

Investors face risks in race for carbon credits

By Emma Saunders in London

Investors are rushing to secure carbon credits from environmentally friendly power projects in the developing world but are failing fully to recognise the risks, according to carbon trading experts.

Arne Elk, a senior analyst at Point Carbon, believes that only about 70-80 per cent of expected credits materialise. Investors will pump about \$45bn into the quest for these credits this year, in some cases relying on arbitrage a tiny chance of failure with no guarantee the projects will ever generate credits.

Last year, at least two such projects funded from the UK and Ireland ended in failure, with the loss of more than €5bn (in expected revenue).

“Lots of hedge fund cash is chasing the same projects,” said Garth Edward, head of emissions trading at Citi. “The price gets pushed up. Yet some of these projects have no development team and no consultants.”

Carbon trading investors - including hedge funds, banks and utilities — can invest in green power generation in developing countries in return for certificates that can be sold in the European Union.

There are two types of these certificates of emission reduction (CERs): one before the project is completed and one after. The difference between the two prices is a measure of the risk that the project will not complete.

However, carbon traders say the prices are converging, effectively reducing the valuation of risk. There is no evidence of a corresponding

increase in the likelihood of projects being completed. Typically, a pre-completion or ‘primary’ CER sells for €8-€10, reflecting the individual nature of each project and its risk. The range used to be €7-€10.

The upward shift in prices has narrowed the gap with post-completion ‘secondary’ CER which trade in the EU for about €6.

The reason for the rise is thought to be an increase in demand for primary CERs from hedge funds in particular, awash with cash following a shift from other asset classes amid the credit crunch. There is also a rising number of hedge funds committed to investing solely in emission reduction projects.

The risk to investors, and to hedge funds in particular, lies in selling secondary CERs before the project is completed to mitigate risk.

