VCMI Voluntary Carbon Markets Integrity Initiative

Scope 3 Flexibility Claim

Beta version

vcmintegrity.org

Executive Summary

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The Voluntary Carbon Markets Integrity Initiative's (VCMI) new Scope 3 Flexibility Claim – launched as a beta version on November 28th 2023 – is designed to drive climate action on corporate pathways to net zero.

The new claim permits a company to make limited use of high-quality carbon credits to close the gap between its estimated scope 3 greenhouse gas (GHG) emission reduction target level and its current scope 3 emissions in a given year, as long as it has already taken other steps to reduce its current emissions. Scope 3 emissions are the emissions a company is indirectly responsible for because they are linked to its full value chain, rather than the emissions produced by its direct operations.

To ensure the claim is not used as an excuse to reduce decarbonization efforts, the Scope 3 Flexibility Claim includes guardrails limiting the total use of carbon credits to 50% of scope 3 emissions, and only up until 2035.

Many companies experience difficulties in meeting their near-term scope 3 emission reduction targets[1]. The new claim will unlock demand for carbon credits from companies making progress towards science-aligned targets, but unable to fully meet them.

The claim provides a mechanism to incentivize corporates to get back to making progress towards meeting their targets, while also helping to mobilize urgently needed climate finance. Recent analysis suggests that the emissions gap between companies' scope 3 emissions reduction targets and their current emissions, is currently around 1.4 gigatonnes of carbon dioxide equivalent (rising to over 7 $GtCO_2e$ by 2030)[2].

The Scope 3 Flexibility Claim draws on extensive feedback from consultations with a broad and diverse group of stakeholders. However, VCMI has launched this new claim as a beta version because further fine-tuning is needed. This paper sets out a roadmap towards fully operationalizing the claim in 2024. VCMI invites other standard-setting and accountability organizations to work collaboratively with us on these issues. Until this work is completed, companies will not be able to make a Scope 3 Flexibility Claim. Nevertheless, we invite them to join VCMI in testing this beta version.

1 Challenges include the decarbonization cost, engaging the supply chain, data limitations, organizational capacity, market timing, availability of renewable energy, lack of information around strategies to reduce scope 3 emissions, broader macro issues (e.g. Covid 19, regional conflict), inflexibility or lack of clarity on target setting and/or disclosure frameworks, lack of access to financing (e.g. lack of external incentives or funding) and governance limitations (e.g. lack of decision making structures) (TCB, unpublished report). "Corporate Engagement with Voluntary Carbon Market Claims: Findings and Recommendations".

2 MSCI Carbon Markets (formerly Trove Research), 2023. "Assessing the impact and effectiveness of carbon credit use in corporate climate strategies".

Introduction

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The Voluntary Carbon Markets Integrity Initiative (VCMI) has launched a beta version of a Scope 3 Flexibility Claim that will temporarily allow companies to use a limited number of high-quality carbon credits towards their decarbonization objectives.

Drawing on research[3] that suggests such flexibility will accelerate and deepen greenhouse gas (GHG) mitigation globally, the new claim is designed to contribute to:

- **Stimulating more climate action.** High-integrity voluntary carbon markets can play an important role in driving more climate finance to where it is most needed, ensuring that currently available opportunities to reduce GHG emissions are not lost.

- **Helping companies make more progress towards scope 3 emission reduction targets.** By creating a de facto price for emissions, the new claim will incentivize companies to address their scope 3 emissions.

The Scope 3 Flexibility Claim has been the subject of an extensive consultation process involving stakeholders from business, government, NGOs, and civil society, as well as nearly 100 participants across VCMI's Expert Advisory Group, Stakeholder Forum, and Early Adopters Program[4].

Analysis conducted[5] found that:

1. A large gap exists between companies' scope 3 target levels and their GHG emissions inventory, which, if temporarily filled through voluntary carbon markets, could generate huge demand for climate mitigation projects globally.

2. Companies are more likely to meet their targets, and to set more ambitious future goals, if some flexibility regarding the use of carbon credits is allowed.

3. Corporations that use carbon credits tend to be more ambitious in their climate action.

Wide use of the new claim could generate $19bn of additional demand for climate mitigation projects[6].

3 MSCI Carbon Markets (formerly Trove Research), 2023; The Climate Board, unpublished report; Ecosystem Marketplace, 2023.

4 See Background Document - section B for feedback.

5 See below for more details. Publications from MSCI Carbon Markets (formerly Trove Research) and The Climate Board will be published on the VCMI website.

