



CERs – Why quality matters

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- Founded in 1985, TFS Energy is a subsidiary of Compagnie Financière Tradition (CFT), the global brokerage firm
- TFS is the World's third largest broker in OTC financial and non-financial products
- TFS has over 2,000 brokers worldwide, with 150 in the UK covering Coal · Power · Natural Gas · Crude Oil · Weather Derivatives · Renewable Energy · Emissions
- TFS has been voted Energy Broker of the Year in the Commodities Now awards in 2005 and 2006, and won the Silver Award in Emissions Markets in 2005

- From a market perspective, the output of a CDM project is simply a tradable, certified emissions reduction certificate
- The monetary value is largely determined by demand from compliance buyers
- Compliance buyers are simply interested in not exceeding their emissions caps
- Therefore, “quality” comes with registration with the CDM-EB as this confirms that the buyer can use the certificate for compliance

- *"A commodity is something for which there is demand, but which is supplied **without qualitative differentiation** across a given market."*

Source: Wikipedia

- Characteristics of Secondary CERs:
 - Guaranteed by highly rated international banks
 - One CER cannot be differentiated from another
 - Demand is driven by compliance, co-benefits become irrelevant
- Hence secondary CERs can be considered a commoditised product where compliance is the only driving force
- However, primary CERs (direct from the project owner) **can** be differentiated e.g. by country, methodology

- Compliance Buyers want to ensure they receive the expected CER volume while adding to brand value and adhering to legislation
 - Quality = low delivery risk combined with co-benefits

- Financial Institutions are concerned with security of their capital and economic returns
 - Quality = low sovereign risk, low credit risk, low delivery risk

- Speculators/ Investors want to “buy low, sell high”
 - Quality = high relative economic value

- Host Countries define their own sustainability requirements for projects
 - Quality = low negative social, environmental and economic impacts

- Buyers aim to either:
 - ***avoid*** projects with little co-benefits and negative perceptions; or
 - ***promote*** projects which use best practice and have beneficial local impact

- Low “Quality” Avoidance:
 - In early 2007, most buyers were bidding below the market for HFC23 projects but this practice is decreasing
 - Many buyers also avoid projects which may result in forest degradation

- High “Quality” Promotion:
 - Currently, there is increasing buyer emphasis on sustainability, additionality and credibility of the projects they buy from
 - Some buyers pay premiums social attributes with little economic value e.g. biomass projects which source locally, small scale cook-stoves

- CDM requires a tool to encourage high quality projects and ensure that any gaps in quality assessment can be filled
- The Gold Standard brings improved credibility to CDM and raises the bar in terms of quality
- All else being equal, a Gold Standard CER carries a premium to a non-Gold Standard equivalent illustrating that buyers pay for quality
- In addition, the Gold Standard is a risk management tool
 - It introduces a second layer of due diligence
 - Projects that have passed through the Gold Standard process are likely to be registered with the CDM-EB due to the stringent quality requirements

- The Gold Standard only applies to renewable energy projects and energy efficiency projects.
- It has a strict additionality test to ensure that the emissions reductions are beyond the “business as usual” scenario
- It also requires that projects embark on detailed sustainability assessments, beyond the requirements of the CDM.
- Any additional costs are low and are more than covered in the higher price of the CERs

- EBRD and EIB have included the World Commission on Dams (WCD) criteria on hydro projects in their due diligence process
- The Netherlands Clean Development Mechanism Facility only targets renewable energy, energy efficiency improvement, fuel switch & methane recovery and sequestration
- There is anecdotal evidence to show the market favoring higher quality projects, or certainly, discounting lower quality projects



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