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# AFD Group's position on carbon finance

Carbon finance puts a monetary value on GHG emission reductions to finance mitigation projects, including via carbon markets. While these markets make it possible to mobilize additional funding for decarbonization projects, caution is required to ensure that they are effective, transparent, and deliver a real contribution to sustainable development objectives. In order to mobilize these resources for the benefit of its partners while ensuring the integrity of the mechanism, AFD Group has adopted initial intervention principles for carbon finance, described in this note.

# CARBON FINANCE: ISSUES, AREAS, PRINCIPLES

## CHALLENGES OF CARBON MARKETS

Carbon finance places a monetary value on greenhouse gas (GHG) emissions reductions and can therefore serve as a tool for funding mitigation projects. Carbon markets are trading systems in which carbon credits are bought and sold, enabling buyers to 'offset' their emissions and sellers to fund their projects.

The Paris Agreement introduces the use of this type of mechanism in Article 6, which sets up a framework, under the guidance of UNFCCC, for countries to cooperate with each other to achieve the objectives of their Nationally Determined Contributions (NDCs), by trading mitigation results (emission reductions or carbon removals). Alongside this mechanism, the voluntary carbon market (VCS) is developing, enabling entities to trade carbon credits on a voluntary basis, without any link to regulatory requirements.

**Recent progress on the implementation of Article 6 of the Paris Agreement and the increase in volumes traded on the voluntary carbon market (VCM) in 2021 and 2022** have generated strong interest in these mechanisms, particularly in the sectors and geographies where AFD Group operates. However, the decline in transactions on the voluntary carbon market from 2023 onwards reflects an **increased pursuit for integrity** in the credits issued on this unregulated market. At the same time, the gradual implementation of Article 6 of the Paris Agreement could have a substantial impact on the voluntary market in terms of methodologies and definition of best practices.

Carbon finance represents an **undeniable opportunity to mobilize new financing**, particularly from the private sector and over the long term, for mitigation projects and, more generally, for sustainable development.

**Nevertheless, many challenges need to be overcome for these mechanisms to effectively contribute to global decarbonization goals.** These include the lack of reliability regarding the actual emissions avoided or carbon sequestered by projects, criticism of the principle of "offsetting" emissions by buyers, the predominance of "avoidance" credits, the still-low price of CO<sub>2</sub> per ton, a lack of transparency and governance, the absence of clear benefit-sharing rules, and the lack of regulatory frameworks in many countries. These are recurrent concerns about voluntary carbon markets (VCM) that the mechanisms under Article 6 aim to address.

**While carbon finance certainly holds potential for the development agenda, its use must be carefully regulated to ensure that the mechanism is functional at the project level, as well as at territorial, national, and global scales.**

## AFD GROUP'S AREAS OF INTERVENTION

To promote high-integrity carbon finance, AFD Group intends to provide tailored support to meet the needs of its partners and host countries through three main areas of intervention:

**Supporting governments** in strengthening their capacities and knowledge in carbon finance, developing national strategies on carbon finance aligned with the host country's climate and development objectives, and formulating public policies and regulatory frameworks to facilitate the implementation of Article 6 and/or better regulate voluntary carbon markets;

**Supporting the development and financing** of projects and funds that leverage carbon finance and deliver multiple co-benefits (biodiversity, social benefits);

**Sharing experiences and building expertise** on the subject through mobilizing research and collaborating with other public development banks.

## INTERVENTION PRINCIPLES OF AFD GROUP

In order to maximize co-benefits, address risks and ensure a real contribution to the objectives of the Paris Agreement and the Sustainable Development Goals (SDGs) of the UN 2030 agenda, the AFD group applies the following intervention principles<sup>1</sup> for its operations relating to carbon finance:

- 1. MAXIMIZING DEVELOPMENT IMPACTS: CARBON, BIODIVERSITY AND COMMUNITIES**
  - Promote an SDG approach, by **prioritizing projects with social, economic, biodiversity or adaptation co-benefits** in addition to those related to mitigation. The search for co-benefits strengthens the quality and integrity of the mechanism.
  - Support **carbon sequestration projects** as a priority (including nature and ecosystem conservation). For avoided emissions projects, it will be necessary to ensure their additionality, quality and robustness, for example through jurisdictional approaches that help limit "leakage" of avoided deforestation projects.
  - Ensure **inclusion and equitable benefit-sharing mechanism with local populations**, as well as a fair ownership of credit.
- 2. SUPPORTING AMBITIOUS NATIONAL STRATEGIES**
  - Ensure that the projects supported **are part of a national carbon finance strategy** or, when possible, help initiate one to prepare for implementation of Article 6 and contribute to national decarbonization trajectory objectives.
- 3. ENSURE THE INTEGRITY OF DEMAND**
  - **Require transparency** on final credit buyers.
  - **Ensure the robustness of buyers' decarbonization strategies**, particularly in terms of short-, medium- and long-term objectives. Certification of these trajectories by independent and recognized initiatives is recommended.
  - AFD group will not support carbon credit projects developed by developers or project companies that are owned mostly by groups in the fossil fuel sector.

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<sup>1</sup> The operationalization of these principles is underway and may lead to an adjustment of their formulation.

#### 4. FOLLOW THE MOST DEMANDING STANDARDS

- Ensure the quality of the offer by **supporting only projects certified according to the best existing standards**, preferably combined with premium labels (for example, CCB - Climate, Community and Biodiversity standards or SD Vista - Sustainable Development Verified Impact Standard).
- **Refer to the recommendations and principles of international initiatives**, whether general (for example, the 10 principles of the Integrity Council for Voluntary Carbon Markets IC-VCM) or sector-specific (e.g. High-Quality Blue Carbon Principles and Guidance).
- Ensure that a **robust system of measurement, reporting and verification (MRV)** is implemented by the project owner to provide transparency on the evolution of emissions or storage of CO<sub>2</sub> and their impacts, as well as on the means allocated to achieve the project's objectives.

#### 5. BUILD ON AND/OR STRENGTHEN LOCAL EXPERTISE

- **Support and encourage local expertise**, and where possible, provide capacity building throughout the value chain, whether with host countries or buyers.





@Pierre Terdjman / AFD

#### About AFD Group:

Agence Française de Développement (AFD) Group finances, supports and accelerates the transitions necessary for a more just and resilient world. It thus contributes to implementing France's policy on sustainable development and international solidarity. It is with and for communities that we build, with our partners, solutions in more than 160 countries, as well as in 11 French overseas departments and territories.

Our objective: To reconcile economic development with the preservation of common goods: climate, biodiversity, peace, gender equality, education and health. Our teams are involved in more than 3,600 projects in the field, which are part of the commitment of France and the French people to fulfilling the Sustainable Development Goals. For a world in common

Climate and Nature Unit (CLN) – Executive Directorate of Sustainable Development Solutions (SDD) – Agence Française de Développement (AFD)



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Twitter : @AFD\_France – Facebook : AFDOfficiel – Instagram : afd\_france

5, rue Roland Barthes – 75598 Paris Cedex 12 – France