

**IPART Submission - October 2024**  
**Monitoring the NSW biodiversity credits market**

██████████ is a privately held agricultural company that is currently setting up ██████████ Biodiversity Stewardship sites ██████████ and is actively looking for more potential sites to increase its conservation efforts.

**Role of government organisations in the market**

Currently the Biodiversity Conservation Trust (BCT) completely controls all aspects of the market. The BCT oversees the operation of the market; interprets and enforces the regulations; and is the agent and custodian of all funds. At the same time the BCT is the main market participant due to proponent payments into the fund and then subsequent BCT acquittals. The BCT are also curating and controlling all the market data and auction processes which gives them inside information to manage their own obligations.

The omnipotence of the BCT inevitably leads to conflicts of interest, with the most obvious example being the way that prices are being distorted and artificially held low to protect the BCT against losses at the expense of the biodiversity outcomes the scheme is designed to protect.

**BCT's Huge Liability and Accounting Loss**

The BCT are effectively short a huge liability due to all the credits that proponents have bought from the BCT by paying into the fund and for which the BCT then needs to source and acquit. If the price of these credits rises then the BCT realises a large loss on the difference between what they sold the credit for and then the higher price that they will pay if they acquire and acquit that credit.

For example in the 2021-2022 BCT Annual Report<sup>1</sup>, which is no longer published on the BCT website, the BCT recognised a loss of \$68.154m in that year and \$77.575m overall due to increasing credit prices.<sup>2</sup> This equated to over 40% of the balance sheet equity of the BCT at that time. This is shown in the note below:

Note 20 in the BCT financial statements shows that the provision for unacquitted credit obligations was revalued at 30 June 2022 to determine what the BCT may now expect to pay to acquit these credit obligations. The provision was assessed to now be worth \$167.536 million, an increase, or forecast loss to the BCT, of \$77.575 million relative to the payments made of \$89.961 million.

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<https://www.parliament.nsw.gov.au/tp/files/83431/NSW%20Biodiversity%20Conservation%20Trust.pdf#page=53>

2

<https://www.parliament.nsw.gov.au/tp/files/83431/NSW%20Biodiversity%20Conservation%20Trust.pdf#page=99>

## BCT Change of Accounting Policy

In the following 2022-23 Annual Report the BCT wiped away these losses by unbelievably changing their interpretation of the BC Act.<sup>3</sup> This note, buried deep within the accounts, at the stroke of a pen covered up the \$68m loss and effectively means that the biodiversity aims of the legislation will never be delivered. Going forward under the new accounting policy the BCT would only spend what it received from developers rather than actually purchase the credits it had sold which had now risen in price.

The last paragraph in the section copied from note 30 below is key:

### **30. Changes in comparatives due to prior period error**

Under Section 6.30 of the *Biodiversity Conservation Act 2016* (the BC Act), a person (typically a developer) who is required to retire biodiversity credits may satisfy that requirement by instead paying an amount into the Biodiversity Conservation Fund (BCF). If that amount is paid into the BCF, the developer's requirement to retire biodiversity credits is satisfied.

Under Section 6.31 of the BC Act, the BCT is to apply the amount paid into the BCF towards securing biodiversity offsets determined in accordance with the regulations in substitution for the relevant number and class of biodiversity credits otherwise required to be retired (by the developer).

A provision is recognised when funds are received from developers under Section 6.30 of the BC Act.

These provisions can be referred to in summary form as 'developers' payments offset obligations'.

In the 2022 financial statements the BCT revalued the developers' payments offset obligations using the BCF Charge System, and in prior year financial statements the developers' payments offset obligations were revalued using the Biodiversity Offsets Payment Calculator. The revaluation was to reflect the estimated cost to the BCT to procure the relevant number and class of biodiversity credits otherwise required to be retired (by the developer).

Subsequent to the completion of the 30 June 2022 financial statements, the BCT has assessed, and confirmed via external advice, that the financial liability of the BCT in relation to developers' payments offset obligations is limited to spending the dollar amount paid into the BCF by developers, rather than a requirement to secure a specified number of biodiversity credits.

