Submission to the UNFCCC Supervisory Body Calls for input

07 April 2025

Introduction and Overview

IETA is a non-profit business association that is committed to achieving the goals of the Paris Agreement. It has a membership of over 300 leading international organisations operating in compliance and voluntary carbon markets. Since its foundation in 1999, IETA has been the leading voice of business on market-based ambitious solutions to climate change. We are a trusted adviser to governments to support them build international policy and market frameworks to reduce greenhouse gases at lowest cost, increase ambition, and build a credible path to net-zero emissions. We provide these comments in support of the secretariat and the Article 6.4 Supervisory Body (SBM) in achieving their mandate and goals under Article 6.4 of the Paris Agreement.

The secretariat of the UNFCCC, on behalf of the SBM or its supporting panels, has launched two **calls for input** to seek views of stakeholders on specific topics or issues.

1. Call for input 2025: Provision of a functionality for security interest arrangements in the mechanism registry through a pledge system
2. Call for input 2025: Ownership of account holdings in the A6.4 mechanism registry.

This document is a submission responding to those calls for input.

As the calls for input are considered separately, we are responding separately, however it should be noted that there is material cross over between the two issues.

Call for input 2025: Ownership of account holdings in the A6.4 mechanism registry.

Regarding the Information Note *Analysis of the pros and cons related to framing users' rights with regard to control versus confirming ownership of account holdings* ("**Ownership Note**")

In addition to the points made in the IETA position paper on OWNERSHIP OF A6.4ERs IN THE PARIS AGREEMENT CREDITING MECHANISM REGISTRY from January 2025, the following points are noted.

1. *The SBM looks at other carbon market registries, specifically Verra and UCR, pointing out that these registries do not provide any legal title and state they have no obligation to verify or otherwise enquire into the validity of legal title*. While this is correct, this has been a key barrier to the growth in material finance for projects registered with such registries. It is worth noting that there are several other registries that do provide a presumption of title clearly vesting with the account holder and clear representation that such title does not vest with the relevant issuing body or registry administrator.
2. *The CDM registry did not address ownership in its operational framework*. While this is correct it required complex work arounds to give effect to the solutions that we are now suggesting are expressly included in the Paris Agreement Crediting Mechanism (PACM) registry as per paragraph 4 below.
3. The SBM notes that the mechanism registry does not fall under any national or regional jurisdiction and as such it raises certain concerns in respect of recognition of ownership, as set out below:
    a. Recognition of ownership would require an applicable law and jurisdiction to govern the mechanism registry which could expose the secretariat to increased legal disputes.
    b. Recognition of ownership could significantly increase the likelihood of ownership-related disputes involving, or brought against, the UNFCCC secretariat by third parties.
    c. If A6.4ERs are recognised as assets or financial instruments, this may impose increased due diligence obligations – such as prevention of fraud etc. – on the Registry Administrator (RA).

    these concerns are addressed in paragraph 4 below.
4. While the SBM is correct to consider such concerns, **IETA makes the following suggestions to mitigate such risks and provide account holders and secured parties with the certainty needed to encourage participation in the PACM**. The registry rules should include a user agreement for all entities and Parties using the mechanism which would include the following provisions:
    a. An express provision indicating that all entities and Parties using the mechanism attorn to/accept the presumption of ownership of A6.4ERs in an account vest with the account

holder; and that registration and issuance into an account may be taken as prima facie and sufficient evidence of title. By example the EU Registry Regulation[1] Article 40 (*Nature of allowances and finality of transactions*) provides:

> " 1. An allowance or Kyoto unit shall be a fungible, dematerialised instrument that is tradable on the market.
>
> 2. The dematerialized nature of allowances and Kyoto units shall imply that the record of the Union Registry shall constitute prima facie and sufficient evidence of title over an allowance or Kyoto unit, and of any other matter which is by this Regulation directed or authorised to be recorded in the Union Registry."

b. A governing law for the user agreement and a clear mechanism of dispute resolution including choice of law, rules and forum for the resolution of disputes that is independent of the SBM and the RA. Acceptable arbitration rules could include ICSID, PCJ, UNCITRAL, ICC, HKIAC, LCA.

c. The RA and the UNFCCC are fully protected with privileges, immunities and full indemnities. This would protect the UNFCCC and the secretariat from being brought into any ownership-related disputes.

d. An express requirement for the Parties to Paris Agreement to waive their sovereign immunities and privileges in respect of ownership disputes.

e. It is not necessary for the user agreement to define the nature of A6.4ERs under private law as assets or under public law as financial instruments. These are matters of other applicable law.