6 MSCI Carbon Markets (formerly Trove Research), 2023.

Scope 3 Flexibility Claim

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VCMI's Scope 3 Flexibility Claim is designed to be accessible to a greater number of corporates than - and provide a pathway to obtaining - the Carbon Integrity Silver, Gold, and Platinum Claims, which are presented in the Claims Code and ready to be used by companies.

The new claim requires high-quality carbon credits to be purchased and retired to bridge a company's scope 3 emissions gap in any given year.

Under the VCMI Claims Code, companies seeking to make a Scope 3 Flexibility Claim must:

- Comply with the **VCMI Foundational Criteria** (VCMI Claims Code Step 1).
- Make progress towards meeting scopes 1 and 2 **emission reduction targets** (VCMI Claims Code Step 2).
- Use high-quality carbon credits to **bridge the gap** between their most recently reported scope 3 emissions and their target scope 3 emissions for the same year, based on the level of emissions on a trajectory consistent with the company`s science-aligned target (VCMI Claims Code Step 3). The sources of emissions included are those covered by the scope 3 target boundary and the company must observe the claim guardrails.
- Disclose all information required to conform with VCMI Claims Code Step 4 on obtaining third-party assurance.

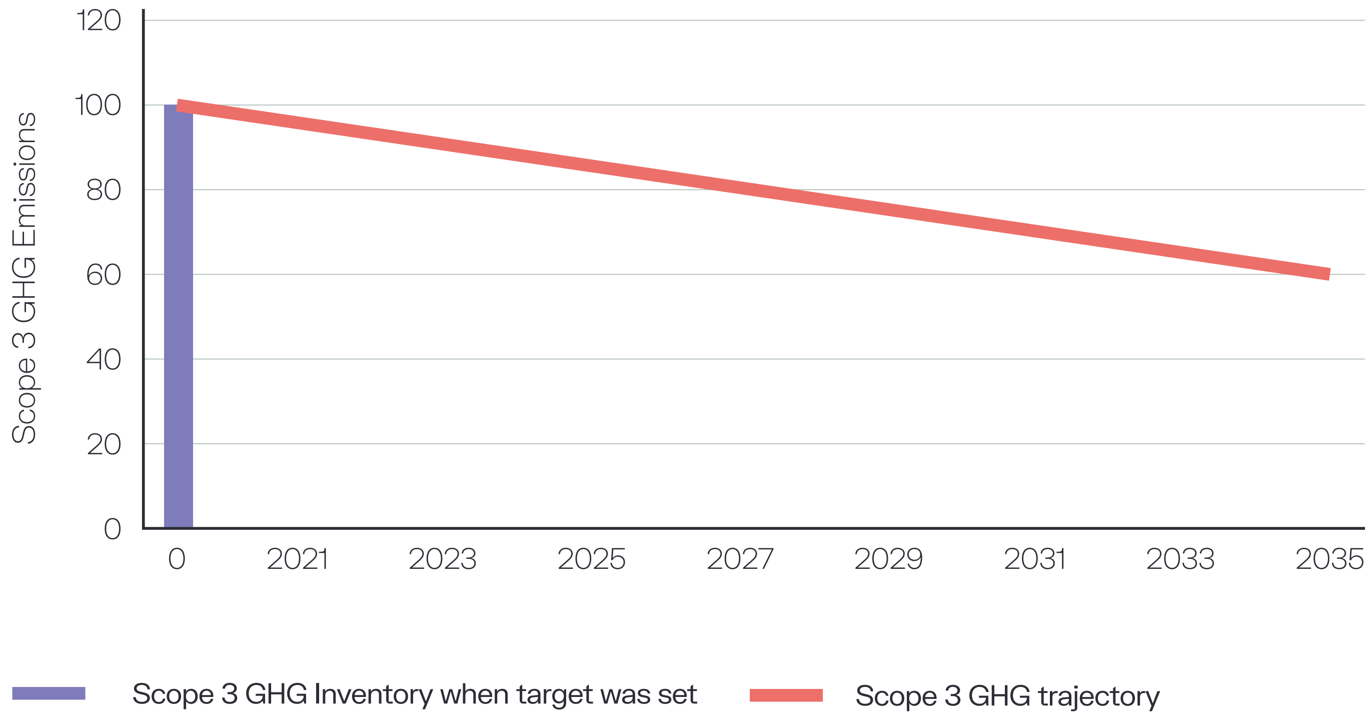
To enable the Scope 3 Flexibility Claim, two key calculations must happen:

1. **Determining the scope 3 emissions gap** to be bridged; and
2. **Determining the maximum number of credits** that can be used – the limit – by applying the guardrails.