This unbelievable policy change means that the BCT will never want to pay higher prices for the credits it has sold because if it did then it would again realise the \$68m loss and not be able to cover it up by the change in accounting policy. If credit prices doubled again from the 2022-23 prices then the loss would be in the hundreds of millions. This is based on the \$159.3m of unrequited obligations disclosed in the 2022-23 Annual Report - which was the amount originally paid by proponents and that had already increased by 86% by 2021-22.<sup>4</sup> It should also be noted that the Acquittals report is no longer available on the BCT website.<sup>5</sup>

The BCT only holds enough funds to cover roughly half the credits they had sold to developers when remarking their obligations at the prices in their 2021-22 report and prices have continued to rise since and would rise a lot higher if not suppressed by the BCT. So the biodiversity outcomes that will be delivered by the BCT are well below 50% of what proponents have impacted. This is clearly nature negative rather than the shift to net positive biodiversity standards espoused by the NSW Plan for Nature.

So now it has been shown that the BCT covered their loss with a change of accounting policy and can only pay 2021-22 credit prices to actually retire their outstanding obligations without actually crystallising that loss.

<sup>3</sup> <https://www.bct.nsw.gov.au/sites/default/files/2023-11/annual-report-fy23.pdf#page=100>

<sup>4</sup> <https://www.bct.nsw.gov.au/sites/default/files/2023-11/annual-report-fy23.pdf#page=22>

<sup>5</sup> <https://www.bct.nsw.gov.au/report-acquitted-obligations>

## BCT Use of Variation Rules

The BCT then carefully enacted a policy of using variation rules to nominally retire their outstanding obligations rather than the actual credits originally impacted by proponents. This further reduces the biodiversity outcomes of the scheme. They are able to do this by making another policy change which was disclosed on a 2023 document.<sup>6</sup>

The document acknowledges that

*“To 30 June 2022 all credits purchased by the BCT were used to acquit offset obligations on a like-for-like basis. In the 2022-23 financial year, the BCT began to cautiously apply the variation rules in the BC Regulation to acquit a small number of offset obligations.*

*The BCT Board has approved the framework the BCT takes to conservatively apply the offset hierarchy set out in the BC Regulation. The approach seeks to maximise biodiversity outcomes while managing any financial risks to the BCT in operating the Biodiversity Conservation Fund.*

*Under this framework, the BCT only considers the use of variation rules or conservation actions after the obligation has been held for more than two years or when two market offerings (i.e. tenders and/or fixed-price offers) have failed to secure like-for-like credits.”*

So now the BCT simply has to sit on its hands for two years and ensure it offers low prices in the tender auction so it can then use the variation rules to acquit credits to avoid crystallising a loss. This is made explicitly clear in the BCT’s FAQs that are emailed to reverse auction participants, *“Because the NMO needs to sell the credits on to proponents, prices above the BCF Charge amount will not be considered.”*

This is exactly what has happened as evidenced by the latest tender results which have just been released in September 2024.<sup>7</sup> The strategy is obvious with the very low clearance rates and huge proportion of credits purchased using the variation rules. For example in the last tender offer they bought 6,034 ecosystem credits out of the 49,477 on offer and staggeringly they used the variation rules for over 4,530 of those purchased credits. That means only 1,504 credits out of 49,477 offered (equal to just 3%) were bought on a like-for-like basis.

This completely undermines the purpose of the scheme and indeed their own statement in the same report that “The BCT prioritises purchases of like-for-like credits to meet BCF obligations”.

This needs to be thoroughly investigated by IPART.

So to summarise:

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<sup>6</sup> <https://www.bct.nsw.gov.au/sites/default/files/2023-10/annual-report-22-23-offset-obligations.pdf>

<sup>7</sup>

<https://www.bct.nsw.gov.au/sites/default/files/2024-09/outcomes-report-credit-tender-24-01-sept-2024.pdf>

- The BCT sold credits to proponents at below market prices and well below the price the vast majority of independent sellers would now sell them
- Back in their 2021-22 Annual Report they acknowledged this loss of \$77.575m
- This loss would only increase as credit prices go higher
- In their 2022-23 Annual Report they reversed this loss by changing their policy and rather than retiring like-for-like credits they would just spend what has been paid into the fund by proponents
- This change effectively meant they would only crystallise a loss if they actually paid the higher prices to retire like-for-like credits
- In 2023 they also changed their policy of using the variation rules if they had not bought back the like-for-like credits after two years or two tender offers
- As the BCT are in complete control of what they pay for credits they just offered very low prices during the tenders and explicitly state they do not pay above the BCF Charge amount. This has meant clearance rates of less than 5% on like-for-like purchases.
- They can then use the variation rules to cover the bulk of acquittals by buying cheap credits rather than like-for-like credits even though like-for-like credits are offered by sellers in those tender auctions and in the broader market
- Biodiversity outcomes are sacrificed in the process and independent sellers are left holding the like-for-like credits the BCT should be buying

██████████ believes the following changes should be enforced:

The BCT should be forced to cover on a like-for-like basis any credits that it has sold to proponents within a 2 year time period. After 2 years there should be a transparent mechanism such as an ascending bid where, for example, the BCT is forced to increase its bid price by 10% per month until a seller is found and matched.

