TRANSCRIPT

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 it is 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 themself 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):

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