Australian Banking Association

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The Climate Change Authority Secretariat
The Climate Change Authority
By Email: enquiries@climatechangeauthority.gov.au

Dear Colleague,

Review of international offsets

The Australian Banking Association (**ABA**) is pleased to make this submission to the Climate Change Authority's (**CCA**s) consultation on the review of international offsets. We refer to the issued document the 'Review of international offsets: consultation paper' (**consultation paper**).

Carbon markets are an important mechanism in Australia's transition to a low carbon economy. Therefore, trust and integrity in the units traded are critical to the success of the carbon markets and Australia's contribution to decarbonisation.

Australian Carbon Credit Units (**ACCU**s), issued by the Clean Energy Regulator (**CER**) are widely regarded as best in class. ACCUs benefit from a government regulated carbon market with a level of governance and methodology transparency that affords credibility and confidence in the high quality of offsets generated. The banking sector supports the development of a liquid and transparent domestic carbon market in Australia. Additionally, Australian banks are instrumental in supporting their customers in mobilising the supply of ACCUs.

Over time, we anticipate a convergence in global carbon markets, especially as Article 6 of the Paris Agreement is scoped and implemented. Continued access to high integrity global carbon markets will be important for banks as they seek to implement their operational decarbonisation plans. Therefore, we support the development of a global carbon market that is underpinned by robust standards and governance to ensure environmental integrity and avoidance of double counting.

The annexure contains responses to questions raised in the consultation paper. We would be pleased to engage with the CCA if you would like further information.

Kind regards,

Emma Penzo
Policy Director

Annexure – Consultation Questions

Part 1 General

Question 1. What considerations should guide the use of international offsets in Australia?

Several considerations should guide the use of international offsets in Australia:

A mark of quality of the international offset market.

'Trust' and 'Integrity' are essential market elements. These elements provide offset purchasers comfort that the scope, stated aims, methods, and projected outcomes of a project are verifiable. This would include mechanisms such as:

- A ***notification obligation*** by the scheme operator to the market and offset holders when they become aware of situations which will change the project's stated outcomes – both positively and negatively.
- ***Regular verified reporting*** of projects from inception, duration, and closure is essential. This would include the provision of ongoing updates of project progress, intermediate agreed targets/metrics including co-benefits and outcomes achieved.
- ***Consequences for false and misleading*** project disclosures, including a requirement for market participants to be informed of such circumstances on a timely basis.

The harmonisation of 'trust' and 'integrity' elements across global markets will also build interoperability between different markets and therefore scale and liquidity.

Generally accepted accounting methodologies

Generally accepted account methodologies for several elements should be a feature of offset markets. Elements which could be considered for standardised treatment include:

- Additionality: Especially required for accounting for the social co-benefits claimed by the project in addition to accounting for emissions removal/avoidance.
- Permanence: A mechanism for adjustments when 'permanence' is no longer deliverable by the project. For example, if after a project has completed, the effects of that project are destroyed or undone (e.g., a forest fire), the offset purchaser will be required to be notified and appropriate adjustments to be made.

The CCA could consider a form of 'certificate' for an international voluntary market where such certification would signal standards of market integrity and transparency in the market. Such certification would also assist in reducing the costs of purchasing entities by reducing the amount of due diligence required to be undertaken by those entities.

No quantity limits for international offsets

Given climate change knows no boundaries, we suggest quantity limits not be applied to the use of international offsets. This view is informed by the following considerations:

- Use of offsets is tightly aligned with the entity's decarbonization strategy and social impact strategy. For example, one entity may choose to acquire offsets in a selection of international markets in which they have a footprint; another entity may choose to acquire offsets which will deliver significant co-benefits that are aligned to that entity's social impact objectives.
- Where a good mix of domestic offsets should be included in the offset mix of entities, this needs to be considered in view of challenges in buying offsets from Australian sources. The quantity of international carbon offsetting projects significantly outstrips the number of domestic carbon offset projects currently available. By limiting the quantity of international offsets accessible by Australian companies, a growing number of companies in Australia will be competing for a limited number of carbon offsetting projects at a much higher cost.

