# High-integrity Voluntary Carbon Markets in the Global South

## Options for Policymakers in Latin America and the Caribbean

Policy Brief

CAF DEVELOPMENT BANK OF LATIN AMERICA AND THE CARIBBEAN
iC INTEGRITY COUNCIL
VCMI Voluntary Carbon Markets Integrity Initiative
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# CAF´s Commitment

CAF's role as the region's green bank is to accompany the countries to bridge the identified gaps so that the impact of VCMs contributes to the sustainable development of Latin America and the Caribbean. To achieve this, CAF must assume a leadership position in the regional discussion, articulating the needs and expectations of all countries, with a diverse and participatory approach that leaves no one behind.

In this sense, CAF proposes to work with all the actors involved in the carbon markets – and markets of other environmental assets, such as biodiversity, water, and plastics – to accompany their technical and institutional strengthening, as well as to enable conditions for the transfer of knowledge and capacities within the framework of the following objectives to be ensured:

- **Integrity:** contributing to the generation of carbon markets with guaranteed compliance with the highest standards of Governance, Additionality, and Environmental and Social Safeguards.
- **Transparency:** enabling conditions for all information on carbon markets developed in the region to be public and available in interoperable registry systems that support confidence in the market
- **Impact:** Enabling the generation, transfer, and adoption of the best existing knowledge in carbon markets for an adequate accounting of the impact on mitigation, adaptation and restoration.
- **Institutionality:** Strengthening the necessary institutional arrangements at the planning, operational and supervisory levels for the promotion, development, and implementation of projects with real, measurable and traceable impact, aligned with the NDCs of each country and along the entire value chain.

In short, CAF is committed to collaborate with all the countries in the region and with relevant stakeholders in VCMs to close the existing gaps in the carbon markets, thus enabling conditions for an effective mobilization of resources for the development of projects that contribute to the fulfillment of the mitigation, adaptation and restoration goals established in the NDCs.

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# Foreword

Limiting global warming to 1.5°C, in line with the Paris Agreement, requires that global annual greenhouse gas (GHG) emissions be cut by 50 percent of current levels by 2030 and reduced to net zero by 2050[1]. Reaching net-zero GHG emissions by 2050 is essential to mitigating the negative impacts of climate change on global standards of living, livelihoods, and natural resources. Part of the solution to this challenge lies in firms across industries focusing on decarbonizing their production, distribution, and supply chains. This pressing need explains the increasing number of companies that have started to make commitments to achieve net-zero targets by reducing their emissions, which are mainly associated with supply chains, and the use of their products. However, some companies, especially those engaged in activities where emissions are tough to abate may find meeting their net-zero transition goals challenging. Many corporates are therefore interested in buying carbon credits through Voluntary Carbon Markets (VCMs) to compensate for a proportion of their remaining emissions, or to achieve sustainability targets linked to ESG criteria. VCMs can be a powerful tool to enable organizations to increase their climate ambition by purchasing carbon credits to finance climate change mitigation[2], either through carbon removals or emissions reduction projects[3]. In fact, recent research has found that companies engaging in the voluntary carbon market are reducing their own emissions quicker than other companies who are not[4].

For finance flows to fund emission reduction or removal projects, there is a need for the development of robust, well-functioning VCMs made up of high-quality carbon credits. A liquid VCM at scale could allow billions of dollars of capital to flow from companies making commitments such as carbon neutral or net-zero into projects that can reduce and remove GHG emissions. Estimations suggest that under favorable market conditions, demand for voluntary carbon credits could increase at least 15-fold by 2030 and 100-fold by 2050 from current levels, contributing to the achievement of pathways consistent with net-zero scenarios[5]. Overall, the market for carbon credits could be worth upward of $50 billion in 2030[6].

However, concerns about social and environmental integrity (e. g. the quality of carbon credits being traded, the lack of standardized and comparable methodologies to evaluate credit quality and integrity of carbon credits as well as the potential negative effects on human rights and lack of transparency in benefit sharing) have been raised[7]. At the same time, the spread of allegations of misleading carbon neutrality claims (greenwashing) and issuance of low-quality carbon credits could hinder the scaling up and consolidation of this market. Legal cases have started to be brought before judicial bodies[8], unlocking a new sphere of litigation, and leading to closer monitoring and enforcement by some supervisory authorities[9]. Effective VCMs will enable the private sector to take ambitious steps towards impactful, additional climate action, at the same time delivering significant sustainable development co-benefits to the global south. It is fundamental that high-integrity VCMs are used as a complementary tool, and do not displace science aligned internal GHG emission reduction efforts.

1 McKinsey (2021). A blueprint for scaling voluntary carbon markets to meet the climate challenge. Available at: https://www.mckinsey.com/capabilities/sustainability/our-insights/a-blueprint-for-scaling-voluntary-carbon-markets-to-meet-the-climate-challenge

2 Use of carbon credits is not a substitute for decarbonizing, but is a responsible action to take in addition, where decarbonization is not yet feasible.

3 As many of these mitigation project could potentially generate broader environmental, social, and economic benefits, ranging from increased biodiversity, job creation, support for local communities, and health benefits, companies may use voluntary carbon credits with the aim of meeting corporate social responsibility goals.

4 Ecosystem Marketplace (2023). New research: Carbon credits are associated with businesses decarbonizing faster. Available at: https://www.ecosystemmarketplace.com/articles/new-research-carbon-credits-are-associated-with-businesses-decarbonizing-faster/

5 IIF, McKinsey (2023). Voluntary Carbon Markets Monitor. New Core Carbon Principles to Drive Growth. Available at https://www.iif.com/Publications/ID/5377/Voluntary-Carbon-Markets-Monitor-New-Core-Carbon-Principles-to-drive-growth

