

ESG Now Podcast

“Finally! A Global Carbon Market!”

Transcript, 25 October, 2024

Mike Disabato (00:00):

What's up everyone? And welcome to the weekly edition of ESG now, where we cover how the environment, our society and corporate governance effects and are affected by our economy. I'm your host Mike Deto, and this week we discuss a major development for the global carbon markets. Thanks as always for joining us. Stay tuned. The Paris Agreement was signed nearly a decade ago in the innocent time of 2015, yet the structure of one of its fundamental tools still hasn't been agreed upon. That is until October 11th of this month when a UN expert group reached a compromise on key elements of the global Carbon trading system, which is going to be presented in two weeks at COP 29 in Baku as Azer. Apologies if I pronounced that wrong. Azer Bajan. We're getting the carbon trading mechanism off the ground is the top priority of this annual conference that brings together representatives for nearly 200 countries to coordinate global climate action.

(01:12):

Now, there's a couple reasons why this is such a big deal. The first, for better or for worse is that carbon credits are vital in our fight against climate change and to reduce carbon emissions. They are critical for sectors with really hard to reduce emissions like the airline industry or mining, which may need to rely on a lot of carbon credits to offset their emissions as they transition into shorter or medium term. And they have been seen as a cost effective way for countries to help achieve their emission reductions by trading carbon credits than if everyone was left off to their own devices. But where they have at times faltered, and this is the second point here, why it's so important is when their integrity is called into question and not integrity in the moral sense. I mean integrity as it is formally used in the carbon markets.

(02:03):

That is the assurance that a carbon credit that is being traded represents a project that is actually reducing or removing a ton of carbon dioxide, which is what one credit is supposed to be equivalent to. Now, how do you ensure a credit's integrity? Well, I think we all know. I'm not going to tell you that myself. Instead, I have with me one of Hernandez, a colleague of mine that works on our MSCI carbon markets team and has the long built expertise on all things carbon markets policy and implementation. And so I called her up and I asked her that question specifically, how do you ensure a credit has integrity? And then don't worry, I'll get to why the UN proposal is going to allow this to blossom and become a thing. But first, let's hear from wana how she and MSCI overall assesses carbon credits integrity.

Juana Hernandez (02:54):

One, how much carbon dioxide has been reduced or removed? Second one, how did the project reduce that CO2 and third one, how are the credits then reviewed and used?

Mike Disabato (03:08):

Okay, so she gave me some details on what all that stuff is all about. And here's what it says that how much CO2 has been reduced, remove piece for that. We, because we at MSCI carbon markets assess the quality of a carbon credit, we look at how likely it is that the reduction or removal of that carbon dioxide would've actually occurred even in the absence of the incentives created by the carbon credit. That's important. How likely is it that the actual carbon dioxide impact of the project has been accurately estimated? And how likely is it that the carbon dioxide reductions or removals achieved will not be reversed for a sufficiently long term for the how did that project reduce or remove carbon dioxide piece you talked about? We basically look at how the project

delivered on its promises and didn't mess up any communities or peoples in the process of delivering its promises. That's important as well. And for the third one, how were the credits reviewed and used? That's all about making sure there isn't any double counting. Were two parties say they reduced their emissions by the same project and two emission reduction processes is counted toward our collective emissions reduction. And is the project actually transparent? Have they disclosed enough to us? So those are the details of the three things that want to mentioned.

Juana Hernandez (04:29):

As you can imagine as anyone hearing this is most of those issues are open to interpretation and difference of opinions. So what's most important is setting a benchmark on how to compare what a high integrity project looks like. Over the past three years, the voluntary carbon market has been doing that work. The Integrity Council for the voluntary carbon market provided that benchmark last year with their core carbon principles. And now what the UN mechanism is doing and what this documents provide is that same benchmark is saying what do methodologies for the projects need to be to ensure high integrity?

Mike Disabato (05:14):

Right? Aswan noted before this human agreement, we had this decentralized blueprint set up by various players in the voluntary carbon markets like Vera or the Gold Standard or Climate Action Reserve that set carbon credit standards for assessing credit integrity. And then there were these independent verification bodies like the Integrity Council for the Voluntary Carbon Market, also called the I-C-B-C-M that created basically a label called the Core Carbon Principles or the CCP that certain credits sold by these voluntary carbon market players like Vera. If they met the I-C-B-C-M standards and were verified as a CCP project, then you investor or company can be assured that by the council's opinion it is of high quality. But those were all decentralized and away from the Paris agreement itself, which is what these credits want to ultimately support. So what the UN has done is set up a mechanism that provides a centralized blueprint for markets to register and trade credits that both companies and importantly countries can use in their carbon reduction plans because the UN has verified that they have integrity. But what about those BCMs, those voluntary carbon markets? Are they going to be pushed out by the un? Are they going to overlap with them or is there going to be a further divergence in the carbon credit assessment world?

