



Response to CFTC Request for Information - VCM

7 Oct 2022

About BeZero Carbon

BeZero Carbon is a global carbon ratings agency. We provide carbon credit ratings, data, and analytics powered by our proprietary BeZero Carbon Rating (BCR) methodology.

Our platform, BeZero Carbon Markets, hosts the largest database of rated and analysed carbon projects across all major accreditors, sectors, and regions to help all participants price and manage risk. Ratings are also available via API. Headline ratings are freely available on our website www.bezerocarbon.com/listings.

About BeZero Carbon Ratings

The BeZero Carbon Rating (BCR) of voluntary carbon credits represent BeZero Carbon's current opinion on the likelihood that a given credit achieves a tonne of CO₂e avoided or removed.

To be eligible for a BeZero Carbon Rating, a project must have applied an additionality test, be audited by a recognised third party auditor, and have sufficient information on the project publicly available at all times.

A simple alphabetic symbol is used to convey our rating utilising a seven point scale across three categories: AAA (high), AA (moderate), A (low) likelihood of achieving 1 tonne of CO₂e avoidance or removal. The addition of a '+' (plus) or '-' (minus) signs for 'AAA' and 'AA' ratings reflects comparative standing within the category. The full range of ratings (from high to low) is therefore: AAA+, AAA, AAA-, AA+, AA, AA-, A. The BCR follows a robust analytical framework involving detailed assessment of six critical risk factors affecting the quality of credits issued by the project: Additionality, Over-crediting, Non-permanence, Leakage, Perverse incentives, Policy and Political Environment. Our approach involves a top down assessment of macro factors like project methodology, location and sector, as well as project specific analysis, including a range of analytical techniques ranging from policy and financial analysis through to earth observations. A rating is only assigned when unanimously agreed by our ratings committee.

Attached is the combined BeZero Carbon Rating technical document. More information on these approaches as well as our sector classification and FAQs are available on www.bezerocarbon.com/ratings.

Introduction

BeZero Carbon welcomes the opportunity to comment on the CFTC's request for information on Climate-Related Financial Risk. Our comments, feedback and recommendations pertain to the Voluntary Carbon Markets (VCM), specifically Question 22, related to "ways in which the Commission could enhance the integrity of voluntary carbon markets and foster transparency, fairness, and liquidity in those markets".

We wholeheartedly support the intention to enhance the integrity of the VCM and foster transparency, fairness, and liquidity in those markets. This purpose is very much aligned with BeZero's own mission to provide ratings, research and analytics that help market participants assess quality and manage risk, that help to build and scale the VCM, and that ensure the VCM contributes positively to global climate change mitigation goals.

Summary Conclusions & Recommendations

As outlined in the sections below there are a number of features of the current market setup that hamper that mission. Here we summarise our recommendations to the Commission to address and overcome these obstacles to increased integrity in the VCM.

While this could be achieved through voluntary industry initiatives such as the IC-VCM, the Commission could also consider tougher rules and regulations that mandate this (as we see in other asset markets).

1. Raise levels of transparency and disclosure from VCM projects

BeZero advocates measures that lead to raised levels of transparency and disclosure from VCM projects. Mandating much stronger minimum standards of disclosure addresses a key flaw in the VCM as it exists today.

BeZero considers the provision of basic project information (e.g. on the project location and proponents) to be essential for all stakeholders and the wider public to gain confidence in the VCM. Moreover, much of the proposed disclosure requirements should not be onerous for developers or standards bodies to implement.

Evidence of additionality represents a key disclosure requirement. This is a fundamental criteria to assign a BeZero Carbon credit rating. However, we advocate this be adopted more widely in the VCM given it is the single most important component of value of a carbon credit.

2. The key building blocks of carbon credit issuance should be available to market participants.

The key building blocks of carbon credit issuance should be readily accessible, standardised and straightforward to interrogate for all VCM projects. Provision in spreadsheet format should become standard in the industry. In particular, if carbon credits are to be treated as a physical commodity, the underlying carbon accounts are essential to underpinning market integrity.

3. Foster greater standardisation and consistency of reporting and information disclosure across the global VCM.

In addition to raising levels of disclosure at the project level, better disclosure and higher quality data should lead to greater consistency. The industry should aim to achieve such consistency particularly between data reported in project documentation and data provided on registries.

4. Risk buffer pools need to be implemented and managed more effectively.

Risk buffers are designed to mitigate the risk of reversals in carbon projects. However, in our view, they fall short of providing adequate system-wide insurance of the risks posed.

We highlight three key factors where more work is required to provide broader insurance products to help scale the market: 1) Project-specific risk assessments vary considerably across registries, meaning buffer pool contributions may not always match the risk profile of the project. 2) How the risk buffer is practically used in the case of reversals varies across registries and is not always clear from public disclosures. 3) Market participants need more sophisticated tools that better model risks and match the payouts to the losses in case of any reversal events.

