

ESG Funds/Carbon Credit Project Developers: LSE Launches The New Voluntary Carbon Market Designation

by Stewart Worthy

On 10 October 2022, the London Stock Exchange (**LSE**) introduced the Voluntary Carbon Market (**VCM**) with the aim of promoting transparency and standardising carbon disclosures (a counter to “greenwashing”) and increasing the flow of finance to climate-change mitigation projects (some of which might otherwise be economically unviable).

The VCM designation will be available to closed-ended investment funds or operating companies, which are admitted to the LSE’s Main Market or Alternative Investment Market (**AIM**) and intend on investing (directly or indirectly) in nature-based and technology led climate-change mitigation projects that are likely to generate carbon credits (i.e. a tradable certificate, which represents the removal or avoidance of one tonne of carbon dioxide or the carbon dioxide equivalent of another greenhouse gas).

A VCM issuer will need to identify, in its prospectus, a climate-change mitigation project that will generate carbon credits. Any such climate-change mitigation project will have to be independently certified and appear on the register of the relevant voluntary carbon industry body in order to be a **Qualifying Project** (whereas a **Proposed Project** is a project which is reasonably likely to become a Qualifying Project).

Under the new Schedule 8 of the LSE’s Admission and Disclosure Standards, the VCM issuer will be required to disclose information relating to the climate-change mitigation project. Such disclosures will include details of the **Qualifying Body** whose standards will apply to the climate-change mitigation project, the type of project, the expectant carbon credit yield and whether the climate-change mitigation project will meet any environmental and social benefits, as set out in the United Nations’ Sustainable Development Goals.

The VCM issuer must also adopt a carbon credit policy which will set out its intentions as to (i) the distribution of carbon credits to its investors as a dividend-in-specie, (ii) retirement of carbon credit (i.e. taking them off the market forever); and/or (iii) the onward

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sale of carbon credits.

An important point to note is that VCM issuers can undertake other business activities/make investments outside of climate-change mitigation projects, although to the extent they do so, they will need to confirm that any related revenues can be mapped to the Tier 1 or Tier 2 micro sectors within FTSE Russell's Green Revenues Classification System.

The requirements for a VCM designation are in addition to the existing requirements of LSE Admissions and Disclosure Standards and/or applicable rules (including the requirements for admission to trading on the Main Market or AIM).

New additional continuing obligations

For continued eligibility of the VCM designation, an issuer is required to comply with the new continuing obligations requirements set out in Schedule 8 of the LSE Admissions and Disclosure Standards. In this regard, the VCM issuer must have commenced investments (in the case of a fund) or funding (in the case of an operating company) in at least one Qualifying Project or Proposed Project within two years of receipt of the VCM designation and maintain at least one Qualifying Project or Proposed Project thereafter. To the extent that the issuer is no longer compliant with the aforementioned, it has to notify the LSE of such non-compliance.

The VCM issuer is also required to ensure that its audited annual financial statements include a statement confirming that there has been no change in the fund's investments or operating company's funding arrangements in the Qualifying Project or Proposed Project. Where there has been a change, the VCM issuer is required to report it accordingly. In addition, the VCM issuer will be required to provide detailed updates on its progress towards a Proposed Project becoming a Qualifying Project (including expected timing of implementation).

The issuer's audited annual financial statements will also need to include a restatement of the VCM issuer's carbon-credit target yield and a comparison of how the VCM issuer has performed in relation its previously stated carbon-credit target yield. This restatement must be accompanied by a detailed description of the carbon credits received by the VCM issuer, including the project name and issuing registry for each carbon credit issued.

Where the VCM issuer elects to retire the carbon credit on behalf of the shareholders, it is required to make appropriate arrangements to provide information to shareholders of their entitlements in accordance with Schedule 8 and notify retirements of carbon credits via an RIS as if they were dividends in accordance with the Dividend Procedure Timetable published by the LSE.

Schedule 8 also requires VCM issuers to maintain a website setting out essential information such as details of the Qualifying Project or Proposed Project and the minimum percentage of assets which have been invested (directly or indirectly) towards

the aforementioned projects.

The LSE may remove the VCM designation where the issuer is in breach of, or is unlikely to be able to comply with, its obligations as set out in Schedule 8 and/or has not complied with or is unlikely to comply with any special condition(s) imposed by the LSE. Similarly, an issuer can make an application to have its VCM designation removed by providing 21 business days' notice to the LSE. This will not affect the listing and/or admission of the issuer's securities to the LSE's markets.

Investor and issuer considerations

It should be noted that the VCM does not represent a trading venue for carbon credits themselves. Instead the LSE views the VCM designation as a solution to accelerate the availability of financing for projects that will support a just transition to a low-carbon green economy. Both investors and issuers will be able to build and implement their respective net zero transition strategies through the financing of climate-change mitigation projects. In addition to the direct financial benefit for the investors and issuer, it is hoped that the VCM will decrease global social and environmental risks relating to climate change.

Investors are likely to be institutional investors and corporate retail investors who seek a long-term supply of carbon credits to contribute to their decarbonisation strategies. There is increased pressure on many companies (especially those with a large carbon footprint) to obtain carbon credits in order to achieve net zero by 2050. In this regard, investors may fund VCM issuers and contemporaneously address residual and unavoidable emissions in accordance with their decarbonisation strategies. The benefit of investing via the VCM primarily relates to the transparency that comes with the Schedule 8 governance, disclosure, reporting and public market requirements, which, if successful, should increase investor confidence and incentivise further investments in the sector.

The LSE's aim is for the VCM to provide access to deep pools of capital for carbon credit project developers and ESG funds, including those raising more early stage equity investment on AIM.

For more information or advice relating to the Voluntary Carbon Market, please contact, Stewart Worthy on the details set out below:

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