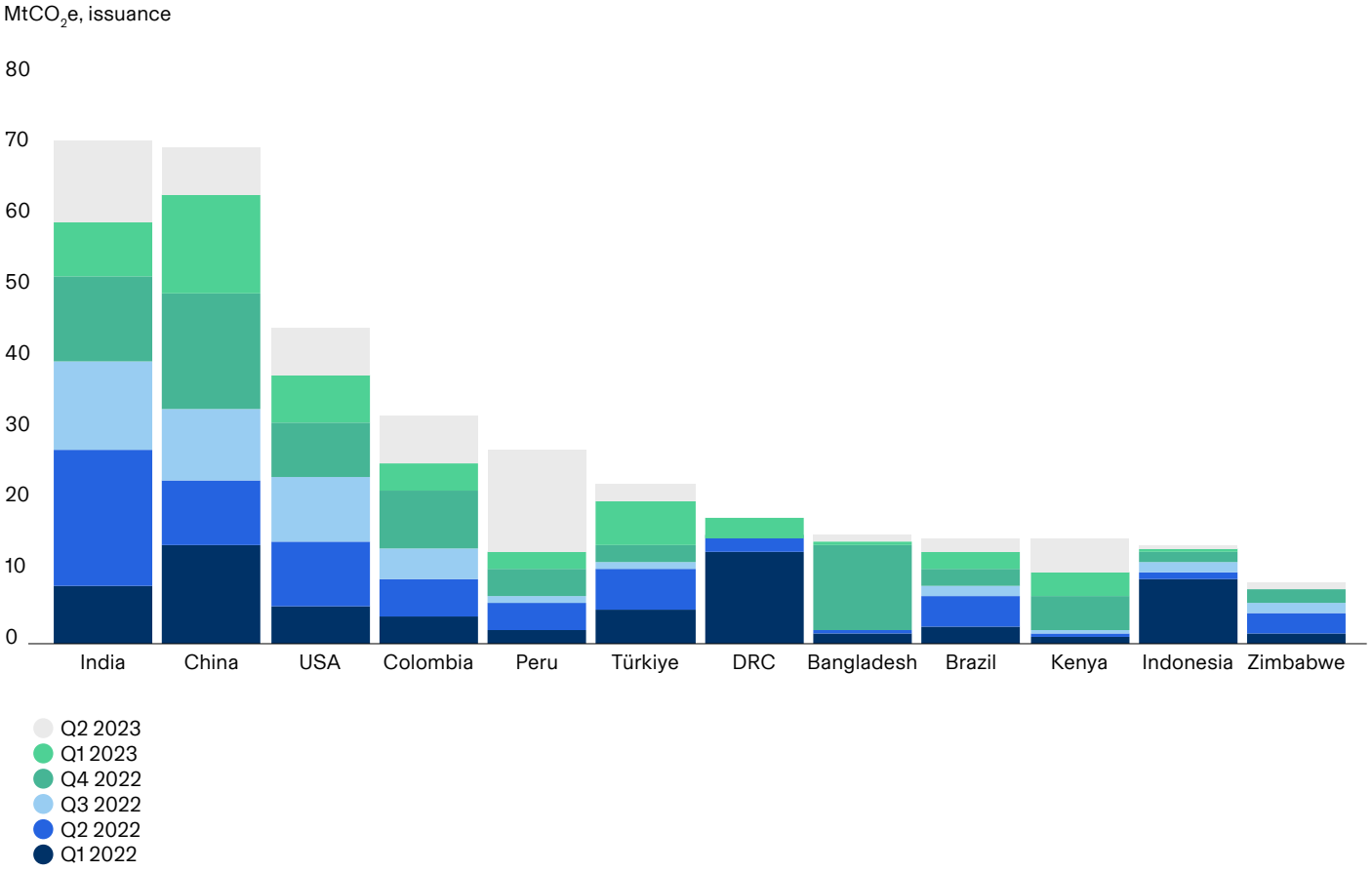
6 Taskforce on Scaling Voluntary Carbon Markets (2021). Final Report. Available at: https://www.iif.com/Portals/1/Files/TSVCM_Report.pdf, and

7 IOSCO (2022). Voluntary Carbon Markets: Discussion Paper. Available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD718.pdf

8 Zapata J, Acosta J (2023). Suspenden proyecto de bonos de carbono en Colombia por falta de consulta previa. Available at: https://www.hklaw.com/en/insights/publications/2023/09/suspenden-proyecto-de-bonos-de-carbono

9 NGFS (2023). Climate-related litigation: recent trends and developments. Available at: https://www.ngfs.net/sites/default/files/medias/documents/ngfs_report-on-climate-related-litigation-recent-trends-and-developments.pdf

**Chart 1.**
**Most voluntary carbon credits originate from emerging markets and the U.S.**
Source: IIF, VCS, GS, CAR, ACR, CB; $MtCO_2e$ = million tonnes of carbon dioxide equivalent, excludes ARB[10] eligible issuance




VCMs could, where necessary safeguards are in place, play a vital role in the Global South by mobilizing private capital for climate action, green growth, sustainable development, and nature benefits. These regions possess abundant natural carbon sinks (forests, oceans, and soils) and renewable energy sources (hydro, wind, solar, geothermal, biomass, etc.). As Chart 1 shows, Latin America and the Caribbean (LAC) is not an exception and in some of its countries carbon credit issuance is significant.

However, VCMs still face several challenges to optimize their potential and effectively increase ambition to lower the costs of climate action in LAC. Concerns around transparency, lack of standardized methodologies, or incomplete legal frameworks are among other the main aspects that policymakers and authorities should consider when structuring policies to develop this type of environmental asset.

To understand the challenges that face VCMs in LAC and to efficiently scale its opportunities, CAF held a seminar on the topic in Buenos Aires in August 2023. Relevant partners and governments from the region were invited to participate and provide their inputs. During the session, a survey was launched to the participants (60 on-site and 700 remotely) which included representatives from governments of the region. The results obtained showed that the role of national authorities is key to create the enabling conditions and unlock the potential of VCMs (see Box 2).

10 California Air Resources Board

# Box 1
# G7 Principles of High Integrity Carbon Markets

A recent G7 communique sets out a series of *Principles of High Integrity Carbon Markets* to guide their supply, demand and market infrastructure to improve credibility, transparency, and overall confidence in the markets.

- **Supply side**: There are two priorities in this regard. First, the need for a robust certification standard to oversee the design, measurement, reporting, and verification (MRV) processes concerning emission reductions or removals, ensuring effective GHG mitigation. Secondly, there's a strong emphasis on identifying, disclosing, and addressing environmental and social impacts by monitoring and safeguarding measures to ensure the respect of human rights, gender equality, and the rights of Indigenous Peoples.

- **Demand side:** Three principles are defined to underscore the stringent alignment of carbon credits with the 1.5°C goal and global net-zero emissions, prioritizing direct emission reduction strategies in unavoidable instances. They emphasize that emission reductions supporting carbon credits must be authorized for a country's NDCs and international mitigation following specific guidelines to ensure legitimacy. Furthermore, transparency in reporting credit usage to the public stands paramount, fostering accountability by disclosing types, sources, and quantities used for actions extending beyond the value chain.

- **Market integrity:** Three principles are set to ensure the availability of transparent and clear information to enable better understanding and alignment of existing initiatives, taking a step towards higher integrity. The need for public registries, signaling supply- and demand-side participants, and cooperation among global standard-setting bodies, are identified as fundamental for that purpose.

If upheld, these principles can inform global efforts to enhance integrity of carbon credits to allow all stakeholders to take advantage of the full potential of carbon markets for both voluntary and compliance purposes.

## Box 2
## Results from the survey to governments in Buenos Aires

Three (3) brief questions were launched during the seminar to identify:

- **What is the main advantage of LAC to foster carbon markets:** 66% of the audience recognized the natural capital of the region as the main driver, followed by the development of renewable energies (16%), previous experience on the Kyoto Protocol (12%), and a robust environmental agenda (6%).

- **What is the main barrier for the development of successful carbon markets in LAC:** the need for a definition of clear rules by the governments (34%), of clear international rules (21%), and the complexity of the markets themselves (21%) are identified as the main barriers. Lack of funding (13%), and knowledge gap/access to technology (10%) were also considered relevant.

