Dr. Liane Randolph
Chair, California Air Resource Board
1001 I Street
Sacramento, CA 95814

May 8, 2024

RE: Comments on April 23 workshop regarding potential amendments to the cap-and-trade regulation

Dear Chair Randolph:

We greatly appreciate the opportunity to provide the comments attached below in response to the public April 23 workshop on potential amendments to the cap-and-trade regulation.

Lombard Odier Investment Mangers (LOIM) is the asset management arm of the Lombard Odier Swiss banking group, founded in 1796, with a core investment conviction in the net zero transition, including through investments in carbon markets. The authors of these comments constitute Lombard Odier's carbon team, based in London and New York. One of the authors (Ruben Lubowski) was a co-lead author of the PMR-ICAP *ETS Handbook,* including the chapter on temporal flexibility (ICAP-PMR 2016) relevant to our current comments, and also teaches Carbon Pricing as an Adjunct Professor at Columbia's University School of International and Public Affairs.

The views expressed here are those of the authors alone and do not necessarily reflect those of others at our organization.

Thank you very much for your time and consideration.

Sincerely yours,

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2020 to 2031 Transition Considerations

A discontinuity in 2031 should be avoided to reduce disruptions from both a market and environmental perspective. If there is a decision to follow an emissions trajectory anchored in the 2030 and 2045 targets, a discontinuity could be mitigated by focusing on the cumulative rather than annual budgets post 2030. There is already a precedent for following cumulative budgets in the manner that CARB has proposed to adjust the 2021-2030 cumulative pathway through an adjustment over the 2025-2030 period. The same cumulative emissions budget from 2031-2045 could be maintained without a jump in 2031 by maintaining an emissions cap in 2031 below that for 2030 and then having a flatter, more gradually declining cap trajectory through 2045. One such option for smoothing the post-2030 pathway is illustrated in the figure below. The alternative green dashed pathway maintains the same cumulative budget over 2031-2045 as the proposed "48% scenario" pathway shown with the black dashed line.[1]

If there is a concern that the pathway in green could potentially imply an infeasible or overly costly decarbonization trajectory at the start of the next decade, this risk could be managed by making future volumes conditionally available at the APCR tier levels in the early 2030s. This would be preferable to risking undermining the price signals to stay on track with the 2045 target through an abrupt release of added supply in 2031.

