The Climate Regulatory Landscape

How to prepare for impending global climate regulations

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Introduction

The voluntary carbon markets (VCMs) are in need of a rebrand. Not as a result of recent bad press, but rather because "voluntary" is a slightly misleading adjective. If anything, voluntary is the liminal period when a nascent market recognizes integrity is a constraint of growth, but it still lacks the guardrails that enable accurate, timely, and auditable data to underpin integrity.

Regulatory action may seem daunting, but well-designed interventions can help increase participation in sustainable activities like carbon credits.

Voluntary disclosure and assurance is the status quo today, but regulations around climate disclosure, ESG (Environmental, Social, Governance), and transition risks on the horizon are set to impact carbon markets.

Companies are acting today to get ahead of regulations to ensure compliance and stay competitive.

Direct regulation of the voluntary carbon markets is unlikely in the immediate future, but there are more broad upcoming regulations that will impact the carbon market.

Introduction

Continued

Regulators have the challenging job of both defining the rules within their own jurisdiction while also harmonizing with their international counterparts. Luckily they are not starting from scratch.
There are three categories of regulations that are important for carbon market stakeholders to follow:

(i) Disclosures

Regulations mandating the reporting of ESG information with the goal of improving quality and consistency of corporate sustainability disclosures.

(ii) Claims

Regulations surrounding the kinds of climate and mitigation commitments, or green claims, a company can make. For example, claims regulation would set criteria and governance for statements like "net zero" or "carbon neutral."

(iii) Legal treatment of carbon credits

Voluntary carbon credits are treated as commodities in some jurisdictions, but there is not yet consensus on the legal characterization of a carbon credit. The legal status of an asset, for example security or commodity, dictates regulatory treatment, level of oversight, as well as the regulatory agency responsible.

Asset Type	Description	Carbon Market Application
Commodity	A negotiable financial instrument representing an economic good that is fungible or interchangeable with other goods of the same type. E.g. Oil, soy, gold	Commodity markets enable liquidity and fungibility, allowing carbon to be priced. Pricing carbon means emissions are no longer free.
Security	A negotiable and fungible financial instrument with some monetary value. E.g. Equities, debts	Securitization unlocks increased lending to carbon projects as it spreads risks and cash flows across an investor base, limiting single-project risk. There are currently no carbon securities in the market.

The Starting Point of Regulation

The genesis of new regulation is spurred by private sector demand and regulators looking to the market to set the tone. It is common for industry-led governance initiatives to serve as the starting point for regulations.

When it comes to sustainability reporting and climate disclosures, the investment community has already been leveraging tools from TCFD (Task Force on Climate-related Financial Disclosures) or CDP (Carbon Disclosure Project) to understand the climate risk of their investments.

Nearly 20,000 companies voluntarily disclose environmental data through the TCFD-compliant CDP system. Industry-developed tools and best practices are used by regulators to inform the creation of regulatory frameworks.

While there will be regional variations, global regulators have coalesced around existing voluntary standards that many companies are already reporting against, making it easier to navigate climate disclosure requirements across jurisdictions.

As of today no governments have direct carbon market regulatory interventions. However, there are carbon market multi-stakeholder groups aiming to align carbon market activities.

For example, the IC-VCM (Integrity Council for the Voluntary Carbon Market) exists to standardize quality criteria for carbon credits and enhance disclosure on the supply side and VCMI's (Voluntary Carbon Markets Initiative) mission is to drive integrity on the demand side and clarify guidance around corporate claims.

Markets thrive when there is shared language and consistency. Regulators can facilitate alignment and set guardrails that promote harmonization for a growing market like the carbon markets. The surge of international regulatory proposals and programs demonstrates we are entering the era of enhanced climate reporting and transparency.

This paper includes regulatory programs from around the world to highlight criteria companies should be factoring into their climate action strategy. Disclosure and claim regulations may seem like a bowl of alphabet soup from a different market, but will have material outcomes for carbon markets.