- **Which are the main challenges to achieve high-integrity and high-quality carbon credits in the region:** the need for strong national regulatory framework (28%) and well-structured projects (28%) were highlighted by the audience. The lack of financing (17%), governance (11%), international rules (8%), permanency of credits (4%), and quality managers (3%) are other relevant challenges.

The objective of this policy brief is to increase the understanding and awareness in policymakers from the institutions in charge of regulating existing carbon market mechanisms, on what high integrity means, and how to embed high integrity carbon markets within national strategies and frameworks, that align with their NDCs and broader climate and sustainable development policy priorities. Governments have an interest in understanding and strategically engaging with VCMs. This involves understanding how VCMs relate to transactions under Paris Agreement's Article 6. Several policymakers, therefore, have indicated strong interest in the integrity of VCMs in both the domestic and international policy context, including how they relate to:

- The channeling of private finance into priority mitigation actions.
- The role of VCMs in the domestic climate policy mix including contributing to (and going beyond) compliance with NDCs.
- Ensuring interoperability across voluntary and regulatory markets.
- Domestic private sector net zero decarbonization strategies.
- The role of governments creating enabling conditions for a sustainable supply of carbon credits from projects that address the real needs of the countries, that comply with the highest integrity standards, and that ensure a proper distribution of the benefits.
- Rules and regulations regarding claims, truth-in-advertising, and the prevention of greenwashing on the demand side.
- Creating inclusive mechanisms to integrate Local Communities and Indigenous Peoples in the design and implementation of projects, ensuring they receive fair benefits of voluntary carbon markets.

For that purpose, CAF partnered with three (3) institutions with relevant international reputation in building integrity in VCMs worldwide: the Integrity Council for the Voluntary Carbon Market (ICVCM), which works on the supply side and published the Core Carbon Principles (CCP)[11] to provide a global benchmark for high-integrity carbon credits that set rigorous thresholds on disclosure and sustainable development; the Voluntary Carbon Markets Integrity Initiative (VCMI), which works on the demand side and published the Claims Code of Practice[12] to guide and give confidence to companies to make transparent, credible claims involving carbon credits as part of their climate commitments[13]; and the Institute of International Finance (IIF), a global association of financial institutions that has been working for years in carbon markets providing innovative research and advocating for the necessary regulatory, financial and economic policies for the implementation of high-integrity VCMs.

The document is structured as follows:

1. Evolution of carbon markets in LAC, identifying the systemic gaps that the region faces.
2. Opportunities to build integrity in the region, considering the works from ICVCM and VCMI.
3. Recommendations for governments to build high-integrity VCMs.

11 The Integrity Council for the Voluntary Carbon Market (2023). Core Carbon Principles, Assessment Framework and Assessment Procedure. Available at: https://icvcm.org/wp-content/uploads/2023/07/CCP-Book-R2-FINAL-26Jul23.pdf

12 Voluntary Carbon Markets Integrity Initiative (2023). Claims Code of Practice. Available at: https://vcmintegrity.org/wp-content/uploads/2023/09/VCMI-Intro-C-Markets-context-for-govts-ENGLISH_Extra.pdf

13 IIF (2023). Voluntary Carbon Markets Monitor: Build Integrity and Scale Will Follow. Available at: https://www.iif.com/Products/Voluntary-Carbon-Markets-Monitor

# Carbon markets & integrity in Latin America and the Caribbean

## Evolution and status of the carbon markets: Opportunities for accessing direct investment into mitigation actions

Carbon finance has demonstrated to be an effective way to reduce GHG emissions and governments play a key role designing and implementing climate policies to ensure that carbon credits are effective, consistent with other national policies, and adapted to the national circumstances[14]. If well-designed and sufficiently ambitious, carbon credits can contribute to reducing GHG emissions cost-effectively and, hence, to the achievement and enhancement of countries' NDCs. It is estimated that trading in carbon credits could reduce the cost of implementing countries' Nationally Determined Contributions (NDCs) by more than half – by as much as $250 billion by 2030. In other words, carbon credits could facilitate the reduction of 50% more emissions (about 5 $GtCO_2e$ per year by 2030) at no additional cost[15].

According to the United Nations Framework Convention on Climate Change (UNFCCC), 83% of the NDCs globally state the intent to use international market mechanisms to reduce GHG emissions[16]. Considering this, compliance with Article 6 of the Paris Agreement and the design and implementation of robust national carbon market instruments is crucial. The Paris Agreement defined Article 6 to "enable greater ambition [of countries] in their mitigation and adaptation actions and to promote sustainable development and environmental integrity." It proposes a roadmap for emission reductions through international cooperation, allowing countries to transfer carbon credits, obtained from GHG emission reductions, to help other countries meet their respective NDCs. However, the lack of specific guidelines for its implementation is hampering its operation: in 2023 and prior to COP28, there are still many issues that parties must resolve to implement the defined mechanisms[17].

Despite this, a growing number of countries stand ready to activate Cooperative Approaches, whether through voluntary or compliance markets, and an increasing number of companies are announcing science-based net zero targets that will only be achievable through access to credits from voluntary carbon markets[18]. These factors drive demand for functioning carbon markets, and the governments in LAC are interested in attracting this increasing private finance to accelerate NDC implementation, and support climate, nature, and socioeconomic prosperity policy priorities.

Latin America and the Caribbean region is rich in natural resources, possess massive carbon sinks, and have enormous potential for Nature-Based Solutions (NbS) and Technology-Based Solutions (TbS)[19]. These natural conditions offer a strategic advantage to lead the generation of high-integrity environmental assets like GHG emission reductions and removals. As a result, VCMs are gaining rapid interest in national and subnational governments. Besides their high potential to act as mechanisms to achieve climate goals in the short to medium term, they also leverage additional funding required to incentivize transformational changes in several sectors. Experts

14 IICA (2023). Concept Idea Note for Ag Carbon Partnership. Working Paper. 7 p.

15 UNFCCC (2022) 2022 NDC Synthesis Report. Available at: https://unfccc.int/ndc-synthesis-report-2022#Planning-and-implementation-process

16 UNFCCC (2022) 2022 NDC Synthesis Report. Available at: https://unfccc.int/ndc-synthesis-report-2022#Planning-and-implementation-process

17 UNFCCC (2023) Meetings of the Article 6.4 Supervisory Body. Available at: https://unfccc.int/process-and-meetings/bodies/constituted-bodies/article-64-supervisory-body/meetings-of-the-article-64-supervisory-body

18 Stolper, A and Robert O'Leary, R. (2022). The Guide to Environmental, Social and Corporate Governance. Law Business Research. United Kingdom.

