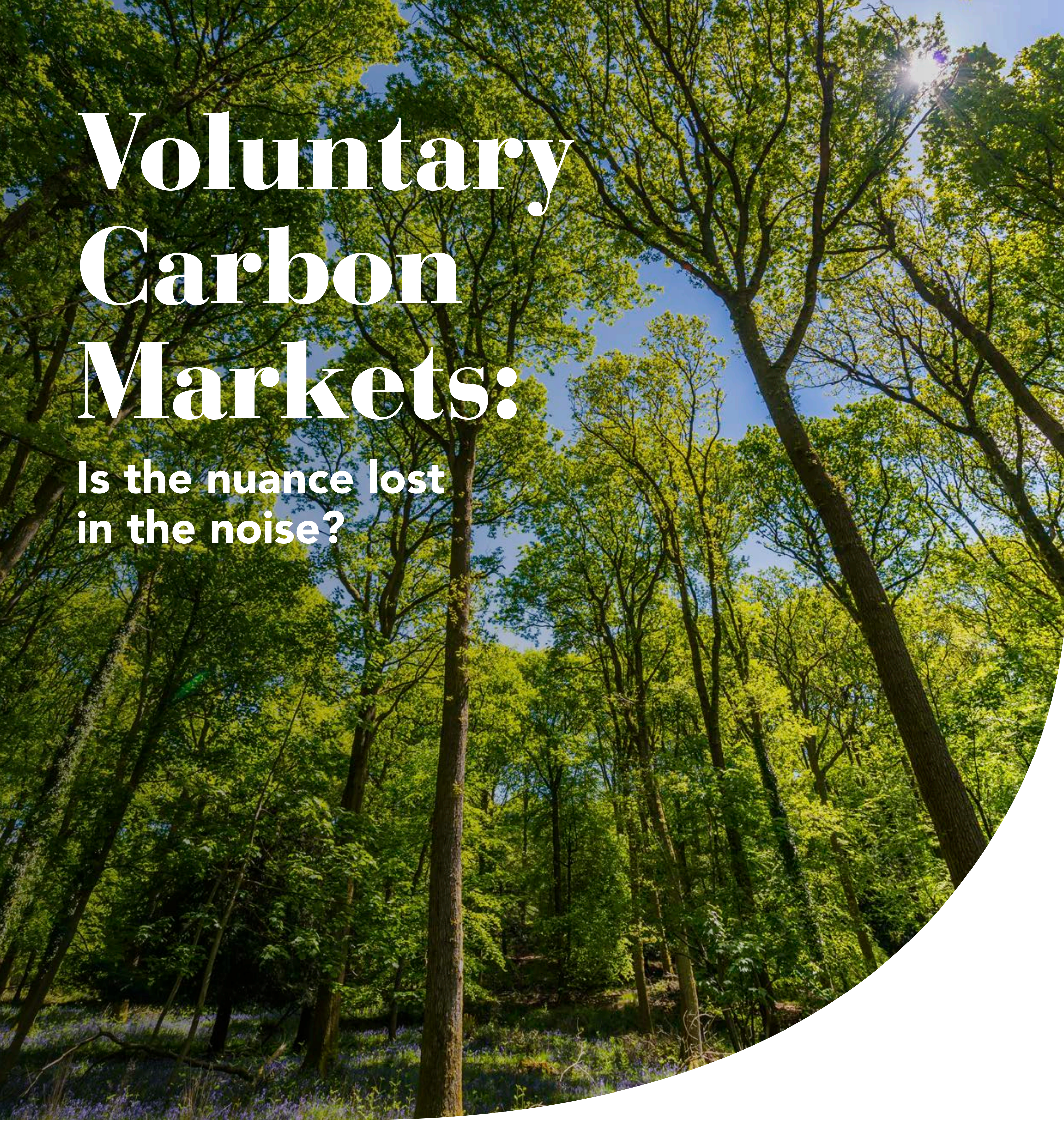
Voluntary Carbon Markets:

Is the nuance lost in the noise?



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The integrity of some of the world's Voluntary Carbon Market (VCM) schemes is a hot-button issue. However, we believe it's important to understand some of the differences in standards around the world – as well as the progress being made towards tightening them.

Fast reading

- **Recent press about global Voluntary Carbon Markets (VCMs) has, rightly, raised concerns about the integrity of some of the schemes available for investors looking to offset their carbon footprint.**
- **Not all VCMs are built the same, however. VCMs endorsed by the UK government use a methodology based on scientific consensus and are free from methodological subjectivities and uncertainties, which is in contrast with the international schemes currently attracting criticism.**
- **This means commonly cited concerns around VCM overstatement of impact in other parts of the world are not relevant or applicable to the UK context.**
- **The UK Nature Impact strategy is well aware of this nuance.[1] Indeed, the creation of the strategy and its UK-only investment universe was motivated by our belief in the integrity of the UK methodological VCM framework.**
- **We continue to monitor the situation and welcome progress on tightening non-UK VCM standards.**

Any casual reader of recent coverage of voluntary carbon markets will, rightly, be concerned about the scope for greenwashing and overstatement of benefits. Far too often, schemes that have been sold to investors as a way of offsetting their carbon footprint have fallen short of stated goals while exaggerating climate benefits and underestimating potential harms.