Determining the scope 3 emissions trajectory and establishing the emissions gap

Companies should determine a **scope 3 GHG emissions trajectory** consistent with their science-aligned target, by using the 1.5ºC-aligned pathway adopted by the Science-Based Target Initiative[7]. For each year (t) after the year the target was set (t=0), expected emission levels must be reflected in the trajectory from which the scope 3 emissions gap can be calculated (Figure 1).

FIGURE 1: EXAMPLE OF A SCOPE 3 GHG EMISSIONS TRAJECTORY



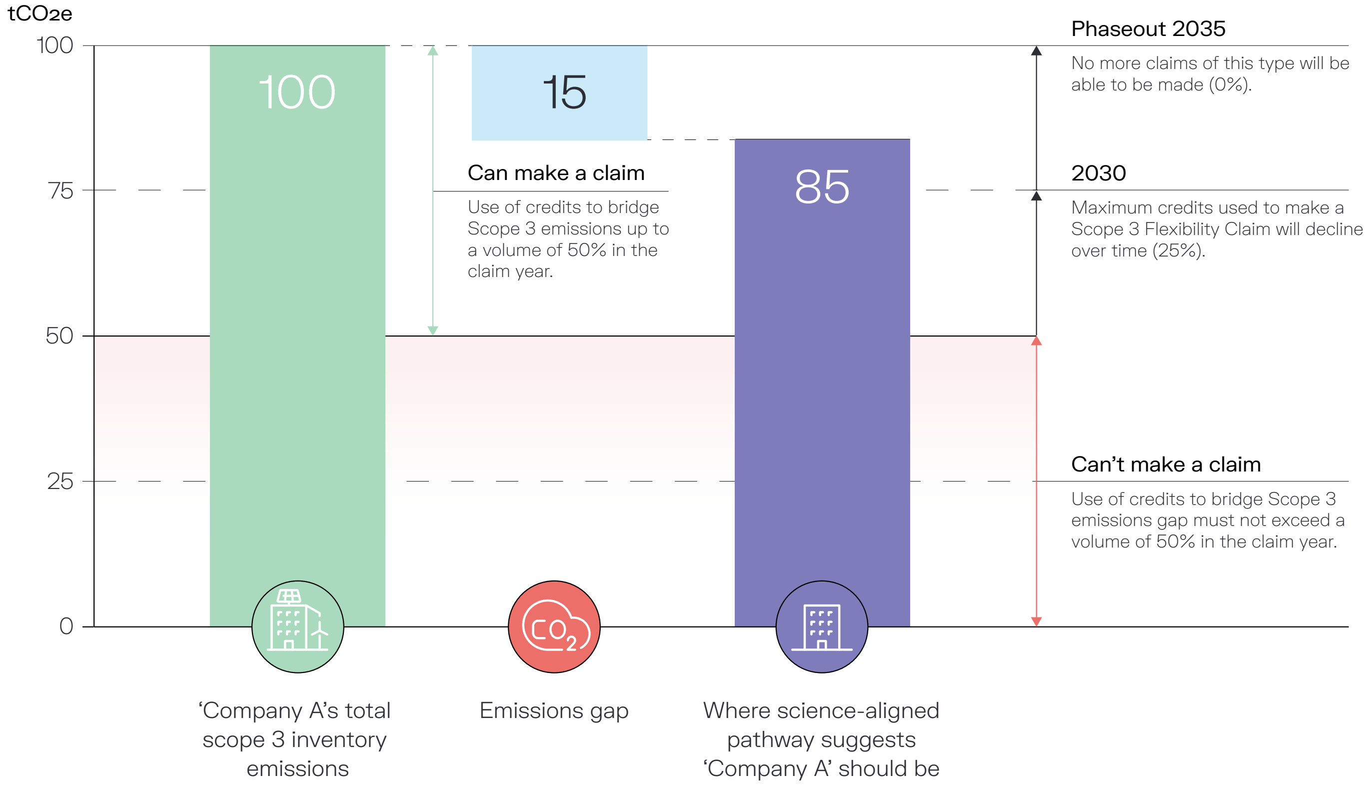
VCMI recognizes that many companies' emissions do not follow a linear trajectory and, in some cases, may increase in a given year as a result of factors outside their control such as changing practices, product lines and suppliers, adoption of new technologies, sales and acquisitions.

