CLIMATE CHANGE AUTHORITY

Review of international offsets: consultation paper

MARCH 2022

Australian Government
Climate Change Authority

The Authority recognises the First Peoples of this nation and their ongoing connection to culture and country. We acknowledge First Nations peoples as the Traditional Owners, Custodians and Lore Keepers of the world's oldest living cultures, and pay our respects to their elders – past, present and future.

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Review of international offsets

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CONTEXT

The Climate Change Authority (the Authority) is an independent statutory agency, established to provide expert, evidence-based advice on Australia's climate change policy.

The Authority is conducting a review of international carbon markets in the context of the Paris Agreement, at the request of the Minister for Industry, Energy and Emissions Reduction, the Hon Angus Taylor MP (the Minister) (see Appendix 1 for the written request). The review will provide advice on the principles and criteria to apply to the future use of international offsets under the Government's Climate Active program. The advice will also inform the development of Australia's Indo-Pacific Carbon Offsets Scheme, and may be relevant to other policies and programs, and for accounting for Australia's emission reduction targets.

A review of the criteria for international offsets is timely. International carbon markets are evolving rapidly as efforts to implement the Paris Agreement accelerate, including to achieve net zero emissions by 2050. Significantly, countries reached agreement on the rules for international carbon markets under the Paris Agreement at the United Nations climate conference in November 2021 (COP26).

Demand for high-quality offsets is growing rapidly in Australia as an increasing number of businesses commit to net zero by 2050 and interim emission reduction targets. These commitments, and the action taken to meet them, are key to Australia's ability to meet its national 2030 emissions reduction target and net zero by 2050 target.

International carbon markets and the role of offsets

Limiting global temperature rise this century to 1.5°C above pre-industrial levels requires moving rapidly to global net zero carbon dioxide emissions by 2050, and to net negative emissions in the second half of the century.[1]

The scale and magnitude of this task requires not only significant and rapid emissions reductions, but also accelerated development and use of emissions removal and sequestration techniques. International carbon markets can play an important role in getting to net zero and to net negative, allowing access to the cheapest emissions reductions and removals options and reducing the overall cost of decarbonisation.

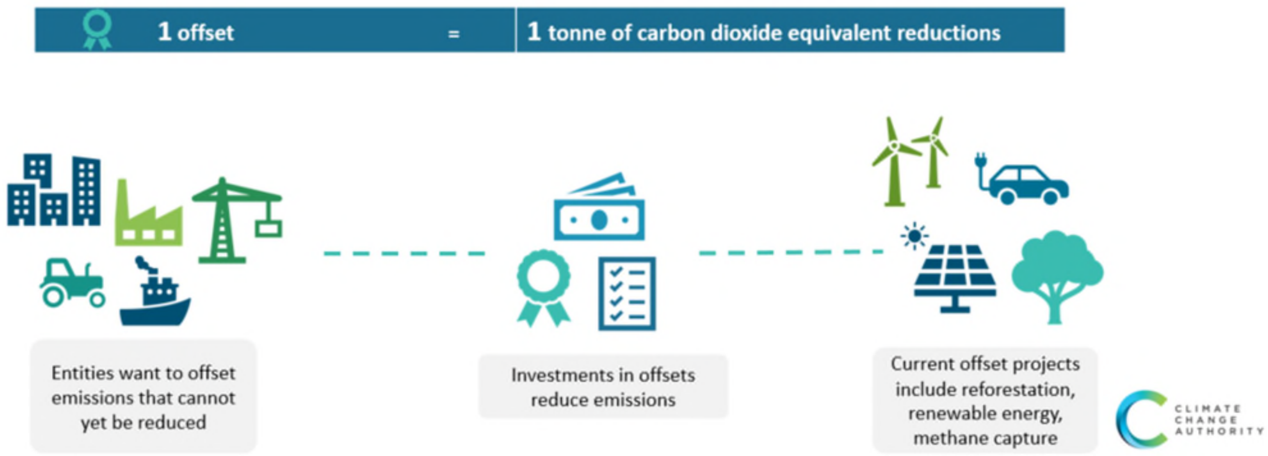

Figure 1: How offsets work

[1] Intergovernmental Panel on Climate Change (2021). *AR6 climate change 2021: The physical science basis.* Cambridge University Press. Of five scenarios of future climate change from the near to the long term under different emissions pathways, the rise in average global temperature by 2100 exceeds 1.5ºC in the scenarios that do not involve net negative emissions in the second half of the century.