19 Umweltbundesamt (2021) Certification of Carbon Removals, Part 2: A review of carbon removal certification mechanisms and methodologies. Available at: https://www.ecologic.eu/sites/default/files/publication/2022/50035-Certification-of-carbon-removal-part-2-web.pdf

predict that the development of advanced carbon marketplaces in LAC could lead to significant revenue generation as global revenues from carbon pricing continue to soar. Moreover, expanding carbon markets in the region would increase the international competitiveness of the supply of GHG emission reductions and removals, further encouraging the development of carbon markets globally.[20]

LAC's existing carbon market landscape includes both voluntary and compliance approaches, and currently, is the second largest source of GHG emission reductions in the world, generating approximately 20% of all carbon credits globally in 2020 and 2021[19], mostly from Nature-Based Solutions (NbS) and Technology-Based Solutions mainly from renewable-energy projects. Peru, Brazil, and Colombia are by far the region's most significant contributors of carbon credits, representing more than 80% (71 $MtCO_2e$) of all LAC carbon credits retired to date in the Voluntary Carbon Markets. [21]

Regulatory frameworks for carbon credits within LAC vary by country and serve as an indicator to measure the different levels of development of Carbon Finance in the region. Some governments have established carbon taxes, whether at the national or subnational level. In contrast, others provide subsidies promoting low-carbon technologies and the development of carbon capture and storage technologies (CCS) within their existing energy infrastructure[22]. According to the *State and Trends on Carbon Pricing*[23], as of 2023, five (5) countries in the region have a carbon tax implemented or scheduled (Argentina, Chile, Colombia, Mexico -which pioneered developing carbon taxes at subnational level-, and Uruguay). Brazil is still considering implementing a carbon tax. These systems implemented in the region cover 17% of the total regional GHG emissions, which makes LAC the third region in terms of total GHG emissions covered by compliance carbon pricing mechanisms, following East Asia & Pacific (35%) and Europe and Central Asia (30%). Furthermore, carbon tax rates in high-income countries tend to be higher than those in middle-income countries, thus prices are significantly higher in Europe than in LAC, except for Uruguay.

# Gaps in Latin America and the Caribbean: the need for creating enabling conditions

Although the Paris Agreement pursuits the international community's confidence in the effectiveness of market-based instruments as catalysts for climate action, the fact is that both the mechanisms stipulated in Articles 6.2 (ITMOs) and 6.4 (A6.4 Mechanism)[24] are still being operationalized by UNFCCC´s Subsidiary Body for Scientific and Technological Advice.

Beyond the challenges related to its operationalization[25], there are regional circumstances that should be considered in the process. In Latin America and the Caribbean, for example, the high natural capital of the region with potential to be used for climate change mitigation (e. g. Amazon biome) has positioned it as an ideal place for the development of projects that reduce or remove GHG emissions and mobilize finance through tradable carbon credits. However, in some cases, such land use and forestry projects have been questioned for their lack of environmental and social safeguards, development challenges, transparency and impact, shortcomings mainly due to the lack of institutional frameworks in this area in the countries of the region.

Despite these challenges, the current climate turmoil must be addressed with haste: gaps to the implementation of market-based instruments should be identified and bridged. It is necessary to make use of all existing climate action instruments and to ensure coherence among them. The markets for environmental assets, particularly the VCM, must be carefully designed and implemented with maximum guarantees of integrity, transparency, institutionality, and impact, so that the reduction of GHG emissions is truly effective. Furthermore, VCMs should be designed and implemented considering the decisions made by UNFCCC regarding Article 6 operationalization, to ensure full complementarity.

20 White & Case (2023). Growth of carbon markets in Latin America. Available at: https://www.whitecase.com/publications/insight/latin-america-focus-fall-2022-growth-carbon.

21 IICA, VCMI, Climate Focus (2023). Agricultural and Blue Carbon Market Opportunities in Latin America and The Caribbean. Available at: https://repositorio.iica.int/handle/11324/21837

22 Stolper A, O'Leary R (2022). The Guide to Environmental, Social and Corporate Governance. Law Business Research. United Kingdom. Available at: https://latinlawyer.com/guide/the-guide-environmental-social-and-corporate-governance/first-edition

23 World Bank (2023). State and Trends of Carbon Pricing 2023. Available at: http://hdl.handle.net/10986/39796

24 Article 6.2 creates the basis for trading International Transferred Mitigation Outcomes (ITMOs) across countries while ensuring the promotion of sustainable development, environmental integrity, and transparency. Article 6.4 is expected to be an improved version of the Clean Development Mechanism of the Kyoto Protocol: it establishes a mechanism for trading GHG emission reductions between countries under the supervision of the Conference of Parties. While the first is a decentralized system in which countries can make bilateral or multilateral agreements to trade ITMOs that would allow them to achieve their NDCs and in which they are responsible for the governance (authorizing the issuance, transfer, and retirement of credits as well as conducting MRV and ensuring their quality); the Article 6.4. Mechanism is a centralized system administered by the Supervisory Body (SB), created at COP26, which will be responsible for all governance matters for what will be called A6.4 Emissions Reductions (A6.4 ERs).

25 The latest developments can be checked at UNFCCC´s website:

Even though there exist numerous reasons why each country develops their capacity to host high-integrity VCM projects at different speeds (such as the fact that each country is free and sovereign to decide how VCM will be developed and how they will be implemented), some common systemic gaps for the developing of VCM in the region have been identified[26]:

1. **There are limited technical, institutional, and operational capacities**, as well as knowledge and information, within stakeholders involved in implementing and consolidating carbon markets to allow replication and scaling of financial instruments in mitigation and adaptation programs in the region. Different VCM approaches require different capacities and infrastructure; currently, many gaps exist.

2. **There is a lack of credibility at the international level in the robustness of the region's institutions to guarantee the issuance of high-integrity reductions/removals**. Although some countries in South America have advanced their establishment of institutional frameworks and GHG registries, accounting systems, and accounting rules to promote environmental integrity and ensure the issuance of reliable credit units, there still need to be more confidence in providing high quality, transferable carbon units. Ensuring quality requires the appropriate design of carbon market mechanisms, which can be challenging, mainly because international guidance needs to be more specific. For instance, in Latin America, REDD+ projects involving reforestation and avoiding deforestation provide a significant opportunity for carbon credits due to the region's forest resources. These projects can benefit local communities but are also subject to criticism for lack of regulatory oversight and for imprecise calculations (e. g. overestimation of GHG ERs) with the potential to result in inaccurate accounting of these carbon credits. This uncertainty can jeopardize regional climate goals and the reliability of carbon markets generally. Caution and independent diligence are advised for those relying on these credits to support regional climate goals and carbon markets.

3. **There are incomplete regulatory frameworks for effectively implementing market instruments that compliment and comply with Article 6 of the Paris Agreement (accounting, authorization of international transfers, corresponding adjustments,[27] and enhanced transparency framework).** Although some countries in South America have experienced significant advances in the revision and adjustment of their regulatory frameworks and their climate policy instruments to facilitate the implementation of VCMs, there are still regulatory barriers that need to be considered and overcome to establish solid transparency frameworks that foster the ambitious and transparent implementation of Article 6. Additionally, interactions with other climate, energy, and economic policies must be understood to assess whether they are complementary, overlapping, or contradictory when designing carbon pricing instruments. For instance, fossil fuel subsidies are countervailing policies that must be considered when designing carbon pricing instruments.