The UK Nature Impact team has been monitoring these concerns closely – and we are familiar with the implications for the credibility of nature investing. That said, we believe there are nuances around the question of integrity in VCMs that sometimes get lost in the 'noise'. In this update, we plan to explore some of those nuances and to explain why it's important to understand some of the differences in VCMs around the world – as well as the progress being made towards tightening standards.

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To begin with, it's important to stress that much of the negative coverage of VCMs has focused on schemes in developing countries, and especially 'REDD+' projects[2].

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The credits generated from these REDD+ projects – also referred to as 'avoidance' or 'reduction' credits – are often generated by projects that seek to protect rainforests and avoid deforestation.

To calculate this, scheme operators will generally create a 'business-as-usual' baseline whose aim is to illustrate the level of deforestation that would otherwise have taken place. Often this will be by way of comparison with a nearby 'reference' region.

Inevitably, this approach introduces layers of complexity and subjectivity. Indeed, we would argue that the calculation methodologies currently used by some REDD+ credit schemes make for inherent levels of ambiguity around what is actually being achieved[3].

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[1] The UK Nature Impact strategy is jointly managed by Federated Hermes and Finance Earth, a leading environmental and social impact investing advisory firm.

[2] Here, 'REDD' stands for 'Reducing Emissions from Deforestation and Forest Degradation in Developing Countries'. The '+' stands for additional forest-related activities that protect the climate, namely sustainable management of forests and the conservation of ecosystems.

[3] NB: We acknowledge that steps are being taken by the international verification bodies to address this issue.

Take the question of the number of credits generated by a single region for instance. Here, the 'reference' or 'benchmark' region can be the key factor in determining how much deforestation has been avoided. A reference area with high levels of deforestation or background human activity can potentially create a very different benchmark from one with minimal deforestation or human activity. There is a potential incentive to 'cherry pick' the most preferential reference region, and while there are processes put in place by governance and monitoring bodies to mitigate this risk, in practice it's challenging to make sure in every case the number of carbon credits fairly reflects the additionality of the project.

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REDD+ projects have generally been large, high-carbon-credit-volume projects and one result of recent negative press has been a significant price softening for REDD+ carbon credits which form the majority of nature-based carbon credits currently available in the VCM.

UK-based schemes are different

Here, one contrast with REDD+ we can highlight is with schemes that operate out of the UK and in particular the two VCMs endorsed by the UK government.

The first of these, UK's Woodland Carbon Code (WCC), calculates the carbon sequestration achieved from planting new trees. Crucially, it doesn't link credits to the level of deforestation avoided or human activity reduced – and so avoids the potential complication of proving a reduction in emissions versus business as usual.

The WCC approach has an additional benefit: it offers a granular, realistic view of how much carbon can be sequestered by any scheme as a function of the species of tree planted, the type of soil available and stocking densities. This information is based on extensive field data through a methodology developed by UK government experts and academic institutions including the UK Centre of Ecology and Hydrology (UKCEH). In contrast to REDD+ projects, there is no need to refer to external reference regions to demonstrate additionality.

The second VCM endorsed by the UK government is the UK Peatland Code. In common with REDD+, this code adopts an avoidance/reduction approach but with one crucial difference: rather than a focus on reducing human activity such as deforestation, credits are generated by reducing emissions from existing degraded peat habitats.

This can be easily measured – and there is a large amount of evidence and a broad scientific consensus on the business-as-usual emissions of such habitats in different states of repair.

The International Union for the Conservation of Nature (IUCN), a global environmental not-for-profit and scientific institution, and the UKCEH have developed the science behind the Peatland Code's carbon calculation methodology by calculating emission rates from degraded peatlands and measuring the reduction in emissions from restoring those habitats to different extents. Thus there is no requirement for comparison to a 'reference site' or assumptions around future human activities.

Both the Woodland Carbon Code and the UK Peatland Code take a conservative approach to estimates and both build in uncertainties and risk buffers to reduce the amount of credits available to sell for any single scheme.