5. Nature based projects should disclose their location and boundaries in a geospatial file format.

BeZero recommends the inclusion of a requirement that shapefiles are provided by nature-based project developers, as this facilitates external earth observation interrogation of project assumptions. These should not be limited to the project area, but all associated regions such as the reference and leakage management areas.

6. Encourage a standardised definition of commitment periods be used and applied across standards bodies.

Considering how commitment periods vary from sector to sector, a key issue for assessing non-permanence risk in carbon projects is ensuring fungibility across credit types, i.e. allowing comparative assessments for different project types with different commitment periods. This can be achieved by making assessments of the likelihood that a project's carbon benefits will remain for the

duration of its commitment period, using both top-down and bottom-up analyses.

This is particularly relevant for nature-based and removals projects, where understanding the carbon storage dynamics is key to integrating credits into a broader carbon accounting framework.

7. Robust independent third-party validation and verification

BeZero advocates for more standardised frequency of reporting requirements across accreditors, as current approaches vary significantly.

We would also like to see more robust safeguards against conflicts of interest. Currently, project developers choose and pay for auditors, which could create incentives for auditors to validate and verify projects less scrupulously. One way to counteract this is to introduce greater transparency requirements on auditor performance, which would allow buyers to make more informed decisions. Best practices such as auditor rotation should be widely adopted (also common in compliance markets).

1. The importance of transparency for the VCM

Markets are built on data, information and views

Vibrant asset markets are built around a robust information infrastructure. In established financial and commodity markets, ratings, research and data analytics providers form an important part of that infrastructure; complementing the issuers, auditors, exchanges, reporting bodies and regulators. Their role is essential in underwriting the integrity of those markets: improving market function and facilitating information and price discovery, risk management, and easier decision making.

For the Voluntary Carbon Market (VCM), data, information and analysis are fundamental. Each is used by everyone in the market; buyers doing in-depth due diligence, intermediaries wanting to understand specific project risks, consultants wanting to know which projects to recommend to their clients, insurers wanting to understand the exposures they are being asked to underwrite or rating agencies to assess the efficacy of carbon credits.

In order to scale, the information infrastructure of the VCM must be developed further. It should comprise transparent, independently verified information that is easily accessible and in standardised formats. This transparency will propagate the development of the research and analysis products and services crucial to accelerating the growth of the VCM.

Setting a standard for disclosure

At BeZero we have taken the lead to engender a positive cycle of greater transparency in the VCM.

Firstly, we have defined the minimum amount of verified information and data a project must have published to be [eligible](#) to be rated by us. This includes

- The project must have applied an additionality test or provide sufficient information on how it is deemed additional
- The project must be audited by a recognised third party auditor in order to ensure the robustness of the data and information published

We derived these criteria driven by the following beliefs:

- [Additionality](#) is the most important assessment of the carbon efficacy of a credit,
- The information and data we use to assess a project must be reliable.

Secondly, we require that the project must have sufficient publicly available information, on an ongoing basis, to enable BeZero Carbon to assign a rating. The public availability of relevant, verified information is an important ingredient for the development of a robust information infrastructure for the VCM.

Thirdly, we embrace the transparency agenda ourselves, by making our [methodologies](#), technical documents and headline [ratings](#) publicly available. Moreover, we maintain full independence within the VCM - we do not create, invest in, trade, recommend or sell carbon credits.

Quantifying the building blocks of credit issuance

We have created a standardised way to calculate and understand how credit issuances are arrived at. We believe a minimum provision of standardised data is essential to reduce information asymmetry and is a hallmark of a well functioning market.

At present this information is contained in extensive project documentation published through the accreditation registry but with no consistent format or structure. Our standardised model calculates issuance by comparing project carbon stock changes to baseline assumptions and adjusting for any leakage or risk buffer allocations. While there can be varying degrees of complexity underlying these headline numbers, they can be applied to any type of project.

Fostering a liquid, transparent, high integrity market

In this submission we address specific features of the VCM and how they might evolve to achieve the fair and well functioning market that is needed if the VCM can play its part in achieving Net Zero objectives. In particular, the lack of standardised data and information raises the cost and ease of engaging in the market and inhibits its ability to scale. Ratings agencies and other data and research providers have a role to play in addressing this. However, more robust rules and market structures also form part of the solution.

2. Disclosures in the VCM

The Voluntary Carbon Market suffers from a lack of transparency in many areas. Depending on the standards body, project developers face varying degrees of

disclosure requirements. In practice, some accredited carbon projects lack transparency on some key areas of project information.

Strong levels of carbon project disclosure are important to foster trust across the value chain and for all stakeholders to function optimally. As a carbon rating agency, transparency on project related information is a critical pillar of BeZero's analytical approach. Indeed in order for a project to be eligible for a rating, certain elements must be publicly available. Importantly, a project must have sufficient publicly available information, including changes in project carbon stocks, baseline assumptions, leakage assumptions, and risk buffer allocation (if any).

The ratings process incorporates critical analysis of all project documentation among a range of sources. Greater transparency on project information is viewed more favourably in the ratings process compared to those publishing minimal information. Indeed, a thorough examination of all the risk factors is inherently easier with strong levels of disclosure.