4. **There are inadequate information systems to monitor, report, and verify reduced/removed $tCO_2e$, make corresponding adjustments in national accounting, and carry out international transfers of mitigation results (ITMO).** Even though some countries in South America have Monitoring, Reporting, and Verifying (MRV) systems put in place or have advanced in the strengthening of existing national systems, there are still technical and operational limitations in tracking reduced/removed $tCO_2e$ in several sectors and performing accurate accounting that ensures environmental integrity and transparency. Furthermore, NDC accounting is an essential prerequisite for ITMOs. This requires that NDC targets are clearly defined (e. g., about their geographical coverage, the emissions sources and GHGs included, and the timeframe covered); that they are expressed in quantifiable terms (e. g., GHG emissions or megawatts of renewable power capacity); that the target level be specified (e. g., about historical data or a BAU emissions path); and that progress towards NDC targets be tracked.

5. **There is limited cooperation among the region's countries for disseminating good practices, lessons learned, and transnational opportunities in developing and implementing carbon markets**. As mentioned above, in the LAC region, Argentina, Chile, Colombia, Mexico, and Uruguay are pioneers in applying carbon pricing instruments, alongside broader fiscal reforms. The experience gained through this process is a crucial source of information that may support other countries in the region. It is essential to encourage cooperation between countries to collectively advance toward the consolidation of effective carbon markets that allow the implementation of the country's NDC, as well as fostering more ambitious projects and programs that fuel the increasing need for climate action in the region.

26 Gaps listed were identified from interactions between CAF and relevant stakeholders from public and private sector of VCMs in LAC.

27 Making a corresponding adjustment means that when Parties transfer a mitigation outcome internationally (under A6.2 guidelines) to be counted toward another Party's mitigation pledge, this mitigation outcome must be 'un-counted' by the Party that agreed to transfer it.

6. **There is a limited involvement of other non-governmental actors (e. g., academia, CSOs, NGOs, etc.) in carbon markets**. If done well, VCMs can offer significant co-benefits, including improved air quality, socio-economic development, and revenues which can promote other essential aspects such as a just transition, other climate action measures, or reducing other environmental impacts (e. g. loss of biodiversity, etc.). For that reason, robust VCM policies need broad support from civil society. Environmental Non-Governmental Organizations (NGOs) and other civil society groups play an essential role in solid climate policy as a vital counterweight to the interests of GHG emitting industries. They can produce data and information to inform the development of climate policies and play a fundamental role in supporting long-term climate policies that contribute to increasing carbon prices. Additionally, non-governmental actors can act on the supply side of carbon markets by developing mitigation projects with the potential to generate carbon credits or by developing quality standards for carbon credits like the CCP and assessment framework by the ICVCM, among others. They are also acting on the demand side by guiding companies and other non-state actors how to make credible voluntary use of carbon credits as part of their climate commitments, and what associated claims they can make regarding the use of those credits, as the VCMI is doing through its Claims Code of Practice.

Capacities, credibility, regulation, information, cooperation, and stakeholders´ involvement. Gaps in these six (6) areas show that there is still a lot of work to do in Latin America and the Caribbean to fully implement effective VCM initiatives. For this reason, CAF -Development Bank of Latin America and the Caribbean-, is committed to contribute to the creation of the necessary enabling conditions to fill these gaps. CAF is working together with governments and other relevant stakeholders in the region to ensure that integrity, impact, institutionality, and transparency underpin any environmental asset markets to be implemented.

# Opportunities to build integrity in Latin America and the Caribbean

A high-integrity voluntary carbon market is a key complementary tool to reduce and remove GHG emissions above and beyond what would otherwise be possible and to channel finance towards climate resilient development. High-integrity carbon credits can unlock urgently needed finance to reduce and remove billions of tones of emissions. The world is on track for 2.6°C warming by 2100. We need every tool available working at full speed to secure a livable future. A high-integrity voluntary carbon market is one important tool that can help finance the transition to 1.5°C by 2030.

While public sector efforts are vital, it is abundantly clear that they alone are insufficient to deliver the $125 trillion of investment that the transition to net zero requires, according to analysis by GFANZ. Approximately 70% of the capital required could come from the private sector, with nearly half financed directly by corporates. Some portion of that could be mobilized by the voluntary carbon market (VCM), which provides a means for private companies to channel finance into emissions reductions and sustainable green growth as part of their voluntary commitments to climate action.

## Required elements of integrity in the demand side

Ensuring integrity is critical to building trust in VCMs and enabling them to grow, value and impact. Entities operating on the demand side of VCMs who do not act with integrity undermine the reputation and ultimately the value of VCMs.

Companies are the main users of carbon credits transacted in VCMs and are therefore primarily responsible for ensuring high-integrity use. Companies using carbon credits should consider the following demand-side elements to ensure high integrity, ambitious voluntary climate action:

- **Science-aligned** – Company strategies, targets, activities, and engagement in voluntary carbon markets should account for the latest scientific consensus on safe upper limits for global warming. As such, alignment with the Intergovernmental Panel on Climate Change (IPCC) model pathway of carbon dioxide ($CO_2$) emissions reductions that limit global warming to 1.5 degrees Celsius, with no or limited overshoot, is the ultimate objective.
- **Additional** – Company action, investment, and carbon credit purchases should support emissions reductions and/or removals that are additional to those that would occur in the absence of demand for carbon credits.
- **Transparent** – Companies should transparently disclose information relating to their climate commitments and activities, including their scope, coverage, underpinning strategies and assumptions, performance metrics, relevant definitions, and the nature of carbon credits and their use. Companies should publicly report on progress and learning as they move toward achievement of their climate mitigation goals (e. g. net zero targets).
- **Comprehensive** – Companies should base their climate targets and actions on accurate and complete greenhouse gas inventories in line with the most recent requirements set out by the GHG Protocol (or equivalent, should one be developed).

- **Net-positive benefit** – Companies' climate action should create net-positive benefits to individuals and communities impacted by the supply and use of carbon credits, including Indigenous Peoples, local communities, women, and underserved communities. Such action maximizes social and ecological co-benefits and avoids or minimizes adverse impacts.

- **Rights-compatible** – Company climate action should respect, protect, and fulfil human rights under international law, including lack of discrimination based on identity, the rights of Indigenous Peoples, and those associated with health, labour, land, and Free Prior and Informed Consent.

- **Nature-positive** – Company climate action should align with the need to slow, halt, and reverse nature loss and move toward a nature-positive state of recovery and renewal.

- **Immediate** – Companies should prioritize immediate action to reduce their own emissions, including within their value chains. Scientific evidence shows that the years leading up to 2030 will be critical to avert environmental tipping points caused by increased concentrations of GHG emissions in the atmosphere.

- **Progressive** – Businesses should progressively increase the ambition and significance of their investments in interventions that accelerate climate change mitigation within and beyond their value-chains, and they should aim to reflect the value of unabated emissions within their value chains, including projects that generate carbon credits for voluntary carbon markets.

- **NDC enabling** – Companies' actions, investments, and demand for carbon credits should support the implementation of national climate plans, contribute to and help exceed the ambition of countries' Nationally Determined Contributions (NDCs), and avoid potential for disincentives to increasing the ambition of NDCs.

