IDEAcarbon

Questions and Answers

The Carbon Ratings Agency

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Key questions and answers

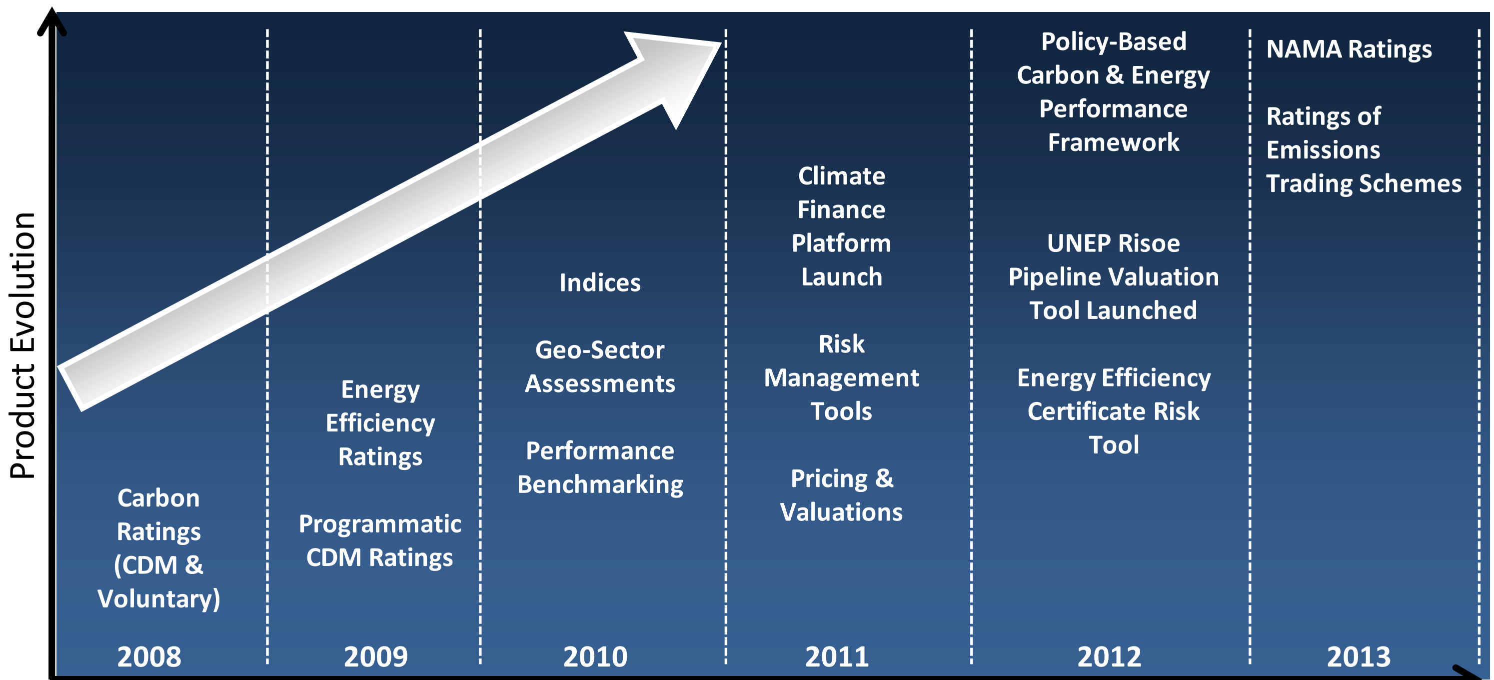
Five important questions we have been asked:

1. How is it possible to consistently rate different carbon assets?
2. How does an ICA become useable for international compliance?
3. How do ideas for a CDM/CER stabilization fund fit in with the ICaR scheme?
4. Will the ICaR need a ‘endless pot of cash’?
5. How can the ICaR system recognise the other non-market climate policies that countries are enacting?

Q1: How is it possible to consistently rate different carbon assets?