With the BeZero Carbon Rating (BCR) framework we analyse the quality of disclosure in our consideration of [information risk](#). Our information risk analysis assesses the availability, transparency, quality and reliability of all data and information provided by project developers and proponents. That assessment may be top-down, where the information is accessed from external sources such as national data or industry data; or it may be bottom-up when the information comes from internal project-specific sources.

Proprietary study of transparency in the VCM

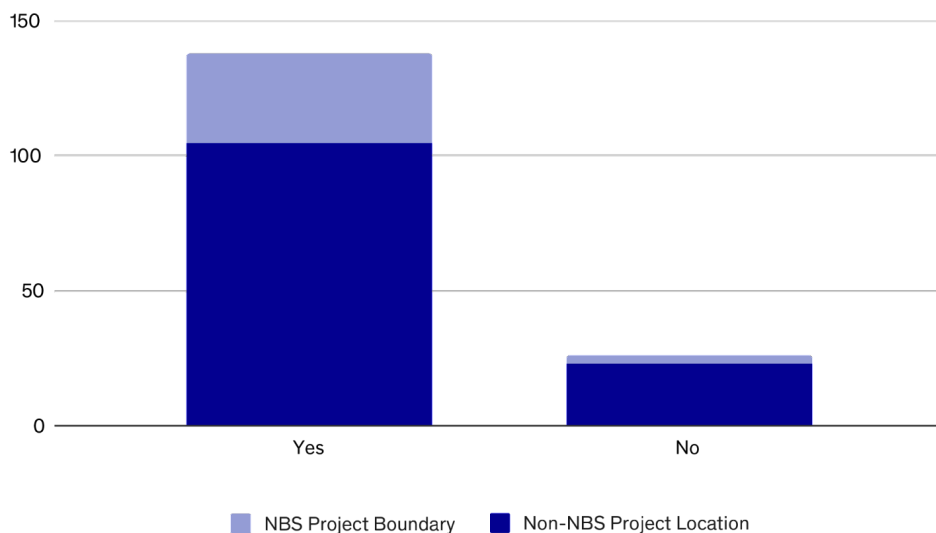
To explore the current state of project transparency in the VCM, we have carried out a pilot study of 128 projects across four major registries: Verra's VCS, Gold Standard, Climate Action Reserve, and the American Carbon Registry. Projects from a variety of sectors were selected based on the highest outstanding issuance from the last five years, representing the most liquid credits in the market.

Each project was analysed and assigned a transparency score (in percentage terms) based on a series of 20 questions, interrogating project details such as developer information, financial disclosures, methodology, project design, carbon accounting methods, and stakeholder inputs. A higher transparency percentage indicates that the project has divulged project details and made more information public, while a lower score indicates a lack of available information or detailed disclosures.

Here we discuss some of the key areas of transparency for any stakeholder assessing a carbon credit project. We also provide evidence in each case from our own experience providing carbon quality ratings on over 260 projects and our proprietary transparency study.

Project location & boundary

Number of Projects with Location and Boundary Information Disclosed



A simple (yet essential) disclosure to substantiate information related to a carbon offset project is its location. Although the majority of projects do provide project location details, our study found that 23 projects or 18% of the sample did not - leaving no way to physically verify the project's details.

For nature based solutions such as forestry projects, detailed project boundary maps are essential for independent assessment or monitoring of project fundamentals. Although our pilot study found that 92% of NBS (Nature Based Solutions) projects do include some form of project boundary, insights from BeZero's Earth Observation team highlight that many are riddled with inconsistencies. For a sample of 81 NBS projects evaluated, only around half provided a project boundary in a spatial format to the registry. Of these, one in five had analytical issues, e.g. the boundary provided contradicts what is stated in the project's description.

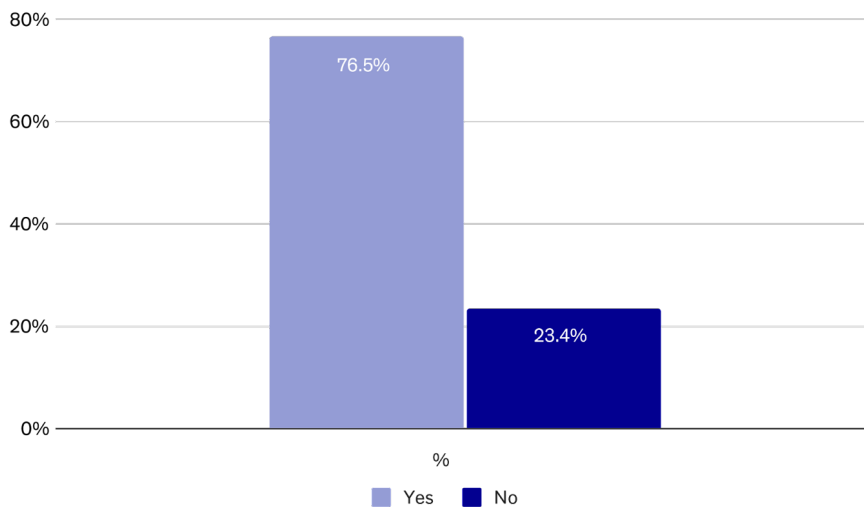
Other findings from this sample include:

- Where a geospatial file (e.g. shape file or KML (Keyhole Markup Language)) is not provided or has issues:
 - a decent boundary can be approximated (by manual digitization of images in the project documents) for ~20% of project areas
 - a somewhat usable boundary can be approximated for 50%
 - for the remaining 30% it is not possible to extract anything meaningful from the information made available
- Leakage belts (LB) are relevant for around half of the projects. Only two of these projects provide them, and one of those has issues.
- Reference regions (RR) are relevant for around half of the projects. No project provides them.

