Business Council of Australia

Climate Change Authority Review of international offsets: consultation paper

BCA Submission

April 2022

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1. About this submission

The Business Council of Australia (BCA) welcomes the opportunity to respond to the Climate Change Authority's *Review of international offsets: consultation paper*.

The BCA supports accelerated action to reduce Australia's national emissions — this decade and beyond — in order to transition the Australian economy to net zero by 2050 in an orderly and economically prosperous way. Our recent report, *Achieving a net zero economy*, outlines a proposed policy architecture for achieving this.[1]

2. Role of offsets in decarbonising the economy

The following three principles are of primary importance as we transition to net zero emissions in pursuit of the Paris Agreement warming goals

1. environmental effectiveness — that all actions to avoid and remove emissions result in scientifically robust abatement outcomes[2]
2. economic efficiency — that the total cost of actions to avoid and remove emissions is minimised over the longer term
3. transitional equity — that vulnerable (often regional) communities are not adversely impacted by, and ideally benefit from, actions to reduce emissions.

Carbon credits (or carbon offsets) are financial instruments that reflect the value of actions to avoid and remove emissions.

Markets for offsets have a critical supporting role to play within a holistic climate policy approach to reducing emissions effectively, efficiently and equitably. Businesses face incentives from a range of policy measures — including the Safeguard Mechanism and the Technology Investment Roadmap — to reduce their own direct and indirect emissions overtime, which ultimately is necessary to achieving a net zero economy.

The development of a robust, transparent and liquid global market for carbon offsets supports businesses as they seek to reduce their own emissions overtime, as follows:

- markets for offsets enable all potential sources of abatement to be part of the solution over time depending only on their relative costs,
- markets for offsets enable the balancing of abatement costs between easier-to-abate and harder-to-abate sectors, within countries and between countries,
- voluntary demand for carbon offsets from shareholders, consumers and civil society is helping to reduce emissions,
- markets for offsets can help finance low and zero emission technologies and thereby accelerate their development and deployment,
- regional communities can monetise land-based and technology-based carbon offset supply opportunities, often realising co-benefits and in conjunction with bio-diversity credit creation.

As we move toward a net zero economy, a mix of avoidance and removal-based offsets will be required. After all feasible avoidance-based emission reductions have occurred, removal-based emission reductions will have an ongoing role to play in offsetting residual emissions.

While Australia has a vibrant and growing domestic carbon offset market, current and potential voluntary demand from Australian businesses' access to high quality international sources of offset supply is important.

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[1] https://www.bca.com.au/achieving_a_net_zero_economy

[2] Examples of removal based emission reductions include afforestation and reforestation, agricultural soil management, direct air capture and ocean-based carbon sequestration. Examples of avoidance based emission reductions include renewable energy deployment, methane abatement, energy efficiency improvement and industrial carbon capture and storage.

Putting this in perspective, if the 50 largest companies in Australia pursued carbon neutrality under the Climate Active program, the total supply of ACCUs currently would cover about 5 per cent of their total scope 1 and scope 2 emissions footprint.[3]

The BCA is supportive of initiatives, like the Indo-Pacific Carbon Offsets Scheme, which will develop emissions reduction projects in the region and increase access to offsets for Australian businesses.

A long-term strategic objective of the domestic framework governing the use of international offsets should be to maximise Australian businesses' and regional communities' potential benefit from the global carbon offset market.

3. Harmonisation of offset criteria and standards

Robust offset criteria and standards are critical to ensuring the environmental integrity or 'quality' of carbon offset units. The criteria and standards underpinning the existing global offset market emerged in a period defined by the Kyoto Protocol and continue to evolve in line with the Paris Agreement.

This review is timely given recent agreement to the Article 6 rules governing international trading of units under the Paris Agreement. These rules provide the foundation for global harmonisation of criteria and standards and will boost confidence in the use of offsets generally in meeting countries' nationally determined contributions (NDC). In particular, the internationally traded mitigation outcomes (ITMO) and corresponding adjustments (CA) framework defined under Article 6 is designed to avoid double counting when units are traded between countries and counted towards an NDC.

The Taskforce on Scaling Voluntary Carbon Markets is a private sector-led initiative working to scale an effective and efficient voluntary carbon market to help meet the goals of the Paris Agreement.[4] The Taskforce estimates that demand for carbon offsets could increase by a factor of 15 or more by 2030 and by a factor of up to 100 by 2050, and that overall, the market for carbon offsets could be worth upward of $US50 billion in 2030.[5]

To facilitate this massive scaling up, the Taskforce established an independent governance body in 2021 — the Integrity Council for the Voluntary Carbon Market — with a mandate to "set and enforce definitive global threshold standards for quality carbon credits in the voluntary carbon market".[6] The Integrity Council is developing a definitive set of global threshold standards — based on Core Carbon Principles and an Assessment Framework — due to be launched in the third quarter of 2022.[7]

Other related initiatives launched in 2021 include:[8]

- Singapore's sovereign wealth fund Temasek, DBS, Standard Chartered and the Singapore Exchange established Climate Impact X to help scale the global voluntary carbon market.
- Four global banks (the Canadian Imperial Bank of Commerce, Itaú Unibanco, National Australia Bank and NatWest Group) announced Project Carbon, a pilot platform for trading voluntary carbon offsets.

