BlackRock

June 18, 2021

Taskforce on Scaling Voluntary Carbon Markets (TSVCM)
Phase II Consultation

Submitted via email
To: TSVCM@iif.com

RE: Taskforce on Scaling Voluntary Carbon Markets (TSVCM) Phase II, BlackRock Response

To Whom It May Concern,

BlackRock[1] is pleased to have the opportunity to respond to the invitation to comment on Phase II of the Taskforce on Scaling Voluntary Carbon Markets (TSVCM).

Consistent with our fiduciary duty, we engage with companies to advocate for governance and business practices that drive the sustainable, long-term financial returns that enable our clients to meet their investing goals.

As a long-term investor on behalf of our clients, we recognize that climate risk is investment risk—the mitigation of global warming and transition to a low-carbon economy is an urgent priority.

We therefore welcome the opportunity to comment on the issues raised by the TSVCM consultation and are available to further discuss any of our points.

Sincerely,

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[1] BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

Overview

The BlackRock has reviewed the proposed governance structure and Phase II of the TSVCM framework.

As noted by the working group members, we agree with the need for an established "infrastructure for a scaled and high-integrity voluntary market for the trading and exchange of carbon credits" and a corresponding governance body as a fundamental element in driving this initiative forward.

As this governing body will be tasked with overseeing the market, creating the legal principles to support the market, and determining the Core Carbon Principles (CCP), we believe that the composition of members with the appropriate skill set and experience, is critical for the successful execution of this work.

In addition to ensuring sound governance, BlackRock is committed to furthering consistent, concise, and comparable data across the market for climate-related risk and mitigation efforts. Over the last four years, BlackRock has encouraged companies to utilize the TCFD framework, in conjunction with the SASB metrics, to articulate the risks and opportunities presented by climate change, as well as other material sustainability considerations. In 2021, we updated the BlackRock Investment Stewardship (BIS) Global Principles and regional proxy voting guidelines to stipulate that we expect companies to articulate how they are aligned to a scenario in which global warming is limited to well below 2° C and is consistent with a global aspiration to reach net zero greenhouse gas ("GHG") emissions by 2050.[2]

In addition, BIS has made climate risk and natural capital key engagement priorities. In order for long-term investors to better understand the risk/ return profile of their investments, disclosure of material climate risks is essential—we are interested to know how companies are managing and mitigating risk, while also positioning their strategies for a low-carbon, resource constrained world. In addition, we want to know how companies are contributing solutions to the preservation of nature-based emissions reduction resources and technology that will help mitigate the worst effects of climate change.

Strategic considerations for the management and mitigation of climate risk and implications for carbon emissions reduction efforts are critical. From this perspective, we have outlined feedback for your review in formulating the governance oversight and elements of the TSVCM.

The Role of Voluntary Carbon Markets

In the context of various efforts and pathways to support the transition to a net zero economy by 2050, it is important to understand the potential contributions and limitations of carbon credits.

From a global socio-economic perspective, the science is clear that immediate emission reductions should be maximized in order to avoid the risks of overshoot and overreliance on CO_2 removals (or negative emissions). Part of a global net zero ambition means re-orienting capital towards companies that are committed to broad and systematic emissions reduction, in both the energy system and the land use system. Nature-based solutions (NBS) are essential to achieving the transition to net zero, as they can potentially reduce the land system's GHG emissions and offer the only currently available solution for CO_2 removal.

In principle, carbon markets offer a mechanism for individuals, companies, and financial institutions to finance either emissions reductions or removals as a complement to their climate mitigation strategy. Yet, too often the flexibility that these markets offer can serve to detract from operational emissions reduction efforts; inadvertently, the availability of credits may serve to prevent such actors from pursuing a more ambitious mitigation plan.

As such, we believe voluntary carbon credits and markets should only be used as a *supplement* to science-aligned emissions reduction efforts on the path to net zero. Carbon markets and instruments should not

[2] The global aspiration is reflective of aggregated efforts; companies in developed and emerging markets are not equally equipped to transition their business and reduce emissions at the same rate—those in developed markets with the largest market capitalization are better positioned to adapt their business models at an accelerated pace. Government policy and regional targets may be reflective of these realities.

replace or disincentivize efforts to rigorously reduce today's emissions; in order to progress towards a global net zero outcome, a fundamental shift in the use of energy and reliance on fossil fuels should occur on an accelerated timeline.

