ESG Now Podcast
"Carbon Credits in 2024"

Transcript, 12 January, 2024

Mike Disabato (00:00):
What's up everyone? Welcome to the weekly edition of ESG. Now it's our first episode of 2024. Remember, if you forgot that we cover how the environment, our society and corporate governance effects and are affected by our economy. I'm your host Mike Deto. In this week we are discussing the carbon markets, how they fared in 2023, what they might look like in 2024, and why they remain an important part of our world's attempts to decarbonize. Thanks as always for joining us. Stay tuned.
(00:41):
This time. Last year an expose was published by The Guardian, the German Weekly Zeit and source material, which is a nonprofit investigative journalism organization. And this expose was basically calling into question one of the largest carbon credit certification companies on the market. It said that 90% of rainforest carbon offset credits certified by a company called Vera were actually phantom credits that did not represent the genuine carbon productions that were promised and packaged in the carbon credit that Vera was verifying. And it led to the CEO. This expose did to depart Vera in May, and it was part of this growing course of concern about the carbon markets and their ability to live up to the promises made that they would actually be able to help our world reduce its carbon footprint. Yet the concerns were met with the reality that the carbon markets are an important tool that our economy has in lowering emissions that are hard to abate, for example, or more simply put emissions that we just can't figure out how to reduce.
(01:49):
So since it's a new year, I thought that we should return to the carbon markets debate to discuss where the markets ended up in 2023, where they're likely to go in 2024 and what sectors are likely to be the most reliant on them in the coming year. So to do that, I talked with my colleague, guy Turner, now Guy founded what was called Trove research and Trove research tracked corporate climate commitments and provided insights into the voluntary carbon market until it was bought by us by MSCI last year. And now he leads the MSCI carbon markets team where he does the exact same thing. It's just with the MSCI team at his side and his team side. Now trope was a source of intelligence on the voluntary carbon markets. So I think Guy is a perfect person for me to talk to about the carbon markets and how they're going to look in 2024.
(02:39):
And what I'm going to do for you, what I'm going to do for this episode is I'm going to play you a segment of our conversation and you'll hear guy and I talking about what he thinks the carbon markets are going to do in 2024 and what they did in 2023. And I hope you enjoy it. Okay Guy, thanks so much for joining me. I was wondering if you could start us off with a brief overview. I think the idea of carbon markets is still something everyone is getting their heads wrapped around, so maybe you could give us a quick overview of the carbon markets to start us off and then we can move from there.

Guy Turner (03:11):
Well, the word carbon market is a broad term. There are two main types of carbon market essentially they do the same thing. They allow one, let's say a corporate to outsource the obligation to reduce emissions to somebody else. So they have a target to reduce emissions and intention to reduce emissions. They think this is actually going to cost them quite a lot of money. So they say, would it be better if we paid somebody else to reduce the emissions, which is they can do at lower cost. That can come about in two main ways. One is through a compliance, a regulatory approach. So in Europe, thousands of companies over half of European emissions, greenhouse gas emissions are covered with the European emissions trading scheme, which places a

target on the big emitters, power companies or the refinery, cement plants, chemical plants, et cetera. And they have to reduce emissions.
(04:15):
If they can't, they can buy allowances from those who are in compliance against their targets. The same system design works in California and Quebec, that's called the Western Climate Initiative. And there is a legend scheme in the northeast of the us, Reggie, the regional Greenhouse Gas Initiative. And there are other sort of schemes around the world in South Korea, in Japan and Australia, et cetera, not as dynamic and not as ambitious, but those form sort of what's called a cap and trade scheme. Another form of carbon trading is sort of a system where a company voluntarily wants to make an emission reduction and they buy a credit an offset from another company or another project from somewhere else in the world. These projects that produce emissions that are verified and set up on our standard and a registry could be anything from a renewable energy project to growing trees, preserving the Amazon rainforest, controlling landfill gas emissions, sequestering carbon underground through carbon capture and storage, distributing cook stoves in Africa that burn fuel much more efficiently. All of these things can be registered and quantified in terms of the carbon benefit they create and those credits can be sold and used and claimed by a corporate entity that's trying to show it's doing the right thing for the planet.

Mike Disabato (05:52):
And I think that's sort of the context that we need before we launch immediately into the differing opinions that are out there regarding carbon markets. Because on the one hand you have that loud course of public opinion that I discussed and even some industry organizations saying that carbon credits aren't what they purport to be. There are issues with how the amount of carbon abated as being quantified and that companies shouldn't be promoting their use in the manner that they are. There's just a lot of consternation around their use and a lot of discussion around that worry. And then you have the situation that guy you wrote about for a post on msci.com where you said, and I want to quote you here, December, 2023 saw the largest ever volume of voluntary carbon credits, retired 36 megatons of credits were issued by corporates in 2020 3rd of December, beating the previous high of 30 megatons in December of 2021. So guy, how do you square that peg there? How do you think about the consternation that a lot of people had in 2023 and the growth that the market seems to be seeing at the end of December compared to 2021?

