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JPMorgan Outlines Voluntary Carbon Market Principles

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In a recently published white paper, JPMorgan outlined its approach to improving and strengthening voluntary carbon markets to promote scalable decarbonization efforts. JPMorgan focused its analysis on voluntary carbon markets, *i.e.*, markets where "companies or individuals to purchase carbon credits to meet their own emissions goals" independent of markets "created and regulated by mandatory international, national or regional carbon management regimes," (*i.e.*, compliance markets). JPMorgan also cautioned that voluntary markets are "not a substitute for robust public policies designed to address climate change."

Under JPMorgan's analysis, carbon markets provide benefits to the global effort to reduce carbon emissions beyond those offered by regulatory programs for three major reasons. First, they allow companies in industries that face challenges in reducing their carbon emissions where, for instance, "the technologies necessary to address emissions may not yet be commercially available or else may still be prohibitively expensive," to offset their greenhouse gas emissions by purchasing carbon credits, thereby "enabling greater deployment of climate solutions elsewhere in the economy." Second, by incentivizing investment, carbon markets "facilitate more rapid deployment of proven solutions, which can drive down net emissions more quickly." Third, investing in projects via carbon credits can promote other environmentally friendly actions, including reforestation efforts, or a slowing of deforestation, which increases biodiversity, reduces other forms of pollution, and promotes stronger environmental resilience.

Still, JPMorgan recognized that carbon markets and the use of carbon credits may not be adopted on a global scale and across all industries as quickly as necessary to maintain net-zero targets without other efforts. Accordingly, it advises that companies should still devise business strategies and invest in technologies that will directly reduce their carbon emissions. While these actions may impose

significant short-term capital expenses, they will likely increase business efficiency and reduce long-term costs, according to the bank. JPMorgan also cautioned that voluntary markets are "not a substitute for robust public policies designed to address climate change."

The voluntary carbon markets provide for trading two main forms of credits: (a) avoidance credits and (b) removal credits. Avoidance credits are created when a company takes an action that either fully prevents or reduces the amount of carbon it normally would have produced under business operations. For example, companies can generate these types of credits by transitioning to solar energy or by taking actions to reduce deforestation. Removal credits, on the other hand, are created when a company actively promotes removal of GHGs from the atmosphere. This can be accomplished through a variety of options, including nature-based solutions like reforestation, or through technological developments like investments in, or promoting the use of, carbon-capture technology. JPMorgan noted that while nature-based solutions like reforestation tend to be more readily accessible and cheaper, they only store carbon for short periods of time. Technology like carbon-capture provides long-term removal of GHGs from the atmosphere, but tends to be expensive and is not yet fully developed.

Avoidance credits and removal credits work in tandem to complement each other. In the near-term, avoidance credits reduce the amount of GHGs released and slow the accumulation of carbon in the atmosphere. In the long-term, deployment of more expensive carbon-capture technology has the potential to partially reverse historic GHG emissions and counteract the continued release of GHGs from industries where emissions-reduction is prohibitively expensive or technologically difficult. As JPMorgan observed, while the goal of net-zero emissions by 2050 will largely be accomplished through reducing carbon emissions, "the large-scale removal of GHGs from the atmosphere will be [also] be necessary[.]"

JPMorgan also identified eight major factors it utilizes when assessing the value and utility of carbon credits, given widely recognized issues associated with "variation in the availability and quality of information needed to assess credit quality, resulting in a lack of confidence for many market participants." Under its framework, the GHG emission reductions underlying each carbon credit should be: (1) real and proven to have actually taken place; (2) measurable and quantifiable according to recognized methodological approaches; (3) in addition to what would have already been undertaken by the company; (4) unique and traceable to each initiative; (5) independently verified by a reputable GHG accreditation program; (6) not simply a displacement of carbon emissions from one sector of the economy to another; (7) durable and long-term; and (8) equitable by promoting and supporting marginalized communities.

JPMorgan highlighted additional challenges facing the development of effective and efficient voluntary carbon markets. These include, in addition to a lack of quality information about each carbon credit, a scarcity of high-quality carbon credits that would promote and support large-scale efforts at decarbonization; the existence of "multiple marketplaces, competing frameworks and principles"; and an inability to "support more sophisticated forms of trading, which limits its ability to meet the needs of different kinds of participants. Improved trading infrastructure and further development of advanced features such as forward market instruments and reference contracts are needed to support increased

liquidity, transparency and risk management, which can contribute to greater scale and efficiency."

JPMorgan's report highlights the potential value to companies of integrating high-quality carbon credits into their overall sustainability plans, while also acknowledging the challenges in doing so. The integrity of carbon credits is an ongoing source of controversy and challenge. Last year, for instance, the Chair of the International Organization of Securities Commissions cited concerns around the "appropriate levels of integrity, transparency, and liquidity" of voluntary markets.

Conclusion

Of note, the integrity of credits traded on voluntary carbon markets is not outside of federal regulatory oversight. Earlier this year, the Chairman of the Commodity Futures Trading Commission ("CFTC"), Rostin Behnam, announced in a speech that the CFTC recognizes environmental products as "commodities" and therefore "can play a role in voluntary [carbon] markets, and that carbon markets must be transparent and have integrity and adhere to basic market regulatory requirements." The CFTC Chair's statement followed a letter to the CFTC sent in the fall of 2022 by a group of Democratic senators asking for improved regulation of the market for carbon offsets. It remains unclear how the CFTC would exercise this authority in practice and what the implications are for the developments of voluntary markets; however, the CFTC has identified as a top priority addressing financial risks posed by climate change as well as prosecuting fraud and manipulation in carbon and environmental markets. In June of 2023, the CFTC published guidance for whistleblowers to report fraud in spot and forward carbon markets, and then announced the creation of an environmental fraud enforcement task force. Further, on July 19, 2023, the CFTC held its second convening to discuss the development of voluntary carbon. Nonetheless, carbon markets are likely to remain active, and have been growing around the world, including in the UK, Brazil, Australia and Africa.

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