In addition, as the TSVCM understands and aims to address, voluntary carbon markets currently suffer from a lack of regulation, oversight, and quality checks. While carbon credits may facilitate investment in valuable projects and nature-based solutions, challenges persist in the context of net zero goals due to lack of a global regulatory framework and verification mechanisms. In part related to methodological issues with carbon accounting discussed below, the prices and quality of credits on such markets also vary significantly.

For carbon credits to achieve the requisite quality to fully support global climate change mitigation, several key methodological issues must be solved in a standardized way. Core components are as follows:

- **Additionality** details whether investment in projects is changing outcomes, rather than rewarding suppliers for the status quo. For example, in forestry projects, additionality is the requirement that emissions avoidance or removals are greater after project implementation than before under the most plausible alternative scenario. This is the main condition for carbon credit project eligibility. While additionality can be difficult to prove, confidence can be increased through mitigation measures such as buffer pools.[3]

- **Leakage** occurs when a carbon offset project inadvertently creates emissions outside the boundaries of the project. In forestry, carbon, and energy-related projects, leakage can take two forms:
    - Activity shifting leakage, for example, when forest conserved in one area leads to deforestation or degradation elsewhere; and
    - Market leakage, when mitigation policies influence commodity prices and drive changes in investment patterns towards high emissions activities. For example, reduced timber and crop production can lead to higher prices and inspire a shift to more intensive activities.

- **Permanence** assures that once removed, emissions will stay removed and not be re-emitted. Projects fail to maintain permanence (typically defined by a period of 100 years) when, for example, afforestation or reforestation efforts are cut down or destroyed by fires, pests, or drought.

We are supportive of TSVCM's efforts to bring greater certainty, scale, and liquidity to carbon markets. In the meantime, we advocate for a cautious and tempered approach to use of carbon credits.

For companies, we believe carbon credits can be used in addition to stringent operational emissions reduction efforts. As a long-term investor on behalf of our clients, we seek to understand how companies are working to reduce their emissions, including short-, medium-, and long-term targets, that enable investors and other stakeholders to monitor progress. In addition, we recognize the need for companies, particularly those in land-intensive sectors, to reduce emissions with nature-based solutions alongside investing in technology to propel their businesses, and the global economy, towards low-carbon solutions.

TSVCM Governance Feedback

BlackRock is supportive of TSVCM's intent to develop "an umbrella governance body with the mission to promote the integrity, liquidity, and growth of the global voluntary carbon market."

We also agree with this umbrella governance body's three-part mandate to:

- Establish, host, and curate the Core Carbon Principles (CCPs) and eligibility principles for suppliers and Validation and Verification Bodies (VVBs);
- Provide oversight for standard setting organizations' adherence to CCPs and for determining participant eligibility;

[3] A "buffer pool" is an approach for addressing non-permanence that requires a project to maintain adequate "buffer" reserves of non-tradable carbon offsets to cover unforeseen losses in carbon stocks. These non-tradable carbon offsets are pooled into a commingled buffer pool, where they can't be sold and if a project doesn't go as planned, the pool must cover it.

- Coordinate the work of and manage interlinkages between individual bodies, serving as the steward for the Voluntary Carbon Market.

The first two aspects of this mandate are essential; without them, a valid, scalable market for voluntary carbon credits will not emerge. However, the third aspect of the mandate must not be overlooked. This is a dynamic, evolving space with significant expected change in the regulatory context and in adjacent regulated carbon markets. Stewarding voluntary carbon markets to ensure an effective, complementary role in the broader carbon credit landscape will be essential.

BlackRock recognizes and appreciates that in designing the governance body and defining terms of reference for it, the TSVCM has prioritized objectivity and independence from the commercial interests of any market participants. This is vital if the CCPs and eligible suppliers of credits are to achieve the standardization and validation necessary to enable widespread adoption.

