

ENERGY TRANSITION | TRANSPORTATION — 18 Feb 2021 | 12:10 UTC — Insight Blog

Voluntary carbon markets: why they matter and the next steps to scale up

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Commodity [Energy Transition](#), [Transportation](#)

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Voluntary carbon markets have a significant role to play in global decarbonization, but need rigorous standards and greater transparency to build trust, write Jonty Rushforth and Paula Vanlaningham

"Every year, the world emits approximately 51 billion mt of greenhouse gases into the atmosphere. To avoid the worst impacts of climate change, we need to reduce that number to zero—and we need to do it in the next 30 years. This will be one of the hardest challenges humanity has ever faced, but we can meet it if we act boldly to reduce emissions worldwide"

— *Bill Gates, Foreword, Taskforce on Scaling Voluntary Carbon Markets, Final Report*

Nearly five years after the signing of the Paris Agreement, the urgency of the global climate crisis is more apparent than ever before, and with that urgency has come a stronger move towards collective action to mitigate the worst impacts of climate change.

Not only are national governments instituting policies to meet the climate objectives set out by the Paris Agreement, shareholders and consumers are also driving new action within the private sector. Corporations large and small are now setting ambitious carbon neutrality goals, with many aiming to go "net zero" within the next twenty years.

In the private sector, the focus has turned increasingly towards voluntary carbon credits, which businesses can purchase to reduce their carbon debts. Voluntary Carbon Credits are generated by specific projects that avoid, reduce or remove greenhouse gas emissions from the atmosphere, and are verified and validated according to a set of independent standards created by coalitions of NGOs and carbon market participants throughout the last few decades.



The voluntary markets are, crucially, different to regional compliance markets like the European Union's Emissions Trading System or North America's Regional Greenhouse Gas Initiative, which have so far dominated the discussion around global emissions reductions.

Instead, the voluntary markets are a product of the private sector initiatives that fall outside of the compliance jurisdictions defined by the United Nations Framework on Climate Change.

Some of these initiatives are semi-regulatory, such as the International Civil Aviation Organization's Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), whereby airlines can reduce their carbon debts through the use of either credits or sustainable aviation fuel, while others are entirely voluntary.

The volume of trade in voluntary carbon credits is becoming significant, and the market is set to grow exponentially over the next several years. Indeed, it needs to, if there is to be any hope of meeting the objectives of the Paris

Agreement.

While voluntary carbon markets have been around since the Kyoto years, they have matured rapidly in a very short time, and now encompass a wide range of different project types, geographies and standards. These can range from large-scale renewable hydro projects in India, to reforestation efforts in Brazil.

However, the quality of the carbon credits available in the open market can vary widely, which has led to the development of carbon Standards (with a big 'S' for emphasis) to provide some measure of structure to the market.

New carbon "Standards"

Markets for these carbon credits have arisen without government definitions and structures, and have instead been created by partnerships between NGOs and corporations.

These organizations, or Standards, as they are known, have created their own methodologies and systems to define and certify projects across the world that work to either limit, completely avoid, or remove greenhouse gas emissions from the atmosphere.

Project developers draw on those Standards to turn ideas into projects and these projects into carbon credits. And the credits are verified, validated and held in the registries of those same Standards for trade in the open market.

A technology company might want to look for credits from a project that uses new tech, whereas a food company might want to invest in those that use soil management techniques.

Hence the description voluntary carbon markets—because they have resulted from the free choices of a myriad of companies to engage with the environmental challenges ahead without the compulsion of regulation.

The Standards help to mitigate a problem that nearly sank the voluntary carbon market in the early 2000s: a lack of faith that a carbon credit was really doing what it said it was doing.

While the development of stronger standards to verify project outcomes has helped rebuild faith in the voluntary markets, the scale of growth expected in the next few years is likely to throw up additional roadblocks in the development of a functioning market.

At this year's World Economic Forum—a mostly virtual Davos, given the restrictions on international travel prompted by COVID—the **Taskforce on Scaling Voluntary Carbon Markets released its final report**, calling for greater transparency in what has hitherto been an opaque, over-the-counter market.