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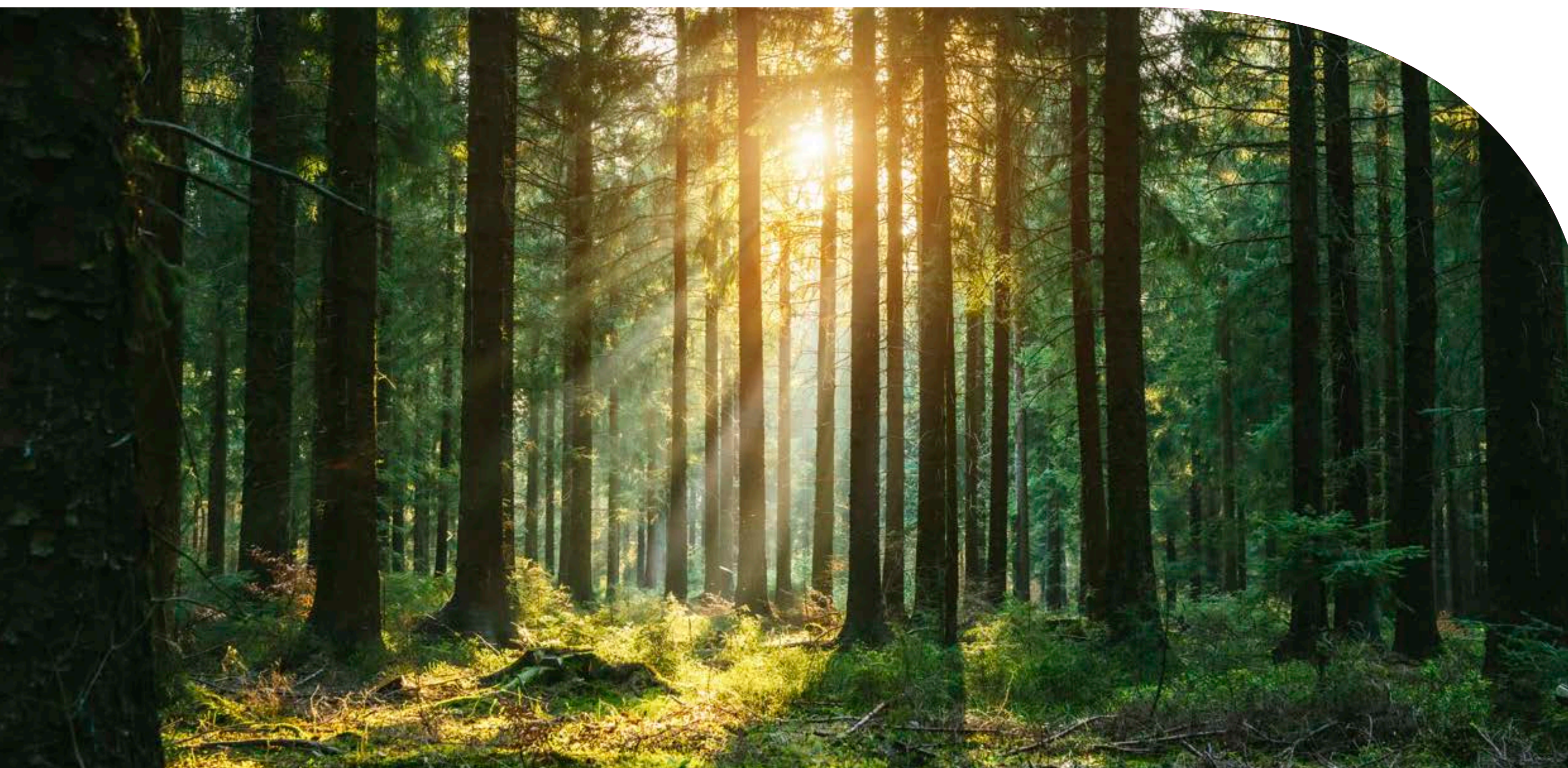

Thus far we have not seen and are not aware of any negative press in relation to the calculations behind the WCC or the UK Peatland Code – and, indeed, we would be surprised to see any. For one thing, there is full transparency behind their methodologies but, in addition, both schemes have been subject to public scrutiny for several years already, and they are regularly reviewed and updated by experts in response to advancements in the science.

Our approach

In summary, our view is that some, but not all, of the criticism of REDD+ projects is valid. At the same time, we note that much of what has been reported has been misleading having been written by those with limited technical understanding of the standards.

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One key development we *can* point to is that bodies like Verra[4] and other REDD+ project proponents are actively responding to concerns around VCM methodologies and are working to improve project integrity.

We continue to monitor these developments closely, not least because we recognise the value of preserving and enhancing the ecosystems such as those found in the rainforests of Borneo, the Amazon and Congo. The same can be said of the local social benefits of programmes such as Verra's Climate, Community and Biodiversity (CCB) Standard to which many high quality REDD+ projects also verify.

Yet, we also hold the view that stakeholders *do* need to be satisfied that the REDD+ approach is robust and that the methodologies are of the highest integrity.

For now, the UK Nature Impact strategy is only planning to invest in projects aligned to the two UK government-endorsed codes rather than taking a more global approach. While there is some scope to invest in other UK carbon codes, we will only do so if they can demonstrate an equivalent level of scientific integrity.

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For the future, where we have an international mandate and where it is appropriate, we may consider broadening our investment universe to include REDD+ schemes – and, in this, we will take the lead from our Science and Impact Advisory Committee (SIAC). This committee, a unique feature among our peer group, will provide additional guidance ensuring any emerging ecosystem service investments are appropriately robust with carbon credit volumes based firmly on scientific consensus.

[4] Verra is a non-profit organization that operates standards in environmental and social markets, including the world's leading carbon crediting program, the Verified Carbon Standard (VCS) Program.

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