Juana Hernandez (06:32):

What we're seeing right now is that they're pretty similar. We will need to know to see those other more specific requirements that will come out next year to finalize our analysis. But what would be ideal and what we hope to see, and I think everyone in the market so to see, is that these two mechanism, like these two frameworks on setting integrity will converge. And then you'll stop seeing such a fragmented market that we currently have in the VCM and it will be more in terms of there will be alignment,

Mike Disabato (07:10):

Alignment and thus confidence. Because wall integrity is an opinion. It's still supposed to be an opinion based on fact. The credit either represents a ton of carbon dioxide removed or reduced or it doesn't sort of has to be this black and white designation. And if there isn't good alignment on how to assess that, then theoretically there is the risk that one verification body says a credit has integrity and another doesn't. And you all of a sudden get into a tricky situation. Now there's one more big thing that this UN proposal creates and it has to do with country's climate plans and the compliance requirements set in the Paris agreement itself.

Juana Hernandez (07:47):

So there is one part that is like now we will have the UN also stamping the integrity of projects, which is broadly aligned for now with the I-C-V-C-B-M. So we'll see a convergence in carbon markets between the voluntary and this, let's say, let's call it semi compliance market. Additionally, it will unlock at demand of countries. Right now the VCM is mostly used for voluntary targets of companies, but countries are not able to

use it against their NDCs. They are doing, they having to do bilateral agreements between countries are very slow, not able to scale and will never make actual impact. So what will this will provide is one unified market for countries to buy and trade those credits with also corporates included in them and project developers.

Mike Disabato ([08:51](#)):

Well, the voluntary carbon markets we're really in practice just for companies to trade on. The UN is creating a market that is compliant with the Paris agreement itself, a market compliant for countries targets and that's what they want to use. And that means the markets which are set up using the US framework are really going to get pumped with that sweet, sweet government money because according to the MSCI carbon markets assessment right now, the voluntary carbon market is worth around two to \$2.5 billion US our sovereign demand estimate for countries to meet their NDCs, their climate plans show that for 2030 countries will require around 300 million tons of carbon dioxide equivalent credits. And our price estimation is around \$40 per credit in 2030. So let's see, 300 million times 40, that's around \$12 billion worth of credits being created and traded and retired, which is a lot when you remember that a credit is supposed to be worth a ton of carbon dioxide reduced or removed from the atmosphere. Now the thing is, I've kind of been going through all this like this is already a done deal, but the conversation around the global carbon market system within Article six, that's what this is all about. First began about a decade ago. Remember I said that? And the UN is the un. We all know this. So what are the chances the proposal actually goes through?

Juana Hernandez ([10:13](#)):

I can't predict the future and the UN has proven to be slower than everyone expected, but we are seeing very positive signals. So what we've heard from delegates from the UN governing body is that now because they changed their strategy, what they decided to do this time, instead of going and taking the methodology document to call and for countries to approve them, they went and approved them and adopted them themselves and are now telling countries at COP to endorse their strategy. So what we've heard from delegates is that they actually will need to reject them instead of approving them. So the over 190 country representatives would need to come together and agree to reject this for it not to stay in enforced and well, what we've seen in the past is that getting all these countries to agree on anything is actually very difficult. So there are very high chances that we will see this coming to implementation next year.

([11:37](#)):

This is not finished. So it's not like after cop, we have a UN Paris agreement crediting mechanism up and running after this is approved at COP or actually not rejected what the governing body, so this technical team has been working on the documents will need to do is to finalize the more specific methodological requirements, ideally in the first half of the year whilst also finishing the registry to get it up and running. And then we will be able to see them starting to approve methodologies so projects can align to those methodologies and then can be approved in the mechanism.

