BeZero Carbon: Submission on amendments to California Cap-and-Trade Regulation

BeZero

Executive Summary

- As a carbon ratings agency, BeZero Carbon supports the inclusion of high quality carbon credits within compliance carbon markets. We therefore welcome California's Compliance Offset Program, and your ongoing commitment to ensure that offsetting protocols meet robust standards and reflect the best available science.

- We believe that independent, expert-led, transparent carbon credit ratings are a vital tool for driving up standards within carbon credit markets, helping buyers to identify credits with the greatest carbon efficacy. Ratings are increasingly driving demand and price trends within the voluntary carbon market: we have found that, on average, the price difference between credits separated by one BeZero rating notch has been around 25%.

- We would advocate for the inclusion of independent carbon ratings within the framework for California's Compliance Offset Program. Ratings can be used as a tool to incentivize or mandate the use of high quality credits, for example by requiring market participants to disclose ratings or by setting a minimum ratings threshold.

- **We would welcome the opportunity to discuss the opportunity for ratings within California's Compliance Offset Program in greater detail, and would be pleased to meet at your convenience.**

Context: BeZero Carbon

BeZero Carbon is a carbon ratings agency. We equip world-leading organizations with the knowledge, tools and confidence to make better climate decisions. Our aim is to scale investment in environmental markets that deliver a sustainable future.

Our offices are in London, New York and Singapore. With a 150+ strong team made up of climate scientists, geospatial experts, data scientists, financial analysts and policy specialists, and global partnerships with local experts and world-leading research institutions, our ratings and risk tools help organizations make risk informed decisions on carbon projects of any type, at any stage, anywhere in the world. Our analytical frameworks are deeply sector nuanced and bring to the fore our extensive experience in rating hundreds of projects across dozens of sub-sectors.

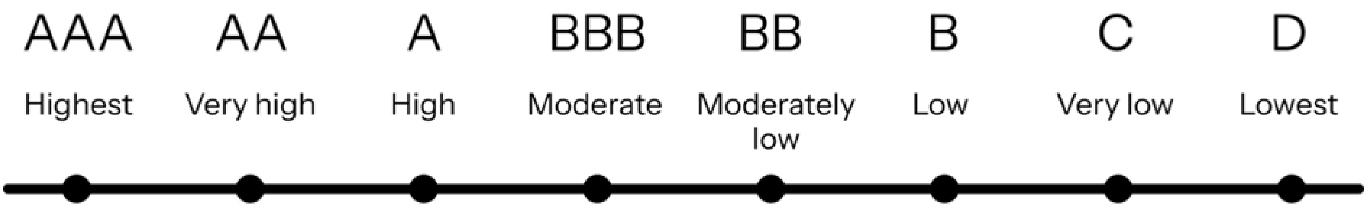
Our platform, BeZero Carbon Markets, hosts the most comprehensive database of rated carbon projects across all major accreditors, sectors, and regions to help all participants price and manage risk. Ratings are also available for display on third party carbon exchanges and marketplaces. Headline letter ratings and ratings summaries are publicly available on our website at bezerocarbon.com/ratings/listings.

Our clients and partners span across all facets of the market for carbon credits including end-buyers, project developers, banks, insurers, exchanges and governments. We will shortly be announcing an industry-first rating of Article 6 carbon credits on behalf of a major government buyer.

Context: Carbon ratings

Ratings represent an informed assessment of whether a carbon credit is likely to deliver its promised amount of carbon emissions removed or avoided.

The BeZero Carbon Rating represents BeZero's opinion on the likelihood that a given credit achieves a tonne of CO_2e avoided or removed from the atmosphere. With 'AAA' representing the highest likelihood, and 'D' representing the lowest, the rating scale is fully aligned with financial market standards, making it easy to interpret. BeZero's public website hosts all of its headline ratings and ratings summaries.