[1] Directive 2003/87/EC

Call for input 2025: Provision of a functionality for security interest arrangements in the mechanism registry through a pledge system

Regarding the Information Note on the *Legal, technical and financial implications of providing functionality for the treatment of financial security interests in Article 6.4 emission reductions within the mechanism registry* ("**Security Interest Note**")

1. **Reference to independent carbon market registries.**
    a. The Security Interest Note looks at other carbon market registries, specifically Verra and UCR, pointing out that these registries do not provide any functionality to facilitate security interests. While this is correct, this has resulted in increased transaction and diligence costs (largely born by project developers) and has been a key barrier to the growth in material climate finance for projects in many G77 countries and constitutes a barrier to scaling the carbon market.
    b. This lack of functionality to facilitate security interests in some of the independent registries has proved to be a practical barrier for IETA members to raise finance at scale and to attract finance from established mainstream financiers including Banks. A financier accustomed to other markets (such as renewable finance or finance in global commodities markets) requires effective and enforceable security over a range of assets and rights of the borrower, backed by a positive legal opinion on enforceability of such security from a reputable law firm. Law firms are unable to provide such enforceability opinions with respect to security over accounts in many independent registries, including those referred to in the Security Interest Note, because they do not provide any functionality to facilitate security interests. This has resulted in either an increased risk premium for a transaction, or a failure to attract finance from established financiers.
2. **Proposed Pledge system**
    a. **Summary of the IETA position.**
        i. We agree with the statement in the Security Interest Note which says that ownership may not be critical to all security interests. There are established forms of security that require transfer of "possession" of the secured asset. Such an established form of security is a "**Pledge**" between the borrower (the "**Pledgor**") and the secured party (the "**Pledgee**"). Transfer of possession can be actual possession (in this case by transfer to the secured party account) or it can be constructive possession in the form of full control of the secured asset (through an irrevocable instruction from the Pledgee to the RA to act exclusively to the instruction of the Pledgee). While the Security Interest Note sets out a process for what it terms as a pledge, that process as set out is not effective as a Pledge. For a Pledge to be effective full possession

(actual or constructive) must be transferred to the secured party. The established requirements for a Pledge are set out at 2.b below and commentary on the proposed form of pledge in the Security Interest Note follow at a paragraph 3.

ii. In practical terms for a Pledge to be effective the Pledgor (borrower) instructs the RA to follow instructions from the named Pledgee (secured party) in respect of the secured assets until such point as the Pledgee notifies the RA otherwise. The RA must acknowledge such instruction to both the Pledgee and the Pledgor. From that point the Pledgee has the sole authority to deal with the secured assets. The terms of the Pledgee authority, for example on what trigger events the Pledgee may liquidate the secured assets, are governed by the terms of the security arrangements between the parties. The RA does not need to have sight of those terms or be a party to them. The RA does not need to provide assurances on the form or effectiveness of such security arrangements. In practical terms, this leads to two critical clarifications for the proposed Pledge mechanism:

    1. Clarify that, from the point of registration of the Pledge until it is removed by the holder of the Pledge, the RA will respect the instructions of the secured party in respect of the secured A6.4ERs (including dealing with secured A6.4ERs without the requirement for an arbitral decision suggested in paragraph 35 of the Security Interest Note);

    2. Not involve the RA in the process to remove a Pledge. The Pledge holder would be the recognised entity that can remove a Pledge. This does not prevent the account holder procuring that the Pledge holder is compelled to release the Pledge by court or arbitral order issued under the documentation between the account holder and the Pledge holder.

iii. If an entity wants to secure only some of the A6.4ERs in its account, then a form of sub account administration would facilitate this process. It may also benefit from allocation of a label to the A6.4ERs that are the subject of the security interest.

iv. We acknowledge the conclusion at paragraph 24 of the Security Interest Note in respect of the suggestion to create future A6.4ERs. However, we do consider it remains critical for the effective finance of A6.4 projects that it is recognised that a Pledge may apply to all or a specified portion of A6.4ERs upon their creation. That is, without the requirement for a further Pledge to be established upon each issuance of A6.4ERS for a project.

b. Required parameters of an effective Pledge

i. The parties enter into a *pledge agreement* between themselves setting out the parameters of the security arrangements. The RA/SBM, or any part of the UN, do not need to be a party to this agreement and indeed should not be. Such agreements would be subject to the governing law selected by the parties to that agreement. This may be different to the governing law of any terms and conditions relevant to the registry itself.