Mike Disabato ([12:20](#)):

So there's still a lot to go. The supervisory body aims to finalize the five critical standards on baselines, additionality and more by 2025. Additionally, the registry standard after consultation is expected to be approved in early 2025, but we are very close to closing a part of the Paris agreement that has been pushed around for almost a decade. And if the latest research by the UN Environmental Program that found the world's ability to remain within the target of 1.5 degrees Celsius of global warming will be gone within a few years without rapid action as any indication, we're going to need as many mechanisms as possible to try and quickly lower our collective emissions. And that's it for the week. I want to thank Wana for talking to me about the news with the sustainability twist. I want to thank you so much for listening. If you'd like what we're, don't forget to rate and review us and subscribe wherever you get your podcasts. Thanks again and talk to you soon.

Speaker 3 ([13:31](#)):

The M-S-C-I-E-S-G Research podcast is provided by MSCI Inc. Subsidiary M-S-C-I-E-S-G research, LLCA registered Investment Advisor and the Investment Advisors Act of 1940. And this recording in data mentioned herein has not been submitted to nor received approval from the United States Securities and Exchange Commission or any other regulatory body. The analysis discussed should not be taken as an indication or guarantee of any future performance analysis, forecast or prediction. The information contained in this recording is not for reproduction in whole or in part without prior written permission from M-S-C-I-E-S-G research. None of the discussion or analysis put forth in this recording constitutes an offer to buy or sell or promotional recommendation of any security financial instrument or product or trading strategy. Further, none of the information is intended to constitute investment advice or recommendation to make or refrain from making any kind of investment decision and may not be relied on As such, the information provided here is as is and the user of the information assumes the entire risk of any use it may make or permit to be made of the information. Thank you.

About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit www.msci.com.

This document and all of the information contained in it, including without limitation all text, data, graphs, charts (collectively, the "Information") is the property of MSCI Inc. or its subsidiaries (collectively, "MSCI"), or MSCI's licensors, direct or indirect suppliers or any third party involved in making or compiling any Information (collectively, with MSCI, the "Information Providers") and is provided for informational purposes only. The Information may not be modified, reverse-engineered, reproduced or disseminated in whole or in part without prior written permission from MSCI. All rights in the Information are reserved by MSCI and/or its Information Providers.

The Information may not be used to create derivative works or to verify or correct other data or information. For example (but without limitation), the Information may not be used to create indexes, databases, risk models, analytics, software, or in connection with the issuing, offering, sponsoring, managing or marketing of any securities, portfolios, financial products or other investment vehicles utilizing or based on, linked to, tracking or otherwise derived from the Information or any other MSCI data, information, products or services.

The user of the Information assumes the entire risk of any use it may make or permit to be made of the Information. NONE OF THE INFORMATION PROVIDERS MAKES ANY EXPRESS OR IMPLIED WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE INFORMATION (OR THE RESULTS TO BE OBTAINED BY THE USE THEREOF), AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, EACH INFORMATION PROVIDER EXPRESSLY DISCLAIMS ALL IMPLIED WARRANTIES (INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTIES OF ORIGINALITY, ACCURACY, TIMELINESS, NON-INFRINGEMENT, COMPLETENESS, MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE) WITH RESPECT TO ANY OF THE INFORMATION.

Without limiting any of the foregoing and to the maximum extent permitted by applicable law, in no event shall any Information Provider have any liability regarding any of the Information for any direct, indirect, special, punitive, consequential (including lost profits) or any other damages even if notified of the possibility of such damages. The foregoing shall not exclude or limit any liability that may not by applicable law be excluded or limited, including without limitation (as applicable), any liability for death or personal injury to the extent that such injury results from the negligence or willful default of itself, its servants, agents or sub-contractors.

Information containing any historical information, data or analysis should not be taken as an indication or guarantee of any future performance, analysis, forecast or prediction. Past performance does not guarantee future results.

The Information should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. All Information is impersonal and not tailored to the needs of any person, entity or group of persons.

None of the Information constitutes an offer to sell (or a solicitation of an offer to buy), any security, financial product or other investment vehicle or any trading strategy.

It is not possible to invest directly in an index. Exposure to an asset class or trading strategy or other category represented by an index is only available through third party investable instruments (if any) based on that index. MSCI does not issue, sponsor, endorse, market, offer, review or otherwise express any opinion regarding any fund, ETF, derivative or other security, investment, financial product or trading strategy that is based on, linked to or seeks to provide an investment return related to the performance of any MSCI index (collectively, "Index Linked

InvestmentsSM). MSCI makes no assurance that any Index Linked Investments will accurately track index performance or provide positive investment returns. MSCI Inc. is not an investment adviser or fiduciary and MSCI makes no representation regarding the advisability of investing in any Index Linked Investments.

