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Insights from the Asia Climate Summit 2022

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By: Jooyoung Song

Voluntary v. Compliance

Two distinct markets—compliance and voluntary—have developed around the world in response to increasing interest in reducing greenhouse gas emissions. As the names suggest, compliance markets serve as a regulated mechanism for market participants to trade allowances (representing a permit issued by a regulator for certain carbon emissions) to comply with a regulatory regime (such as California's cap-and-trade market and the emissions trading system in South Korea), whereas voluntary carbon markets (VCMs) operating with various accreditor organizations (such as Gold Standard and Verra) have emerged where private-sector firms voluntarily purchase carbon credits generated by projects that avoid or remove greenhouse gas emissions to offset or compensate for their emissions.

Throughout ACS 2022, the fundamental question over whether it will be VCMs or compliance carbon markets that will better achieve the goal of reduction and/or removal of greenhouse gas emissions was repeatedly debated, and there was a general consensus that "light-touch regulation" of carbon markets is imperative to enhance carbon market accessibility and liquidity. Although there were different views about the timing and scope of the required carbon market regulations, ACS 2022 participants generally acknowledged that (1) the current VCMs are highly fragmented and opaque, so some form of "soft regulation" can be helpful to mitigate issues such as lack of standardization and transparency, but (2) over-regulation of carbon markets (in the form of too onerous reporting and disclosure requirements, for example) could deter development of carbon projects and lead to a liquidity crunch. In the Asia-Pacific region, this debate becomes further complicated because countries in the region have to maintain the balance between the current momentum to actively develop and

implement emissions trading systems to meet their Nationally Determined Contribution (NDC) targets and the need to increase cooperation with different countries to make their national policies more effective, consistent and harmonized.

Although no specific next steps were presented at ACS 2022, it was clear that (i) stakeholders in the region and around the world (including relevant authorities) are heading in the same direction in the sense that they are ready to accommodate some regulations to overcome challenges in carbon markets, but (ii) at the same time, they will continue to investigate which market and regulatory model will be the most appropriate.

Challenges in Voluntary Carbon Markets

ACS 2022 recognized that VCMs currently face certain challenges versus credits issued under regulated carbon markets. Some of these are outlined below:

- **Lack of Oversight**

Whereas rules are set by national or international public authorities in compliance carbon markets, the rules governing the issuance of the credits in VCMs are established outside of government-regulated schemes and generally tend to be less transparent. Although private credit-certifying bodies such as Gold Standard and Verra are trying to address the challenge of insufficient governance, the VCMs remain highly fragmented and comprise a wide range of programs, protocols and standards that differ significantly. Participants at ACS 2022 therefore shared the following sentiments:

1. Lack of governance and unified standards make it difficult for markets to agree on the quality of a carbon credit and create a trust issue in relation to measurement, reporting and verification of a given offset project.

2. A light-touch regulation to make required standards clear and transparent and to clarify which party would be accountable in case a dispute arises in relation to credit quality would be a meaningful first step to take.

- **Quality and Trust Issues**

ACS 2022 also noted increasing scrutiny of the quality of carbon credits. This quality issue stems from the lack of oversight discussed above, variability of accounting and verification methodologies and the fact that markets are yet to develop an appropriate price benchmarking for carbon offset projects' co-benefits (such as community economic development and biodiversity protection). Although VCMs may be suffering from a lack of

trust, the participants at ACS 2022 found it promising that these issues are being raised and progress is being made.

For example, the Integrity Council for the Voluntary Carbon Market, an independent body that seeks to set and enforce definitive global threshold standards for high-quality carbon credits in the VCMs, has already released its draft Core Carbon Principles, which should serve as a global quality standard for carbon credits. The Core Carbon Principles, which touch on issues such as additionality, double counting and permanence, is expected to contribute to restoration of trust in the market by allowing market participants to better understand common minimum requirements for the integrity of purchased credits.

The representatives from exchanges such as AirCarbon Exchange and Intercontinental Exchange also explained that they are trying to build trust and stability in VCMs by standardizing carbon-credit trading and price discovery through the use of well-defined, tradable spot and futures contracts.

- **Greenwashing and Green-hushing**

The ACS 2022 acknowledged that greenwashing—the practice of marketing a company or organization so they appear more environmentally friendly—is a real issue that needs to be carefully scrutinized because otherwise it would be very challenging to increase trust and participation in the VCMs. However, the participants warned against excessive, unwarranted greenwashing allegations against corporations because companies may then decide to take no action and/or no longer disclose details of their climate targets in an attempt to avoid scrutiny and allegations of greenwashing. Concerns over such "green-hushing" were expressed multiple times at ACS 2022 because, if fear among corporations of being called out on misleading and or exaggerated environmental and sustainability claims continues to grow, they may be incentivized to be less ambitious with their internal targets to reduce greenhouse gas emissions and it would be more challenging to monitor the private companies' efforts to achieve their net-zero goals. As one project developer, active in the region, would put it when commenting on a sense of urgency around hitting the key climate tipping points, we need to create a positive way for developers to stop being "hit over the head" with integrity, as too much scrutiny can railroad projects that are otherwise very high quality.

