FFEM principles for supporting project initiators using "carbon finance"

Note for project initiators

Voluntary carbon market: developments and challenges

Carbon finance was introduced as part of the Kyoto Protocol in 2005, in the form of two flexibility mechanisms, the Clean Development Mechanism (CDM) and Joint Implementation (JI). These were designed to allow developed countries to offset their surplus greenhouse gas (GHG) emissions by funding GHG reduction or carbon storage projects in countries in the "Global South", or by trading rights to pollute with other countries. Alongside these regulated markets, the voluntary carbon market (VCM) has emerged, allowing entities not covered by the Kyoto Protocol to fund GHG reduction and carbon sequestration projects. This growing unregulated market, driven by company CSR policies and net zero commitments,[1] relies on independent certification standards to ensure the quality of the carbon credits generated.[2]

The FFEM is being approached by potential project initiators (NGOs, communities, local authorities and the private sector) who want to link their projects to the generation of carbon credits, or to pre-finance projects where the carbon credits will be used for regulated offsetting or sold on the voluntary carbon market. "Carbon finance" can be a useful source of additional funding to launch new projects or to sustain the activities and outcomes of existing ones. Funders are also encouraged to investigate additional innovative financing mechanisms, in order to mobilise the cash flows needed for climate change mitigation and adaptation, and to address other environmental challenges. However, vigilance is needed with regard to the integrity of these markets and their role in achieving carbon neutrality and in observing the avoid-reduce-compensate hierarchy.

Although "green carbon" (mainly forestry), "blue carbon" (e.g. restoration of mangroves or seagrass beds) and energy transition projects (e.g. developing biomass industries) can have a

[1] 188 $MtCO_2e$ in 2020 and >500 $MtCO_2e$ in 2021

[2] In March 2022, the Directorate-General for Energy and Climate at the French Ministry of Ecological Transition and Territorial Cohesion published a comparative study of existing offset standards, produced in French by I Care: [Standards-compensation_MTE.pdf (ecologie.gouv.fr)]

highly positive impact on climate, biodiversity and human well-being, the aim here is for the FFEM to set out the principles against which it will appraise future submissions.

FFEM principles for supporting carbon finance projects

The comparative study of offset standards published by the French Ministry of Ecological Transition and Territorial Cohesion was based on analysis against 5 basic criteria: measurability, verifiability, permanence, additionality and uniqueness. Three additional criteria were applied: observance of human rights; inclusion of criteria on environmental, social and economic co-benefits of the project; and link with the United Nations 2030 Agenda Sustainable Development Goals (SDGs). The FFEM will apply these criteria in evaluating projects with a carbon finance component, with an emphasis on 5 principles:

- multisolving projects, as part of a territory-wide or sector-wide approach
- robust certification
- transparent and participatory governance that encourages scaling-up
- transparent and fair distribution of benefits
- compensation as a last resort in the avoid-reduce-compensate hierarchy.

Multisolving projects, as part of a territory-wide or sector-wide approach

Project proposals must employ a "multisolving" approach that emphasises not only benefits in terms of carbon and climate, but also in aspects such as biodiversity, social impact and adaptation. The FFEM will make sure that these aspects are addressed in tandem with carbon savings, as in the SDGs and as needed to address specific problems in a territory or sector.

This multisolving approach should be reflected in the use of certification standards (see below) which incorporate these aspects. Here, the FFEM will encourage the use of the most stringent certification standards, as well as "premium" labels.

Robust certification

The certification process is an essential requirement for FFEM support. The process will need to be scientifically robust: the baseline scenario must be constructed rationally and there must be appropriate scientific support for carbon accounting. The project's additionality must be rigorously demonstrated, i.e. proving that the project could not have happened without the income generated through the carbon credits. There must be a clear difference between the baseline scenario and the scenario involving the project. These issues are particularly critical for projects focusing on avoiding deforestation, and more broadly for organic carbon projects (e.g. green or blue carbon, soil carbon). Here too, the process will look at the status of ecosystems in addition to carbon accounting.