A further consideration for the CCA is whether there ought to be targets for use of offsets originating in emerging economies. Emerging economies could be hit hardest when it comes to climate change and developed economies have an obligation to help developing economies to become better prepared. If developed countries don't invest in international carbon offsetting projects, then the risks to these emerging market economies increases.

Question 2: What is the role of offsets in Australia's transition to net zero emissions and how might this change over time?

a. Does this vary by offset type (e.g., sequestration vs emissions reduced or avoided?)

The ABA supports an alignment with the Paris Agreement and the SBTi Net Zero Standard. The Net Zero Banking Alliance also has guidance on standards for offset use.

The CCA could consider recommending an emissions abatement hierarchy.

We support offsets used to meet net-zero targets should predominantly be of the carbon removal offset type. While emission reduction (and avoided) offsets are important and to be supported in the interim, by 2030 the majority of offsets created in developed economies should be of the carbon removal type. To this end, the government has a role to encourage further investment and development of carbon removal solutions in Australia. The balance of credits created in developing markets is a more nuanced. There is increased risk of destruction of significant carbon sinks by developing nations who have less capacity to protect natural reserves and may come experience greater economic pressure to utilise natural resources as climate change impacts escalate.

b. What are the opportunities and risks presented by international offsets now and into the future?

We note several opportunities presented by international offsets:

- Enablement of access to a more diversified range of carbon offsetting projects.
- Enablement of funding to projects which need help the most (i.e., emerging markets) and therefore potentially enable emerging and developing nations to leapfrog stages of economic development.
- Enablement of access to international projects with different and varied price points (including projects that are cheaper than Australian projects) which is helpful for offsetting entities with budget constraints.
- Enablement for entities to offset in geographic locations where they have an operational footprint.
- Enablement of protection of globally significant carbon sinks where this is not otherwise guaranteed through existing nature reserves.

There are several risks associated with international offsets:

- It can be challenging for Australian entities to confirm the benefits achievable or achieved by an overseas project. This is especially in respect to claimed project co-benefits. For example, the avoidance of situations and outcomes which are detrimental to human rights is challenging to ascertain (e.g., modern slavery).
- Regulation of international carbon offset schemes is fragmented, which has given rise to issues such as double counting where a host country selling a carbon offset to another country may also claim that same emissions reduction.
- Some international offset markets could improve the facilitation of information transparency to build trust and integrity in the offset units traded.

- Care should be taken to not take a 'cookie cutter' approach to assessing and valuing projects. Delivering the exact same project in one country may not deliver the exact same results in another due to various climate/environmental and social conditions.

Question 3: Are there lessons to be learned from experience with international carbon markets to date? What are most relevant to this review?

The lack of transparency when considering many projects is a concern (we note that this is a factor of the nascency of the carbon markets). For example, the lack of standardised reporting requires the offsetting entity to undertake detailed due diligence of the project. Such processes are lengthy and costly to the offsetting entity. The length of time taken to undertake such due diligence processes has seen cases of Australian banks missing out on those projects as the credits had been acquired by other purchasing entities whilst the bank was undertaking its due diligence of the project.

A specific instance for promoting transparency could be a requirement to disclose cashflows to recipient projects. Confidence in the efficacy of the carbon credits and associated co-benefit claims would be significantly improved if this was a required disclosure. As a tradeable commodity, the buyer has a very limited view on how much of its investment in carbon credits is going towards climate action versus administration, broker margins and trading profits.

Alignment on measurement approach for different technologies is yet to occur. We refer for example the UK government announcement in late 2021 that the British emissions trading scheme will also enable projects which seek to sequester carbon. The measurement of such offsets is unclear; therefore, it is unclear how entities can rely on such credits without undertaking their own extensive due diligence.

We note the increasing use of blockchain technology in the creation and trading of carbon credits. Neither the tokenisation nor the exchanges supporting the trading of the tokens, be they crypto or non-fungible token (NFTs) exchanges, are regulated in Australia. Any fraudulent activity will diminish trust in the overall market for carbon credits.

