

SO, YOU'RE SERIOUS ABOUT OFFSETTING

What do your offsets say about you?

The big Glasgow meeting wasn't "the COP that killed coal". Nor the summit to end fossil fuel subsidies. On the list of tasks faced by world leaders, Article 6 - the Paris Rulebook for emissions trading and accounting - was by no means the toughest: the appetite for improved governance in carbon markets is keen. A "Brazilian victory" in Glasgow legitimised fast-growing voluntary offsets, while moving compliance markets closer to a globalised carbon trade.

Emissions trading is a crucial mechanism for delivering Nationally Determined Contributions (NDCs) to curbing emissions under the Paris Agreement. Portfolios that enable both long-term removal of atmospheric carbon and cleaner, greener business processes set the standard for a better 'net' in net zero. Best-in-class offsets are both a litmus test and a showcase for decarbonisation.

- COP26 deal with South Africa creates model to scale green finance
- New rules to implement Article 6 reduce scope for 'double counting' of credits
- 'Share of Proceeds' levy settled with two-track approach and 2013 cut-off date
- Growing role for machine learning to gauge credibility, while policy evolves
- Asset owners and listed companies positioned to drive net zero
- Oxford Principles test for relevance and sectoral impact

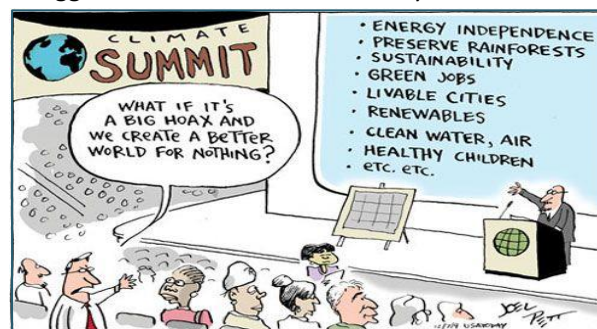
PUSHING THE ENVELOPE

Campaign in poetry. Govern in prose. The pre-Glasgow briefings anticipated a "tidal wave" of new green finance. Instead, COP26 set the course for a +2.4 degrees pathway – if pledges are met – with emissions at roughly double the Paris goal. But for first-movers, new rules on the implementation of Article 6 augur well for a globalised carbon trade.

An awkward, sobering precedent was \$8.5 billion in concessionary loans to clean up South Africa's coal-powered Eskom utility. As a replicable formula to fund the clean energy transition in developing countries, the deal made welcome precedent. Delivery "lies in the hands of a semi-criminal enterprise — and a coal fanatic," noted a seasoned South African editor, a reference to the incumbent minister and the scandal-prone utility.

Carbon markets should provide help here, if only we knew how. With better rules on international

transfers of credits and clearly defined "mitigation outcomes", benefits should be tradeable: the greater the benefit, the higher the carbon price. But not just yet. The question of how credits can support non-market mechanisms such as the Eskom plan remains wide open, while higher-value offsets often struggle to find demand in voluntary markets.

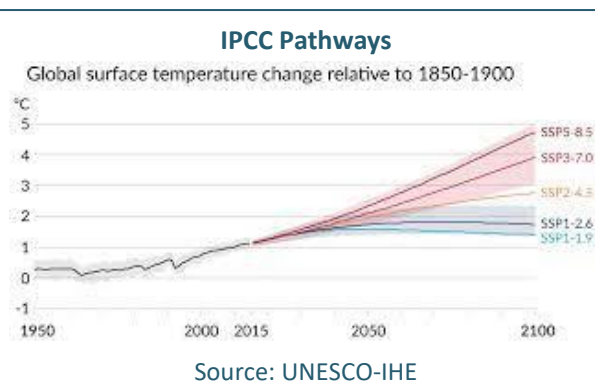


Source: Cartoon Arts International

This will change. Transparency in carbon markets is the lubricant to accelerate the energy transition. Data has been described as the new oil, but here transparency means: more light, not more oil.

