UNCITRAL Colloquium

Financial regulation as a catalyst for the use of VCCs in financing transactions

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The financing costs for the green transition will be significant…

What's the cost of net zero?

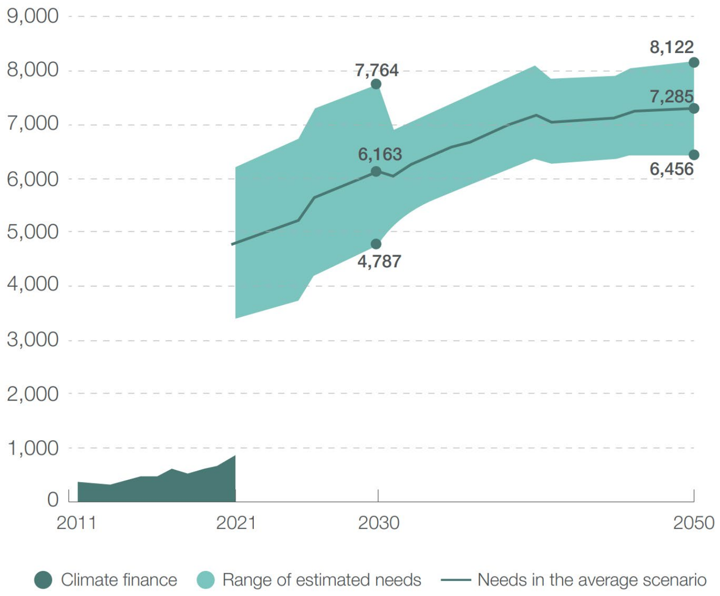
Commissioned by the UN High-Level Climate Action Champions, new research with support from Vivid Economics breaks down the numbers behind the where, who and how of the trillions of investments required to meet the net zero goal.

BY CLIMATE CHAMPIONS | NOVEMBER 3, 2021

$125 trillion of climate investment is needed by 2050 to meet net zero, with investment from now until 2025 needing to triple compared to the last five years to put the world on track.

… but there is a green financing gap…

Figure ES.1: Global tracked climate finance and estimated annual climate finance needs through 2050 (USD million)



Source: Climate Policy Initiative

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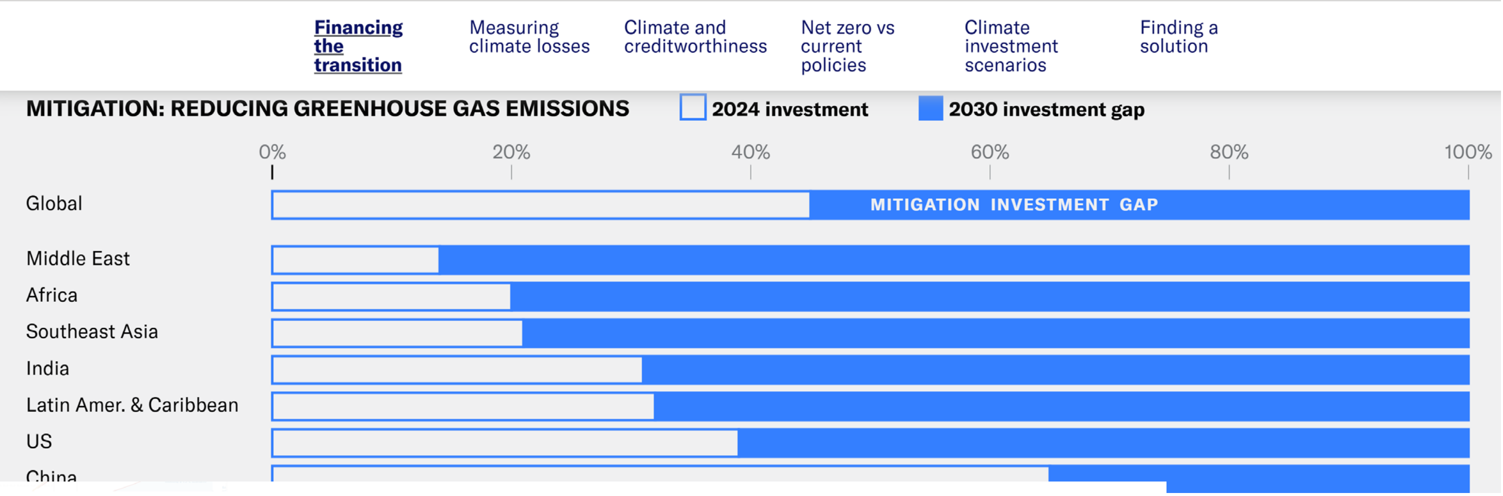
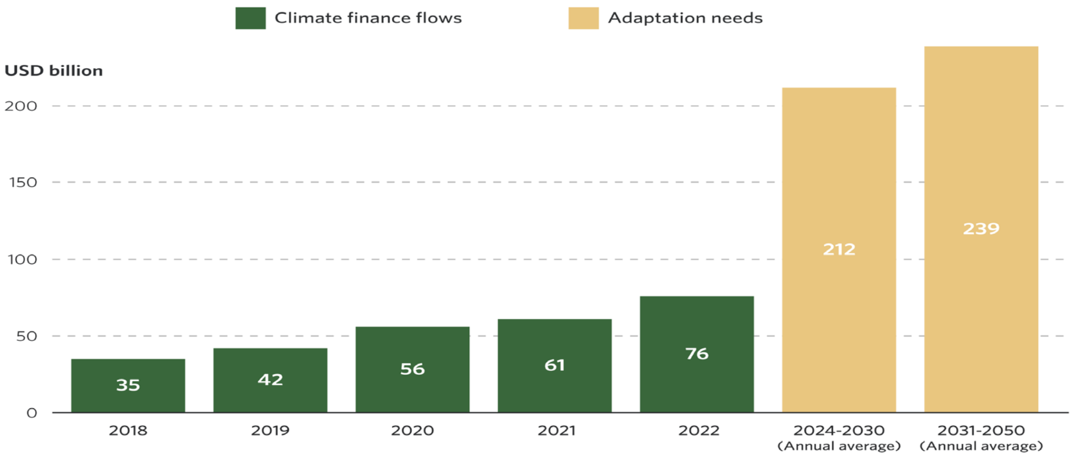


