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Brazilian Congress Approves Legislation Aiming to Stimulate Carbon Credit Markets

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On May 2, 2023, the Brazilian Senate **approved legislation** that amends rules relating to public forest concession contracts and, significantly, now allows the use and commercialization of carbon credits. The amendment, which is considered to be an important milestone in the regulation of Brazil's voluntary carbon market, was also **approved by the Brazilian Chamber of Deputies** on March 30. President Lula is expected to ratify the measure in the coming weeks.

Brazil's forest concession system was established in 2006 and provides a legal framework for the development of long-term sustainable timber production in the Amazon region. Under the framework, Brazilian public forest land can be leased to private enterprises for sustainable logging activities overseen by the Brazilian Forest Services (SFB). The scheme has had limited uptake to date, with a **2021 study** showing that forest concessions in the Amazon region cover only 1.6 million ha (Mha) of a potential area of 35 Mha. Concessionaires reportedly face challenges to make concessions profitable as they compete with cheap timber produced by illegal logging operations. It is hoped that by allowing concessionaires the ability to issue carbon credits, forest concessions will become more profitable and coopt private enterprise into President Lula's ongoing efforts to reduce Amazonian deforestation and **turn Brazil into a leader** on global environmental policy as well as a major destination for green investment.

Importantly, the proposed rule changes would allow Brazil's development bank (BNDES) to allow financial industry participants and fintechs to finance carbon credit operations with resources from the Brazilian National Fund on Climate Change. The financial sector has so far shown little interest in financing Brazilian forest concessions but the growing market for carbon credits may provide motivation for engagement with newly-issued concessions under the revised framework.

The development is also seen as a first step in Brazil regulating voluntary carbon credit markets. For years, policymakers have pushed for a regulated market that can be integrated into those operating in Europe, the U.S. and other jurisdictions. In 2022, the government of former president Bolsonaro made legislative proposals relating to a National System for Reducing Greenhouse-Gas Emissions (SINAIRE) but this has still not been implemented to date.

Taking the Temperature: As we have frequently reported, environmental policy has been high on President Lula's agenda with a focus on reactivating enforcement in order to reduce illegal deforestation in the Amazon region. Lula has also been active in seeking international financial support for environmental protection initiatives and scored a notable success in May when President Biden pledged $500 million to the Amazon Fund. During Lula's state visit to China in April, carbon credits were reportedly on the agenda. China is one of the biggest buyers of carbon credits worldwide and has pledged to achieve net-zero emissions by 2060 despite continued heavy reliance on coal and oil.

The carbon offset market has grown rapidly in recent years as has scrutiny and criticism of some carbon credit schemes. Concerns have been raised that carbon credit projects in developing countries may, in some cases, disenfranchise local populations. For example, in 2022, the *Wall Street Journal* reported that only a small proportion of money raised via the sale of carbon credits and intended for rainforest preservation in Peru actually reached local communities.

At a more fundamental level, there are concerns that carbon credits do not provide real greenhouse gas mitigation unless they are tied to carbon-saving projects and may even reduce incentives for companies to actively work towards carbon reduction. According to a report published by the World Economic Forum, many carbon offset programs are not transparent due to their complexity and varying definitions of carbon credit quality. The World Economic Forum made five recommendations for organizations seeking to improve the carbon market, including setting scientifically aligned decarbonization pathways to provide credibility around using carbon credits, creating market transparency through corporate disclosures and adopting leading standards such as the Integrity Council's Voluntary Carbon Market.

As we have reported, various jurisdictions, including the U.S. and Australia, are independently reviewing existing carbon trading practices and considering further regulation. At COP-27 last year, John Kerry, the U.S. Special Presidential Envoy for Climate, announced the "Energy Transition Accelerator" (ETA), a billion-dollar carbon credit program designed to help private companies in wealthier countries support developing countries to reduce their reliance on fossil fuels. According to the announcement, "operating at the scale of national or subnational jurisdictions, the ETA will produce verified greenhouse gas emission reductions, which participating jurisdictions will have the option of issuing as marketable carbon credits." The European Union is currently formulating mandatory disclosure and certification rules for companies that use carbon credits. The proposal is based on companies conducting their own assessment of carbon removal in accordance with certain key criteria using methodologies prepared by the European Commission, and then submitting that assessment for independent verification through a certification scheme.