Other Developments in the Asia-Pacific Region

- **Article 6 Implementation**

Growth in bilateral cooperation in the Asia-Pacific region to implement Article 6 of the Paris Agreement was highlighted at ACS 2022. Singapore has been active by recently signing memoranda of understanding with Papua New Guinea and Peru, respectively, to collaborate on carbon markets and also substantively concluding negotiations with Ghana on an implementation agreement on carbon credits cooperation, which is expected to be formally signed in early 2023. Thailand also signed a cooperation pact with Switzerland in June 2022, so that they can voluntarily cooperate to achieve emission reduction targets set out in their NDCs. New Zealand is in discussion with multiple countries including Switzerland, Singapore and Chile to cooperate to reduce emissions and increase climate change action in line with Article 6.

Although issues such as transparency still need to be resolved and capacity buildings are required for the integrity and success of market-based cooperation under Article 6, the participants at ACS 2022 agreed that action on Article 6 needs to move from the negotiating rooms to the real world, and development of bilateral cooperation along with the launch of the Article 6 Implementation Partnership initiated by Japan demonstrates positive steps taken by the countries in the Asia-Pacific region to ultimately achieve net-zero emissions.

- **Industrial Decarbonization**

ACS 2022 noted the Asia-Pacific region is facing a daunting task to balance energy security, affordability and decarbonization, given many countries in the region are still developing economies and they struggle to meet the dual challenges of decarbonization and rapid economic growth, especially from the Scope 3 emission abatement perspective.[1] Although some suggested that decarbonization of the industries in the region should be prioritized over development of carbon markets given the size and pace of emissions from the fast-growing economies, the consensus was that (a) decarbonization shouldn't be treated as a precursor to development of carbon markets and instead both efforts should be progressed concurrently and (b) creative solutions (such as a Clean Energy Exchange Rate Coverage Facility) would need to be further discussed and developed to facilitate flows of international capital and thereby help developing countries meet the double objectives of decarbonizing and addressing climate change while promoting and accelerating economic growth.

- **Nationalization of Carbon Credits**

Nationalization of carbon credits in the form of export restrictions on carbon credits is a new development in Asia, as many countries in the region are maintaining a policy of keeping a high percentage of carbon credits produced within their borders to ensure they are able to

meet their NDCs, instead of making such credits available for trading in VCMs. It may not be unreasonable for countries to fear that if too many carbon credits produced on their domestic soil get exported via trading in the VCMs and/or Article 6-compliant bilateral carbon markets, not enough may be left for their own governments to reach their own NDC targets, but it is somewhat surprising given Asia represents approximately 50 percent of the global natural base capacity for carbon credits. However, the participants at ACS 2022 worried that this trend (which coincides with protectionist tendencies embedded in the implementation of the climate transition) may lead to a sharp reduction in the supply of credits available internationally, resulting in a significant liquidity issue.

- **CAD Trust**

At ACS 2022, the Climate Action Data Trust (CAD Trust) was officially launched. The CAD Trust is a joint initiative of the IETA, the World Bank and the Singapore government. As mentioned above, carbon markets are fragmented, and a lack of centralized registries between voluntary and compliance markets poses a serious challenge to ensuring maximum market transparency. The CAD Trust seeks to serve as a global digital platform that creates a decentralized log of carbon credits to store data from multiple major carbon registries, which in turn is expected to mitigate the risk of double counting and enhance the integrity of markets.[2]

At ACS 2022, Dirk Forrister, president and CEO of the IETA, said: "[the] launch of the CAD Trust marks a significant step in the evolution of carbon markets. It will lead to the creation of a centralised, accessible and secure digital infrastructure that national governments and private businesses can rely upon as they expand carbon markets to meet their net-zero goals. This system will provide the integrity and public trust necessary for scaling up investment in climate action."[3]

The CAD Trust is timely, especially given that there was a debate during the COP27 Climate Summit over whether some countries are trying to push through proposals for an overly lax regulatory framework that could enable double counting of carbon credits towards climate goals.[4] Given critics of carbon markets continue to raise concerns over poor transparency, limited supply and quality of the projects, it would be interesting to see whether the CAD Trust can indeed fix those issues by integrating all the carbon credit project's data in one place and making it available to the public.

[1] Greenhouse gas emissions are categorized into three groups or "Scopes" by the Greenhouse Gas Protocol. Scope 1 covers direct emissions from owned or controlled sources (e.g., emissions from combustion in owned or controlled boilers, furnaces, vehicles, etc.; emissions from chemical production in owned or controlled process equipment). Scope 2 covers indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by a reporting company, and Scope 2 emissions physically occur at the facility where electricity is generated. Scope 3 includes all other indirect emissions that occur in a company's value chain; some examples of Scope 3 activities include extraction and production of purchased materials, transportation of purchased fuels and use of sold products and services.

[2] https://climateactiondata.org/about/

[3] https://climateactiondata.org/cad-trust-officially-launched/

[4] https://www.reuters.com/business/cop/un-carbon-market-talks-drag-beyond-cop27-deals-elusive-2022-11-17/

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