Source: *The Business Times,* p44
Date: 14 April 2025

COMMENTARY

Improving carbon credit frameworks to enhance carbon project quality and financing

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COUNTRIES such as Singapore have recently started to directly procure credits to supplement their Nationally Determined Contribution (NDC) goals towards climate-change mitigation.

New research from the Sustainable and Green Finance Institute (SGFIN) at the National University of Singapore (NUS) indicates that these countries – and others that are considering to follow their footsteps – need to carefully review the frameworks that are used to evaluate these credits to minimise future reputational and reversal risks of the carbon credits they procure.

Recent certifications of major carbon credit frameworks, such as Verra and Gold Standard by the Integrity Council for the Voluntary Carbon Market (ICVCM) and the Carbon Offsetting and Reduction Scheme for International Aviation (Corsia), highlight the importance of these frameworks and their certifications in facilitating high-integrity carbon credits and high-quality carbon projects.

These certifications coincide with the intense spotlight on global carbon markets at COP29, with the rapid developments related to the Article 6 carbon market initiated by the United Nations and the Article 6.4 Supervisory Body.

Singapore has been the "market leader" in this space, having established Implementation Agreements of Article 6 credits with five countries in quick succession.

Such certifications presumably reduce the due diligence required by credit buyers and increase confidence in the certified credits.

The current approach adopted by these certification entities, however, falls short in addressing reputational risks for those purchasing carbon credits – including governments purchasing Article 6 credits – and cash flow risks for financiers providing initial project capital for carbon abatement and removal projects.

Financiers face heightened risks during the pre-project development and throughout the project's implementation. Operational disruptions and changing regulations could result in future shortfalls in the number of credits issued, compared with initial estimates.

This would diminish the project's projected cash flow, forcing financiers to adopt a more conservative approach to value and finance these projects, leading to higher financing costs and rendering well-intentioned projects more expensive to realise.

The current frameworks, including those certified by ICVCM and Corsia, rely on broad categorisation of project types, making it difficult for financiers and governments to develop accurate assessments of projects operating under these frameworks.

Indeed, in scrutinising the quality of the applicable standards and methodologies for each framework, there would be concerns whether they provide sufficient assurance.

Enhancing the dissemination of project-level data, rather than generalising merely based on project type, would allow for lower financing costs, increased availability of loan capital to project developers and easier comparison across projects.

We surmise that providing transparent, standardised, project-specific disclosures would be essential for financiers and governments to set the appropriate financing costs.

Shortcomings of "blanket" certifications

Current framework certifications by ICVCM and Corsia focus on assigning quality labels to methodologies and the associated frameworks.

One could then assume that projects assessed to be acceptable by certified frameworks would be capable of generating higher-quality carbon credits, potentially reducing cash flow risk.

Unfortunately, this approach exacerbates the issues above, generalising and categorising projects to the extent that increases the risk of them not being truly "additional" or "real".

This raises the critical question: To what extent are financiers' concerns regarding a project's cash flow risk reduced when the project falls under frameworks certified by Corsia and ICVCM?

The recent research from SGFIN proposes a set of principles and requirements for carbon credit frameworks to ensure that only high-quality projects are eligible. The white paper also introduces a scoring methodology to quantify the integrity of these frameworks.

Using this methodology, several prominent frameworks certified by Corsia and ICVCM are shown to have significant differences in quality. There is a growing concern that the perceived quality of a certification by the two would be set to the quality of the worst-performing framework certified by these entities.

With the current tools, financiers and buyers can only be assured of the established baseline quality in each certification system. They are unable to determine the extent to which the certification mechanism will perform in the future.

This is especially important for countries that are using carbon credits to meet their climate goals as it enables them to accurately predict the long-term reliability of offsets.

To address the issue of differing standards and methodologies covering the disparate carbon markets, standardised and mandatory disclosure requirements for eligible projects are urgently needed.

To ensure that project-level information is effectively communicated, these requirements should use a standardised report template with key performance indicators tailored to each project type and shared publicly.

This would provide financiers with access to fixed project metrics, simplifying their valuation process and increasing confidence in valuation results.

Projects should also commit to specific measurement, reporting and verification (MRV) technologies from the onset, providing early insight into how emission reductions are tracked, verified and monetised.

Finally, a transparent quantification methodology would be essential to facilitate external verification of the results.

While Corsia and ICVCM incorporate transparency as an essential principle, they do not provide guidance on details required to satisfy this principle.

These vague requirements are insufficient for financiers and governments to effectively assess the associated risks.

These certifying bodies should use their influence to create a list of standardised key indicators, alongside a template for a standard set of information that eligible projects must regularly share with their stakeholders.

Financiers and governments will then be able to achieve a more robust valuation of a project's impacts and cash flows.

Project developers will be encouraged to adopt more advanced MRV techniques, such as digital tracking, which allows for real-time auditing of impacts, again providing an additional safeguard of quality during project implementation.

Singapore has recently accelerated its procurement strategy of Article 6 credits, having established Implementation Agreements with five countries and putting out a direct tender for projects capable of generating at least 500,000 Article 6-eligible, nature-based carbon credits.

Through this mechanism, the Republic has exhibited its desire to have tighter control over the credits they will use to satisfy its NDC – a stance that other governments can follow suit.

Despite the tender's requirement for awarded credits to be from countries that Singapore has formed Implementation Agreements with, there is still a need for Singapore to choose among suitable projects.

Singapore has recently accelerated its procurement strategy of Article 6 credits. PHOTO: YEN MENG JIIN, BT

Any future claims of non-additionality or Article 6.2 eligibility reversal on already chosen credits, for example, would undermine the Republic's ability to endorse higher quality credits and the reliability of its overall net-zero strategy.

Project-level standardised disclosures would facilitate this process by increasing the ease in comparing key metrics underlying such risks.

Subsequently, countries' efficacy in identifying high-quality offsets can improve, making offsetting a more trusted method in the global net-zero pathway.

Emerging trading mechanisms

Standardised disclosures can also support the quality of credits selected for use in sector-specific carbon credits trading mechanisms, such as one currently being proposed for international shipping, substituting the original international shipping levy that was to be implemented.

This credit trading mechanism raises concerns similar to the usage of carbon credits to meet NDC goals.

Without stringent regulations, shipping companies may find it more cost-effective to simply purchase credits while continuing business as usual, especially if carbon credit prices remain low or if fossil fuel costs fall below the price of these credits. This would mean a failure in delivering the intended decarbonisation of the shipping industry.

Therefore, there is a need to choose credits of sufficiently high quality and are priced justifiably high.

Standardised disclosures, by increasing confidence of financiers and governments in providing loans, can help motivate more ambitious and highly priced projects to be generated for such trading mechanisms.

Project-specific disclosures are crucial for creating a high-quality carbon market for both financiers and buyers.

As the Article 6.4 carbon market approaches, the Article 6.4 Supervisory Body and the UN emphasising standardised guidelines for project-specific disclosures would be critical to overcoming quality concerns that have plagued voluntary carbon markets, ensuring the success of the promulgated global carbon market.

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