



EXPLAINER SERIES

CLARIFYING CARBON CREDITS AND THEIR RELEVANCE TO EQUITIES AND INVESTMENT MANAGERS

EVERGREEN CONSULTANTS

A carbon credit is a tradable permit or certificate which allows a country or company to produce a certain amount of carbon emissions. These can be traded if the full allowance is not used. One carbon credit is equal to one tonne of carbon dioxide, or in some cases, carbon dioxide equivalent gases or greenhouse gases.

With this in mind, the Albanese government has recently announced a proposal with regard to carbon credit

price caps and revised baseline emission levels for Australia's worst 215 polluters.

The proposal builds upon the Abbott government's "Safeguard Mechanism", which was put in place in 2014. It has essentially nothing to do with the Gillard Government's carbon tax.

Under the safeguard mechanism, facilities which produce over 100,000 tonnes of greenhouse gases are set a 'baseline' emissions level by the government. If this

limit is exceeded, facilities effectively need to cancel Australian Carbon Credit Units (ACCUs), which are deemed by the regulator as each unit being the equivalent of one tonne of carbon dioxide.

As it stands now, ACCUs are issued primarily by the Emissions Reduction Fund, on a per-project basis, for either of two reasons; removing carbon dioxide from the atmosphere or avoiding future emissions (the latter of which is and should be heavily scrutinised).

ACCUs can be sold back to the government, sold on the private market, held, or cancelled as per the above.

Under the new proposal, revised baselines would be set. The former baselines are being criticised as being far too high, they are practically unreachable and therefore superfluous.

By 2030, it is expected for these new baselines to result in a decline in the emissions of Safeguard-covered facilities by achieving a reduction of 4.9%p.a. until 2030.

There will also be a \$75 cap on ACCU prices, set to rise by inflation +2% each year. The spot price of generic ACCUs as at 30 January 2023 was \$38.50 – far from the \$75 cap.

The more contentious part of the Albanese government's proposal, which will require the support of either the Greens or the Opposition, is that facilities who beat their baselines will be awarded ACCUs. This will completely change the supply dynamics of ACCUs, together with the likely increased demand resultant of more difficult baselines.

The Greens take issue with the fact that emitters would effectively be able to continue expanding their emissions, so long as they bought up enough ACCUs to offset them.

As it relates to investment managers

Is this better or worse for those who favour exclusionary approaches such as negative screens, given increased costs for super-emitters, or active owners who may see an angle in generating excess credits through improvements to traditionally RI-weak sectors? Is the long-term ACCU price cap linkage to inflation a compelling story for the defensiveness of RI equity Funds from an asset allocation perspective? How material will ACCUs be to corporate P&L?

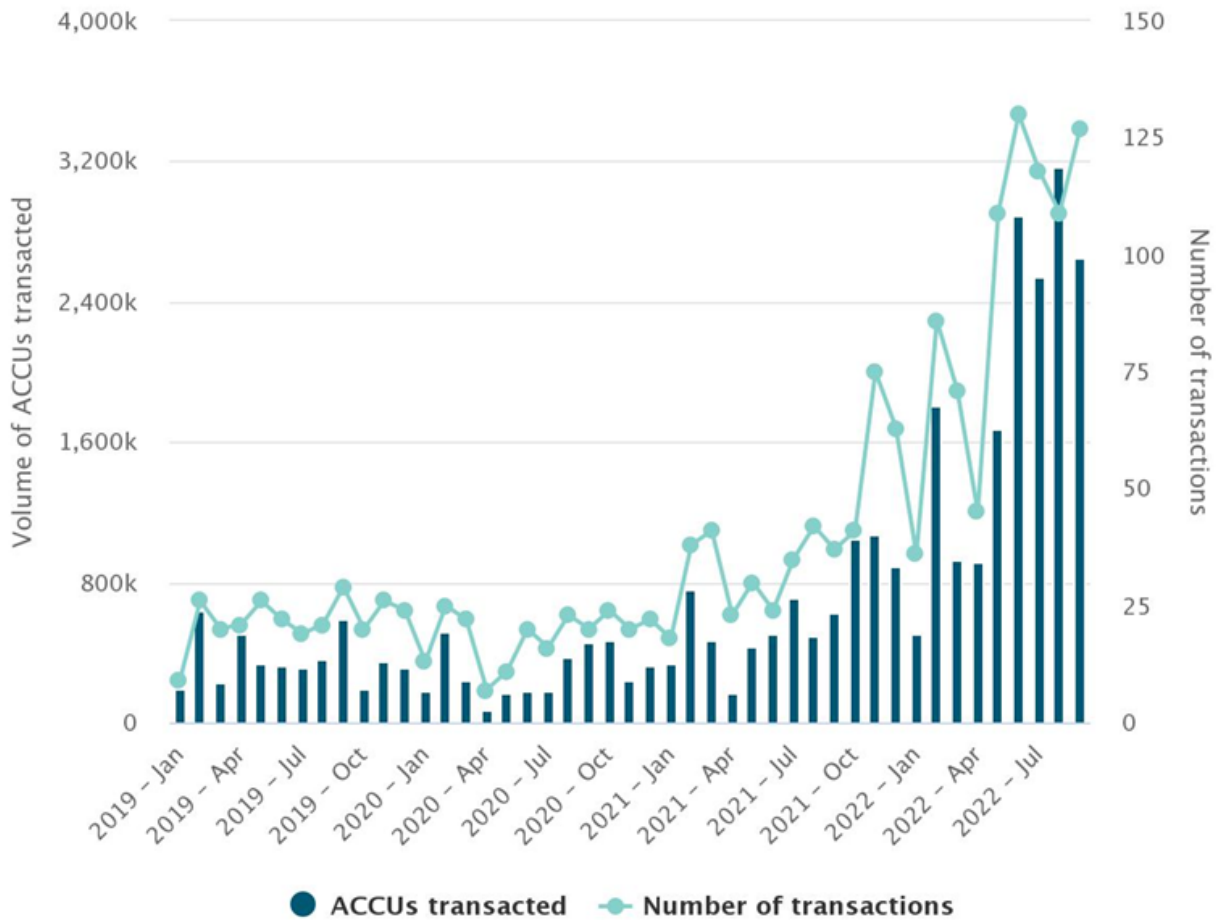
Interestingly, the private market is attaching a premium to ACCUs linked to what is being determined as 'better' activities. For example, the below shows that Human-Induced Regeneration ACCUs are attracting a higher price.