Companies can use credible alternative pathways if they are derived from an equivalent, robust, emissions reduction trajectory. If a company uses this option, it will need to provide details on the methodology and underlying assumptions used to build the trajectory, publicly disclosing the information on its website so it can be assured.

The scope 3 emissions gap is defined as the difference between the most recent reported emissions, in accordance with the near-term target boundary and as disclosed in a company's GHG emissions inventory, and the trajectory emissions level in that same year, as established iabove. Figure 2 shows how to calculate the amount of high-quality carbon credits that should be purchased and retired.

7 SBTI, 2021. "Pathway-to-Net-Zero.pdf (sciencebasedtargets.org)".

FIGURE 2: CALCULATING SCOPE 3 EMISSIONS GAP AND AMOUNT OF CARBON CREDITS THAT CAN BE USED.

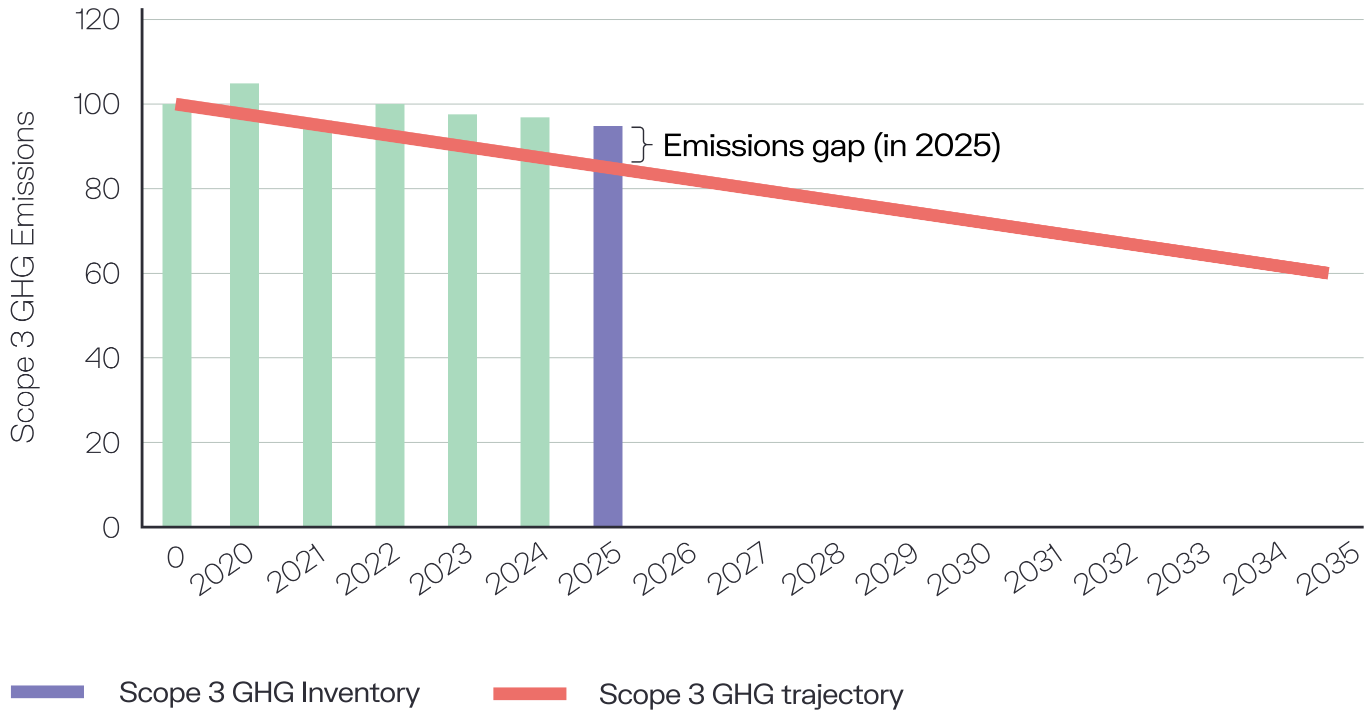


In this illustrative example, a company's most recent Scope 3 emissions are 100tCO_2e and the assumed target level, based on a trajectory consistent with its next science-aligned target, is 85tCO_2e. As shown in the graph above, the company's scope 3 emissions gap is therefore 15tCO_2e; this constitutes the volume of credits the company is required to purchase and retire to bridge the gap and make a claim.