The term “offset” refers to a tradable unit that represents the reduction or removal of a tonne of greenhouse gas emissions. Offsets are generated by one entity and sold to another, to compensate for emissions that cannot immediately be reduced by the purchasing entity.

Well-functioning carbon markets, with deep and liquid trade in offsets, can promote the development and deployment of the technologies, techniques and equipment needed for emissions reductions and sequestration by channeling investment to fund activities that might otherwise not occur. Offsets can also produce a range of co-benefits – for example, providing an extra revenue source for local communities or farmers to finance emissions reduction activities that also improve the productivity, resilience and environmental health of their land.

Experience from the operation of carbon markets to date has emphasised the importance of thorough accreditation, governance and verification standards and institutional arrangements to ensure that offsets genuinely reduce emissions, and do not represent false claims.

Criteria and standards are commonly used as a means to ascertain the quality and integrity of offsets. Simple identification of principles alone is not adequate for ensuring that an offsets unit represents a genuine emissions reduction or removal – equally important are the governance and institutional arrangements in place. The Emission Reduction Fund combines offsets integrity standards and governance arrangements (administered by the Clean Energy Regulator) to provide a strong integrity framework for the creation, tracking and use of Australian Carbon Credit Units (ACCUs), as set out in the *Carbon Credits (Carbon Farming Initiative) Act 2011*.

The Department of Industry, Science, Energy and Resources, which manages Climate Active, currently uses a decision framework based on the offsets integrity principles in the program’s Carbon Neutral Standard, along with an assessment of supporting governance arrangements, to determine the eligibility of offsets under Climate Active.

Periodic reassessment of the criteria and arrangements underpinning international offsets is important to ensuring that offsets used in Australia represent real emissions reductions, make a genuine contribution to the goals of the Paris Agreement, and provide confidence in action by Australian companies to achieve targets.

Climate Active Carbon Neutral standard

The standard currently uses the integrity principles listed below as a guide for determining which offsets are eligible for use under the program.

- **Additional**: it must result in emissions reductions that are unlikely to occur in the ordinary course of events, including due to any existing commitment or target publicly agreed by the entity responsible for issuing the units. It must represent abatement that has not been double counted.
- **Permanent**: it must represent permanent reductions in greenhouse gas emissions. In the case of sinks, this requires that the carbon stored is sequestered and will not be released into the atmosphere for a period of 100 years. Where a period of less than 100 years is applied to sequestration units, an appropriate discount must be applied.
- **Measurable**: methods used to quantify the amount of emissions reductions generated must be supported by clear and convincing evidence.
- **Transparent:** consumers and other interested stakeholders must have access to information about the offset project that generated the abatement, including the applied methodology and project-monitoring arrangements.
- **Address leakage**: the system responsible for generating the offset unit must provide deductions for any material increases in emissions elsewhere which nullify or reduce the abatement that would otherwise be represented by the offset unit.
- **Independently audited**: the circumstances responsible for the generation of the unit must be verified by an independent, appropriately qualified third party and not found to be in contradiction with these integrity principles.
- **Registered**: the offset unit must be listed and tracked in a publicly transparent registry.

Climate Active

Climate Active is a Commonwealth program that provides a carbon neutral certification standard for businesses who wish to demonstrate they have credibly reached net zero emissions. The Climate Active certification requires participants to measure, reduce, and offset their emissions. Participants must use eligible units to offset their remaining emissions to achieve the carbon neutral certification.

Currently, Climate Active allows the use of domestic offsets generated under the Emissions Reduction Fund (ERF), and international offsets from the Gold Standard, Verified Carbon Standard, Clean Development Mechanism and Kyoto Protocol. Participants also produce a public disclosure statement of their carbon neutral claim that is available on the Climate Active website. All carbon accounts are validated by a qualified independent party.

Indo-Pacific Carbon Offsets Scheme

The review will also help inform the design of Australia's new Indo-Pacific Carbon Offsets Scheme. The scheme is intended to help partner countries generate and trade high integrity carbon offsets under the Paris Agreement.

It also aims to encourage investment in high quality emissions reduction projects to support partner countries and Australian businesses to meet climate goals.

