Supporting note

The Use of Carbon Credits in Climate Target Setting

September 2023
Preface

Purpose of this document

To support Net-Zero Banking Alliance (NZBA) member banks in developing targets, the Alliance has developed this short paper to provide clarification on the already-published Guidelines for Climate Target Setting for Banks outlining how the Alliance views the treatment of offsetting in relation to member commitments.

The paper does not introduce additional principles that member banks must meet as part of their NZBA commitment.

We note that further technical work will be necessary to operationalise these principles and define use cases for carbon credits, which is discussed at the end of this report.

Current NZBA guidelines on offset inclusion in target-setting

The Guidelines for Climate Target Setting for Banks (hereafter the Guidelines), published in April 2021, note that:

- In implementing and reaching targets for all Scopes of emissions, offsets\(^1\) can play a role to **supplement decarbonisation in line with climate science**.
- The reliance on carbon offsetting for achieving end-state net zero should be **restricted to carbon removals** to balance residual emissions where there are limited technologically or financially viable alternatives to eliminate emissions.
- Offsets should always be **additional and certified**.

In the Guidelines, the role for offsets is calibrated to when and how offsets are integrated into bank emission-based commitments:

**Long-term targets**

As indicated in the Guidelines, reliance on carbon offsetting for **achieving end-state net zero (assumed to be 2050 or sooner)** should be restricted to carbon removals and limited to instances where technologically or financially viable emissions elimination alternatives do not exist.

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\(^1\) ‘Offsets’ is used to refer to carbon credits used to voluntary balance, or offset, greenhouse gas emissions
Interim targets

The Guidelines do not specify an unambiguous or clear approach for interim targets but offer guiding principles which can be applied to interim targets:

- Offsetting can play a role that is **supplemental to sectoral and economy-wide decarbonisation**
- Any supplemental use of offsetting should be **aligned with climate science-based net-zero scenarios**, and
- Alliance members will look to **apply evolving leading practice** on offsetting.

Alignment of NZBA guidelines with other frameworks

Other important frameworks provide guidance to corporates on how to use carbon credits in climate target setting and what claims they can make in relation to their use. The Voluntary Carbon Market Integrity Initiative (VCMI) published its **VCMI Claims Code of Practice** in June 2023 and while it provides more detail, its recommendations are consistent with those found in this supporting note.

The Alliance understands that VCMI is looking at how carbon credits could be used for further sub claims in the coming months and may publish further guidance in late 2023. In this case, NZBA will consider this as part of its ongoing review and potential revision of the Guidelines for Climate Target Setting for Banks due to be completed in April 2024.
Discussion

What is offsetting?

For the purposes of this document, the activity referred to as “offsetting” means using carbon credits to compensate for greenhouse gas (GHG) emissions made elsewhere, with a carbon credit defined as the measured and credited avoidance or removal of a unit of GHG emissions.

Offsetting emissions in this way may be done to satisfy specific regulatory requirements or as a mechanism to support voluntary emissions claims (such as having reached ‘net-zero’ emissions).

Using carbon credits to reach net-zero climate targets

To reach end-state net zero, only carbon credits from projects that remove GHG from the atmosphere ("carbon removal credits") and are limited to instances where technologically or financially viable emissions elimination alternatives do not exist, are consistent with NZBA guidelines.²

The Guidelines introduce principles which can be applied to interim targets that offsetting is limited to instances where it is supplementary to sectoral decarbonisation and is consistent with the scenario upon which a target is based (itself consistent with latest climate science to limit warming to 1.5°C).

For interim targets, the Alliance guidelines do not specify which type of credits may be used, though they do introduce the expectations on quality highlighted below. Such usage should be justified by the bank.

In addition, in relation to a bank’s different sources of emissions:

- In meeting a bank’s financed emissions interim targets (Scope 3, Category 15), NZBA recognizes a potential role for offsetting where carbon credits are client attributed,³ meet high quality criteria (see below), and do not exceed volumes consistent with a sectoral target that aligns with a science-based net-zero climate scenario.

- Although the Guidelines do not address Scope 1, Scope 2, and Scope 3 (Categories 1–14) emissions, banks are encouraged first and foremost to look to reduce their direct and indirect emissions when setting targets for these emissions.

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² Any credits used by bank clients to satisfy regulatory obligations shall be accounted for within overall science-based pathway limits on the use of carbon credits, whether to achieve net zero or meet an interim GHG target.