Figure 2.3: Global adaptation finance flows vs. needs



Note: Measuring the adaptation gap is challenging both conceptually and quantitatively. These figures are likely underestimates as they only account for EMDE needs and many costs cannot be accurately measured. Over 2018 to 2022, EMDEs accounted for 92% of adaptation finance.

Source: Climate Policy Initiative

VCCs can help bridge this gap…

Carbon credits offer a market-driven solution to bridge the financing gap, particularly when policy and economic incentives are lacking….

Keynote Speech by Ravi Menon, Singapore's Ambassador for Climate Action & Senior Adviser,14 November 2024

…by catalyzing green financing in multiple ways…

VCCs as collateral and security: Reducing the costs of funding

Revenue streams: Generating additional income to support the capital structure for transition financing

Reduce funding costs: Credits can enhance sustainability positioning for capital takers

Creating new transmission mechanisms for investment: Increases new transmission mechanisms for the flow of capital to transition financing

…but only if there is a strong legal foundation…

Legal Implications of Voluntary Carbon Credits

EXECUTIVE SUMMARY

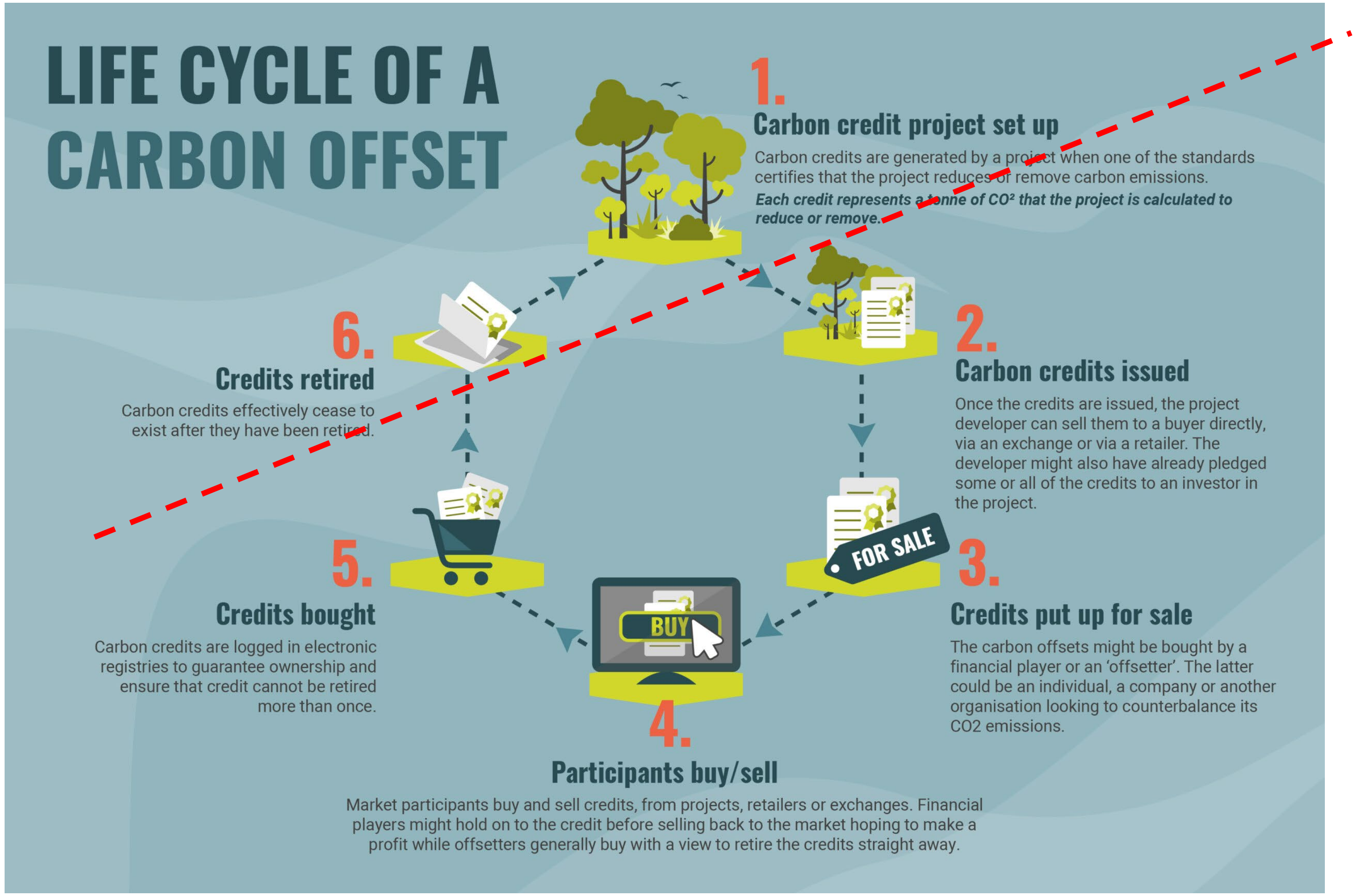
The transition to a low carbon economy is estimated to require significant funding globally[1]. The voluntary carbon market continues to play a critical role in that transition by helping to channel funding into projects that reduce carbon emissions or remove carbon from the atmosphere.

A robust voluntary carbon market must be grounded in a strong legal foundation. Much of the process of creating, verifying and transferring the benefit of project activities that reduce emissions already exists within robust legal frameworks. As the market grows in size and complexity, however, secondary markets in fungible voluntary carbon credits (VCCs) would be significantly enhanced by steps being taken both nationally and internationally to better understand the legal nature of VCCs.

