September 8, 2023

Nellie Liang, Under Secretary for Domestic Finance
Ethan Zindler, Climate Counselor, Climate Hub
Ned Shell, Counselor to the Under Secretary for Domestic Finance
U.S. Department of the Treasury

Dear Under Secretary Liang and Counselors Zindler and Shell:

As a coalition of public interest groups focused on the intersection of climate change and financial regulation, we are grateful for your efforts so far to assess and reduce climate-related financial risk. We are following up on our November 2022 letter urging you to issue guidance for financial institutions on transition plans. We write to provide updated information and urge that any guidance should squarely address fundamental problems with the widespread and controversial use of carbon offsets.

Last November, our groups and partner organizations provided the Treasury Department with detailed recommendations on the principles that should guide net zero and transition planning for financial institutions to ensure that those plans are meaningful, robust and equitable. Since then, the evidence has mounted that financial institutions are failing to carry out the transition planning that is so essential to protecting the financial system from climate-related financial risk.

For example, earlier this month the Transition Pathway Initiative Global Climate Transition Centre released an analysis of the climate action plans of 26 of the world's largest banks and found them deficient in numerous respects, including a broad failure to disclose the total share of finance directed towards climate solutions as well as a failure to include the full range of on- and off-balance sheets activities in their-zero targets. A 2022 Ceres report highlights the risks to the financial system from this failure to disclose off-balance sheet activities. Also, a Sierra Club report released last month shows that major banks are subverting their transition plans by exploiting a loophole in their climate commitments that lets them finance the parent companies of coal-fired power plants.

The widespread practice of using voluntary carbon offsets in financial institutions' transition plans should concern regulators. Reliance on, and lack of adequate disclosure around, voluntary carbon offsets represents a major problem with the transition plans of both financial institutions and operating companies. *See*, *e.g.*, Net Zero Tracker, Net Zero Stocktake 2023 (analysis of 2,000 largest publicly-listed companies shows that 44% with 2030 net-zero targets, and 60% with 2050 net-zero targets, fail to disclose whether transition plans include reliance on offset credits).

We urge you to include a substantial discussion of this problem, along with solutions, in any guidance you may provide to financial institutions.

The voluntary carbon market is plagued with legal and scientific shortcomings, as highlighted by numerous scholarly reports and journalistic investigations. Thus, it is no surprise that there is a consensus among relevant global leaders that, except in extremely narrow circumstances that are virtually non-existent in today's transition plans, carbon offsets must not be used to net emissions for purposes of transition planning and achieving net-zero pathways. The Science Based Targets initiative (SBTi) has held this position since the issuance of its first standard, and it reiterated the position in its June 2023 draft guidance on science-based targets for financial institutions:

> 3.4 Emissions accounting requirements
>
> FI-C11 – Offsets: The use of offsets must not be counted as emission reductions toward the progress of companies' or FIs' science-based targets. The SBTi requires that FIs set targets based on emission reductions through direct action within their own operations or their investment and lending portfolios. *Offsets may only be considered as an option to finance additional climate mitigation beyond their science-based targets* (emphasis added).

SBTi is the most credible international voice on transition planning. Its approach was followed in the recent Voluntary Carbon Markets Integrity Initiative (VCMI) Claims Code, which prohibits reliance on offsets in transition plans, as well as the parallel recommendations of the United Nations Expert Group on Net Zero. SBTI and VCMI dismiss the utility of today's carbon offsets as a component of a transition to net-zero and insist that permanent carbon removal and storage for residual emissions be used only after all feasible decarbonization has been achieved. Specifically, the SBTi corporate standard provides: "After a company has achieved its long-term target and cut emissions by >90%, it must use permanent carbon removal and storage to counterbalance the final <10% of residual emissions that cannot be eliminated."

We know that many in the climate policy and investment world hope that voluntary carbon markets can eventually become a reliable and adequate source of climate investment. Pointing out the pervasive integrity problems in these markets does not foreclose that possibility, but rather highlights the widely shared view that large structural changes and accountability mechanisms would be needed to make these markets deliver on their promises.

Transition planning guidance that fails to address the serious questions that have been raised about the purported climate benefits of voluntary carbon offsets, and fails to offer an approach for financial institutions to respond to these questions, would have limited usefulness. In fact, such guidance might inadvertently encourage continued undisclosed reliance on cheap, low-quality offsets at the expense of meaningful decarbonization of value chains. We urge the Treasury Department to issue transition planning guidance of the same scientific rigor, clarity,

and integrity as the leading private standard setters. This would be an essential contribution to the ultimate goal of harmonizing transition plan guidance into one global standard capable of truly delivering net zero emissions.
Thank you for your time and attention to this matter.

Sincerely,

Public Citizen
Americans for Financial Reform Education Fund
Sierra Club