Guy Turner (07:03):
I think first of all, the December is a peculiar month because a lot of companies will make purchase credits throughout the year but not actually off retire them. So what happens in that retirement process is a credit is bought by somebody, but it's only when it is retired IE taken out of circulation and deducted from the registry or canceled on the registry that the claim is cemented. And that can happen at any time in year, but typically companies do it at the last minute towards year end in December. So it's always the busiest year for that retirement process. So could have, there's definitely been a slow down in the market this year. There's definitely been a fall in prices across the board. Not all, some prices have held up, but generally there's been a sort of a downtrend in prices which reflects the points you've made that there's been a sort of cooling off and pausing really in companies just like waiting to see whether or not the industry can get its act together and produce the credits from the projects that are unequivocally high quality and there's a lot of work going on. The good news is that the Integrity Council on voluntary Carbon markets course, Syria in the airlines, Vera of the biggest registries and standard setting bodies is changing their methodologies.
(08:33):
There's a lot of work on the buy side. There's a voluntary carbon market integrity initiative, which is trying to make sure that companies are claiming correctly against their targets. So there's a lot of work going on.

Mike Disabato (08:45):

I assume that change in methodology that work is really the attempt to assure companies and the public that the carbon markets as a whole are something that as you said, are high quality. So what kind of changes are they doing to their methodologies to accomplish that?

Guy Turner (09:06):
This is a relatively slow process for starters because these methodologies are quite long and they're very technical and they are put out to consultation. And then there's this a process that they run to try and update the methodologies. They're very scientific. So this is not just one organization of suddenly waving a magic wand and changing a of a rule book. These things have to be done by consensus amongst experts. It does take a while. One of the major ones was the Vera, the largest standard setting body and registry of voluntary carbon market projects changed its methodology for calculating carbon credits from reserving forests. The theory I don't think many people would disagree with that is better to preserve a forest rather than chop it down and then destroy the natural environment and habitat and then try and regrow it. So preserving habitats and a stored carbon is a good thing, but how do you calculate that benefit?
(10:07):
And it's actually quite a lot more difficult than it first seems. So for example, one challenge is that if you preserve a forest in one part of the country, who's to say that somebody in another part of the country, the forests have been cut down and you've achieved the same deforestation, you just haven't looked in the right place. That's sort of referred to as leakage in the industry. And one way of getting around that is by taking a much broader view of the landscape, the land area that you're interested in. So rather than looking at one particular project, say a hundred thousand hectares, you would look at the whole country and look at the rates of deforestation in the whole country and make sure that that project was contributing to a national level deforestation objective. And that's the change that Vera has recently introduced into its calculation process for calculating carbon credits from reducing deforestation. And they will most importantly apply that retrospectively to all projects of that type, which they haven't done before. So that is sort of a very significant development and I think it's a lot of confidence to the market that the standard setting bodies are sort of taking action to clean up some of these issues.

Mike Disabato (11:27):
It also sounds like Vera is starting to see this process of preservation as almost a biodiversity one. It's a holistic thing. One that cannot just be limited to a relatively small area. And to your point, leakage is just a tough problem. You drive deforestation deforesters out of one area and they just go to another and they just say, well, who cares? So what have these changes meant for companies these methodological that want to participate in the carbon markets? How are they viewing the methodological changes that you just talked about?

Guy Turner (12:01):
I think that a lot of companies are looking at this activity and saying, this is great. We want to make sure that if we dip into this market that we are not going to get burned in terms of public scrutiny. So I expect there to be a sort of holding pattern in 2024. The other thing that is happening is that the prices that you see on the market are all those traded on the secondary market. A response to this scrutiny on the credits that are being traded is companies are going direct to the project themselves and they're saying, we're going to bypass the market. We're going to invest directly in preserving a chunk of the Amazon rainforest or growing sea grass in the Caribbean or whatever. And they're going to fund those things directly now. And they know exactly about the projects. They're involved directly in them or through partners and that gives them a lot more comfort and a lot more certainty. And when they talk about them to their stakeholders on their websites in their communications, they can say, look, these are the projects that we've invested in directly. Here they are.