That said, as the TSVCM moves from being a taskforce to an operating organization in this complex and rapidly evolving area, we have two concerns for which we can suggest possible solutions.

First, scaling up voluntary carbon markets can only succeed if the markets meet the collective needs of participants—the buyers (particularly real economy corporates who will bring capital to the market), sellers, and the intermediaries who will facilitate trading and support liquidity. BlackRock believes that the current governance design can be improved to ensure that market participants' needs are considered more explicitly, while also preserving the integrity and independence of ultimate decision-making. We propose this could be done in three ways:

- Ensuring that the founding sponsors, board members, and expert panel members collectively bring sufficient recent, practical markets experience and perspectives. This should also be a consideration in making key leadership decisions, such as Chair of the Board of Directors, Chair of the Expert Panel, and Director of the Executive Secretariat.

- Formalizing the role and composition of the member consultation group. Ideally, this group will be comprised of a balanced set of members representing the collective (not individual firm) interests of sellers, buyers, and intermediaries. It should have a formal consultation and input role—not a decision-making role—into major policy, strategy, and organization decisions being considered by the Expert Panel and the Board of Directors.

- Clarifying the role of membership of the emerging voluntary carbon markets organization. This should include an outline of the activities available to and expected of members. It should also outline membership criteria, benefits, and obligations including fees.

Secondly, the TSVCM envisions a '2 stage' organization, with an initial three-year phase under one model and then a transition to a permanent, steady state model. While it is understandable that the Taskforce is not yet ready to stand up a fully-fledged organization, BlackRock observes a few potential risks with this approach.

First, it introduces some complexity, coordination, and communication costs, as the new body seeks to explain not just one but two operating models. Second, it may make it more difficult to attract individual participants to key roles that are expected to change in substance and time commitment as the organization evolves.

For these reasons, we believe it would benefit the voluntary carbon markets effort to accelerate both design and implementation of the steady state organization to the extent possible and practical.

Scope of Core Carbon Principles

We agree with the TSVCM that the standardization of carbon credit markets is likely to increase their efficiency and scalability. However, we urge the Taskforce to reconsider the position that it will "not exclude any credits from the market and simply label high-quality CCP credits." We are concerned that failure to address the continued existence of poor-quality carbon credits could jeopardize stakeholder acceptance and recognition of high-quality CCP credits.

For this reason, we would recommend that the Taskforce consider as a secondary objective the best 'end state' for poor-quality carbon credits that fall outside its rigorous baseline screening criteria. Some poor-quality carbon credits should be effectively disallowed and acknowledged as worthless in the context of an evolved voluntary carbon market system.

Differentiating between Removal and Avoidance or Reduction

We believe that the difference between removal and avoidance or reduction credits is substantial and should be addressed by the TSVCM framework to ensure that the categorizations are clearly differentiated and understood for market participants. In addition, we would expect fundamental differences in the use cases for these credits. For example, some market participants may wish to only acquire removal credits. BlackRock believes this should be addressed in the "additional attributes" section of the CCPs reference contracts. In our view, frameworks or exchanges lacking clarity or downplaying these differences may deter market participants.

Moreover, the risk of non-permanence, as defined by the CCPs, will typically be lower for removal credits, and generally removals are seen as a more credible part of net zero commitments in current frameworks. This in turn might increase demand for and prices of removal credits. Such an increase in prices could address one of the shortcomings of current carbon markets, which is that low prices distort the incentive for companies to switch to lower emitting technologies and processes.

That said, we recognize that avoidance or reduction credits represent the vast majority of carbon credits available today, and that they have a different but legitimate role to play in emissions reduction. Therefore, we believe that the TSVCM framework, and any carbon credit exchange, should be designed both for removal and avoidance or reduction credits, with transparent differentiation. This will enable market participants to make informed decisions, and it will facilitate effective price formation. We believe this transparency is also more likely to garner the support of governments, policy makers, NGOs, and broader stakeholders. Credits that include both avoided emissions and removals, such as jurisdictional REDD+ (Reducing Emissions from Deforestation and Forest Degradation) programs, should be transparently labelled as such.