As with any intangible asset, the legal nature determines how a VCC as a fungible instrument can be created, bought, sold and retired. It affects what type of security may be taken and enforced in relation to VCCs and how that can be achieved, as well as how VCCs would be treated following an insolvency (including with regard to netting). It may also have an impact on broader considerations, including the regulatory, tax and accounting treatment of VCCs. In short, understanding the legal treatment of VCCs is necessary to achieve deep and liquid secondary markets, which, in turn, will enable the development of a clear price signal for carbon and allow funds to be efficiently channeled to emissions-reducing projects.

Paper by ISDA, Legal Nature of Voluntary Carbon Credits, December 2021

So what should Financial Regulation focus on?



Financial regulation should focus on these stages

Graphic from carbon-wise- https://carbonwise.co/how-are-offsets-used-the-life-cycle-of-a-carbon-offset/

The key principles that should guide Financial Regulation…

Financial regulations should focus on the following key topics…

1. **Clear regulatory and legal treatment of VCCs is key**
2. **VCCs should not be subject to duplicative regulation**
3. **Financial regulation should focus on the financial market issues associated with VCCs, and not on regulation of the underlying projects**
4. **Financial regulation should be aligned with tax and accounting treatment approach**
5. **Consumer protection and address abusive, fraudulent, manipulative, evasive, or disruptive activity**
6. **Domestic (between various domestic authorities) and international consistency and common regulatory approach to carbon credits**

How can you contribute…

- Increase involvement in international efforts to create a harmonized regulatory architecture for VCCs
- Provide thought leadership and proposals to support the acceleration of a robust legal framework for VCCs
- Capacity building for regulators to create awareness and deep understanding on VCCs
- Engage industry and market participants to understand the market imperatives and key risks

… and relevant legal areas connected to these principles…

- Laws relating to security and collateral
- Securities law governing OTC transactions
- Consumer protection statutes
- Insolvency and bankruptcy
- Regulations relating to finality of transactions
- General fraud statutes
- Market conduct rules relating to securities transactions
- Stamp duty, VAT and revenue statutes
- Contract laws
- AML, KYC regulations

The following are some examples of the areas that financial regulators will need to consider in depth to regulate the VCCs effectively and efficiently