The Government has indicated that projects under the scheme should also endeavor to deliver co-benefits which contribute to United Nations Sustainable Development Goals.

Paris Agreement international carbon market rules

Article 6 of the Paris Agreement provides a high-level framework for international carbon markets, coining a new term for internationally traded units that that may be used to meet targets in Paris Agreement Nationally Determined Contributions – internationally transferred mitigation outcomes (ITMOs). There may continue to be international trade in units that do not meet the definition of an ITMO, but these cannot be used to meet countries' Paris targets. Participation in Paris Agreement markets is voluntary, and is open to countries to help meet national targets, and to other participants, e.g. businesses, to invest in emissions reduction projects or to purchase units to help meet targets. Trade may occur through bilateral or multilateral arrangements made directly between countries under Article 6.2, or via a new centralised mechanism under Article 6.4.

At COP26, countries reached agreement on detailed governing rules for Paris Agreement markets, including principles and standards designed to ensure the integrity of ITMOs and their trade. A brief summary of these is provided at Appendix 2.

AREAS OF INVESTIGATION

Terms of reference

The Authority invites stakeholders to provide their views on the following matters as listed in the requesting instrument. Stakeholders may also wish to consider the additional guiding questions provided below in the preparation of their submissions.

The Authority is to review the following matters:

a. the most important criteria for accepting emissions offsets for use in Climate Active and as part of IPCOS, including considering emissions offset claims from within and across different carbon accounting frameworks; and
b. what are leading practice approaches for taking into account non-carbon benefits and avoiding adverse impacts; and
c. potential differences in criteria relating to the use of those offsets under Climate Active, as part of IPCOS or for other purposes; and
d. whether the criteria can or should be applied at a scheme level, by classes of units or project types or individual projects; and
e. to what extent the vintage of units (such as relating to abatement, project registration or issuance) should be relevant to the use of those offsets; and
f. which offsets could be eligible for use under Climate Active at the present time.

Guiding Questions

These questions are intended as a guide only, respondents are welcome to address as many or as few of them as they like, and should raise any other issues they deem relevant. Please include any supporting evidence you can provide for your responses.

General

1. What considerations should guide the use of international offsets in Australia?
2. What is the role of offsets in Australia's transition to net zero emissions and how might this change over time?
    a. Does this vary by offset type (e.g. sequestration vs emissions reduced or avoided?)
    b. What are the opportunities and risks presented by international offsets now and into the future?
3. Are there lessons to be learned from experience with international carbon markets to date? What are most relevant to this review?

Use of offsets by Australian companies

4. Does your company (intend to) use domestic or international offsets and, if so, why?
    a. What are the most important factors you (will) consider in choosing which international offsets to purchase?

Criteria and standards

5. What criteria and standards should govern the use of offsets in Australia and under Climate Active in particular? What criteria and standards should be adopted by IPCOS?
    a. Should different criteria and standards apply at different scales (e.g. at the method, project, scheme and trading platform levels)?
6. What is your view of the criteria and standards currently applied by international offsets programs such as the Gold Standard, the Verified Carbon Standard and the Clean Development Mechanism?
    a. Are there any gaps in the criteria used? What changes and/or additions are needed?
    b. What is your view of the standards applied to ensure an offsets credit represents a real reduction in greenhouse gas emissions (e.g. permanence, additionality, measurement, reporting and verification (MRV) standards)?
    c. What is your view of the standards applied for taking into account co-benefits?

    d. What is your view of the standards applied to avoiding and addressing adverse impacts?
7. Should the age of units (their vintage) be considered in the criteria for eligible offsets in Australia?

Governance arrangements

8. In the context of the Paris Agreement, how important is it to consider the governance and institutional arrangements in place for the generation, trade and use of offsets?
9. What are the key elements of good governance arrangements? Are there elements missing from current offsets programs such as the Gold Standard, the Verified Carbon Standard and the Clean Development Mechanism?

Co-benefits

10. How important is it that offsets also produce co-benefits?
    a. How important is it that IPCOS produces co-benefits in partner countries?
11. What are the range of co-benefits that might result from the production of offsets?
    a. Are some co-benefits more valuable than others, and if so, which?
    b. Are there specific offsets activities that might have a particularly positive impact?
12. In your view, what are the most appropriate and effective approaches for supporting, recognising and valuing co-benefits associated with offsets, and ensuring the delivery of co-benefits in local communities?