The CRA's Product Cycle to date

- Ratings must be credible, transparent, rigorous and comparable to other asset classes.
- The CRA has already built a suite of rating capabilities to NAMA level.
- Ratings of 'abatement approaches' and international carbon index, natural extension of the CRA's work to date



Applications
- UN FVA
- Pilot globally networked carbon markets
- Credible / transparent donor financing of NAMAs
- Public/private/ risk metrics for carbon assets
- GCF

Climate Finance Platform
- Covered Bonds
- Leveraged Loans
- Mark-to-market accounting
- Programmatic CDM & energy efficiency

Risk Management Tools
- Quantified outputs for risk managers

Ratings work necessary to operationalize climate action

- The work to rate these different carbon assets (NAMAs, schemes, sectors, etc) to operationalize key global initiatives:
  1) UN Framework for Various Approaches
  2) Globally Linked Carbon Market
  3) Credible funding for the GCF

- Ratings must be to standard and rigour:
  1) comparable to ratings in other assets classes
  2) satisfy risk officers and regulators (margining, NAV, capital allocation etc)
  3) Enable credible public-private risk sharing

Those who have contributed to IDEAcarbon and the CRA

Mr Ian Johnson

Mr Johnson co-founded both IDEAcarbon and the Carbon Rating Agency (CRA), following a distinguished career at the World Bank. For eight years he was the Bank's Vice President for Sustainable Development overseeing its work on climate change and carbon finance. Prior to that he played a major role in negotiating the establishment of the Global Environment Facility (GEF) and managed its day-to-day operations for six years.

Ms Christiana Figueres

Ms Figueres joined as Vice Chairman of the Carbon Ratings Agency in February 2009 and left in July 2010 as the new Executive Secretary of the UNFCCC and as such had to relinquish her role with the CRA. She sat on all CRA rating committee meetings during her tenure and initiated CRA's analysis work for programmatic CDM.

Lord Nicholas Stern

Lord Stern rejoined the IDEAglobal advisory board in 2007 until March 2013 and was vice chairman of IDEAGlobal group between 2007 and 2008. The author of the seminal Review on the Economics of Climate Change and former Chief Economist at the World Bank, currently the IG Patel Professor of Economics and Government at the London School of Economics. He was Adviser to the UK Government on the Economics of Climate Change and Development, reporting to the Prime Minister from 2003-2007

Mr Nitin Desai

Mr Desai joined IDEAcarbon's Advisory Board in 2008. Mr Desai is a Special Advisor to the UN Secretary General for Internet Governance, and chairs the Advisory Group that organises the annual UN Internet Governance Forum. He is an Honorary Fellow of the London School of Economics and Political Science (LSE), and advises the Indian Government on its national climate change action plan.

NAMA Ratings

- Ratings are anchored in fundamental and portfolio ratings
- This pattern parallels the development of ratings in other well-accepted financial asset classes
- The Carbon Ratings Agency is well-positioned to develop ratings of carbon assets on the basis of related experience developed to date

Q2: How does an ICA become useable for international compliance?

A:

- When a national or sub-national scheme joins the ICaR scheme, it automatically accepts the ICA as valid for compliance in its own scheme.
- Furthermore, it is quite possible that the UNFCCC could approve the ICA for compliance under the FVA, and therefore recognized for UNFCCC obligations.
- Even further, it is possible that an ICaR member scheme, whose units did not pass the UNFCCC's tests for FVA, could participate in the FVA via swapping its units for ICAs at the CARA discount rate (since the discount would effectively give them FVA approval).

Q3: How do ideas for a CDM/CER stabilization fund fit in with the ICaR scheme?

A:

- ICaR treats CER's as just another carbon 'asset' or currency in the index & allows CER's participation within the ICaR framework
- This inclusion rightly compares CERs relative to other key ICaR assets and gives them appropriate 'credibility & value'
- Inclusion provides valuable relative value to CER's (irrespective of a stabilization fund)10 year forward 'price discovery' within the ICaR's structure leverages CER's (or pooled CER fund) to all benefits of ICaR
- In summary, the value of a 'CER stabilization fund' is enormously strengthened within an ICaR framework

Q4: Will the ICaR need a 'endless pot of cash'

A:

- With appropriate market regulation, it is possible to calculate ICaR's capitalisation requirements for any given set of domestic scheme members, by multiplying the volumetric purchase commitment by the set of price commitments.
- Furthermore, this maximum capitalisation requirement would only be tested in the case of global demand falling off completely.
- The required regulation to safeguard ICaR would be a ban on 'naked' short selling of ICA's.

Q5: How can the ICaR system recognise the other non-market climate policies that countries are enacting?

A:

- CARA ratings will take into account all of the relevant climate policies which interact with any carbon asset it rates.
- For instance, in a scheme where the ‘shadow’ price of carbon is higher than the allowance price this could push the ambition rating above the 100% level. Potentially leading to a domestic unit’s international price being above the ICA price.
- Similarly, different ratings could be given to the same asset but from different countries. For instance, within the EU there are substantially different climate policies in various countries, on top of the EU ETS. A country with generous subsidies for wind and solar, would achieve a higher rating on its EUAs that a country which does not.