Is this corporate virtue-signalling, or some sort of risk premia given that ACCUs may be forcefully relinquished after the fact, should the regulator change its mind on the validity of the projects that generated them in the first place?

There is still some work to be done regarding effectively managing carbon emissions, particularly narrowing the gap between the Opposition and the Greens in terms of their ideal mechanism and baseline for the path forward.

ACCU market transactions

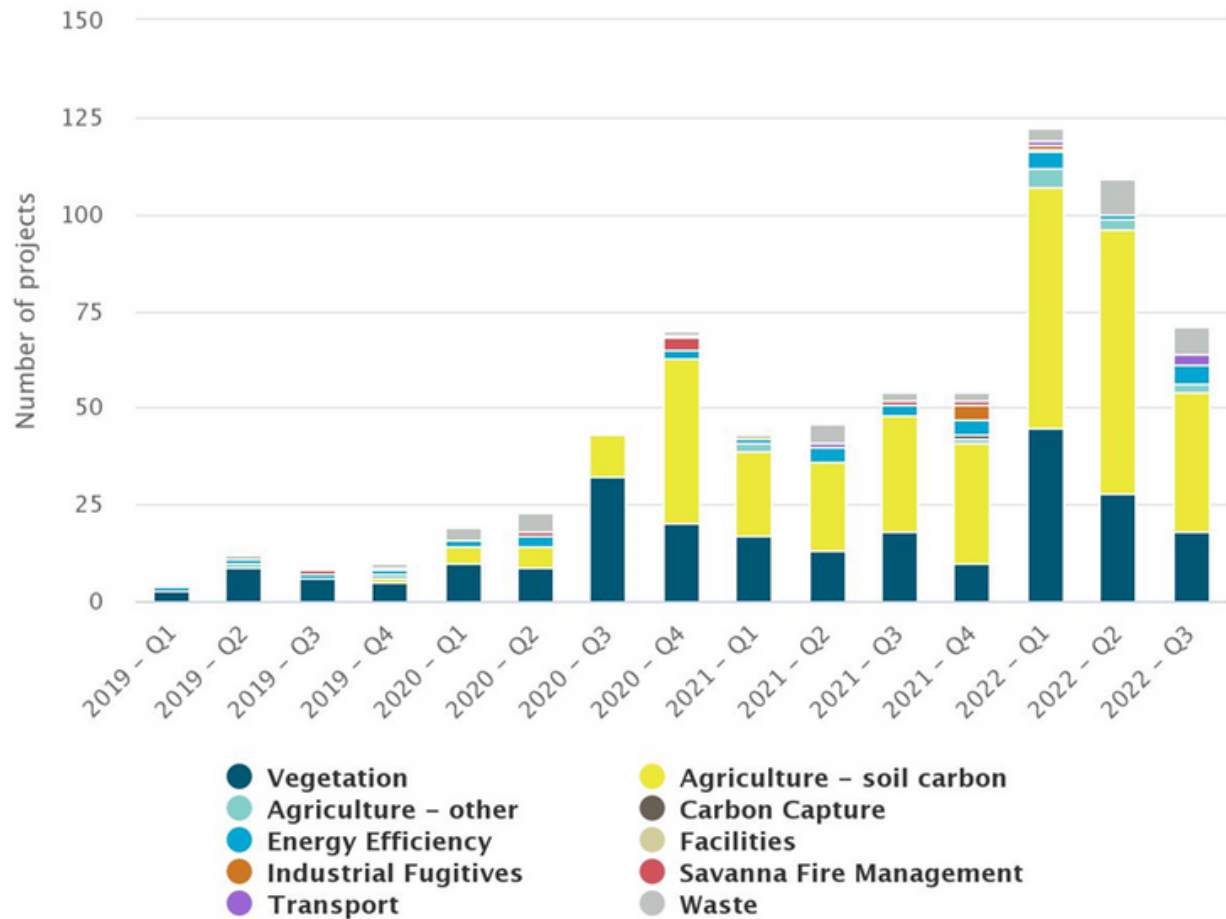
January 2019 to September 2022



