Review of the Emissions Reduction Fund

October 2020

CLIMATE CHANGE AUTHORITY

Overview

The Climate Change Authority is pleased to release its statutory **Review of the Emissions Reduction Fund 2020.**

The ERF retains a central role within the Government's suite of emissions reduction policies. It generates high integrity, low cost carbon offsets, supports voluntary abatement actions and provides a foundation for pursuing broader environmental, social and productivity benefits.

The ERF has been successful in incentivising low cost abatement from the agriculture, land and waste sectors. While Government purchasing had been subdued in recent years, auction results in 2020 suggest efforts by the Government and the Clean Energy Regulator to boost activity are working. These include the announcement last year of significant additional funding under the Climate Solutions Fund and the introduction of optional delivery contracts.

The Authority has made recommendations which aim: to give ERF participants greater confidence over the future market for ACCUs and a greater say in both the range of activities to be included in the scheme and how they are implemented; preserve the integrity of the scheme, and hence its environmental effectiveness and the strong reputation of ACCUs; and to build the scheme's resilience to the impacts of climate change.

Our approach

The Authority consulted widely for the Review and considered 51 submissions received in response to a consultation paper released in April 2020.

The Authority's recommendations build on:

- the Government's response to the ***Report of the Expert Panel examining additional sources of low cost abatement*** **(the King Review)**
- the Government's first **Low Emissions Technology Statement**
- new Government funding for the Clean Energy Regulator to speed up ERF method development and project registration times
- the Authority's recent research reports, ***Prospering in a low-emissions world: An updated climate policy toolkit for Australia***, and ***Economic recovery, resilience and prosperity after the coronavirus***.

What is the Emissions Reduction Fund?

- The ERF is a voluntary scheme that aims to provide incentives for a range of organisations and individuals to adopt new practices and technologies to reduce their emissions.
- A number of activities are eligible under the scheme and participants can earn Australian Carbon Credit Units (ACCUs) for emissions reductions. One ACCU is earned for each tonne of carbon dioxide equivalent (tCO2-e) stored or avoided by a project. ACCUs can be sold to generate income, either to the Government through a carbon abatement contract, or to other buyers looking to offset their emissions.
- The *Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth) (CFI Act) gives effect to the Emissions Reduction Fund. The CFI Act states that the Authority must conduct reviews of the operation of the Act, regulations and other instruments under the Act, such as ERF methods.

What's covered in this review?

In this review, the Authority has examined the performance of the ERF by considering the extent to which the ERF is meeting its objectives to deliver emissions reductions. The Authority's consultation and analysis has led to a focus on three broad themes:

- increasing the ERF's contribution to reducing Australia's emissions, by bolstering the demand for and the supply of ACCUs, while maintaining the scheme's integrity
- improving the operation of the scheme through enhancing the governance arrangements
- proactively managing risk, including climate-related risks.

Key findings and recommendations

Strengthening the demand signal for ACCUs

Government purchasing currently accounts for 95% of all ACCUs sold. The announcement of the Climate Solutions Fund in 2019 provided a strong signal of the Governments intent, however stakeholders remain concerned that funding could be diverted from the ERF to other low emissions initiatives.

The market demand signal for ACCU's could be strengthened by

- annual projections of the ERF's contribution to Australia's 2030 emissions reductions target, including all potential sources of demand
- an indication of how many ACCUs the Government intends to purchase each year
- a commitment to maintaining ERF funding levels.

Demand from voluntary purchasers is small and ACCUs compete with cheaper international units, but are nonetheless prized for their high integrity, Australian origin and, in some cases, co-benefits. The demand for ACCUs from the voluntary market is likely to grow as —

- companies set their own targets to manage their climate risks and meet demand for low-emissions products
- global markets increasingly favour low- and zero-emissions products and services.

High integrity offsets such as ACCUs can support Australian exporters' voluntary decisions to respond to changing consumer and investor preferences and meet 'green' labelling requirements and net-zero standards.

New ways to incentivise voluntary purchasing of ACCUs would increase demand for ACCUs and non-Government investment in abatement.

Enhancing support for ERF projects

The King Review identified a range of ERF activities for which projects have high establishment costs but are slow to earn ACCUs, which can be a barrier to obtaining finance. The Government has said that it will consult with stakeholders on the best mechanisms to encourage such projects on a method by method basis.

Several innovative financial mechanisms, such as concessional loans, revenue-contingent loans, grants and blended finance, could address barriers to ERF projects while also attracting co-investment and contributing to economic stimulus in response to COVID-19.

