12 April 2024

Dear Members of the Article 6.4 Supervisory Body, in response to your call for inputs for A6.4-SB009-A02, I would like to submit my thoughts and opinions with regards to Carbon Removals (CDR) specifically, which I believe is an attractive sub-set of Carbon markets which has the potential to attract real money by achieving institutionalization seen in many flourishing asset classes of Financial Markets.

I am an Investment banker and therefore have steered clear of

a. technical aspects (Quantification) leaving it to august bodies of Climate experts and engineers as well as
b. process-oriented (Lifecycle) aspects leaving it to work being done by esteemed groups such as IC-VCM along with the standards.

My focus in the enclosed submissions, addressed only the view of a financial market participant (efficient allocation of capital), and therefore centered on the following issues:

a. Normalization of Carbon Pricing
b. Addressing Shortfalls & Reversals
c. Article 6.4 Supervisory Body acting as Hub of larger Carbon Ecosystem

My most humble and sincere thanks for offering the opportunity to make these submissions to the esteemed body and hope to contribute a financial markets' perspective towards operationalizing Article 6.4.

Kind regards

Rahul Goela

rahul.goela@gmail.com
+971 56 3436365

Investment Banker working as Structurer in Global Markets division, Middle East Bank
(Submissions have been made in personal capacity only)

A - Normalization of Carbon Pricing

The diverse pricing of Carbon Credits, much as it seems natural and logical, is extremely bewildering aspect of a financial asset class for most large and sophisticated investors and an efficient pricing mechanism for market participants will build in clear attribution of reward (impact achieved – 1t CO_2 removed for CDR) and risks (shortfalls / reversals).

I, therefore, would like to second the approach of Tonne-year accounting (TYA) leading to a more comprehensive approach proposed as Carbon 2.0 by Sky Harvest, which has extended the principles of TYA addressing practical concerns of Investors, for the below reasons:

a. The price of Carbon credit is normalized to 1t CO_2 removed precisely and stored – the benefit

b. The cost today is a discounted value of future benefits, discounting the underlying risks (environmental costs and regulatory penalties, shortfalls and reversals)
c. All risks associated with reversals / shortfalls are attributed within "Risk premium" over and above discount rate attributable to social cost of carbon much like how probability of default is factored into bond prices as credit spreads.

Therefore paying "less" for a Carbon project with large inherent risks vis a vis paying "more" for a higher quality project should be financially normalized – *there are no free lunches*.

I would like to clarify that under Reversals, any change to Corresponding Adjustment being delivered by the Host country shall be included aligning with accounting integrity goals laid by the Supervisory body along with the Climate integrity goal of achieving 1t CO_2 removed.

The risk premium approach is well tested in financial markets and offers a framework for investors to allocate capital by leaving analysis of qualitative factors impacting project's ability to deliver 1t CO_2 removal.

Here, I would like to emphasis the role played by Carbon Ratings agencies in analyzing these factors for investors and offering them a "Fixed Income" like approach which is also well tested.

B – Addressing Shortfalls & Reversals

Section 3.6.3 / A6.4-SB009-A02 offers use of Buffer pools as an effective remediation. 3.6.3.1 further refers to establishing a Reversal Risk Buffer Pool by Article 6.4 Supervisory Body.

I sincerely echo the thought and would like to propose the following extensions:

a. Article 6.4 SB buffer pools could include credits from all registered projects. As mentioned in the document, the credits are not retired for specific period of time and therefore may be used to remediate shortfalls
b. The Buffer pools therefore at any point in time represent an aggregate sum of CDRs or tonnes removed, priced at a volume weighted average price of each CDR.
c. The buffer pool itself "steps in" to remediate a shortfall or reversal by offering the investor purchase at a price based on b
d. Buffer pool makes "deferred" payments to projects on credits purchased by buffer pool, compounding the purchase price for time when "step-in" is required.
e. Buffer pool 1t CO_2 would compound (using weighted average discount factor discussed in Price Nomalization) the price of carbon credits in the inventory along with aggregating new credits from new projects (step b) adjusted for credits used to "step-in" (Step c)

The above buffer pool could be run in conjunction with Insurance companies which offer coverage of ex-ante / ex-post risks achieving an efficient "Umbrella Insurance" vehicle to underwrite these risks leveraging significant amount of thought process and methodologies which has already been developed.

I would like to emphasize that, in my opinion, investors "should" pay for reversals / shortfalls to clearly highlight the risk of lower cost projects.

Investors may "Choose" to buy Insurance by paying a pre-agreed premium against potential losses much like how CDS market allows market participants to hedge Credit risks.

C - Article 6.4 Supervisory Body acting as Hub of larger Carbon Ecosystem

Since the last 2 years, focus on delivering integrity (accounting, climate impact, financial) to Carbon Markets have allowed the Carbon eco-system to expand and include “Valuable” contributions from participants, such as Carbon Rating Agencies as well as Carbon Insurance companies.

To facilitate integration of more such bodies into the eco-system, A6.4 SB could operate as a HUB taking responsibility of integration and alignment of these parties.

I have taken liberty of mentioning 3 participants in this market whose importance may be elevated and be part of the “table” along with many other participants such as Data Scientists ; Standards & Registries and Environmental Ministries of Governments such as:

a. Carbon Rating Agencies
b. Insurance companies
c. Lawyers and legal infrastructure
d. Accounting and Reporting standards

A6.4SB acting as HUB could integrate the above to ensure:

a. convergence of ideas / approaches;
b. knowledge sharing for ex: carbon rating agencies and insurance companies can upgrade their approaches based on each other’s learnings
c. ensuring a holistically complete lifecycle for investors.

Thank you very much once again for allowing me to present the above thoughts and opinions and my most sincere wishes to Article 6.4 Supervisory Board members for success in their endeavours.