Adverse impacts

13. What are the range of adverse impacts that might result from the production of offsets?
14. What are the most effective approaches or frameworks for avoiding or otherwise managing adverse impacts, if necessary?
    a. How can IPCOS best be designed to avoid adverse impacts and address them if they do arise?
15. How important is community and stakeholder engagement is avoiding adverse impacts?

Broader implications

16. Does the use of international offsets under Climate Active have any broader implications in Australia? (For example, for other offset schemes, for corporate reporting and for the development of carbon markets and carbon trading platforms.)
17. What are the lessons learned from carbon markets to date?
18. Outside of Climate Active and IPCOS, where else might offsets criteria be relevant in Australia? Are there different considerations in those cases?
19. To what extent should international offsets used by Australian companies towards their targets also count towards Australia's national targets?
20. Are there other matters the Authority should consider in undertaking the review?

SUBMISSIONS

The Authority invites organisations, businesses and individuals to make submissions to help inform its 2022 review of international offsets.

This consultation paper identifies matters the Authority considers most relevant to the review however, views on other issues in relation to use of international offsets in Australia are also welcome.

The Authority recognises the disruption caused by COVID-19 and acknowledges this may be a difficult time for stakeholders to take part in consultation. In order to assist you to provide input to this review we are providing a range of options for consultation.

How to provide submissions

Lodging written submissions

If you would like to provide a written submission, you can do this by emailing it to enquiries@climatechangeauthority.gov.au until 4 April 2022.

If you intend on making a written submission but will require additional time beyond 4 April 2022, please contact the Authority at enquiries@climatechangeauthority.gov.au.

A coversheet for submissions can be found on the Authority's website at: https://www.climatechangeauthority.gov.au/public-consultation. Please indicate on the coversheet whether your submission is made in confidence. Submissions made in confidence will not be published on the Authority's website.

Submissions to previous reviews

If you have made a submission to a different review process and you would like the Authority to consider the same information as part of this review, you are invited to email that submission to the Authority at enquiries@climatechangeauthority.gov.au.

Targeted discussions

The Authority will also be undertaking targeted consultation with stakeholders to complement the written submissions. If you would like to be part of these discussions either in addition to or as an alternative to making a written submission, please contact us at enquiries@climatechangeauthority.gov.au.

Your contributions are greatly valued by the Authority and will inform the Authority's final review report.

APPENDICES

Appendix 1: Requesting Instrument

AUSTRALIA

Climate Change Authority (Offset Assessment Principles) Instrument 2022

I, Angus Taylor, Minister for Industry, Energy and Emissions Reduction, acting under subsection 59(1) of the *Climate Change Authority Act 2011* (the Act), request the Authority to conduct a review of the following matters to the extent to which they relate to the use of offsets related to carbon abatement outside Australia under Climate Active and/or the creation or use of offsets as part of the Indo-Pacific Carbon Offset Scheme (IPCOS) in the context of the Paris Agreement (including recent outcomes from Glasgow and the finalised Article 6 Rulebook):

(a) the most important criteria for accepting emissions offsets for use in Climate Active and as part of IPCOS, including considering emissions offset claims from within and across different carbon accounting frameworks; and
(b) what are leading practice approaches for taking into account non-carbon benefits and avoiding adverse impacts; and
(c) potential differences in criteria relating to the use of those offsets under Climate Active, as part of IPCOS or for other purposes; and
(d) whether the criteria can or should be applied at a scheme level, by classes of units or project types or individual projects; and
(e) to what extent the vintage of units (such as relating to abatement, project registration or issuance) should be relevant to the use of those offsets; and
(f) which offsets could be eligible for use under Climate Active at the present time.

Receipt of the report under paragraph 60(1)(b) of the Act by 30 June 2022 would assist in the review of Climate Active and development of IPCOS.

Dated 4/2/22

Angus Taylor
Minister for Industry, Energy and Emissions Reduction

Appendix 2: Summary of Paris Agreement rules for international markets

The bulk of the Article 6 rules agreed at COP26 establish arrangements to make Paris Agreement markets operational.