For each subsequent year (t > 0), the **emissions gap** can be calculated after the disclosure of annual GHG inventory emissions, based on the difference between the reported scope 3 GHG inventory emissions as covered in the near-term target boundary and scope 3 GHG emissions trajectory (Figure 3).

Emissions gap (t)=scope 3 GHG inventory emissions (t)- scope 3 GHG emissions trajectory (t)

FIGURE 3: EXAMPLE OF AN EMISSIONS GAP CALCULATION FOR THE YEAR 2025. EMISSIONS GAP: 95-85=10



Applying the guardrails and determining the limit

GUARDRAILS

The Scope 3 Flexibility Claim includes guardrails to ensure the accepted mitigation hierarchy[8] is followed as closely as possible and that its use incentivizes companies to address their scope 3 emissions as fully as possible. These are:

- The number of carbon credits used must not exceed 50% of a company's GHG inventory scope 3 emissions in the year it is making the claim. This constitutes the limit to the number of carbon credits a company can use under the claim, provided that the emissions gap calculated is lower than or equal to such limit.

  Emissions gap (t) ≤Scope 3 GHG inventory (t)*50%;

- Credits used to make a Scope 3 Flexibility Claim must decline over time, leading to their complete phaseout no later than 10 years after the first claim is made, or by 2035, whichever is the earlier. At this point, there should be no further emissions gap to bridge and carbon credits should only be used to address remaining emissions once near-term targets have been met. **The Scope 3 Flexibility Claim therefore presents a pathway for companies to achieve Carbon Integrity Silver, Gold and Platinum Claims under the VCMI Claims Code.**

8 Prioritized steps to limit negative impacts, as much as possible, through mitigation (or reduction), restoration, and beyond value chain mitigation (WWF, 2020).

THE LIMIT

Table 1 below provides examples of companies that are eligible and ineligible for making a Scope 3 Flexibility Claim (also illustrated in Figure 4). It also shows how many high-quality carbon credits a company should purchase and retire to be able to make a claim (for simplicity, these examples use the same trajectory curve and year of last reported inventory as in Figure 3).

TABLE 1: EXAMPLES OF COMPANIES WHO ARE ELIGIBLE AND INELIGIBLE TO MAKE A SCOPE 3 FLEXIBILITY CLAIM

	Last reported inventory year	Scope 3 GHG target trajectory level (2025)	Scope 3 GHG inventory (2025)	Emissions gap (2025)	% of Scope 3 GHG inventory	Eligibility test: Is the gap ≤ 50% scope 3 inventory?	How many carbon credits should be purchased and retired?
Company A	2025	85	95	10	11%	Yes	10
Company B	2025	85	150	65	43%	Yes	65
Company C	2025	85	175	90	51%	No	N/A – non-eligible
Company D	2025	85	80	-5	-6%	Yes	Possible Carbon Integrity Silver, Gold or Platinum Claim if other requirements are met

Figure 4 illustrates specific cases, to show when a company is eligible to make a claim.

FIGURE 4: DIFFERENT COMPANIES' CASES TO ILLUSTRATE ELIGIBILITY TO MAKE A SCOPE 3 FLEXIBILITY CLAIM

For companies A and B, the emissions gap is lower than the limit of 50% (11% and 43%, respectively), thus they are both eligible to make a Scope 3 Flexibility Claim. Company C`s emissions gap, however, exceeds the limit of carbon credits that can be purchased and retired, so the company would not be able to make a claim. Company D has no emissions gap and is meeting its near-term scope 3 emissions reduction target through internal decarbonization. Should the company wish to go above and beyond its target and purchase and retire high-quality carbon credits as a proportion of its remaining emissions, it would be able to make a Carbon Integrity Claim, if the other requirements outlined in the VCMI Claims Code are met.

The impact of flexibility on the use of carbon credits through the Scope 3 Flexibility Claim

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Before publishing this beta version, VCMI needed to be confident that the Scope 3 Flexibility Claim would accelerate GHG mitigation. VCMI therefore commissioned or supported independent research to understand the likely impacts of the claim. The results of this research showed that:

1. **Many companies are far off-track from meeting their scope 3 emission reduction targets.** MSCI Carbon Markets (formerly Trove Research, 2023)' analysis[9] found that currently there are 1,286 companies with SBTi 1.5°C targets with data available to the public and of sufficient quality for assessment.