- **Consistent** – Companies' lobbying efforts and membership of industry associations should be aligned with, not contrary to, their climate commitments.

- **Collective and Predictable** – Companies should work together with a diverse and broad range of stakeholders to act on climate change, including by publicly signalling their expected voluntary demand for carbon credits and aggregating demand for carbon credits to increase certainty and help drive systemic change.

## Box 3
## The VCMI Claims Code of Practice

The Voluntary Carbon Markets Integrity Initiative (VCMI) is an independent non-profit initiative working to enable voluntary carbon markets (VCMs) which deliver real and additional benefits to the climate, people and nature, and accelerate the transition to ambitious, economy-wide climate policies and regulation. On the supply side of the market, VCMI offers support to host countries and regions to develop policy options and strategies to channel VCM finance to where it is needed most for climate and socioeconomic prosperity. VCMI this year released the **VCM Access Strategies Toolkit** in English, Spanish, Portuguese and French.

On the demand side, VCMI is developing international rules of best practice through the **Claims Code of Practice**. The VCMI Claims Code addresses integrity on the demand side by guiding companies and other non-state actors on how they can credibly make voluntary use of carbon credits as part of their climate commitments. It provides clarity, transparency, and consistency on what these commitments and claims mean and will give confidence to all those engaging with voluntary carbon markets.

The Claims Code is the result of two years of research and engagement with stakeholders across all sectors and regions, including road testing of a provisional version published in 2022 and two public consultations. The Claims Code has deliberately been designed in coordination with existing standard setters (e. g., IC-VCM, SBTI, CDP) to align with and complement their work, thereby increasing clarity for businesses, their stakeholders and the wider public.

The Claims Code of Practice is designed not only for **companies**, but also for **individuals or business** interested in making climate-friendly purchases, for **investors** who want to judge the credibility of a company´s climate ambition, and for **governments** that want to incentivize non-state actors to use carbon credits credibly and structure claims to be truthful, clear, and informative. In the latter case, governments might develop or endorse corporate reporting requirements, advertising and consumer protection standards and other policies, and measures or guidance on the use of carbon credits.

While VCMI Claims are limited to voluntary action, VCMI believes that robust comprehensive policy and regulations are essential if the world is to avoid catastrophic climate change. VCMI hopes that the Claims Code will constitute a valuable contribution to this emerging policy architecture.

# Box 4
# The ICVCM Core Carbon Principles

The Integrity Council for the Voluntary Carbon Market (Integrity Council) is an independent governance body for the voluntary carbon market. The Integrity Council's work seeks to bring consistency to the market, overcome this fragmentation and give buyers confidence that they are funding projects making a genuine impact. It will set and enforce a definitive global threshold, drawing on the best science and expertise available, so high-quality carbon credits efficiently mobilize finance towards urgent mitigation and climate resilient development.

What makes a carbon credit of 'high integrity'? In consultation with stakeholders across the market, **the Integrity Council has developed 10 Core Carbon Principles** which set out the key principles for high-integrity carbon credits:

**A. Governance**

- **Effective governance -** The carbon-crediting program shall have effective program governance to ensure transparency, accountability, continuous improvement and the overall quality of carbon credits.

- **Tracking -** The carbon-crediting program shall operate or make use of a registry to uniquely identify, record and track mitigation activities and carbon credits issued to ensure credits can be identified securely and unambiguously.

- **Transparency -** The carbon-crediting program shall provide comprehensive and transparent information on all credited mitigation activities. The information shall be publicly available in electronic format and shall be accessible to non-specialized audiences, to enable scrutiny of mitigation activities.

- **Robust independent third-party validation and verification -** The carbon-crediting program shall have program-level requirements for robust independent third-party validation and verification of mitigation activities.

## B. Emissions Impact

- **Additionality -** The greenhouse gas (GHG) emission reductions or removals from the mitigation activity shall be additional, e. g., they would not have occurred in the absence of the incentive created by carbon credit revenues.

- **Permanence -** The GHG emission reductions or removals from the mitigation activity shall be permanent or, where there is a risk of reversal, there shall be measures in place to address those risks and compensate reversals.

- **Robust quantification of emission reductions and removals -** The GHG emission reductions or removals from the mitigation activity shall be robustly quantified, based on conservative approaches, completeness and scientific methods.

- **No double counting -** The GHG emission reductions or removals from the mitigation activity shall not be double counted, e. g., they shall only be counted once towards achieving mitigation targets or goals. Double counting covers double issuance, double claiming, and double use.

## C. Sustainable Development

- **Sustainable development benefits and safeguards -** The carbon-crediting program shall have clear guidance, tools and compliance procedures to ensure mitigation activities conform with or go beyond widely established industry best practices on social and environmental safeguards while delivering positive sustainable development impacts.

- **Contribution toward net zero transition -** The mitigation activity shall avoid locking-in levels of GHG emissions, technologies or carbon-intensive practices that are incompatible with the objective of achieving net zero GHG emissions by mid-century.

# Required elements of integrity in the supply side

Today, carbon credits are already channeling significant funds to projects that reduce and remove emissions, but they are far from achieving their full potential. Currently, the market is fragmented, and carbon credits are not of a consistent quality and reliability.

The VCM currently includes carbon-crediting programs (also known as carbon standards) that set rules for mitigation activities that achieve emissions reductions or removals. Those mitigation activities are developed and operated by mitigation activity proponents (mainly known as project developers) and their design is validated by accredited third-party Validation and Verification Bodies (VVBs)[28]. Greenhouse Gas (GHG) emission reductions or removals achieved by those mitigation activities are then verified by VVBs and issued by carbon-crediting programs in their registries as carbon credits. Each carbon credit should represent one (1) ton of equivalent $CO_2$ emission reductions or emission removals. All carbon-crediting programs have adopted requirements, procedures, and policies to address governance, decision making, administrative, and operational considerations for developing and implementing mitigation activities known as program documents. However, the quality, coverage, and adherence to the stipulations contained within those documents varies and is not always fully aligned with international standards like ISO 14064.

Within this context, the Integrity Council for the Voluntary Carbon Market (ICVCM) launched the Core Carbon Principles (CCPs) and Assessment Framework with the aim of helping VCM participants identify high-quality carbon credits and establish and progressively raise a threshold for quality and integrity across the VCM that builds confidence and comparability. Buyers will have more confidence in easily identifying and pricing high-integrity carbon credits, no matter who issues them or what sort of project they fund, or where it is generated. This will reduce confusion, overcome market fragmentation, and give buyers confidence that they are funding projects making a genuine impact on emissions. This will also help to channel capital towards the most impactful, low-cost climate mitigation activities globally at pace, which is particularly critical for developing economies.

With the Core Carbon Principles, an ambitious but achievable threshold for high-integrity carbon credits has been set. And this is just the beginning – the Integrity Council has also established a pathway for continuous improvement, working with stakeholders across the market to continually improve and strengthen the CCPs over time. The Core Carbon Principle (CCP) label will provide a credible, rigorous, and readily accessible means of identifying high-quality carbon credits. The Integrity Council's work on the high-integrity supply of carbon credits complements that of the Voluntary Carbon Markets Integrity Initiative (VCMI).