European Union

The EU has been a first-mover for significant sustainability reporting regulation and typically sets the direction for other global regulatory regimes. Recently, the European Parliament voted to require companies to produce climate transition plans.

On July 31st the European Commission adopted the final version of the European Sustainability Reporting Standards (ESRS), a crucial component of the Corporate Sustainability Reporting Directive (CSRD).

European Union

CSRD

Disclosures

What?

The European Financial Reporting Advisory Group (EFRAG) is finalizing the CRSD , replacing the legacy Non-Financial Reporting Directive with new and enhanced standardized requirements.

CSRD disclosures will occur alongside annual financial reporting and will be subject to audit assurance. CSRD will require companies to disclose more than just scope 1-3 emissions and climate risk.

There are 12 thematic sustainability reporting standards including:

- Climate change mitigation and adaptation
- Water and marine resources
- Biodiversity and land use
- Pollution prevention and control
- Circular economy and waste management
- Social capital
- Human rights
- Labor and decent work
- Equal opportunities
- Inclusion of persons with disabilities
- Public health and safety
- Corporate governance

Who?

It is expected that over 50,000 companies will be required to report under the CSRD. All public EU-based companies (excluding micro-cap enterprises) and large EU-based private organizations. The regulations will also impact 10,000 non-EU companies. The CSRD will have extraterritoriality, meaning non-EU domiciled entities with significant operations within the EU will have to comply with certain the CSRD disclosure requirements, impacting around 10,000 non-EU firms.

When?

CSRD is already law and is currently being phased in. Entities who have already been subject to the CSRD's predecessor, Non-Financial Reporting Directive (NFRD), are preparing for their first filings in 2025, using 2024 data. All companies must obtain limited assurance from a third party for their first year of reporting.

Carbon Market Impact?

Companies will be required to disclose the number of carbon credits purchased and retired for its own operations, as well as throughout the value chain. Project financing deployed to carbon credit projects must also be disclosed.

Further disclosures will be required if a company has made a carbon neutrality claim or set a net-zero target, including the credibility and integrity of carbon credits used. These enhanced disclosure requirements will bring transparency and accountability to corporate usage of carbon credits.

European Union

Directive on Green Claims

Claims

What?
The European Commission published the draft Green Claims Directive. It does not legally define acceptable claims, but requires companies to substantiate and verify any environmental claim or label. The goal of the directive is to limit greenwashing.

Who?
The proposed directive would apply to all companies operating within the EU.

When?
The proposal needs to be approved and go through the co-decision procedure, so it will likely be a couple of years before the legislation is adopted. EU member states will have to designate authorities, or regulatory agencies, responsible for compl

Carbon Market Impact?
The outcome of the Directive could have implications for demand of credits. Clarity on strictly defined meanings on claims could give corporates confidence to make ambitious, high-integrity claims around corporate action.

Equally, if corporates shy away from making green claims - so-called 'green hushing' - or if new rules are introduced limiting what claims can be made based on the use of carbon credits, there is concern that VCM growth would stall.

United Kingdom

Many UK businesses are already required to disclose climate related metrics, with reporting requirements set to scale up each year.

The UK outlined its broader regulatory framework in the 2023 Green Finance Strategy , including the intention to position the UK as a global hub for trading in voluntary carbon markets.

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United Kingdom

SECR

Disclosures

What?
The new Streamlined Energy and Carbon Reporting (SECR) program will replace the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme. SECR requires the disclosure of: total energy consumption, scope 1 and 2 emissions, an emissions intensity ratio, efforts taken to improve energy efficiency, and a description of the methodology used to calculate reported metrics.

Who?
All quoted companies in the UK as well as private companies and nonprofits that meet two or more of the following minimum thresholds:

- 250 employees
- £36 million in annual turnover
- £18 million balance sheet

When?
The requirement is already in action for about 12,000 firms in the UK. The policy was implemented April 1, 2019.