- Where the LB or RR is needed, we find it is possible to manually derive a decent or somewhat usable boundary for ~90% of projects.

Additionality

Percentage of projects disclosing additionality information



Data refers to BeZero's sample of 128 projects across four major registries: VCS, GS, CAR, and ACR.



The largest weighting within the BeZero Carbon Rating is [additionality](#), “the risk that a credit purchased and retired does not lead to a tonne of CO₂e being avoided or sequestered that would have not otherwise happened”. The accreditation process requires that a project has passed an additionality test to assess if carbon finance plays a decisive role in initiating project activities. Many such tests are reported.

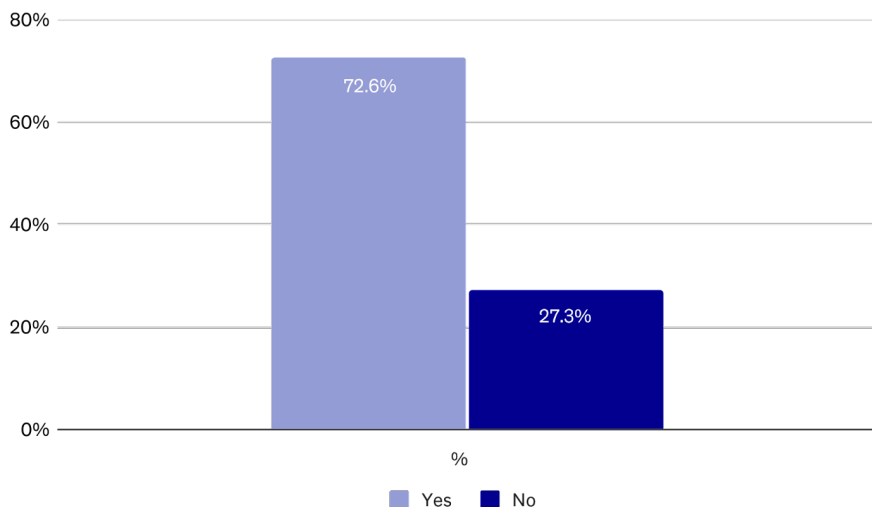
In today's VCM, at least eight explicit and two implicit methods are used to assess additionality across our universe of rated projects. An analysis of projects in BeZero's database finds an average of 2.8 additionality tests but ranges from one to five.

Despite the considerable variation, we have found little relationship between the type of additionality test applied and a project's rating. Therefore, to fully assess additionality, one must interrogate the appropriateness and limitations of the test(s) used, and corroborate any data underlying them.

Unfortunately, this vital information is not universally provided in the VCM. In our transparency study, we found that a quarter of projects have not published clear information on the additionality test used or the underlying details.

Leakage

Percentage of projects disclosing leakage information



Data refers to BeZero's sample of 128 projects across four major registries: VCS, GS, CAR, and ACR.

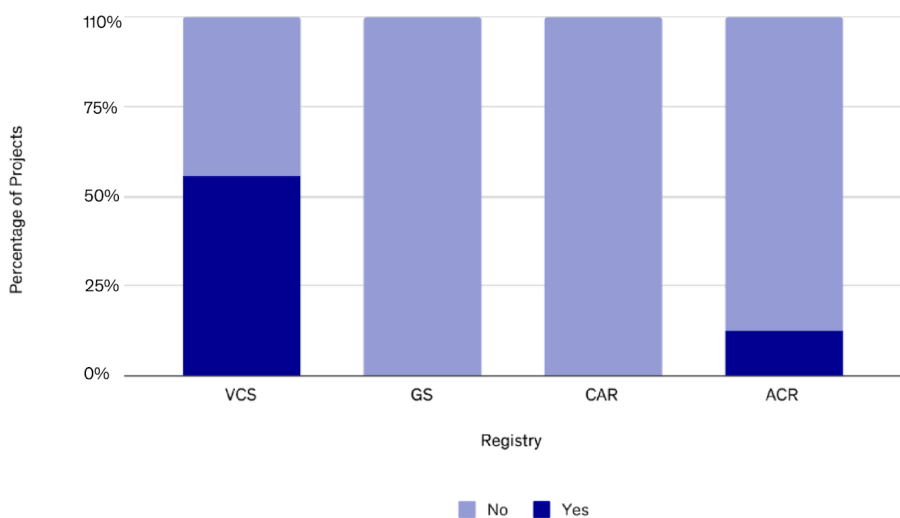


Another key disclosure element required for all projects in the BeZero Carbon Rating is a project's leakage assumptions, the risk that emissions avoided or removed by a project are pushed outside the project boundary. Leakage assumptions vary across sectors and project types. Examples include the use of a leakage belt for nature-based projects or activity shifting and market leakage effects for energy projects.