Country risk is an overlaying risk which needs to be considered. It is challenging for entities to understand the potential political and governmental considerations prevailing in countries in which projects offering carbon offsets operate.

To develop understanding of country risks, ABA members work through brokers to access international offsets. We support the licensing regime of Australian brokers who are required to hold an ASIC issued AFSL and are supportive of similar requirements for international brokers.

Given the nascent state of the carbon markets, the ABA is supportive of the Clean Energy Regulator taking a more active role in assessing the international carbon markets to smooth out information asymmetry between participants.

Part 2 Use of offsets by Australian companies

Question 4: Does your company (intend to) use domestic or international offsets and, if so, why?

a. What are the most important factors you (will) consider in choosing which international offsets to purchase?

Banks use a combination of domestic and international offsets. While the carbon offset strategy will vary from bank to bank, at a principles level, the intention is to invest in the domestic carbon market as much as possible to offset local footprint.

The volume of Australian offsets acquired will also be determined by their price relative to international offsets. As demand for domestic offsets grows, the availability and access to Australian offsets may become problematic.

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Additionally, banks seek to acquire offsets in countries in which they have a footprint.

Other factors which are considered by banks in choosing which international offsets to purchase include: environmental integrity considerations, additionality, permanence, co-benefits, and the avoidance of double counting.

Banks generally seek to apply the same sustainability standards to carbon offset projects as they do to lending for sustainability projects. However, in the international market, some reliance is placed on the reputation of the market, with the integrity claims of markets being relied upon to reduce the duration of the due diligence process.

Finally, we are concerned to not create a predicament of double counted voluntary offsets, where potentially the entity's claims may be revoked by the government of the country in which the offset is generated. To that end we support the early implementation of Correspondent Adjustments per the COP26 agreement on Article 6.

Part 3 Criteria and standards

Question 5: What criteria and standards should govern the use of offsets in Australia and under Climate Active in particular? What criteria and standards should be adopted by IPCOS?

a. Should different criteria and standards apply at different scales (e.g., at the method, project, scheme and trading platform levels)?

Climate Active is a certification program which is underpinned by climate offsetting standards set by the Emissions Reduction Fund (ERF). Climate Active certification is important as it provides credibility to a company's carbon neutrality claims.

Given the function of the ERF, we suggest the ERF could incorporate criteria on:

- Environmental integrity, including 'increased' accuracy of measuring carbon offsets.
- Capability requirements for delivering offsetting projects. Many of the companies delivering offsets are newly formed technology companies where experience and proven ability in delivering/operationalising carbon projects is in infancy or not evident.
- Indicator of political risk for each project.
- Agreed set of operational standards with intermediate benchmarks and metrics to be reported.
- Standard for validating reported progress and outcomes.
- Standards for assessing co-benefits.
- Confirmation that there is no modern slavery in the project or its supply chain.
- Consequence processes for situations where a project fails to meet outcomes.
- Cashflow transparency to enable a view of the underlying investment in carbon removal and associated benefits is key for risk management.

Similar criteria could be adopted by IPCOS and additionally standards for measurable co-benefits could be included.

Question 6: What is your view of the criteria and standards currently applied by international offsets programs such as the Gold Standard, the Verified Carbon Standard and the Clean Development Mechanism?

We consider robust governance as essential to an efficient and trusted offset market and that there is a role for continuous improvement. The ABA suggests focus on the following elements:

- Strengthening of measurement methods to improve accuracy of information and support comparability across programs.
- The programs could improve oversight to keep in check potential for trading offsets for profit.
- Provision of information relating co-benefits including associated financial investment.

Question 7: Should the age of units (their vintage) be considered in the criteria for eligible offsets in Australia?

As a general principle, carbon offsets could aim to acquire units with vintages aligned to similar timeframes as the emissions they are offsetting. However, mitigating factors that may need to be considered by entities seeking to purchase credits include: the lag-time for when projects will deliver benefits (e.g., tree plantations) and carbon unit supply issues. Such factors may make it challenging to completely time-align the vintage of the offset to the year in which an entity's operational emissions took place.