PARIS RULES

Fixing Article 6 of the 2015 Paris Agreement is a crucial step to simplify emissions trading. Glasgow set new terms for integration and reporting standards, clearing a path for governments to buy credits in the voluntary markets, potentially a huge stimulus. Technical steps to consolidation will take time, but higher volumes are a big prize.



Details agreed in Glasgow enable transfers of emissions reductions between countries (Section 6.2), an important and long-delayed step towards legitimising voluntary markets. A cut-off date for transferring carbon credits from the earlier United Nations' Clean Development Mechanism (CDM) into the Paris scheme (Section 6.4) was set for 2013, tightening rules on the retirement of old credits issued under the Kyoto Protocol.

After serial failures at COPs past, Glasgow reached a principled compromise on 'Share of Proceeds'. A two-tier levy was adopted to fund climate adaptation in poorer nations - in effect, a tax on the profits of companies in industrialised countries that trade emissions. Leaked drafts had indicated a potential 2%-6% levy. Instead, Glasgow opted for zero levy on bilateral trade between countries, while introducing a 5% levy for new credits issued under a centralised settlement hub (with further agreement to cancel 2% of current issues).

The scope for double counting of credits (by sellers as well as buyers) is narrowed, not removed. But the Glasgow deal on bilateral trade (Section 6.2) and a centralised hub (Section 6.4) brings clarity to cross-border compliance – a.k.a. Internationally-Transferred Climate Mitigation Outcomes (ITMOs) – and more transparency in reporting “corresponding adjustments”.

COMMENT: The Paris rules are hydra-headed, nowhere more so than Article 6. The founding document of emissions trading is still young, and pre-dated by Europe's cap-and-trade schemes. But post-Glasgow, creative accounting of carbon credits got harder – and the rules more consistent.

The sequence of reforms entails three steps: 1. A spring clean to tidy historical baggage from previous systems, with a strict 2013 cut-off date for transfers of Kyoto-era credits. 2. Phased integration of parallel schemes and geographies, aligned to Paris. 3. New rules on implementation that allow voluntary markets a bigger role in the delivery of NDCs.

For prime movers – companies and national governments alike – the tactical challenge here is about articulation: how to frame, show and tell offsetting as work-in-progress. Offsetting strategy is less about a static transaction, more a moving metaphor for the unfolding energy transition.

CREDIBILITY TECH

In the scramble for net zero, credibility is hard to earn but easily lost. Insurers and central bankers – the world's reinsurers of last resort – are reckoning with the economic shocks. Meanwhile, “the new politics swirling around net zero targets is rapidly becoming a confusing and dangerous mix of pragmatism, self-delusion and weapons-grade greenwash,” warned Professor Simon Lewis.

Hence the generalised scepticism that still clings to carbon credits. Not unreasonably. No agreed framework exists to determine their material impact on the earth's atmosphere. None in the plethora of issuing regimes is sufficiently robust to ensure that every new purchase delivers additional and permanent reductions in emissions.

Even experienced climate ambassadors can fall foul of the still-emerging rules

- Financial Times

Technology can tackle these problems. While regulators drag their heels, artificial intelligence is moving at lightning speed to crunch atmospheric data. Impact, longevity and effectiveness of carbon

sequestration projects can be analysed against historical data in real-time.

In May 2021, London-based start-up Sylvera raised (GBP) £5.5 million in seed funding from Index Ventures to develop independent ratings based on satellite, radar and lidar (remote sensing by laser). With proprietary data sets from collaborations with UCLA, NASA Jet Propulsion Laboratory and University College London (UCL), Sylvera's machine learning claims "to bolster transparency...in a bid to boost accountability and credibility".

Prospective clients for credibility tech include 160+ members of the new Glasgow Financial Alliance for Net Zero, a coalition of investors, banks and insurers managing assets of \$130 trillion. Chaired by Sir Mark Carney, UN climate envoy and former governor of central banks in Canada and England, GFANZ announced a goal to cut emissions from its lending and investments to net zero by 2050.

COMMENT: GFANZ is a formidable lobby of fiduciaries who can wield influence where rule-makers do not. Swifter progress in accounting and reporting carbon credits will strengthen their hands.