Mike Disabato (13:16):

It's going to be interesting to watch how they actually accomplish that. Are they going to be sending people to verify the projects on the ground? Are they going to go into areas to ensure that everything is kept up in the manner that is needed? It's going to be a fascinating thing to watch. I want to pose a hypothetical question to you here. If possible, do these methodological enhancements mean that you could look at a company that says carbon credits, the carbon market's going to be our main source of carbon reduction, and you would think to yourself, okay, that's a good thing or that's a useful operational thing, not a good thing, an operational thing. Could an investor look at a company that says, carbon markets are our be all and end all and think, yes, this company's on the right track, they're going to actually reduce their emissions?

Guy Turner (14:02):
So the first and really important distinction one needs to make is just if I can just sort of unpick the language of the question you just posed, which is if a firm is reliant on using carbon credits to achieve its submission reductions, that concept is not yet accepted by many of the scientists. What is generally used in terms of this carbon market mechanism is that it should be in addition to reducing emissions. So if you think about a company that's is trying to say reduce by X percent over a number of years, it still needs to reduce that number that still hit that reduction line. But what it can do is say, well, if I've reduced by say 10 or 20%, I'm still emitting 90 or 80% of what it was. So I'm going to go and then offset some of that residual emission that I'm still emitting because no one's going to get to zero in a short period of time.
(15:07):
There's a too much fossil fuel embedded in the system for that to happen quickly. We would love that to happen quickly for climate change reasons, but it's going to take decades and multiple decades. So even in the eu, they've proposed and are putting through directives and rules that will not allow companies to claim that they are reducing emissions by using carbon credits, carbon offsets. If they do use them, they will have to be in addition to that reduction target, which is what the science-based targets initiative is proposing as well. Now that's not the only voice there is out there. There's a group called the Voluntary Carbon Market Integrity Initiative, ECMI, which we did some research to back up this latest proposal they're making, which is they do suggest they are proposing that some companies who are struggling to reduce emissions, particularly for Scope three, the big elephant in the room could use carbon credits temporarily to help bring target their emissions back on track. That would be sort of a time limited opportunity for them. But as much as these markets have so many economic advantages and environmental advantages, still the bottom line should be companies should reduce their emissions first and foremost.

Mike Disabato (16:35):
That does bear out in some of the research I've done for one of the industries, I cover airlines because initially the airline industry came out and said, we have corsea and we're going to work to do offsetting. That's going to be one of our main tools. But then the airline industry got together and they passed their net zero by 2050 goal and that signaled a clear turn away from merely offsetting emissions and toward measures to dramatically reduce their CO2 emissions from planes and fuels. And they said, you should use offsets to plug the gap that, as you noted, is hard to bring down the hard to abate gap. And that doesn't mean in the airline industry that the demand for carbon offsets it's going to go down. They're going to be one of the main purchasers or one of the main new purchasers of carbon credits in 2024. All that withstanding. And the reason I bring that up because I think an interesting point to go to now would be to look at how the industry demand for carbon credits is changing. So in your opinion, guy, who are the main industry players that are likely going to be operating in the carbon markets this year in 2024 in your opinion?

Guy Turner (17:47):
I think there are some very high profile sectors that are known about oil and gas. The biggest retiree in December and last year with Shell, very large carbon footprints clearly in terms of their operations, but also the products they sell in terms of oil and gas and high profile, high public profiles, and also they have a lot of financial resources to compensate for their impact. The technology firms, particularly the US West coast, US-

based tech firms, Stripe, Salesforce, et cetera, they have a very unique interest in making sure that they, they're particularly interested in carbon dioxide removal projects. So those are the projects that take CO2 out of the atmosphere and sequester it permanently or in a long-term basis underground.
(18:54):
And therefore, again, they're very wealthy firms and so they've got the financial resources and also brand sort of impact to protect, not least because if AI is going to continue the way it's going to go, we're going to need more data centers and they consume a huge amount of power and then everything else. So there's, the amazing thing about this space is that companies can pop up unexpectedly and with a new commitment. And I also look to different parts of the world. So if you look at Middle East Asia, south America, there are some very interesting developments there. Regional trading hubs that are sort of like Saudi Arabia is doing amazing things with its voluntary carbon market platform and auction process. Indonesia and Malaysia are setting up their own versions of trading schemes Japan. So there's things bubbling up all over the world this year in 2024, we could see a mushrooming effect of these pockets of interest all around the world.