Similarly to additionality, just over a quarter of projects in our study did not adequately address leakage in their published documents. Furthermore, of those projects that did mention leakage, 40% neglected leakage due to the project methodology and 20% applied a standardised leakage factor with minimal explanation.

Non-Permanence & risk buffer

Projects with disclosure of risk buffer assumptions



Data refers to BeZero's sample of 128 projects across four major registries: VCS, GS, CAR, and ACR.



Another key disclosure for nature based projects is their permanence risk assessment and subsequent [buffer pool allocation](#). How projects approach this risk is based on the methodology and rules dictated by the standards bodies and registries. This leads to a degree of disparity of disclosure across projects. Overall, only 19% of projects in our study provided either a non-permanence risk report or an explanation of their buffer pool allocation.

- No projects from Climate Action Reserve disclose this information.
- 13% of American Carbon Registry projects give a detailed explanation of their non-permanence risk.
- 56% of VCS projects publicly disclose a non-permanence risk assessment report or give an explanation behind their buffer pool allocation. The remaining 44% in our sample state their assumed risk buffer percentage or include it in the carbon calculations without disclosing the underlying data. This is despite a non-permanence risk assessment being a VCS requirement,
- The Gold Standard operates with a 20% default buffer percentage meaning projects provide no methodology or evidence of the risks they are exposed to.

Baseline & project emissions calculation

The baseline and project emissions are the key building blocks to understanding the gross emissions reductions or removals achieved by any project. How both are calculated is therefore crucial to assessing the integrity of the carbon accounting.

For avoidance projects in particular, the selection and calculation of a baseline is central to that calculation, given it represents the counterfactual scenario which cannot be objectively observed.

For other projects, the baseline may be relatively uncontroversial, for example in the case of some afforestation projects. In all cases an effective and credible monitoring and calculation of project emissions is central to the process.

To assess these calculations, observers need to understand the assumptions made, benchmarks used and monitoring and measurement protocols put in place. In many cases such policies are either not provided, are not corroborated, or are not evidenced as being appropriate.

In our transparency study we found that 75% of projects provide full and clear information on the baseline methodology/calculation. Meanwhile monitoring plans and calculations were shown clearly by 69.5%.

Ownership & Legal Tenure

Best practice in VCM disclosure should also include comprehensive details of project ownership and control. A full understanding of project cash flows can have an important bearing on additionality assessments and the risk of any

perverse incentives. Clarity on the legal tenure of the project property is essential to rate the risk of non-permanence and indeed project failure.

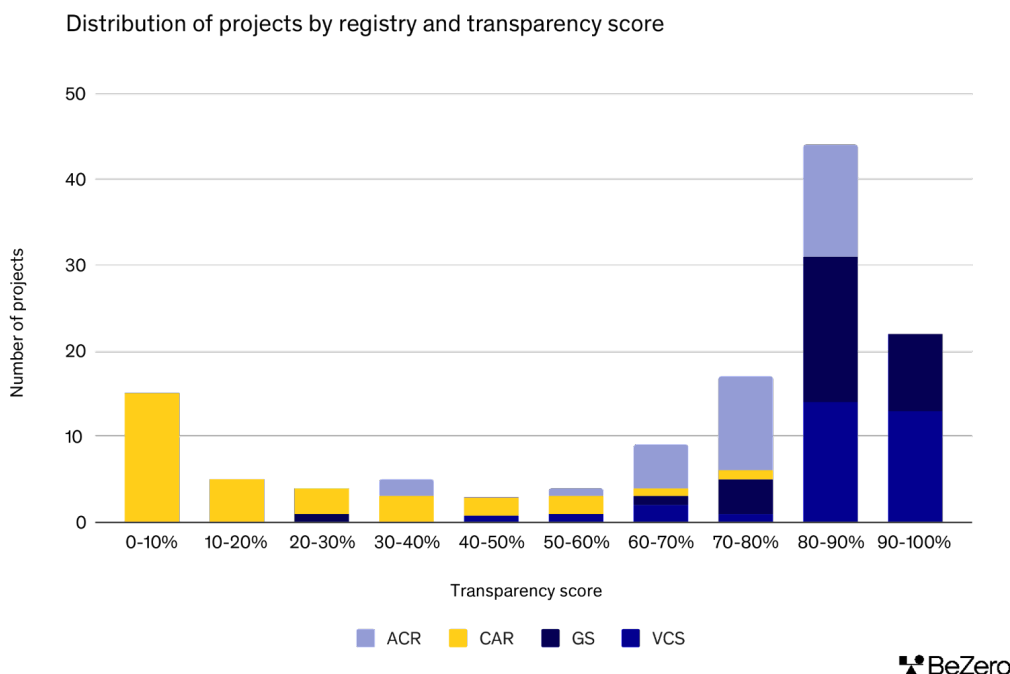
The major registries do generally require auditors to ensure ownership and tenure are in order. However, we have seen cases where ownership disputes or changes in property ownership have not been flagged by developers, audit documents or the registry.