The Taskforce also identified six key areas where greater efforts are required to achieve a large, transparent, verifiable and robust carbon market: establishing core carbon principles, core carbon reference contracts, infrastructure, offset legitimacy, market integrity and demand signaling.

Navigating a complex market

Transparency is undoubtedly one of the greatest challenges facing the voluntary carbon markets. A complex web of project developers, standards, project financiers, and brokers are involved in selling carbon credits, and there is a wide variety of projects on offer—all of which can trade at different prices per metric ton of CO₂e, depending on project type, location, standard certification, vintage and location.

This combination of variables means most activity is still over-the-counter, with credits bundled together into larger portfolios for buyers. In order for the voluntary carbon markets to scale up to the degree that will ultimately be necessary to meet the challenges of the climate crisis, something needs to change. The effort by the airline industry to introduce some standardization to this complex market is one of the more lauded approaches.

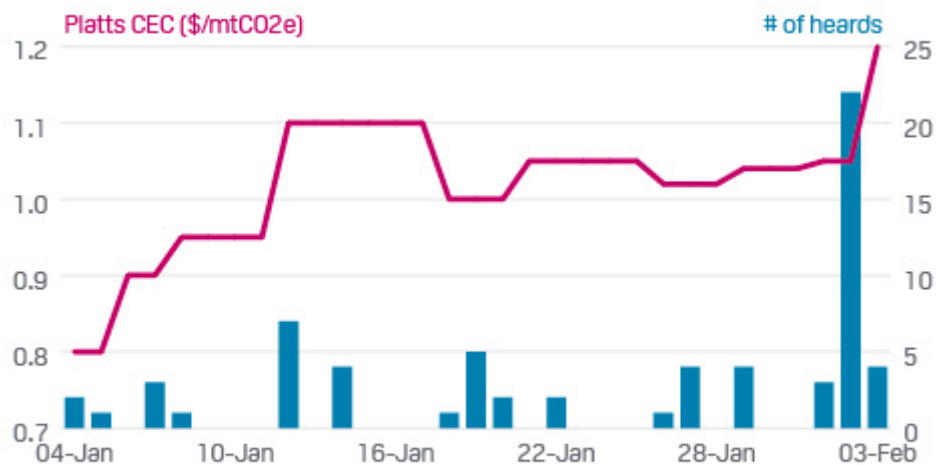
The CORSIA program allows airlines to reduce their carbon debts through the use of credits from the voluntary markets, initially voluntarily, and later under a mandate. The set of specifications contained within CORSIA provides a framework for aggregating credits.

A buyer can pick any of a range of project types, from a range of standards, and use their credits to meet its obligations. It is a simplification that has already started to generate increased liquidity in the global carbon markets. And it is a simple place to start for producing price benchmarks.

That's why S&P Global Platts **started publishing an assessment of CORSIA-eligible credits, Platts CEC**, from January 4, 2021. A single number, from a world of complexity.

This is just the start of a new phase in price transparency in the carbon markets, however. Platts plans to start publishing a suite of prices in this space, in order to cover not just the commoditized CORSIA-eligible credits, but also the full range of project types and co-benefits that the voluntary market represents.

PLATTS CEC vs DAILY HEARDS COUNT



Note: Platts CEC is a daily assessment of CORSIA-eligible carbon credit prices; heards refers to bid, offer and trade information collected by Platts through the day
Source: S&P Global Platts

The price range in that space is significant—everything from 30 cents/mt for some renewable credits all the way to hundreds of dollars per ton for some credits generated from mineralization projects that potentially lock

CO2 away for thousands of years and more.

We believe that this coverage will be a key factor in helping the voluntary carbon markets to grow. By giving buyers and sellers baseline pricing in a broad range of areas, Platts prices ensure more efficient outcomes and ultimately provide a stable framework for growth. And growth in the carbon markets means a faster path to reducing the world's overall greenhouse gas footprint: a faster path to net zero.