Carbon Market Impact?
Reporting on carbon credit usage is not required within current standards. It is likely there will be more strict requirements around emission disclosures and use of credits in climate strategies as the UK expands existing corporate sustainability regulatory regimes.

CRFD

Disclosures

What?
Climate Related Financial Disclosures (CRFD) is broadly based on TCFD's framework and requires companies to report on eight considerations around a company's climate related risks and opportunities.

There is no explicit requirement to disclose carbon emissions, as all companies reporting under CRFD must also report under SECR (the previous disclosure requirement outlined).

Who?
All UK publicly quoted companies and any UK registered companies with at least 500 employees and £500 million in revenue.

When?
The requirement was included for annual report filings in April 2023.

Carbon Market Impact?
Reporting on carbon credit usage is not required within current standards. It is likely reporting on the use of credits in climate strategies will be required under other UK non-financial reporting systems.

United Kingdom

FCA

Disclosures

What?
The UK is moving to make TCFD-aligned disclosures the minimum for all reporting companies by 2025. The Financial Conduct Authority (FCA) requires covered companies to disclose transition plans, if they have them, on a 'comply or explain' basis.

Regulations will evolve to align with the International Financial Reporting Standards Foundation (IFRS) Sustainability Disclosure Standards.

Who?
All asset managers and owners regulated by the FCA as well as standard and premium listed firms. Each year the FCA will expand coverage to smaller firms..

When?
Some early filings have already been made and the FCA has signaled a more stringent approach going forward. The latest filings occurred June 30, 2023.

Carbon Market Impact?
Reporting on carbon credit usage is not required within current standards. It is likely there will be more strict requirements around emission disclosures and use of credits in climate strategies as the UK expands existing corporate sustainability regulatory regimes.

United Kingdom

ASA

Claims

What?

The Advertising Standards Authority (ASA) launched the Climate Change and the Environment (CCE) group to ensure environment and sustainability claims used in advertising are not misleading or irresponsible.

In June 2023, the ASA consolidated guidance on "net zero" and "carbon neutral" claims, acknowledging a lack of consumer understanding of the terms. Guidance recommends:

- Companies avoid using unqualified "carbon neutral", "net zero" or similar claims. Information explaining the basis for claims must be included to facilitate consumers' understanding
- Claims based on future goals relating to reaching net zero or achieving carbon neutrality should be based on a verifiable strategy to deliver them
- Where claims are based on offsetting, they should comply with the usual standards of evidence for objective claims and marketers should provide information about the offsetting scheme used

The ASA is monitoring the application of the guidelines and will assess how such claims are being substantiated. The ASA has said it will take proactive action to address companies making unsubstantiated "net zero" and "carbon neutral" claims.

Who?

Marketing and advertising material in the UK.

When?

The guidance has already been issued.

Carbon Market Impact?

Where a company's claims include carbon credits, marketers must comply with the standards of evidence for objective claims and should disclose information about the carbon credit scheme used. Implementation and future updates to guidance could have implications for demand of credits.

If the ASA were to come out and say that an advertiser had breached their code it would be an open invitation for a greenwashing lawsuit. The ASA is a self-regulation body, rather than sitting within an official government regulatory capacity, and does not have direct regulatory oversight of UK advertising.

United States

Climate discourse in the US can often be clouded by ongoing culture wars, but it is clear regulators are moving to implement. The direction of US policy has a characteristic focus on competition and incentives when it comes to sustainability reporting and climate.

United States

SEC Climate-Related Disclosure

Disclosures

What?
The US Securities and Exchange Commission (SEC), the primary regulator over public financial markets, proposed a draft climate disclosure rule that will require public companies to disclose data regarding carbon emissions and climate risk.

The proposed climate rule uses TCFD as the foundations for reporting requirements. Attestation and assurance will be phased in for companies that qualify as large accelerated filers.

Who?
The rule will be applicable to all companies with an existing SEC reporting requirement, including non-US domiciled companies with US-traded shares.