The rules set out:

- Principles and standards designed to ensure ITMOs generated by Article 6 activities represent real emissions reductions, contribute to the goals of the Paris Agreement, result in positive environmental and social outcomes and avoid adverse impacts;
- Technical guidance to ensure ITMOs are not double counted (e.g. used by more than one country towards meeting its targets);
- Responsibilities for participating parties;
- Requirements for the reporting and independent expert review of regular, transparent information on:
    - the design of Article 6 activities and how they meet the standards and principles;
    - trade in ITMOs, including authorization, acquisition, transfer and holdings; and
    - use of ITMOs towards Paris Agreement Nationally Determined Contributions (NDCs) or other purposes.
- New institutional arrangements for the recording and tracking of trades and the use of ITMOs, including registries, an Article 6 database and a centralized accounting and reporting platform; and
- The rules, modalities and procedures for the operation of the centralized mechanism under Article 6.4 including its administration by a Supervisory Body.

Standards and principles

Standards and principles to ensure the quality and integrity of ITMOs are established by a number of sections of the Article 6 guidance. The rules do not set prescriptive measures for ensuring the delivery of these standards, but require participants to provide regular, detailed information on how their market activities under Article 6 are consistent with them. The Supervisory Body is to ensure the new Article 6.4 mechanism adheres to a similar set of standards and principles.

An ITMO is required to be real, verified, and additional and it must represent mitigation occurring from 2021 onward (i.e. units that are older than 2021 are not eligible to be internationally traded under the Paris Agreement).

Each participating party is to provide information demonstrating that:

- participation in Paris Agreement carbon markets contributes to its Nationally Determined Contribution (NDC), its long term strategy and the goals of the Paris Agreement;
- it has ensured transparency, accuracy, consistency, completeness and comparability in tracking how its trade in ITMOs impacts its progress towards its NDC;
- each Article 6 activity it is engaged in ensures environmental integrity, including:
    - that there is no net increase in global emissions;
    - through robust, transparent governance and the quality of mitigation outcomes,
        - such as the use of conservative reference levels, baselines and below business-as-usual projections,
    - by minimizing the risk of non-permanence of mitigation across several NDC periods; and
    - how it will ensure reversals are addressed in full

Participating parties must also describe how each cooperative approach will:

- minimise and avoid negative environmental, economic and social impacts;
- address human rights and the rights of indigenous people;
- be consistent with the sustainable development objectives of the Party; and
- contribute to providing resources for adaptation, if applicable;

- Contribute to overall mitigation in global emissions, if applicable.

Avoiding double counting

Carbon market accounting for the purpose of NDCs is similar to bank transfers – it requires two countries engaging in the trade of ITMOs to make opposite entries to their emissions accounts, referred to as “corresponding adjustments”. This ensures that only the using country uses the ITMO towards its target, and not the originating country or any intermediary, thus avoiding double counting.

The Article 6 rules provide a number of options to countries for how to make corresponding adjustments, covering the range of different target types that countries have included in their NDCs.

The Article 6 rules provide that countries may authorize ITMOS for several purposes, and in doing so, commit to making a corresponding adjustment to their accounts. The purposes are: for use towards an NDC; use for other international compliance purposes, such as the international civil aviation scheme known as CORSIA, and use for other purposes determined by the originating country. Other purposes may include use under the voluntary carbon market. This gives the voluntary market the opportunity to trade in ITMOS backed by corresponding adjustments, knowing these are not used towards the originating country’s target.

It is possible for the voluntary carbon market to also trade in non-authorised units, for which corresponding adjustments are not made – these are not Paris Agreement ITMOs, and it is yet to be seen what value these unit might have as Paris Agreement markets mature.

Transition of the Clean Development Mechanism.

The Article 6 rules allow some limited transition of Clean Development Mechanism units, projects and methodologies to the Paris Agreement. CDM projects must submit a request to transition to the Paris Agreement to their host country and the UNFCCC Secretariat by the end of 2023, and provide host country approval of the request to the Article 6.4 supervisory body by the end of 2025. Once approved, a CDM project must transition to an approved 6.4 methodology at the earlier of the end of 2025 and its current crediting period.

CDM units – Certified Emissions Reductions (CERs) – from projects registered on or after 1 January 2013 may be used to meet first NDCs under the Paris Agreement. It is yet to be settled whether these can be used only towards host countries’ NDC, as they do not meet the definition of an ITMO, which must represent mitigation from 2021 onwards.