Project initiators will also need to commit to following recommendations from relevant international initiatives. These include the Voluntary Carbon Market Initiative (VCMI)[3] for the demand side, and the 10 principles of the Integrity Council for the Voluntary Carbon Market (IC-VCM)[4] for the supply side, as well as the actions in the Call to action for Paris Aligned Carbon Markets[5] from the Summit for a New Global Financing Pact, and the recommendations in the Joint Statement on Voluntary Carbon Market.[6]

Transparent and participatory governance that encourages scaling-up

Human beings must be the central subjects of the development process, on the basis of their active, free and meaningful participation in the process.[7] True involvement of local communities in a project, and therefore their ownership of it, can only be achieved through a participatory approach. This requires the use of consultative and participative processes to include all stakeholders in the project. One example of this, for projects requiring land access, is the FPIC (free, prior and informed consent) process. The FFEM will ensure that projects provide proof of appropriate forums for participation and consultation, so that the terms and conditions of the project can be co-defined with the local communities.

Targeting the territory or sector level and involving institutional and non-institutional stakeholders greatly increases potential for partnerships and synergies, as well as the capacity to share solutions on a wider scale. The FFEM will scrutinise the link between the projects proposed and the national carbon finance strategy (whether established or in progress) of the lead countries, to ensure that these projects make the best possible contribution.

[3] https://vcmintegrity.org/
[4] https://icvcm.org/
[5] Synthesis of the Chair (pactedeparis.org)
[6] https://www.government.nl/documents/publications/2023/12/10/joint-statement-on-voluntary-carbon-market
[7] Declaration on the Right to Development. United Nations General Assembly resolution 41/128 of 4 December 1986.

An appropriate and scientifically robust monitoring and evaluation process

At every stage of the project cycle – from feasibility study through to final evaluation – the FFEM will ensure that the project initiator and their partners have put in place appropriate procedures to monitor and evaluate the project outcomes against all expected social and environmental benefits. For example, they will need to justify to the FFEM the areas of investigation selected for the feasibility studies, the indicators recommended for monitoring and evaluation (*ex ante* and *ex post*) and the resources (financial, technical and human) allocated to monitoring and evaluation, and these choices will be analysed to check they are appropriate. Involving universities or research centres will add value.

The FFEM considers it essential for the project initiator to establish a robust measurement, reporting and verification (MRV) system, to ensure transparency around changes to emissions or carbon storage and the associated impacts, and around the resources allocated to achieve the project objectives. This will also help to improve understanding where there are scientific uncertainties about storage or abatement of GHG emissions and about the complexity of ecosystems. In this respect, the FFEM has clearly identified a number of challenges in producing sound scientific scenarios, and the project initiators must commit to addressing these issues, particularly in relation to the risks of leakage and non-permanence.

Transparent and fair distribution of benefits

The FFEM considers the mechanisms for sharing the income from sales of carbon credits to be a crucial component, so it needs to be vigilant about the integrity of the projects it supports. Project proposals to the FFEM must guarantee a mechanism for redistribution to local communities. This could, for example, take the form of direct money transfers, creation of community development funds, investment in infrastructure or training and capacity-building programmes. The issue of benefit sharing must be addressed in detail, as part of the project-specific benefit sharing plan. If the project initiator's business model does not include any benefits to local communities or project beneficiaries from the sale of carbon credits (as in some pre-finance for carbon funds), the initiator will be asked to explain the consultation method used to inform the stakeholders and gain their consent. The issue of benefit sharing must be discussed in participatory forums, with the aim of ensuring transparency, equity and justice, and in line with the principle of free and informed participation.

Compensation as a last resort in the avoid-reduce-compensate hierarchy

Carbon finance is one of the pathways for decarbonising business operations, as long as it is part of a genuine "sustainable finance" approach that goes beyond the avoid-reduce-compensate hierarchy. In the interests of sustainability, where the final purchaser of the credits is identified, they will be asked to demonstrate the integrity of the purchase request – in other words the robustness of their internal decarbonisation strategy, throughout their supply chain, particularly in terms of short- and medium-term targets. It will be recommended that applicants refer to certification such as the Science Based Targets Initiative (SBTi)[8] or sign up to integrity principles such as the Oxford Principles for Net Zero Aligned Carbon Offsetting.[9] Additionally, in France, purchasers' claims of carbon neutrality are subject to Article 12 of the Climate and Resilience Act. Negotiations are also underway to establish EU Directives on greenwashing.

[8] https://sciencebasedtargets.org/
[9] https://www.smithschool.ox.ac.uk/research/oxford-offsetting-principles