We support the "additionality" criteria, which we think could be an effective way to ensure that capital flows arising from carbon credit markets are allocated to projects that would not be viable without carbon credits. In other words, the purchase of credits should not further contribute to the profitability or return of existing projects, but serve to incentivize the creation of projects focused on the removal or avoidance of carbon in a way that would not be addressed by a prior aim underway.

We also support the "based on realistic and credible baseline" criteria and believe, in particular, that forestry projects should use baselines established by external third parties with no financial or commercial interests in the project or be jurisdictional in scale and based on jurisdictional baselines.[4] Such a requirement is likely to address one of the common concerns about the quality of some carbon credits and facilitate an independent review of the anticipated project outcome. As stated above, we also believe that establishing a set of minimum criteria for credits will help contribute to the validity of the market and encourage participation.

We also broadly support the other high level CCPs, in that they should be (i) real; (ii) monitored, reported, and verified; (iii) permanent; (iv) accounted for, with minimized leakage; and (v) do no net harm.

We encourage the Credit-level Integrity Working Group to consider this feedback, while building on the high level CCPs and working on the operational considerations for the Standards.

Corporate use of Carbon Credits in Net Zero Claims

We believe that corporates should align their business models with a global net zero ambition by 2050 and focus their efforts on maximizing the use of available technologies to set stringent scope 1 and 2 emissions reduction targets in the short- and medium-term.

[4] See https://www.wri.org/insights/insider-4-reasons-why-jurisdictional-approach-redd-crediting-superior-project-based for definition and consideration of a jurisdictional approach

We do not believe that offsetting mechanisms, such as the purchase of carbon credits in lieu of Scope 1, 2, and 3 reductions, should be the primary mechanism through which companies aim to reduce their carbon footprint. We believe these efforts would likely be an impractical and inadequate global solution because of the technological, geographical, and biological limits to the scale of carbon removal projects. We urge companies to reduce emissions via operational efficiencies and use of alternative energy, rather than relying on offsets to enable reliance on fossil fuels.

However, we recognize that some emissions will be difficult to abate (e.g. cement and heavy industry) and we believe that using voluntary carbon credits, and in particular CCP removal credits, is a legitimate way for companies to complement their emissions reduction action plans and ultimately achieve their net zero ambitions on an accelerated timeline. The use of high quality CCP removal credits can partially alleviate physical damage from past, current, and future emissions, while companies transition their business models to reduce, and ultimately eliminate, emissions.

We also note that a number of public companies are already committed to nature-based solutions, such as REDD+ projects, that contribute to the avoidance or the reduction of emissions. Although these initiatives do not always effectively remove CO_2 from the atmosphere, they may provide essential contributions to achieving net zero by reducing CO_2 emissions associated with land use. When properly designed, they also have additional benefits relating to the protection of ecosystems and the livelihood of local communities. We think the permanence criteria proposed by the CCPs will help to further encourage these beneficial and carbon-abating practices.

We welcome all viable initiatives likely to have a positive impact, including commitments to go beyond net zero by 2050, in abating and removing emissions on the path to decarbonizing a company's value chain emissions.

From the perspective of corporate disclosures, we believe that companies should be transparent about the type of carbon credits they purchase and how they account for those in their reported emissions. Looking ahead, we think it would be beneficial for investors and other stakeholders for corporate disclosures to clearly differentiate between 'removal' and ' avoidance or reduction' carbon credit types, given their different benefits, use cases, and likely pricing differences in the near-term. We believe that these disclosures align within the 'strategy' and 'metrics and targets' pillars of the TCFD, as companies continue to articulate to investors their capital allocations decisions to work towards a net zero outcome.

Conclusion

We appreciate the opportunity to provide feedback and comment on the emerging governance structure and considerations for the TSVCM framework. As long-term investors on behalf of our clients, we believe these efforts can help mitigate the worst effects of climate-related risks, as companies and investors work towards a low-carbon economy and a global aspiration of net zero by 2050. While we acknowledge the role that a formalized and reliable carbon credit market can play in these efforts, we maintain a primary point of focus on GHG reduction efforts and stringent decreased reliance on fossil fuels for the companies we are invested in on behalf of our clients.

We look forward to continued involvement and partnership.