2. Of those companies that are on track for scopes 1 and 2 (589), 50% (293) are on-track for scope 1, 2 and 3, representing total GHG emissions of 3.2 GtCO_2e. Of these, 68 firms have bought carbon credits.

3. **The total scope 3 emissions gap is currently[10] around 1.4 GtCO_2e and is projected to rise to over 7 GtCO2e by 2030[11].** Assuming only the firms that are on track to achieve their SBTi-approved scopes 1 and 2 emissions reduction targets are eligible to use carbon credits to close the gap, this would create a potential demand for carbon credits of 644 million tonnes currently, and 2.2 GtCO_2e in 2030. On the assumption that carbon credits cost $30/t$CO_2$e, this demand would generate an additional expenditure on carbon credits of $19bn currently and $65bn in 2030.

4. 70% of survey respondents[12] said the **use of carbon credits** under specific eligibility criteria to enable a certain degree of flexibility, **would increase the likelihood that their company would maintain a science-based target.**

5. **59% of buyers in voluntary carbon markets have reported year-on-year decarbonization success** (Ecosystem Marketplace, 2023). Buyers are also 1.3 times more likely to have established supplier engagement strategies, and spend 3 times more on emission reductions activities compared to typical non-buyers on average.

6. **73% of VCMI Stakeholder Forum members agreed that additional claims allowing flexibility on the use of carbon credits when companies are not making enough progress towards meeting their targets is required.**

9 MSCI Carbon Markets - formerly Trove Research's database includes over 10,000 companies.
10 Most recent emissions could be for 2022 or 2021 and targets could have been set in 2023.
11 Figures provided are based solely on the number of companies that have declared emissions targets today.
12 The Climate Board has conducted a survey with 145 companies with companies from 10 industries and distributed in 9 regions.

Next Steps – Roadmap to complete and implement the Scope 3 Flexibility Claim

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During VCMI's methodological development of the Scope 3 Flexibility Claim, a number of technical challenges emerged that cannot be resolved by VCMI alone.

The most important of these is how to determine when a company is making progress towards meeting its science-aligned target in the interim years between when a company sets a target and its end date. This is central to the operationalization of the Scope 3 Flexibility Claim. This issue also confronts all those working on corporate climate target-setting, monitoring and accountability. It requires a collaborative effort between these organizations to produce a comprehensive approach that is consistent across all platforms.

Other associated issues include market-based accounting rules, establishing acceptable emissions reduction trajectories, defining the gap companies need to have filled to be making progress towards their near-term targets, as well as further refinement of the proposed Scope 3 Flexibility Claim guardrails.

The launch of the beta version of the Scope 3 Flexibility Claim is designed to ensure that we can sufficiently consult with companies on trialling and application, and with standard setters to collectively address outstanding issues. It should ensure that the claim strengthens the entire corporate climate action ecosystem and the response to the global climate crisis more broadly.

Roadmap

In 2024, VCMI will run a working group for companies interested in understanding, trialling, and applying for the Scope 3 Flexibility Claim. VCMI will continue to work with all other standard setters and others working on corporate climate accountability to create a coherent framework for assessing corporate progress towards their climate and decarbonization goals.

The road test with companies is planned for the second quarter of 2024, when an advanced version of the Scope 3 Flexibility Claim will be published, having incorporated additional methodological improvements. The final release is expected for September 2024, with a new brand and name for the claim to make sure it is connected to, but distinct from, "Carbon Integrity" claims.

To make VCMI's work accessible to more companies, it will look to support companies that face scope 1 and 2 emission reduction challenges, as well as those at the beginning of their decarbonization journey that do not yet meet the Foundational Criteria. An initial framework outlining the design of these additional claims will be submitted for public consultation in 2024. The roadmap for the Scope 3 Flexibility Claim can be seen in Figure 5.

FIGURE 5: SCOPE 3 FLEXIBILITY CLAIM ROADMAP

01 — 2023/24
Standard setter and company engagement.

02 — 2024 Q1
Working Group for methodology co-development & consultation.

03 — 2024 Q2
Updated version of the Scope 3 Flexibility Claim.

04 — 2024 Q2
Road test.

05 — 2024 Q3
Final release.

The Voluntary Carbon Markets Integrity Initiative is an international initiative to drive credible, net zero-aligned participation in voluntary carbon markets.

vcmintegrity.org