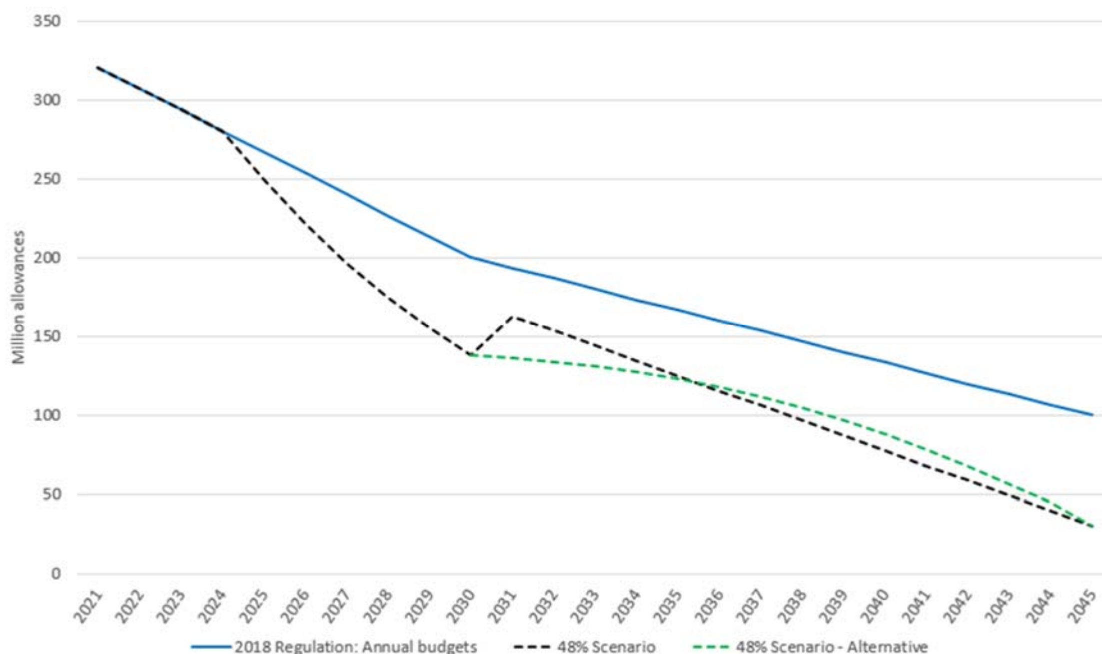

Figure: Alternative 2031-2045 Allowance Budget Trajectories

Holding limit formula

A discontinuity in the holding limit should be avoided. The simplest solution would be to avoid the discontinuity in the allowance budgets in the first place by having a smoother cap trajectory for the cap, as discussed above. If this option is not chosen, an alternative solution would entail fixing a decline

[1] This illustrative pathway begins with 1.525% rate of cap decline in 2031, which increases by 22% per year through 2045. Other alternative formulas could achieve the same objective.

schedule for the holding limit, independent of the annual budgets. Another possibility would be to tie the holding limits for current vintages to a rolling average of past allowance budgets (e.g. over 3-5 years), rather than just the current year's budget. This would smooth over the impact of any discontinuities in annual allowance budgets, while also better reflecting the market size in terms of the volume of allowances in circulation, including the allowances banked from prior years.

We also recommend that CARB consider differentiating holding limits by forward versus current vintage allowances in order to reduce the potential for individual participants to influence the market price of the advance vintage allowances and support efficient discovery of future market prices. Under current regulations, the holding limits for advance vintages are only slightly less for the advance vintages even though the actual supplies of advance vintages are approximately one tenth of the current (up until the time the advance vintage becomes the current). The holding limits for advance vintage allowances should be established in a manner proportional to the volume of forward allowances actually made available to the market, rather than to the allowance budget for each future year. This approach would better reflect the market size for advance vintage allowances which are significantly less liquid than the current vintages.

CAG Triggers

CAG Trigger Concept #1. The proposed exemption when providing cap-and-trade consulting services only to covered entities does not seem reasonable. If the goal is to prevent unfair market influence and market manipulation through coordinated activities, it seems appropriate to be equally concerned about potential market coordination among covered entities as compared to investors.

New CAG Trigger Considerations. It will take some time for potentially affected investors to work with CARB to understand the new proposed CAG triggers and if needed transition their holdings and investment structures. Nevertheless, having a drawn out implementation period would create lingering risk and uncertainty about when potential volumes would come to market. We recommend that CARB seek to balance administrative practicality with timely implementation for the purposes of providing certainty to the market.

General comment. If the goal is to increase price transparency and reduce potential for market manipulation in the context of tighter allowance budgets, increasing the share of allowances sold via auction would be one of the most powerful policy levers. This could be accomplished by requiring that all entities that receive free allocation consign their free allocation for sale during the auctions.

Compliance period alignment

The choice of longer versus shorter compliance periods is one part of a broader set of considerations around temporal flexibility discussed in the Chapter 5 (of the ETS Handbook, 1st edition (PMR-ICAP 2016)[2] and should be considered together with other program features that provide temporal flexibility to compliance entities, including the availability of banked allowances. There is a policy design tradeoff between greater compliance flexibility to reduce costs as compared to more environmental assurance over when emissions targets will be achieved. Reasons for limiting the length of a compliance period are similar to those for limiting or preventing borrowing of allowances from future budgets. Having 4 or 5 year periods are on the longer side relative to most other major programs, with the current exception

[2] https://icapcarbonaction.com/system/files/document/icap-pmr_ets_handbook_1st_edition.pdf

of Washington, so if CARB pursues this route, it may want to balance it with an increase in the annual partial surrender requirements. As a result, all else equal, having 2-3 years periods (as New York is also considering) is likely preferable from a market and environmental effectiveness perspective than 4-5 year periods, especially in the context of a large allowance bank which reduces the need for additional temporal flexibility.

Furthermore, having periods of varying lengths would create complexity and be less desirable from an administrative planning perspective. A solution that merits consideration would be to simply move towards one-year compliance periods, as the RGGI program has indicated it is considering as part of the current program review. A one year period would have the strong advantage of simplicity especially given the presence of the large bank which reduces the need for added flexibility tools.   A further advantage could be to mitigate possible disruptions in the context of market linkages