Mike Disabato (20:03):
For me, I think I do understand where some of the concern around the current carbon market system was coming from, the sort of concern that we reared its head in 2023 and had a lot of people talking. And then there's also the commoditization of forests that can have a number of unattended consequences for indigenous groups that have been the stewards of forests for many, many decades, but have done right. There's also the chance that a massive amount of needed capital from companies, from companies coffers can be transferred to the global south, which often needs funds. Now if I could summarize our chat, it seems like the market is becoming less of a guessing game. There's satellite imagery out there to verify the good from the bad credits and credit issuers are developing methodologies with higher standards and there are some sectors that will need some sort of credit and offsetting mechanism like cement or steel until there is a new material developed that can drastically reduce the emissions created during the production of these sort of societal building blocks.
(21:06):
So yes, it's complicated. Yes, the concerns are valid, but so are the benefits in the proper use of a carbon market system. Now before we go, I want to give you all a bit of a bonus segment from my and guys' discussion. It was sort of too technical, too wonky to put in the main story, but I think if you're curious about the carbon markets, they're useful nuggets of information. So I wanted to play them for you and here you go. So guy, you mentioned that companies are moving, some companies are moving from buying credits on the market to actually going to the project and investing directly in the project. What are the pros and cons of doing that versus buying a credit on the carbon markets themselves?

Guy Turner (21:55):
Yeah, there is, and the obvious one is the two main ones, one is choice and the other is economies of scale and lower costs. So a lot of this market interest now was stimulated three years ago by Mark Carney, the ex-governor of the Bank of England, who saw climate as a systemic financial risk and the use of the voluntary carbon market as a major means to corporates to discharge their obligations at really low cost. But in order for that to happen, it needed to be scaled, there needed to be volume, there needed to be investment dollars put in. And for their part, a lot of investors did come in, they did put money in. We calculated that 36 billion has been invested over the last 10 years in this market, about half of that in the last three years. And about 80% of that money has gone into nature-based projects.
(22:46):
So particularly over the last three years. So the private sector has responded. Now what we need to do is sort of convince the corporates to come back to the table and say, we want to participate in the benefits of those projects, but we only want to do that when we can be guaranteed that every project is high quality. And the problem and the challenge that we've now faced with is some of the projects, I think many of the projects are good, they are additional, they are delivering benefits, just the benefits have been overstated. So that's where

some of the criticism has come in. So if you look at cook stoves in Africa where you can distribute a million cook stoves to core villages in Africa so they can burn their fuel much more efficiently three times more efficiently or certainly more efficiently and improve indoor health and air quality and encourage economic development and education.

(23:47):

Great, great benefits. The question is when you look at it from a climate point of view, are you estimating calculating the reductions in carbon emissions from burning the wood accurately? And it turned out that quite a few projects that overestimated the benefits of climate in terms of the assumptions that they were putting into the calculations and the projects are good, just the climate benefits were overstated. So we need to find a way of turning that on its head and saying, these projects are still good, but this is the true climate benefit. And so one solution to that is for certain types of projects or perhaps on an individual project basis, you could estimate that you need to buy X two or three times the number of credits that are being produced in order to be assured that the net climate benefit is making the gain that you expect it to.

Mike Disabato (24:42):

What about vintage year? I actually don't know much about the vintage year of a carbon credit, the year that it's created and how that comes into play. I know there's been a lot of talk with these certification schemes for a reliable credit versus an unreliable credit that they talk lot about a vintage year, but I'm pretty ignorant to the details of that. Could you kind of take me through what vintage year is, why it's important, what you think about it?

Guy Turner (25:09):

Yeah, so a vintage is like a bottle of wine. You could create a bottle of wine at any point in time and it's date stamped. So Bordeaux 2016 might be a pretty good year, Bordeaux 2020, less so in Carbon World, a project maybe it started in 2016 and then every year that it operates, it is saving emissions compared to the baseline that you had estimated. And so those every year you can calculate the carbon benefits and that gets recorded and verified and that number gets put in a registry and SOSO 20 16, 20 17, 20 18, 20 19. And so it goes on. And so that's the vintage associated with that particular carbon slice of carbon credits. Is there a connection between vintage and quality? It's difficult to be general to generalize on this, but arguably yes, because there was less scrutiny and the methodologies have been improving over time. There was less scrutiny over projects 10 years ago.

(26:21):

Now there is a lot more scrutiny and there's companies like ourselves that are scrutinizing and going back over the project documentation and using satellites and now going, the projects that are now coming off the production line are knowingly doing so under of this new spotlight and are very aware of that. And so if there was any room for interpretation, that room, that scope is now being reduced that wasn't there, say 10 years ago. So I think in general there is a connection between the age or vintage of a credit, the age of the project and the vintage of the credit being created and the underlying quality. But it is very much a generalization.

Mike Disabato (27:13):

Okay, great. Thanks so much. And that's it for the week. I wanted to thank Guy Turner for talking to me about the news with an ESG twist. I wanted to thank you so much for listening. If you like what you heard, don't forget to rate and review us. It helps on people finding us here in 2024. And don't forget to subscribe if you want to hear myself or any of the other ESG now hosts every week. Thanks again and talk to you next week.

Speaker 3 (27:51):

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