The BCT should not be allowed to use the variation rules - especially so flagrantly to cover their own losses. If allowed to use the variation rules it should be after 5 years and only when none of those credits have ever been offered to the market. This gives time for sellers to search for specific sites to deliver those credits.

Full details of any proponent's use of the variation rules should be disclosed to the market.

### **Confidence in the market's integrity and governance**

***What oversight of brokers and accredited assessors would allow you to be confident in their activities in the market?***

The oversight of brokers is a key concept in the regulated financial markets and some of those practices should be enacted by the BCT to the burgeoning biodiversity market.

Firstly, if participants do not want to use brokers then there should be transparent and timely ways of connecting buyers and sellers. This could be improved by making the supply and demand registers much more user friendly and almost replicate the 'order book' of a financial market by only including buyers and sellers who are truly willing to trade and showing the prices and sizes that they are willing to buy and sell.

When brokers are used they should be regulated. Conflicts of interest need to be disclosed and mitigated. Indeed, some brokers have their own stewardship sites and inventory of credits held by related entities and could theoretically front run their clients orders with their own credits. They could also simply match together parties that pay the highest commission rather than at the best price for their client.

In some regulated financial markets for example, brokers are not allowed to charge commission to liquidity providers i.e the suppliers of credits. That way they are always incentivised to find the cheapest price for their proponent clients rather than match them against the seller who pays the highest commission but at a higher price for their buyer.

## **Quality of Information**

***What information do you need to make decisions about buying or selling in the market? What is currently missing?***

Overall data quality; ease of data access and use; and data timeliness is very poor.

There is a lack of data uniformity and reliability across reports. For example, across the transaction report, retired credit report, charge report, wanted credits report, in demand credit list and supply register there is at least 17 different spellings of one of the most traded ecosystem credits the '*White Box - Yellow Box - Blakely's Red Gum Grassy Woodland and Derived Native Grassland in the NSW North Coast, New England Tableland, Nandewar, Brigalow Belt South, Sydney Basin, SE Highlands, NSW SW Slopes, South East Corner and Riverina Bioregions*' TEC credit. It would be very simple to add the Profile ID number for each TEC from Bionet for example.

There are also many instances where the reports do not include information that more accurately reflect the true market price. The credit transactions sales register is riddled with trades done between related parties at much lower than market prices or trades where only the TFD amount is reflected in the transactions register and a separate payment is made to the seller outside of the register (Part A and part B payments).

The charge report also creates the impression of lower prices by not including columns that show the risk premium charge or the delivery fee. There is no reason why a report with 18 columns could not have 2 more columns so that a true reflection of the actual cost is presented to the market.

The consistent pattern above is that data quality is biased to try and show lower prices, which helps the BCT mitigate its issue of having to purchase credits for the lowest possible price to avoid crystallising losses.

Trades done under the old biobanking scheme could also be converted into equivalent trades under the current Biodiversity Offset Scheme so a better picture of past demand could be observed. This would encourage more credit supply by showing the historic liquidity in some credits that have not frequently traded in the new scheme as yet.

The BCT replaced the publicly available online Biodiversity Offsets Payments calculator with the Biodiversity Conservation Fund Charge System in 2022. This inadvertently favours credit buyers because it provides them with an actual price but only provides sellers with a price guide.

Also the BCT has its own policy on species credit requirements, polygon calculations and additionality impacts that are not transparent and go above the requirements in the Biodiversity Assessment Methodology. This makes it harder for those setting up stewardship sites to efficiently generate credits and can cause extra delays and costs.

## **Comments on Recommendations**

### ***1. The option for proponents to pay into the Biodiversity Conservation Fund is preventing the market from developing.***

Options for proponents to pay into the BCF is a very useful mechanism. It means that proponents have a much quicker and cleaner path to satisfying their credit obligations. It also means that credit suppliers know for sure what credits need to be purchased by the BCT and have much more confidence in procuring and setting up sites. However, the BCT should be forced to source and acquit those obligations in a set timeframe and without the inappropriate use of variation rules as discussed earlier in this submission.

If IPART, the BCT or any interested stakeholder wishes to discuss this submission then