Index returns do not represent the results of actual trading of investible assets/securities. MSCI maintains and calculates indexes, but does not manage actual assets. The calculation of indexes and index returns may deviate from the stated methodology. Index returns do not reflect payment of any sales charges or fees an investor may pay to purchase the securities underlying the index or Index Linked Investments. The imposition of these fees and charges would cause the performance of an Index Linked Investment to be different than the MSCI index performance.

The Information may contain back tested data. Back-tested performance is not actual performance, but is hypothetical. There are frequently material differences between back tested performance results and actual results subsequently achieved by any investment strategy.

Constituents of MSCI equity indexes are listed companies, which are included in or excluded from the indexes according to the application of the relevant index methodologies. Accordingly, constituents in MSCI equity indexes may include MSCI Inc., clients of MSCI or suppliers to MSCI. Inclusion of a security within an MSCI index is not a recommendation by MSCI to buy, sell, or hold such security, nor is it considered to be investment advice.

Data and information produced by various affiliates of MSCI Inc., including MSCI ESG Research LLC and Barra LLC, may be used in calculating certain MSCI indexes. More information can be found in the relevant index methodologies on www.msci.com.

MSCI receives compensation in connection with licensing its indexes to third parties. MSCI Inc.'s revenue includes fees based on assets in Index Linked Investments. Information can be found in MSCI Inc.'s company filings on the Investor Relations section of msci.com.

MSCI ESG Research LLC is a Registered Investment Adviser under the Investment Advisers Act of 1940 and a subsidiary of MSCI Inc. Neither MSCI nor any of its products or services recommends, endorses, approves or otherwise expresses any opinion regarding any issuer, securities, financial products or instruments or trading strategies and MSCI's products or services are not a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such, provided that applicable products or services from MSCI ESG Research may constitute investment advice. MSCI ESG Research materials, including materials utilized in any MSCI ESG Indexes or other products, have not been submitted to, nor received approval from, the United States Securities and Exchange Commission or any other regulatory body. MSCI ESG and climate ratings, research and data are produced by MSCI ESG Research LLC, a subsidiary of MSCI Inc. MSCI ESG Indexes, Analytics and Real Estate are products of MSCI Inc. that utilize information from MSCI ESG Research LLC. MSCI Indexes are administered by MSCI Limited (UK).

Please note that the issuers mentioned in MSCI ESG Research materials sometimes have commercial relationships with MSCI ESG Research and/or MSCI Inc. (collectively, "MSCI") and that these relationships create potential conflicts of interest. In some cases, the issuers or their affiliates purchase research or other products or services from one or more MSCI affiliates. In other cases, MSCI ESG Research rates financial products such as mutual funds or ETFs that are managed by MSCI's clients or their affiliates, or are based on MSCI Inc. Indexes. In addition, constituents in MSCI Inc. equity indexes include companies that subscribe to MSCI products or services. In some cases, MSCI clients pay fees based in whole or part on the assets they manage. MSCI ESG Research has taken a number of steps to mitigate potential conflicts of interest and safeguard the integrity and independence of its research and ratings. More information about these conflict mitigation measures is available in our Form ADV, available at <https://adviserinfo.sec.gov/firm/summary/169222>.

Any use of or access to products, services or information of MSCI requires a license from MSCI. MSCI, Barra, RiskMetrics, IPD and other MSCI brands and product names are the trademarks, service marks, or registered trademarks of MSCI or its subsidiaries in the United States and other jurisdictions. The Global Industry Classification Standard (GICS) was developed by and is the exclusive property of MSCI and S&P Global Market Intelligence. "Global Industry Classification Standard (GICS)" is a service mark of MSCI and S&P Global Market Intelligence.

MIFID2/MIFIR notice: MSCI ESG Research LLC does not distribute or act as an intermediary for financial instruments or structured deposits, nor does it deal on its own account, provide execution services for others or manage client accounts. No MSCI ESG Research product or service supports, promotes or is intended to support or promote any such activity. MSCI ESG Research is an independent provider of ESG data.

Privacy notice: For information about how MSCI collects and uses personal data, please refer to our Privacy Notice at <https://www.msci.com/privacy-pledge>.