[3] This assumes that the Australian Government does not take delivery of ACCUs contracted under the ERF and that all ACCUs were available to the voluntary market and used for this purpose. It is important to note that businesses' carbon neutrality claims will be achieved using a mix of offsets and direct and indirect emission reductions overtime.
[4] The Taskforce was initiated by Mark Carney, UN Special Envoy for Climate Action and Finance, in September 2020.
[5] https://www.mckinsey.com/business-functions/sustainability/our-insights/a-blueprint-for-scaling-voluntary-carbon-markets-to-meet-the-climate-challenge
[6] The Integrity Council for The Voluntary Carbon Market https://icvcm.org/wp-content/uploads/2022/03/FINAL%C2%ACKey-Governance-Principles-and-Mandate-for-the-Integrity-Council-for-the-Voluntary-Carbon-Market-_1pager_v4.pdf
[7] https://www.ecosystemmarketplace.com/articles/new-voluntary-carbon-market-standards-for-high-quality-carbon-credits-integrity-council/#:~:text=The%20Core%20Carbon%20Principles%20(CCPs,methodology%20types%20are%20CCP%2Deligible.
[8] https://www.isda.org/a/soigE/Role-of-Derivatives-in-Carbon-Markets.pdf

- The United Kingdom Government and Children's Investment Fund Foundation launched the Voluntary Carbon Markets Integrity Initiative to support private sector climate action by developing guidance on the use of carbon offsets.

Development of a definitive set of global threshold standards is highly desirable for businesses participating on the demand and/or supply side of the global carbon offset market to address their climate change risk. A well-functioning carbon offset market with a high degree of commonality in standards will result in lower transaction costs, higher liquidity and better enable development of risk management features (such as the use of derivatives).

It is critical that the domestic framework governing the use of international offsets evolves with the prevailing global approach to criteria and standards underpinning the quality of carbon offsets.

4. Fit-for-purpose domestic framework governing the use of international offsets

The domestic carbon offset market in Australia has been developing in parallel with the global carbon offset market for over a decade. On the demand side these markets are linked given the high degree of substitutability (in many cases) between domestic and overseas carbon offset units. Unpredictable changes to any aspect of Australia's climate policy settings — including changes that directly impact the degree of linking between domestic and international offset markets — can be very disruptive from a climate risk management and long-term investment perspective.

Business risks caused by climate change, and in particular transition risk, are unavoidable. Carbon offset markets are a key risk management tool for addressing these risks. However, an unpredictable policy environment can drastically dilute the risk management benefits available from participating in carbon offset markets.

For example, a stable policy environment is far more conducive to the development and use of derivatives in carbon offset markets. While the development of exchanges, trading platforms and standardised contract frameworks are also important in this regard, they are no substitute for a stable domestic policy environment.

In our view a stable, a fit-for-purpose domestic framework governing the use of international offsets has the following design feature

- environmental integrity and the requisite assurance, verification and auditing processes is the overriding concern of the framework — aligned with the 'tonne is a tonne' philosophy to reducing global emissions
- offset units created from domestic and international sources have the same environmental status — to promote broader confidence in use of carbon offsets to address climate risk
- environmental integrity includes an assessment of adverse impacts — where international units, with unacceptable environmental and social safeguards, are ineligible for use in Australia
- a single set of criteria and standards is used to determine the environmental integrity of international <u>and</u> domestic offset units for use in Australia — recognising that it may be appropriate for any future domestic compliance schemes to only allow a subset of the units available for voluntary purposes
- co-benefits are valued by the market and facilitated by transparency requirements as part of the criteria and standards process — but international units are not treated preferentially, for the purposes of determining eligibility, because of their co-benefits
- the single set of criteria and standards be reviewed on a regular and predictable review cycle with adequate consultation with market participants — to ensure that Australia's approach is evolving in line with global approaches to criteria and standards development

- there is a **three-year notice period** for any deletion of units from the eligible list determined at review points — with the possible exception of circumstances relating to health and safety if these can be addressed or limited by immediate removal of a unit class from the eligible list.

A fit-for-purpose domestic framework governing the use of international offsets needs a regular review cycle and a single set of criteria and standards to determine the environmental integrity of both international and domestic offset units.

5. Drivers of voluntary demand for offsets are important

The demand for carbon offsets is growing rapidly in Australia and overseas, and increasingly by consumers, shareholders and civil society on a voluntary basis.

While buyers' motivations for purchasing carbon offsets will vary, this growth is clearly predicated on the general perception that voluntary action is contributing to a genuine reduction in emissions and therefore contributing toward the achievement of the Paris warming goals. However, further to this"

- for some buyers it is important that their voluntary action contributes toward achieving Australia's national emissions reduction target or NDC (even when an offset originates in another country)
- for other buyers it is important that their voluntary action is 'over and above' Australia's national emissions reduction target or NDC (even when an offset originates in another country).

Article 6 rules under the Paris Agreement provide the option voluntary market action to be included within the ITMO and CA framework, which means:

- double counting can be avoided when voluntary offsets are imported and accounted for with respect to the importing/exporting country's NDC
- the importing country can then choose whether or not to make a domestic target adjustment to ensure that voluntary offsets (originating overseas) are in effect 'over and above' its NDC.

However, it is likely to take some years for the ITMO and CA framework to be fully implemented and utilised — as technical and institutional requirements are built, and different countries build their capacity (and willingness) to participate in the framework.

The BCA does not underestimate the complexity associated with resolving these issues, but we are concerned that voluntary offset demand in Australia could be undermined by a lack of clarity and certainty as Article 6 arrangements develop under the Paris Agreement framework. This a particular risk for buyers who are participating in voluntary offset markets to drive abatement that would not occur, but for their participation.

A separate review is required to consider the appropriate role of voluntary offsets in meeting Australia's NDC. In the interim, the domestic framework governing the use of international offsets should not undermine strong voluntary demand for offsets.

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