Complex accounting invites manipulation, but scrutiny is already keen - as Carney discovered in April 2021, while wearing another hat as vice-chairman of Brookfield Asset Management.

Carney mistakenly cited "avoided emissions" from new investment in renewables to claim a net zero portfolio. Avoided emissions are not recognised as offsets, and Brookfield's portfolio isn't net zero. Swift apologies aside, a window of opportunity has opened for offsetters to articulate these issues.

THE ROLE FOR FIDUCIARIES

Like central bankers, asset owners and investors play a crucial role in bringing ESG (environmental, social and governance) factors to capital markets. Their influence on listed companies is a powerful lever in the energy transition, notwithstanding listed companies' relatively smaller footprint. Less than one third (estimated: 14%-32%) of all emissions are caused by publicly traded companies.

Incumbents in Europe often object, accurately, that state-owned entities (PetroChina and Sinopec, Coal India, Saudi Aramco) and privately-held fossil energy producers pollute more but report less. These unlisted companies are often weak innovators. Answering to shareholders and capital markets is more likely to foster know-how, disruption and market-making powers required in first movers.

Offsetting is the Wild Wet of sustainability
- Prof. Simon Lewis
University College London

Signs of a firming appetite among corporates for quality offsets are confirmed by US not-for-profit Forest Trends' annual State of the Voluntary Carbon Markets report. Forestry is the fastest-growing sector, helped by more stringent Redd+ certification, while demand for clean cook stoves slumped. Stephen Donofrio, director, described suspicions that offsetting is a fig leaf for inaction as "a myth": offsetting companies are often the most active in decarbonising operations and supply chains.

COMMENT. With hard-won revisions to Article 6, COP26 clearly stated the direction of travel towards a globalised carbon trade. Two-thirds of countries' Nationally Determined Contributions expect to include offsets under Article 6. The gathering momentum in voluntary markets will continue.

While policy work is slow, algorithms move fast. The consolidation in emissions trading will create a new global stage to showcase the contributions of best-in-class offsetters. The Oxford Principles can help buyers to demonstrate relevance and impact, for organisations or sector-wide, while building an evidence base for reputation and reform.

SOURCES



<https://linktr.ee/AshurstFitzpatrick>

OUR VISION

A better net in net zero

Carbon credits play a vital role in the energy transition, creating opportunities for buyers of offsets to differentiate with innovative decarbonisation projects. Guided by the Oxford Principles for Responsible Offsetting, we assess best-in-class offsets for relevance and reach, then create the vision and digital assets for competitive advantage and social licence. We help buyers, project owners and their fiduciaries to act collaboratively as a catalyst for development of new markets for net zero-aligned offsets.

MARK ASHURST

Mark's independent perspective on carbon markets is shaped by a background in media, corporates, and not-for-profits. A former speechwriter for President Nelson Mandela, he has worked in journalism (Financial Times,



BBC), as a policy adviser on accountability for aid, and with activist investors in fossil fuels. In the Netherlands, Mark was global Director of Thought Leadership at Philips Lighting, now

Signify, during its demerger from Royal Philips and subsequent Euronext IPO. He is a graduate of University College Oxford; Bucerius Law School, Hamburg, and WHU Otto Beisheim School of Management, Vallendar.

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SEAN FITZPATRICK

Sean is a filmmaker and Director of Photography with a background in photographic advertising and television. His film work spans commercials and documentary, including corporate campaigns on themes from the

energy transition to biotech, life sciences and industrial process re-engineering. Sean is an experienced creative lead in marcoms, marketing and visual strategy for clients including Port of



Rotterdam, Synspec BV and Gilead. Born and raised in southern Africa, he is passionate about social cohesion and the ethical treatment of societal themes in film and visual media.

 Creative and Network

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A Note on Outsourcing

We know what it takes to transform a values-driven offsetting portfolio into a scalable communications plan, and we'll stick around to help you build a first-rate, iterative content pipeline. For selected clients, we also offer a Content Management service to crowdsource creative and digital assets. This isn't for everyone, but it can deliver measurably better outcomes at savings of 30-50% on typical agency fees.

Referrals are the highest compliments; please share this note and your feedback