Disclosure & Transparency study: high level conclusions

Although a small (but representative) pilot study, the conclusions emerging from our 128 project transparency analysis indicate that transparency and disclosures vary significantly across projects.

Our study found that the average project scored 66%, but 28% of projects score lower than 60%. Across the four standards bodies, projects from one standard scored significantly lower than the other standards bodies, sitting at an average transparency score of 20% compared to an average of 75% or higher for the other three registries.

At the regional level, projects in North America (with the vast majority in the United States) have the lowest average score at just 49%, while all other regions average a score of 80% or higher.



Deconstructing carbon calculations

In order to assess the likelihood that a given credit in the market has achieved a tonne of CO₂e, we need to be able to see how many credits were issued in a given year and how this issuance number was calculated.

This seems like a basic requirement but this information can be notoriously hard to collect. It is often available in extensive project documentation published through the accreditation registry but with no consistent format or structure.

We have built a standardised model to understand how issuances are calculated which is made up of:

- Change in project carbon stocks
- Baseline assumptions
- Leakage assumptions (if any)
- Risk buffer allocation (if any)

Issuance can be calculated as a residual of these four components. While there can be varying degrees of complexity underlying these headline numbers, they can be applied to any type of project.

In addition to the problem of inaccurate or incomplete disclosure we also find a number of instances of data quality problems, notably when comparing data reported in the project documentation versus that provided on registry platforms. From a sample of 215 projects across four standards bodies (ACR, CAR, Gold Standard and VCS) we found discrepancies between registry issuance and reported issuance for 81 projects (38%). That includes over 7% of projects that have more credits in issuance than they have reported in their own monitoring or verification reports.

We also observe discrepancies between reported credits to be deposited in non-permanence risk buffers according to project monitoring and verification reports, and credits actually paid to the buffer pools managed by the standards bodies / registries. In certain cases, these discrepancies are consistent with registry or accreditor guidelines around buffer pool credit issuance. For example, a lack of buffer credit issuance may be related to applied insurance schemes or registry guidelines on alternative developer holding accounts. However, in certain instances, we also note a lack of public disclosure on the discrepancy in buffer credit issuance.

Within our universe of rated projects that are required to deposit risk buffer credits, we find that a majority of NBS projects (54 of 79) exhibit discrepancies between the number of buffer credits noted in monitoring reports and the number issued to registry-held buffer accounts.

Discrepancies are found in both directions but we find that the combined allocation of credits from these projects to the risk buffer pools are 38% below what is reported in project documentation.

4. Project Reporting in the VCM

Within the Voluntary Carbon Market (VCM) there are several processes by which project activities and progress are reported. These involve project proponents, third-party auditors and certification bodies. While there are market-wide

similarities in how reporting can be approached, there remain notable differences between the major standards bodies and across sectors.

This section aims to lay out the available information pertaining to project activities, the pros and cons of regular reporting and the key gaps in current practices.

Document types

Project proponents use Project Design Documents (PDDs) to detail the full extent of project activities. This includes a description of the operation and location, as well as the start date, crediting period and ownership of emission reductions. These documents also identify the most realistic baseline scenario and estimate the emission reductions both in the baseline and project scenario, provide a demonstration of additionality, and lay out which data and parameters will be monitored over the project's lifetime.

Emission reductions and other data are measured and monitored to produce monitoring reports. In some cases there are multiple monitoring periods across a project's crediting period, and their length varies. In these reports, developers must provide information on the status of the project's implementation, including all data and parameters used to calculate the associated emission reductions or removals for a given period.

Validation and verification reports, unlike PDDs and monitoring reports, are conducted by independent third parties known as validation/verification bodies (VVBs). The purpose of these audits is to assess projects against the employed methodology and ensure their integrity. Validation reports are designed to illustrate that a project will generate climate benefits, while verification reports endorse the quality of a project and its delivery over a set time period. These documents are important for helping project proponents to gain trust among stakeholders and investors.

More frequent reporting holds the key benefit of enhancing the transparency associated with a project. Conversely, from the perspective of project proponents, the main downside of frequent reporting are costs involved with producing monitoring reports. This is particularly relevant for nature-based solutions (NBS), where the process of observing progress is more expensive and time-consuming than non-NBS projects due to the need to conduct field-based audits.

Minimum standards of major standards bodies

Projects looking to attain Gold Standard (GS) certification must undergo verification and performance reviews every five years which are published on the GS registry. This is applicable to all project types, and such documents must monitor and report on project progress in terms of emission reductions/removals, impacts on Sustainable Development Goals (SDGs) and stakeholder engagement. Project developers must also produce annual reports

to regularly summarise recent project activities, however these documents are not made publicly available.