³ “Attributed carbon credits” are accounted for by the client, and may be self-generated, procured by the client, or procured and held in custody by a third-party or a bank on behalf of the client.
The Alliance expects any carbon credits utilized to be consistent with the sectoral decarbonization pathway of a selected climate scenario. The Alliance recognizes that assessment of carbon credit quality, additionality and alignment with sector-specific scenarios is nascent and recommends banks to exercise the highest degree of conservativeness while such criteria is being developed by reputable organizations. The market, including—if relevant and applicable—the Alliance, would look to provide enhanced guidance as the practice of sector-specific scenario-aligned carbon credit use evolves.

**High-quality carbon credits**

When using carbon credits, banks are expected to ensure that the credits used align with the current publicly available consensus on high integrity, high-quality standards, and robust governance. Defining a “high-quality” carbon credit requires a range of different criteria depending on the unique type of carbon credit considered by the bank.

Several market initiatives—including the Integrity Council for the Voluntary Carbon Market (ICVCM) which recently published a paper on carbon credits integrity, and the Oxford Principles for Net-Zero Aligned Carbon Offsetting—are working on developing high-quality standards, and NZBA will monitor developments and if necessary issue further guidance as these guidelines are more concretely articulated by sector-specific experts, and clearer norms and standards of practice are developed.

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4 ICVCM—Build integrity and scale will follow
Summary
For end-state Scope 3 Category 15 targets, only carbon credits from projects that remove GHG from the atmosphere ("carbon removal credits") and which are limited to instances where technologically or financially viable emissions elimination alternatives do not exist, are consistent with NZBA guidelines.

- For interim Scope 3 Category 15 targets, NZBA recognizes a potential supplemental role for carbon credits where the credits are client attributed (i.e. accounted for by the client, and may be self-generated, procured by the client, or procured and held in custody by a third-party or a bank on behalf of the client), meet high quality criteria, and do not exceed volumes consistent with a sectoral target that aligns with a science-based net-zero climate scenario.

- For interim Scopes 1, 2 and 3 (Categories 1–14) targets, banks are encouraged first and foremost to look to reduce their direct and indirect emissions when setting targets for these emissions.

The Alliance expects that any carbon credits utilized are consistent with the sectoral decarbonization pathway of a selected climate scenario.

Only carbon credits for which clients or the bank have provided evidence that they meet overall quality principles are considered eligible.

Any inclusion of client-attributed carbon credits should be reported by the banks.

Reporting and disclosure
The following disclosure principles should be reviewed, supplemented or replaced by international reporting standard setters’ and/or regulatory requirements:

- Any inclusion of client-attributed carbon credits should be reported separately. Only carbon credits for which clients or the bank have provided evidence that they meet overall quality principles are considered eligible.

- Banks are encouraged to follow leading practices as well as recommendations or requirements from international initiatives or regulatory bodies as they evolve. NZBA notes that significant improvement in the quality and quantity of disclosures by bank clients on the use of carbon credits will be required for banks to be able to accurately report on the use of carbon credits.

Notwithstanding the above, banks are encouraged to disclose, disaggregated by sector where adequate information is available for client-attributed carbon credits included in financed emissions (Scope 3 (category 15)) targets:

- The aggregated amount (tCO₂e) of retired carbon credits used by clients and applied to bank targets
- The percentage of the bank’s clients’ aggregated total sectoral emissions (and therefore the percentage of the bank’s sectoral or boundary target) which these credits represent
- The split of different types of carbon credits used and, if available, the standard followed
An explanation of how the quantitative threshold included in an interim target was reached with supporting justification of how it is supported by sectoral decarbonisation pathways—if appropriate—and scenarios

Further work

Further technical work is likely to be necessary to operationalize these principles and define expectations of offsetting (e.g, for specific sectors and time horizons). This will likely require work both:

- Within NZBA to frame the scope of carbon credit uses-cases, and
- For external bodies working on carbon credits and their use in net-zero commitments to whom NZBA will be able to refer.

If required, the Alliance will consider outlining more detailed guidance on the use of carbon credits in subsequent revisions of the Guidelines (completion of the next revision is currently anticipated by April 2024) or other publications in line with the articulation of more detailed sectoral pathways, methodological advances in the practice of target-setting, and continued enhancements to the state of the art of carbon credit use.
The industry-led, UN-convened Net-Zero Banking Alliance brings together a global group of banks, which are committed to aligning their lending and investment portfolios with net-zero emissions by 2050.

NZBA is the flagship climate initiative under the Principles for Responsible Banking to accelerate science-based climate target setting and develop common practice. As the banking alliance within the global efforts on net zero across the finance industry brought together under GFANZ, the NZBA is open to all banks globally, including banks that are not UNEP FI members and Principles for Responsible Banking signatories.

unepfi.org/net-zero-banking