The threshold standard set by the Integrity Council's CCPs will be implemented through the Assessment Framework and the Assessment Procedure. This publication forms the complete process and operational requirements that the Integrity Council will follow to assess carbon crediting programs and Categories of carbon credits.

28 GHG accreditation for performing validation and verification of GHG assertions is based on the ISO Standard 17029 (collecting former guidelines by ISO 14065, ISO 14064, and ISO 14066 etc.).

# Box 5
# The ICVCM CCP Assessment Framework & Procedure

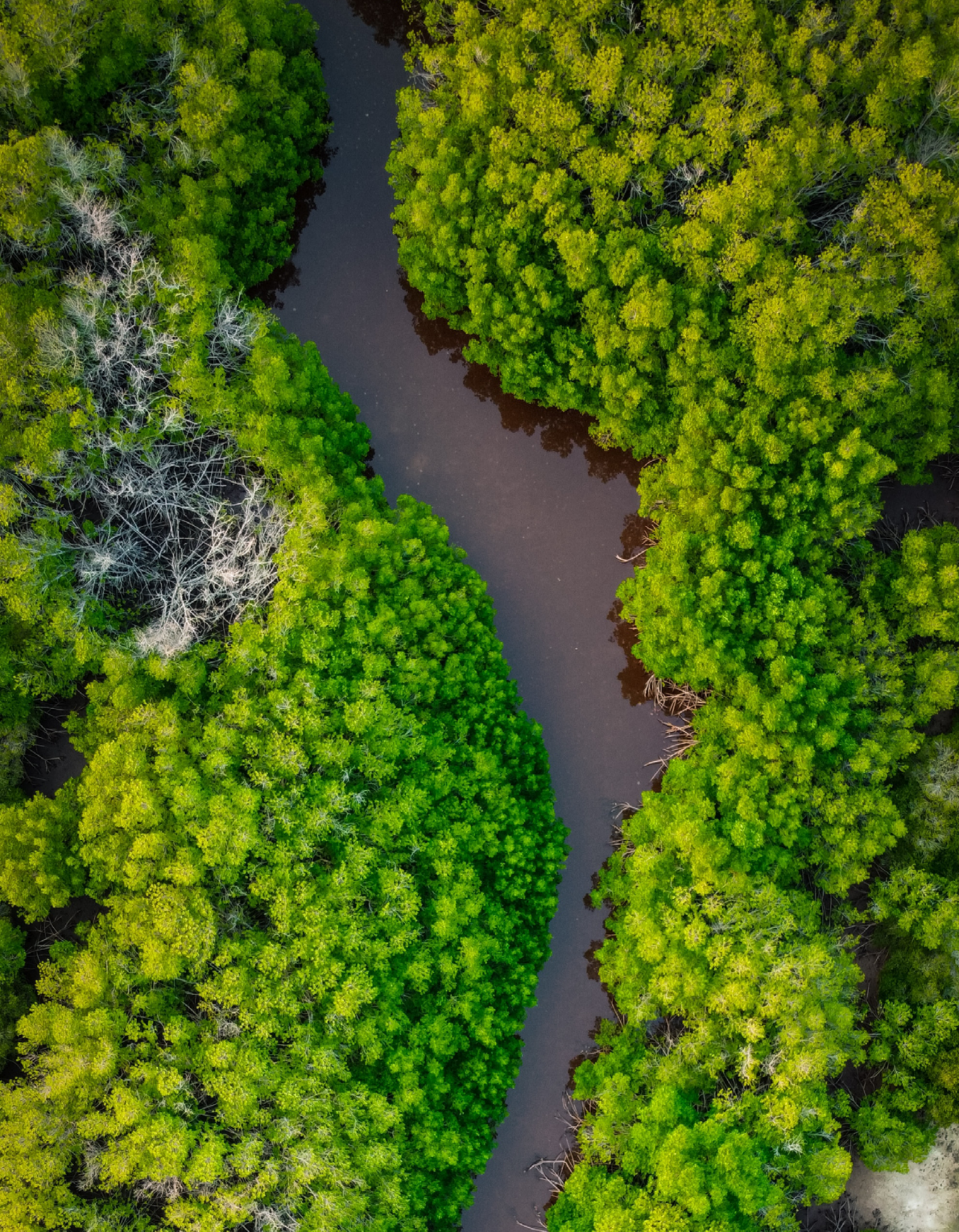
The CCPs are operationalized through the Assessment Framework, which provides rigorous criteria and decision tools for each principle. Carbon credits will receive the CCP label only if both the carbon-crediting program that issued them and the credit category are assessed by the Integrity Council and meet its criteria for high integrity (climate, environmental and social) set out in the CCPs. Carbon-crediting programs can now apply to the Integrity Council for assessment against the CCPs. Applications are being assessed in accordance with the process set out in the Assessment Procedure.

The Integrity Council plans to continually improve the CCPs and related criteria in the Assessment Framework to enhance the VCM, with the next iteration scheduled for 2025 and implementation in 2026. This commitment to progress is based on solid regulatory practices and recognizes the need for ongoing adaptation and innovation, informed by multi-stakeholder work programs.

**The Assessment Procedure** embeds the Core Carbon Principles into the voluntary carbon market. It sets out:

- The IC-VCM´s process for assessing CCP-eligibility.
- How eligible carbon credits will be tagged.
- How the Integrity Council will continue to oversee and enforce the CCPs.
- How this process aims to help facilitate the continual development of the voluntary carbon market.

The Assessment Procedure establishes a collaborative process under which the ICVCM's multistakeholder working groups consider Categories of carbon credits (Categories) and their assessment against the ICVCM's criteria and requirements under the Assessment Framework. All Categories of carbon credits (Categories) undergo an initial filtering, where some are fast-tracked for approval, while many are sent for more rigorous assessment by a multistakeholder working group. The multi-stakeholder working groups are organized by sectoral expertise and Categories are prioritized for deeper assessment depending on their current and trending market share. The multi-stakeholder working groups make recommendations to the Integrity Council on Category assessments. Following the deeper assessment stage, the Category may be approved, not approved, or awarded conditional approval, stipulating matters that an eligible carbon-crediting program needs to remediate for the Category to be approved.



# Recommendations for LAC Governments to build high-integrity VCMs

## Building the required institutional framework across the policy cycle

By bridging environmental, economic, and financial spheres, carbon markets can link to various policy and regulatory objectives, including GHG emissions reductions, environmental conservation and pollution abatement, economic and social development, and financial market efficiency, safety, and stability.