The minimum reporting requirements for Verra's VCS, conversely, vary depending on a project's sub-sector and the applied methodology. Improved Forest Management (IFM) projects, for example, must reassess the baseline every ten years, while for avoided deforestation projects this requirement is every six years. Monitoring reports must determine a project's net greenhouse gas (GHG) benefits by detailing the impacts of project activities on emissions sources, sinks and reservoirs.

Project developers certified by the American Carbon Registry (ACR) must complete monitoring reports for each reporting period, however there are no publicly available requirements pertaining to the frequency of such documentation. These monitoring reports are also not published by the registry. The information required, however, includes descriptions of status of project activities and calculated emission reductions.

Climate Action Reserve (CAR) similarly does not publish project's monitoring reports, but for most of its protocols does demand that project developers monitor project performance on at least an annual basis. To do this, emission reductions must be quantified and verified, while data related to assumptions underlying carbon stock estimates are also required.

Here the key takeaway is that there are no standardised requirements between the major standards bodies, nor between sectors and attendant methodologies. In terms of both frequency of reporting and the degree to which such information is made publicly available, each registry applies its own standards which has resulted in market-wide discrepancies in transparency.

Insights on availability and frequency of reporting

Now we will lay out some key trends based on the ~250 projects currently rated within the BeZero coverage universe, and demonstrate how the frequency and availability of such documentation depends on what sector and registry the project falls under.

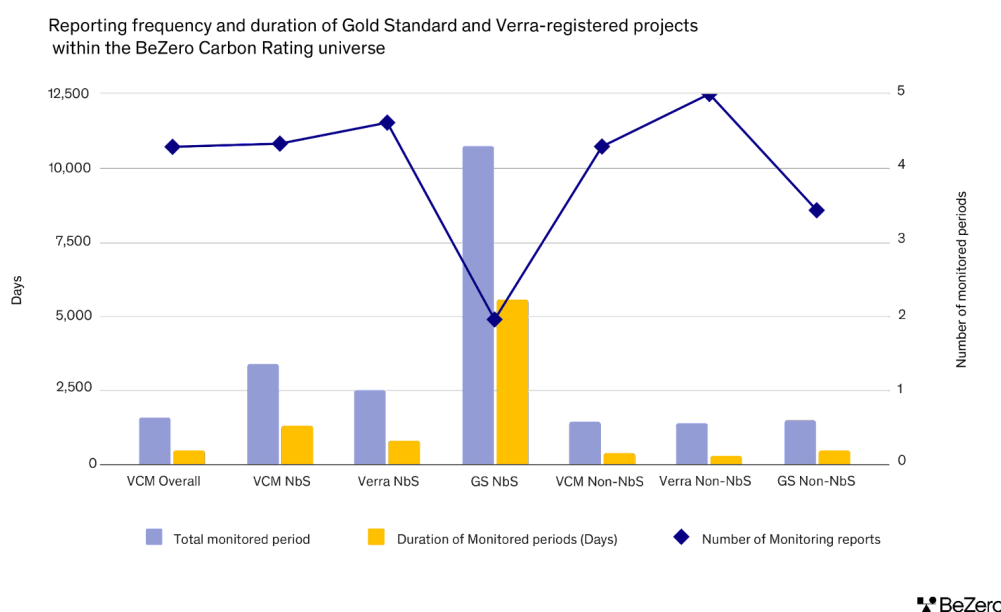
At the sector level, an interesting takeaway is that NBS projects are monitored less frequently than non-NBS projects. Overall in the BCR universe there is no difference in the average number of monitoring reports produced by projects across NBS and non-NBS, at 4 each per project lifetime. This is the market average. However, given that the commitment periods of NBS projects are typically much longer, on average monitoring reports are produced less often for such projects. This is also indicated by the duration of monitored periods in terms of days being over double for NBS projects, as shown in the chart below, in order to cover longer timeframes in fewer reports. Considering the above mentioned process involved with producing monitoring reports for such

initiatives, this is likely done to avoid high reporting costs over the course of a project's lifetime.

We found that projects registered under VCS tend to produce monitoring reports more often than those under GS across all sectors, yet the duration of monitored periods is significantly less. Perhaps unsurprisingly this applies particularly to NBS, where GS projects' monitoring periods are nearly six times longer than those NBS projects under VCS.

The projects registered under the two largest US-based registries, ACR and CAR, do not publish monitoring reports at all.

The reporting frequency and duration of GS and VCS-registered projects within the BCR universe



Conclusion on reporting

Despite the commonality of the types of documentation produced by projects in the VCM across standards bodies and sectors, there is still large variation in the frequency and accessibility of reporting. This is a result of wildly different reporting requirements associated with the major standards, and presently acts as a barrier to the development of a reliable and efficient market. Regardless of which sectors or registries are deemed better or worse, the variability in the frequency of reporting demonstrates the need for more comprehensive transparency standards across the market.