When?
There have been two commenting periods for the proposal already. The finalized rule was expected for May 2023, but pushed back until autumn 2023, meaning compliance will not come into play until 2024. However, most boards and corporations are preparing for disclosure based on demand from investors.

Carbon Market Impact?
Based on draft rules, it is expected that companies companies will be asked to disclose the purchase of carbon credits used to meet climate goals and reflect the corresponding short and long-term costs, as well as risks, within the Item 1502 of Regulation S-K. Enhanced transparency encourages confidence and can incentivize carbon market participation to spur growth for the nascent carbon market.

FTC Green Guides

Claims

What?
The Federal Trade Commission (FTC) produced the first Green Guide for environmental claims in 1992, providing companies with principles for fair environmental marketing and how to substantiate and qualify claims.

The agency reviews rules and guidance every 10 years and recently closed a public commenting period, seeking input on 19 commonly used terms in advertising including "carbon neutrality" and "net zero."

Who?
For all companies with advertising and marketing material in the US

When?
The last updates were made in 2012 and are currently in effect. The consultation and update process took two years to complete for the 2012 update and it is currently unclear when this current round of updates will be in action.

Carbon Market Impact?
If FTC guidelines include provisions outlining how carbon credits can be used within a corporate claim it could have implications for demand of credits.

Similar to the impact of the EU's Directive on Green Claims, if corporates shy away from making green claims - so-called 'green hushing' - or if new rules are introduced limiting what claims can be made based on the use of carbon credits, there is concern that VCM growth would stall.

Equally, clarity on strictly defined meanings on claims could give corporates confidence to make ambitious, high-integrity claims around corporate action.

United States

CFTC

Legal treatment of carbon credits

What?

The international trade organization International Swaps and Derivatives Association (ISDA) has recommended the CFTC (Commodity Futures Trading Commission) is the body to regulate carbon credits and their derivatives, as credits fit under the definition of commodities per the Commodity Exchange Act (CEA).

The CFTC has enforcement authority and regulatory oversight over designated contract markets (DCMs) and any trading in those markets. Carbon credits are the underlying commodities in futures contracts within DCMs, such as the CME Group's CBL (Commodity Bourses Limited) Global Emissions Offset (GEO) futures and Nature-based Global Emissions Offset (N-GEO).

The CFTC launched a Climate Risk Unit and in summer 2022 issued a request for information on climate-related financial risk. In June 2023 , the CFTC issued guidance on how to report cases of fraud and manipulation in carbon markets. Individuals who report violations are eligible for monetary awards under the agency's Whistleblower Program. Within the guidance, the CFTC also asserted that carbon credits are the underlying commodity for futures contracts that are listed on CFTC designated contract markets (DCMs).

On July 17, 2023 the CFTC held its Second Voluntary Carbon Markets Convening to inform the advisory guidance on VCMs which they plan to publish in draft form by the end of the year, with a final version in the first half of 2024. Co-Founder and President Sameul Gill spoke at the CFTC meeting to discuss how carbon data and intelligence unlocks the ability to discern credit quality in the VCMs.

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United States

CFTC

Legal treatment of carbon credits

Continued

Who?
Participants in US derivatives markets, including futures, options, and swaps.

When?
It is unclear when the CFTC will release official guidance.

Carbon Market Impact?
There are currently US-based marketplaces with solutions for carbon credit spot and futures, like the N-GEO from CBL Xpansiv. These financial instruments play an important role in supporting liquidity in the market and encouraging investment.