Considering the diverse approaches to carbon market design and governance structures and the varied interests of corporate and financial actors across the carbon market value chain, different official sector bodies – including environmental, industrial, and securities and financial regulators and supervisors – may consider aspects of carbon market development as relevant to their mandates and strategic objectives. In that context, **scaling VCMs requires an interinstitutional and coordinated effort among regulators and market participants during the VCM policy-cycle[29]: planning and analysis, participation and deliberation, policy design for net zero transition assistance, implementation, accountability, monitoring, and evaluation**. To facilitate that coordination, a series of actions that governments could enact are the following:

- Defining the roles, competency, authority, and scope of influence that environmental and financial authorities should have to enhance market integrity, trust, and market functioning. This includes identifying the regulator or authority that is best equipped to oversee VCMs.
- Defining standardized regulations for carbon credits, especially in terms of their legal nature and regulatory categorizations. Legal nature[30] defines assignment of property rights[31] and classification dictates how carbon credits can be modified, sold, and retired, defining the rights associated with them. On the other hand, regulatory classification determines the applicable rules based on the asset type, such as security or commodity.
- Suppliers benefit from improved access to financing and a clear price signal to inform their investment decisions and enable price risk management. Enhancing contractual and framework standardization is critical to achieving a greater scale-up of VCMs.
- Ensuring that national legislative frameworks adapt to the evolution and operationalization of the Article 6 framework, including issues such as corresponding adjustments (Art. 6.2), participation in the Article 6.4 Mechanism, and the necessary arrangements to authorize, track, and report ITMOs. In that sense, the legislative frameworks governing VCMs, and Compliance Carbon Markets should be developed holistically to facilitate complementarity between these two mechanisms (Art. 6 and VCMs) going forward.

29 Macquarie R, Green F, Kenward T, Müllerová H, Feigerlová M, Balounová E (2023). Just and robust transitions to net zero: A framework to guide national policy. University College London, Grantham Research Institute on Climate Change, and the Environment, ClimLaw: Graz, Centre for Climate Law and Sustainability Studies, Center for International Climate Research. Available at: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2023/10/Just-and-robust-transitions-to-net-zero_A-framework-to-guide-national-policy.pdf

30 Ben McQuhae & Co (2023). The Legal Nature of Carbon Credits. Available at: https://bmcquhae.com/en/2023/03/15/the-legal-nature-of-carbon-credits/

31 Streck C, Von Unger M (2026). Creating, Regulating and Allocating Rights to Offset and Pollute: Carbon Rights in Practice. Available at: https://cclr.lexxion.eu/article/CCLR/2016/3/4

- Setting policies to increase the amount and quality of publicly available information on carbon credits: granular and transparent data is needed on carbon credits prices, as well as data that is timely, comparable, and complete.

- Recognizing and incorporating VCMs into national decarbonization strategies with alignment to NDCs, as it may reduce concerns about market stability overtime.[32]

- Introducing statutory protections for transfers and authorizations of carbon credits transacted through VCMs and considering the role of digital technologies in promoting governance and enhancing market infrastructure.

- Providing more funds to reducing the cost of research and development of technologies that reduce/remove emissions is essential, as these may be big drivers of financial flows from investors.[33]

- Contributing to stimulate the demand by exploring when sovereign carbon-contingent financing[34] can substitute carbon tax within one economy. Capital mobilized through sustainability-linked debt is orders of magnitude larger ($1.6tn total) and has a wider reach, being implemented in countries where support for regulation has been insufficient. Carbon-contingent securities combine global nature of capital markets with the carbon-price incentives of regulation.

## Supporting transparency and integrity in the supply and demand side

Supporting the work of private-led initiatives such as ICVCM and VCMI could help governments to scale and build on existing frameworks set out by integrity initiatives who can contribute technical knowledge, enrich global best practices, and facilitate connections with VCM stakeholders networks, including buyers, project developers and policymakers. Together VCMI and ICVCM are working to create end-to-end integrity in the VCM, building confidence in the generation, trade and use of carbon credits.

Whilst companies must take responsibility for the way in which they use credits (e. g. net zero claims), countries hosting VCM projects can also take action to facilitate high-integrity credit use by creating supportive legal and policy frameworks. Below are some examples of actions governments could take to promote **high-integrity demand** for VCMs:

- Clarify government expectations on buyers for the high-integrity use of carbon credits, including actions buyers should take and claims that can credibly be made.

- Provide information on what buyers should seek in terms of high-quality carbon credits, including social and environmental safeguards and how benefit sharing agreements should be arranged.

- Align regulation on corporate sustainability disclosures, consumer protection, advertising standards and financial regulation with guidance on high-integrity use of carbon credits.

- Refuse advocacy proposals by corporates for regulation that would undermine climate action and call out corporates that are engaged in the use of carbon credits while advocating against climate action.

- Co-sponsor or co-develop carbon market activities and ensure that credits are only sold to high-integrity buyers.

- Clarify and enforce land tenure laws. Selectively provide concessions for VCM activity development only to projects that meet high-quality and high-integrity standards.

- Require that VCM activities report to domestic GHG inventories and GHG emission reductions and removals registries and make those inventories and registries publicly available.

- Clarify if and how approvals and authorizations for VCM activities will be provided, and under what conditions. If governments will authorize corresponding adjustments, they can specify the conditions and requirements for VCM activities to be approved.

32 CSIS (2023). Voluntary Carbon Markets: A Review of Global Initiatives and Evolving Models. Available at https://www.csis.org/analysis/voluntary-carbon-markets-review-global-initiatives-and-evolving-models

33 IIF (2023). Friday Green Minute with IIF Managing Director and Head of Sustainable Finance. Available at https://www.linkedin.com/company/institute-of-international-finance/posts/?feedView=videos

34 Allen F, Barbalau A, Zeni F (2023). Reducing Carbon using Regulatory and Financial Market Tools. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4357160

In terms of actions governments could take to promote **high-integrity supply** for VCMs, alignment with the ICVCM's Core Carbon Principles would help to ensure investments in the voluntary carbon market drive real, additional impacts for the region, with robust social and environmental safeguards applied. Additionally, VCMI´s VCM Access Strategies Toolkit[35] can be used while developing policy options and national strategies to assure that VCM finance is channeled to where it is needed most for climate and socioeconomic prosperity. Further supply side actions policymakers could consider include:

- Consider the guidelines and requirements of eligibility, additionality, buffering, etc., established by the GHG programs to ensure the same GHG ER´s quality in all carbon market.
- Effective alignment of the methodologies established by the carbon market projects and programs with the GHG levels of reference adopted by the countries in their NDCs.
- Creation of supervisory institutions in the countries responsible for continuous follow-up and sanctioning when necessary.

By ensuring that the voluntary carbon market operates with the highest levels of integrity and transparency, the carbon market ecosystem can play a pivotal role in achieving our global climate goals, at the same time channeling significant funds from the Global North to finance urgently needed climate action and sustainable development in the Global South. Government engagement can mark the beginning of a more accountable and action-oriented era, where the voluntary carbon market fulfils its potential role in the fight against climate change.

35 Voluntary Carbon Markets Integrity Initiative (2023). VCM Access Strategy Toolkit. Available at: https://vcmintegrity.org/wp-content/uploads/2023/09/VCMI-Intro-C-Markets-context-for-govts-ENGLISH_Extra.pdf

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