5. Accreditation standards, bodies and audit processes

Historic demand for carbon credits led to the development of private certification standards, including Verra's VCS, Gold Standard (GS), the American Carbon Registry (ACR) and the Climate Action Reserve (CAR). These standards issue carbon credits for a variety of project activities, with their individual approaches resulting in great variability in the quality of different credits.

Auditors are known as validation/verification bodies (VVBs), and act as independent third-parties to assess carbon projects against the rules set out by the relevant registry. While this purpose is common for projects registered under all accreditors, the required frequency of audits varies across the market.

Despite the common underlying principle that carbon projects must be verified to demonstrate measurable additionality and permanence, we find differences in auditing protocols across various accreditors and methodologies within the VCM. The lack of standardisation could be addressed to help the market scale-up, and lessons can be learned from more established compliance markets.

Comparison to compliance markets

Compliance carbon markets present some useful lessons for voluntary markets to develop a framework for implementing standardisation of accreditation and auditing, and introduce regulatory oversight of participating registries. For instance in California's Cap and Trade program regulation¹, the Air Resource Board (ARB) approves Offset Project Registries that can participate and help administer parts of the Compliance Offset Program. Project Registries are required to meet specific regulatory criteria² to receive approval under the Regulation.

Carbon credit standards bodies help facilitate the listing, reporting, and verification of offset projects developed using the Compliance Offset Protocols, and issue registry offset credits. But these registry credits cannot be used directly for compliance with the Cap-and-Trade Program. They must be further approved by ARB thereby converting them to 'ARB offset credits' which then become eligible for use in the program and can be traded in the compliance market.

In addition to the registries, verification bodies³ also need to be approved by the regulatory body ARB to participate in the program. Project Operator or Authorised Project Designee must obtain the services of an ARB-accredited verification body to perform offset verification services

Thus the compliance program has a strict two layer approval process where the governing body first approves the list of registries and verification bodies that can participate in the program and then later also approves the credits from these registries which are eligible to be traded in the compliance market.

1

<https://ww2.arb.ca.gov/our-work/programs/compliance-offset-program/offset-project-registries>

²https://ww2.arb.ca.gov/sites/default/files/2021-07/ISD_CCPEB_051_Application_for_Approval_of_Offset_Project_Registries_0.pdf

³ <https://ww2.arb.ca.gov/our-work/programs/compliance-offset-program/offset-verification>

Currently, only three approved registries can participate in California's cap and trade program – American Carbon Registry, Climate Action Reserve and Verra's VCS.

As part of the approval process for the registries, they are also mandated to attend and successfully complete ARB Compliance Offset Program and Compliance Offset Protocol training classes. Only upon successful completion of training classes by Registry Staff the Executive Officer may approve the Project Registry. So in addition to regulatory oversight and background check, successful completion of mandatory training organised by the regulatory body to maintain a standard of operation is also an essential part of the compliance market system.

Industry integrity initiatives

Industry initiatives such as the [Integrity Council for the Voluntary Carbon Market \(IC-VCM\)](#) have the potential to play an important role by setting and enforcing definitive global threshold standards as part of their overall goal of improving supply side integrity in the voluntary markets. Industry based coalitions and initiatives have the advantage of leveraging the best practices and expertise available globally in an independent and collaborative way.

Audit process

Despite the common underlying principle that carbon projects must be verified to demonstrate measurable additionality and permanence, there are differences in auditing protocols across various accreditors and methodologies within the VCM. However, quality of the audit process is subject to several factors including the variation in auditor eligibility criteria across accreditors, differences in sectoral experience, and the rigour and transparency of the audit process.

A noted conflict of interest on the audit process of the VCM has been that project developers choose and pay for auditors. This can create incentives for auditors to validate and verify projects less scrupulously to maintain business relationships. In addition, a case study on auditor thoroughness in the VCM has revealed positive correlations between the hours worked on a project by an auditor and a project's predicted issuance. This further supports a notion of perverse incentives where a project's payment of auditor resourcing can elicit larger ex ante issuance which can influence project pre-financing and investment.

This is compounded by a fragmentation of the auditors from standards and accreditation, where there is no transparent review process of auditors or tools to measure auditor under-performance. One way to increase confidence in the audit process is to introduce more stringent transparency requirements on auditor performance, which would allow buyers to make more informed decisions. Best practices such as auditor rotation should be widely adopted (also common in compliance markets)

Concluding Comments

VCM stakeholders have a shared interest in helping to build the structures that will allow the market to scale. BeZero's mission to provide ratings and analytical tools to better assess, price and manage risk in the VCM is complementary to that of the CFTC's stated aim to enhance the integrity of the VCM.

As outlined in the sections above there are a number of features of the current market setup that hamper that objective. In broad terms our recommendations to the Commission to address and overcome these obstacles relate to the following:

- Greater transparency and disclosure of project information and evidence for additionality
- Ready access to the key building blocks of carbon credit issuance for all market participants (baseline, project emissions, assumed leakage, and risk buffer)
- More consistency and standardisation of reporting, information disclosure, and audit requirements
- In addition we have provided specific views and recommendations on risk buffer pools, provision of project boundaries in shapefiles (NBS), and commitment periods.