The BeZero Carbon Rating scale. Each letter rating represents the likelihood a carbon credit delivers on its promise of 1 tonne of CO_2e avoided or removed.

Underpinning the headline rating is an in-depth analytical assessment across the factors driving carbon credit quality - **additionality, carbon accounting and permanence**:

- Additionality assesses whether a project would have happened anyway without carbon finance, considering financial, activity, policy and legal aspects.
- Carbon accounting assesses whether a project is using an appropriate baseline and is accounting for any "leakage" taking place outside the project area. To analyse this for nature-based projects, BeZero deploys advanced geospatial and Earth observation technology.
- Permanence assesses the project's ability to mitigate any carbon reversals during its lifetime, including via the capacity and durability of the project's buffer pool.

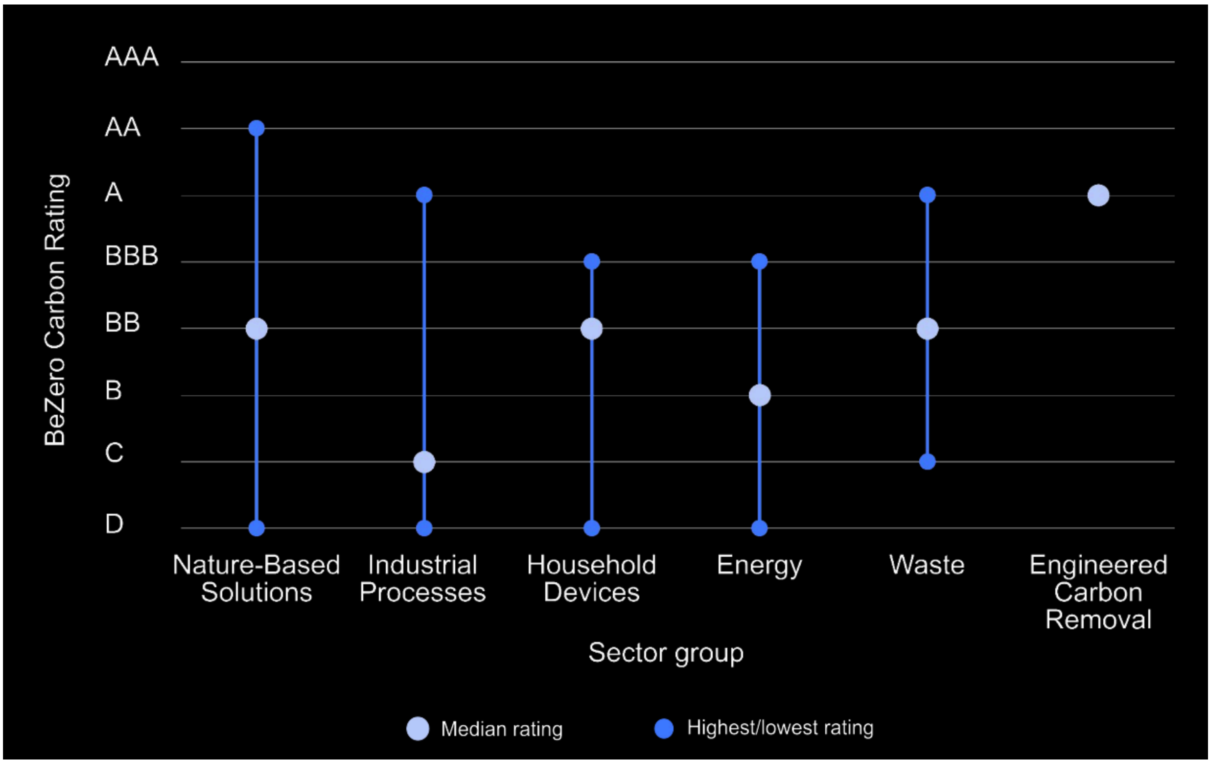
At BeZero, we welcome and encourage transparency in the market and have published all our ratings methodologies and headline ratings. We have signed up to the ICMA's voluntary code of conduct for ESG ratings agencies. Over and above this, we impose on ourselves seven key pillars to guarantee our independence:

1. No internal conflicts: our commercial and analytical functions are separated
2. No trading or developing carbon credits
3. No MRV consulting
4. No privileged rating access: everyone in the market learns about our ratings at the same time
5. No buyer-seller referrals
6. No advisory
7. No results based payments

Ratings in compliance carbon markets

We believe that, with appropriate safeguards in place, the inclusion of carbon credits in compliance markets has significant advantages. They can support compliance markets to achieve greater climate impact with greater efficiency, while channelling much-needed finance to carbon projects and new technological solutions with co-benefits like job creation and biodiversity gains. **This is why we support the broad approach of the California Cap-and-Trade scheme's Compliance Offset Program.**

However, the key issue which must be addressed when integrating carbon credits into compliance markets is the integrity of credits. BeZero's ratings and research has consistently found that the quality of credits varies considerably, even for specific sectors, technologies and methodologies (see figure below).



Overview of BeZero Carbon Ratings across the six sector groups in BeZero's sector classification system.

If market participants are not required or incentivized to purchase and retire higher quality credits, there is a risk of a "race to the bottom" whereby participants seek out the lowest quality, cheapest carbon credits to fulfil their obligations to comply. **Carbon ratings offer a tool that policymakers can use to tackle the underlying integrity issue that poses a risk to carbon credits within compliance markets.**

The table overleaf sets out some illustrative use-cases for ratings within a compliance market such as the California Cap-and-Trade scheme.

Use case	Description
1. Minimum ratings threshold for credits	For a credit to be eligible within the compliance scheme, it must be rated by an independent, accredited carbon ratings agency and achieve a minimum rating standard. For example, only credits rated as having a 'moderate likelihood' or above of delivering 1 tonne of emissions avoided/removed (a BeZero rating of 'BBB' or higher) might be eligible.
2. Credits discounted based on their rating	Regulators define 'discount factors' based on the rating of each credit from an independent, accredited carbon ratings agency, with lower-rated credits being discounted more than higher-rated credits. The total contribution of carbon credits towards an entity's compliance obligations under the CCM is discounted based on the ratings of the retired credits. BeZero proposed a potential discounting framework in our 'Making Credible Claims' white paper.
3. Minimum 'average rating' requirement	Entities participating in the CCM must demonstrate that their credit retirements within a given compliance period meet a minimum 'average rating' standard. The average could be defined using a linear numerical scale for each rating level or a non-linear scale based on an approach similar to the discounting factors discussed in use case 2.
4. Supply-side ratings disclosure requirement	All projects seeking to supply credits to the CCM must be rated by an independent, accredited ratings agency and display their rating on any associated public registries.
5. Demand-side ratings disclosure requirement	All entities participating in the CCM must disclose specified details of the carbon credits used to achieve compliance, including ratings from an independent, accredited ratings agency.

These use cases represent a form of risk management, helping to ensure that, in aggregate, the carbon credits used within a compliance framework have a minimal risk of failing to deliver climate impact. This is akin to the role that credit ratings have in financial market regulation where ratings help to define the minimum liquid reserves for banks and the assets held by pension funds.

While there are already some structural safeguards in place within the California Cap-and-Trade scheme - defining specific protocols for carbon credits and limiting the proportion of compliance that can be achieved with offsets - **we believe that independent ratings would provide an additional layer of regulatory protection**. Their integration into the market would further drive up standards, and help to truly meet the AB 32 criteria for offsets to be real, permanent, quantifiable, verifiable, enforceable, and additional.

This submission provides an overview of our argument for independent carbon ratings to be integrated into the regulatory framework for California's Cap-and-Trade scheme. We would welcome the opportunity to discuss further, and would be pleased to meet at your convenience, or answer any questions via email.