The Clean Energy Finance Corporation (CEFC) is already very familiar with sources of abatement across the economy and is well integrated in the private finance and investment market. It should be well-positioned to catalyse private sector participation and co-investment in the ERF.

Technologies at an earlier stage of development, not yet ready for deployment through ERF methodologies, could be accelerated through other policy mechanisms, such as the recently re-funded Australia Renewable Energy Agency (ARENA).

To facilitate innovative co-financing of ERF projects, particularly those with high upfront costs, the Clean Energy Regulator, CEFC and ARENA should collaborate to align the scheme with the broader suite of Australian governments' climate initiatives and growing sustainable private finance market.

Abatement opportunities under the ERF are limited by the methodologies available. Given the complex and resource-intensive nature of method development, it is important that those activities which offer the best mix of abatement potential, cost effectiveness and deployment readiness are given the highest priority.

After a formal consultation process, a statement of priority emissions reduction activities for method development should be published, in conjunction with the annual Low Emissions Technology Statement.

Streamlining governance and upholding integrity

Maintaining the integrity of the ERF — ensuring that it is delivering genuine emissions reductions — is vital for the ongoing success of the scheme from an environmental perspective, as well as ensuring the scheme contributes to Australia's progress towards its emissions reduction targets. Integrity also lies at the heart of the value of the ERF in the voluntary market and acceptance of ACCUs in a global market.

The right balance must therefore be struck between over-crediting, committing taxpayer funds to activities that would occur in any event, and foregoing genuine opportunities by under-crediting.

The Offsets Integrity Standards are fit-for-purpose and should be retained as they are, but more can be done to communicate how the Standards are interpreted and applied.

The Emissions Reduction Assurance Committee (ERAC) plays an important role in upholding the integrity of the ERF. Increasing its resourcing, participation in method development and variation processes and access to administrative information on the operation of the scheme would further empower the ERAC in its role.

The Government recently announced that responsibility for supporting the ERAC, together with leading on method development and variations, will shift from the Department of Industry, Science, Energy and Resources to the Regulator.

The Authority considers that consolidating public officials with the relevant expertise in one place and formalising the integration of industry and scientific knowledge has the potential to remove inefficiencies and formalise the integration of industry knowledge.

To address the potential conflicts of interest that might arise given the consolidation of responsibilities under the scheme, the Regulator should ensure it has robust probity procedures and checks in place.

Many submissions raised the need for greater, more structured involvement of stakeholders and external technical expertise in ERF method development.

Establishing a formal Steering Committee to advise on method processes could bolster resources and better harness valuable expert and scientific input. This can be combined with a stakeholder engagement plan to ensure all relevant views – including from industry, other stakeholder and third-party experts – are engaged in method development.

To ensure that estimates of emissions reductions are as accurate as is practical, ERF methods, rules and tools need to keep pace with developments in science and technology. As a result, the activities that are eligible under the ERF will change over time.

However, changes made by the Government to the scheme to reflect such developments may have a material impact on a project's abatement potential and business viability, thereby posing risks to project proponents and investors and undermining confidence in the scheme.

The Authority supports the Government's work to develop a robust and transparent framework for risk sharing between the Government and ERF project owners, for changes to the scheme which impact on the value of existing ERF projects. Such a framework would enhance the confidence of investors in ERF activities.

Building greater climate resilience

Australia is already experiencing the effects of a variable and changing climate. Land-based sequestration activities are subject to natural processes and climate variations which affect their ability to accumulate and store carbon.

The Authority engaged the CSIRO to examine the risks that climate change poses for storing and maintaining carbon in the landscape under ERF methods.

Drought-induced stress and mortality, heat stress limiting plant growth and contributing to mortality, and increased aridity/reduced soil water availability were the most commonly occurring risk factors among those identified.

Among ERF activities, management of agricultural soils and planting of new forests were found to be most at risk, followed by savanna fire management, management of intertidal ecosystems and re-establishment of native forest cover.

The ERF scheme's risk management mechanisms – such as a 'risk of reversal buffer' and 'permanence period discount' – should be reviewed to ensure they are aligned with the best available science and are appropriately calibrated to guard against risk of carbon losses in land-based sequestration projects. The Regulator could also play a key role in helping project proponents to identify and manage climate risks to their own ERF projects.

The Government's Climate Compass framework could be used to assess and manage climate risks at the project and portfolio levels, as well as more broadly in relation to method prioritisation, development and review.

About the Climate Change Authority

The Authority is an independent statutory agency, which provides expert advice to the Government on policies to reduce emissions. The Authority is required by legislation to review the ERF every three years.