Although the Gold standard makes the point that 'as long as it meets the criteria of a reputable standard - it shouldn´t matter whether the emission reduction happened this year or five years ago.'[1] as regulations and policies change, older vintages may not meet current requirements/criteria. Therefore, grandfathering of offset stores should be incorporated with changes to standards.

Part 4 Governance arrangements

Question 8: In the context of the Paris Agreement, how important is it to consider the governance and institutional arrangements in place for the generation, trade and use of offsets?

Governance is important to ensure the environmental integrity of carbon offsets are upheld. The Paris Rulebook requires environmental integrity, transparency, and robust accounting to be upheld. When Internationally Transferred Mitigation Outcomes (ITMOs) are involved, Australia should ensure there is no double counting, and that its accounting reflects the corresponding adjustments required for countries with single-year NDCs.

Question 9: What are the key elements of good governance arrangements? Are there elements missing from current offsets programs such as the Gold Standard, the Verified Carbon Standard and the Clean Development Mechanism?

Key elements of good governance arrangements include:

- Register audits.
- Transparency of accepted methodologies, accounting methods and cashflows.
- Project reporting of updates including the key risk metrics (and thresholds) and how these are mitigated across the duration of the project.
- Consequence management for projects that do not achieve planned outcomes.
- Standard grandfathering of existing carbon banks (within reason) where policy adjustments are made.

[1] https://www.goldstandard.org/blog-item/carbon-pricing-why-do-prices-vary-project-type

Part 5 Co-benefits

Question 10: How important is it that offsets also produce co-benefits?

a. How important is it that IPCOS produces co-benefits in partner countries?

It is important that Australia's investments in IPCOS generates co-benefits to partner countries. We consider that there is a need for clear standards as to what is defined as or constitutes and qualifies as a co-benefit; related to this is the need for robust governance to ensure accuracy, transparency, and timeliness of information.

Question 11: What are the range of co-benefits that might result from the production of offsets?

Co-benefits which may result from the production of offsets and for which metrics ought to be developed for reporting include indigenous culture preservation, biodiversity benefits, economic benefits to the immediate community and their stakeholders, trade benefits.

Part 6 Adverse impacts

Question 13: What are the range of adverse impacts that might result from the production of offsets?

We note the following as adverse impacts:

- Additional due diligence is required to assess impacts of the project beyond carbon for alignment with other sustainability goals. This work is time consuming and without established parameters challenging to undertake in a definitive and timely way. This is further complicated by limitations to undertaking site visits.
- Trading for speculative gain can lead to adverse situations such as credit scarcity and potential 'shorting' of the market.
- Potential for governments to intervene in the market without notice or consultation will impact confidence in the market.

There is room for certification of carbon offset markets. We note some markets, for example, Carbon Impact X, are seeking to establish an international, regulated offset market which might alleviate some of these issues.

Part 7 Broader implications

Question 19: To what extent should international offsets used by Australian companies towards their targets also count towards Australia's national targets?

The UNFCC is developing detailed regulations for the implementation of Article 6, and international initiatives such as the Voluntary Carbon Market Initiative are developing guidance on what claims companies can make on voluntary offset use. The outcome of these and other ongoing efforts will provide clarity as to how government national targets and voluntary corporate initiatives can interact whilst meeting the core principles of Article 6 such as environmental integrity and avoidance of double counting.

This process is anticipated to bring such clarity in the next 12-24 months. Therefore, we suggest waiting for clarifications from the UNFCCC and relevant international initiatives to determine if and how the use of offsets bought by Australian companies interact with Australia's national targets under the Paris Agreement.

Question 20: Are there other matters the Authority should consider in undertaking the review?

Offset users undertake significant due diligence and don't solely rely on the recommendations of brokers. Due diligence can be a lengthy process. Strong governance of offset programs and registers will simplify the due diligence process.