This graph shows the volume of ACCUs transacted on the secondary market.

New registered projects per method type

Q1 2019 to Q3 2022

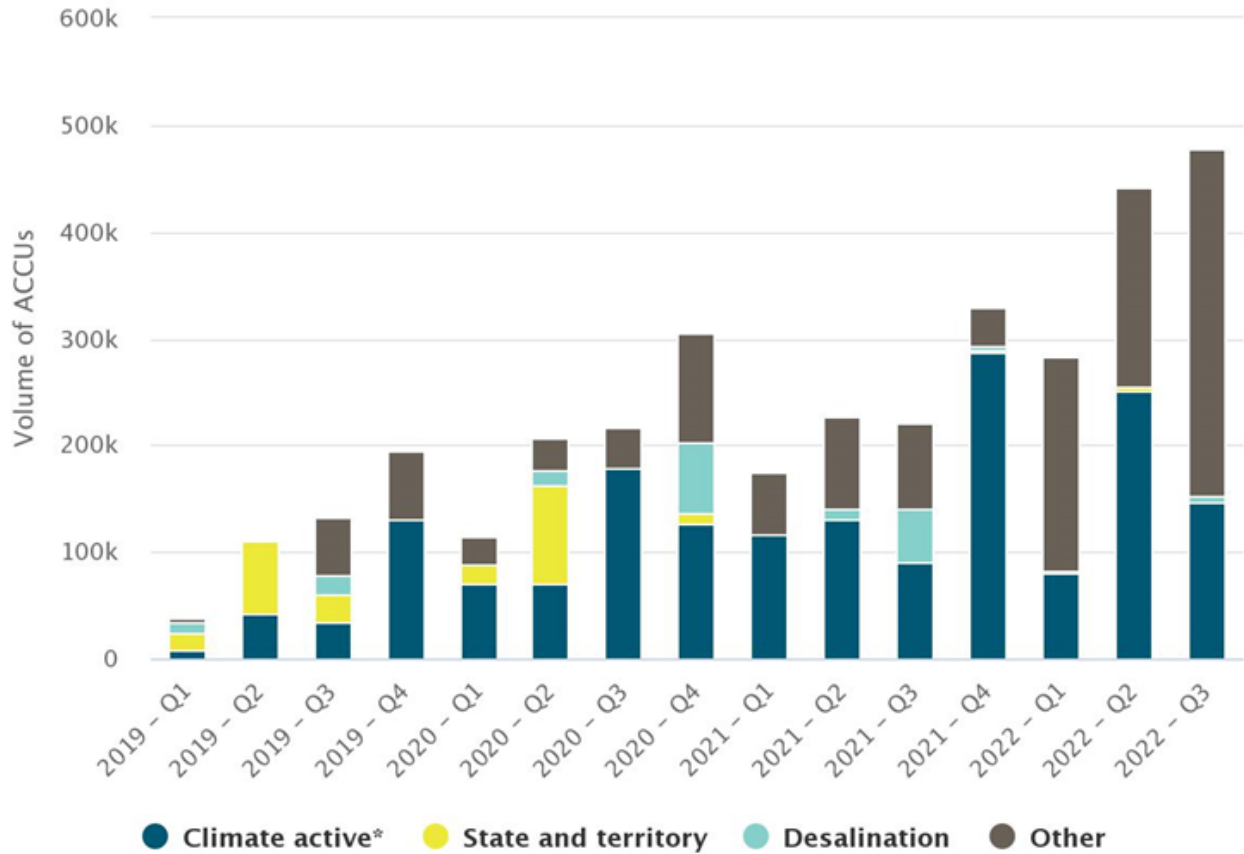


This graph shows new registered projects under the ERF by method type for each quarter.

Clean Energy Regulator

Voluntary private and state and territory government cancellation of ACCUs by reason

Q1 2019 to Q3 2022



This graph shows voluntary private and state and territory government demand for ACCUs by reason for cancellation.

Clean Energy Regulator