Instrument	Description	Example	Benefit
Spot	A commodity is bought and sold for immediate delivery and use.	Buyer A purchases a volume of Project B carbon credits from a Seller C. Credits are transferred immediately at the agreed upon price.	Spot contracts facilitate an active and liquid market where immediate delivery of carbon credits can take place.
Swap	A derivatives contract enabling an exchange of cash flow or liabilities for a predetermined price.	Investor A is financing Project A and Investor B is financing Project B. Both are expecting to receive cash flows from the issuance and sale or credits from their respective projects. To de-risk the investment, the two investors can agree to swap or exchange a determined percentage of cash flow and rights to carbon credit volumes from each project.	Investors can hedge against negative returns and project risks. Pooling capital in this way also makes it easier to deploy project finance at scale.
Futures	A good is bought or sold for an agreed upon future date and price.	An agreement is made to transact a carbon credit at an agreed upon price, but the credit will not be delivered until the agreed upon future date.	Futures contracts enable a stable price for future supply, making it easier to budget.

Global harmonization efforts

Consolidation of voluntary standards and regulatory rules within sustainability is ongoing. Common guidance creates a unification of the market that enables consistency, comparability, and verifiability.

There are numerous international organizations with members that are regulators who will adopt the recommendations of the international organizations. Though guidance from these international bodies is voluntary, these standards could be adopted into law by member regulators.

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IFRS

Disclosures

What?
The IFRS created the International Sustainability Standards Board (ISSB) after COP26 to harmonize global sustainability disclosure standards around a set of common rules. The ISSB has two draft standards, one for general sustainability disclosures and the other for climate disclosure standards, both aligned with TCFD pillars.

The ISSB was created to consolidate the alphabet soup of disclosure standards and create a global baseline comprising basic building blocks of sustainability reporting practices upon which jurisdictions can build regional specifics.

Who?
The IFRS is not a regulatory body, but governments and regulators from around the world can integrate the IFRS standards into mandatory reporting schemes. The IFRS and ISSB sustainability standards have been endorsed by G20 and G7 countries, with many member states announcing their intent to integrate the standards into their mandatory reporting regimes.

When?
The finalized standards were released in June 2023 and will be in action for voluntary usage in 2025, utilizing 2024 data. IFRS and ISSB launched its first two standards, IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures).

Carbon Market Impact?
IFRS S2 includes explicit provisions around disclosure of emission reduction targets and use of carbon credits. Reporting will include information around the planned use of carbon credits to offset greenhouse gas emissions to achieve any net greenhouse gas emissions target as well as credit attributes such as third-party verification/ certification credit type (e.g. nature based or technology based, reduction or removal), and any other relevant information to understand credibility and integrity of the credits used.Similar to SEC rules, this will bring more scrutiny to credit buyers and encourage extensive due diligence on credit purchases.

International Organization of Securities Commissions (IOSCO), the international body that develops, implements, and promotes adherence to internationally-recognized standards for securities regulators, has announced it will review IFRS draft and final standards. If the standards are found to be fit for purpose, IOSCO would provide the basis for all 140 of the member jurisdictions to adopt and apply the climate and sustainability requirements legally.

This proliferation of jurisdictions requiring disclosure of carbon credit usage could underpin the next phase of growth required for the carbon market to reach scale for 2030 and 2050 targets.

Prepare for what's next

The trend of upcoming regulations is evident. We are entering an era where sustainability reporting must be on par with financial disclosures. Despite uncertainty around specific provisions and exact roll out timelines, prudent companies are being proactive and defining data collection structure and aiming to ensure compliance with new regulations.

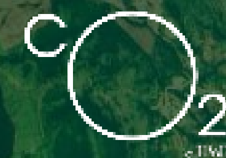
Proposed updates and impending regulations will require more comprehensive disclosures about credit usage. The current alphabet soup of voluntary standards and regimes for carbon markets will eventually crystallize into legally enforceable regulatory regimes.

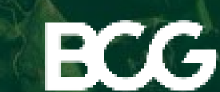
Sylvera has a suite of products that provide organizations with the data infrastructure necessary to find clarity on carbon credit quality and value.

Request a demo

Who trusts the Sylvera platform?

Our customers and partners span corporate buyers, traders and exchanges. They are often large institutions who have made net zero commitments, and who are the biggest buyers of carbon credits in the market.





Contact us to learn more.

Sylvera's mission is to be a source of truth for carbon markets.

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