ii. Part of the suite of documents and obligations under that pledge agreement would normally be the obligation on the Pledgor to *transfer possession* of the secured asset to the Pledgee. In this circumstance this can be done by transfer of the pledged A6.4ERs into an account of the Pledgee (transfer of actual possession) which would require the Pledgee to open an account at the registry. The alternative is transfer of constructive possession through an irrevocable instruction from the Pledgor, in an agreed form, to the RA, that the RA should follow the exclusive instructions of the Pledgee in respect of the secured A6.4ERs and the RA must acknowledge such instruction to both parties. The Pledgee, now being in possession and control, is then the only party that can withdraw the security.

iii. The pledged A6.4ERs must be *clearly identified* as being secured. As noted in paragraph 2.b.ii above, this can be achieved by transfer into an account of the Pledgee. However, it would facilitate financing if segregation could be achieved in a sub-account of the Pledgor. The Pledgee may then, if the security is triggered, liquidate the secured A6.4ERs directly from the Pledgor sub-account without the need to open an account itself at the Registry. It is acknowledged that the RA may need to conduct Know Your Customer protocols on the Pledgee as a party with the authority to instruct the RA even if it does not open an account at the registry. It may also be useful to add an additional label to identify secured A6.4ERs to aid transparency.

iv. The Pledgor must have *ownership* to transfer by way of security. This is one of the core reasons for the IETA view that the ownership to account holdings should be recognised and is further explained in the IETA response to the Call for Input on **Ownership of account holdings in the A6.4 mechanism registry.**

v. Critical to an effective and enforceable security by way of a Pledge is that the Pledgee must have the right to *enforce its security directly* without recourse to the Pledgor, and without **stay** (a legal obligation to wait for a court decision before enforcement) or **delay** (physical or legal delay). Such rights are fundamental to possession. The pledge system as set out in the Security Interest Note does not

transfer actual or constructive *possession* to the Pledgee and therefore does not satisfy the parameters of an enforceable security under most accounting rules.

vi. Without transfer of possession the security arrangement is subject to unquantifiable risks relating to delay in enforcement and uncertainty in respect of the ability to enforce. If the security cannot be enforced without recourse to the Pledgor or without stay or delay the secured party is exposed to multiple risks that devalue the asset as security including:

1. Risks associated with uncertain outcome from any legal proceedings
2. Market risk as the value of the secured asset may fluctuate during the delay
3. Costs of maintaining the liability for which the security was intended
4. Potential non-cooperation of the Pledgor or a related insolvency practitioner

c. The SBM may consider incorporating express provisions in the registry rules for treatment of accounts in the event of an insolvency.

3. **Comments on pledge system proposed in the Security Interest Note.** As noted above a pledge system would be very useful and significantly improve the ability to raise finance. However, the system as described in the Security Interest Note would not provide an enforceable security for the following reasons:

a. *Account holder creates a pledge in favour of a pledge holder* (the secured party): This should also include unanimous consent from the focal points. The pledge agreement is a private law agreement between the Pledgor and the Pledgee. The RA or any part of the SBM or UN do not need to be and should not be a party to such agreement. Such agreements would be subject to the governing law selected by the parties to that agreement. This may be different to the governing law of any terms and conditions relevant to the registry itself. The RA or any part of the SBM or UN would not be providing any commentary or assurances on the effectiveness of the pledge agreement.

b. *The RA would place operational restrictions on the A6.4ERs the subject of a pledge and pledge holder may withdraw the pledge*: The Pledgor must issue an irrevocable instruction to the RA to act only in accordance with the instruction of the Pledgee. Such irrevocable instruction constitutes the constructive transfer of possession necessary to create a Pledge. The terms relating to what the Pledgee may do with the secured assets are governed by the pledge agreements, including when the Pledgee may access and liquidate the secured asset. The RA does not need to be a party to or acknowledge any of the terms of the pledge agreement, it only needs to acknowledge that it will act solely on the instructions of the Pledgee. If the Pledgee acts outside of the contracted parameters of the pledge

agreement that would be a disputed issue between the parties to the pledge agreement and not the RA.

c. *For any dispute regarding the withdrawal of a pledge, the account holder requires a decision from an arbitrator providing specific instructions to the RA to withdraw the pledge*: An effective Pledge requires transfer of possession to the Pledgee, in this case in the form of control over the pledged A6.4ERs. Such control includes the exclusive right to withdraw the Pledge. The only party that can withdraw the Pledge should be the Pledgee. Any dispute between the Pledgor and the Pledgee in respect of the security agreements, and whether or not the Pledgee should lift the security, would be a private legal issue between those parties. The RA should not intervene in such dispute and should only follow instruction from the Pledgee until such time as either the Pledgee lifts the security or is compelled to do so, or the RA is compelled to act differently by court or arbitration order.

d. *RA would transfer pledged A6.4ERs to the pledge holder (i.e. enforce the pledge): on mutual agreement or on instruction from an arbitrator:* As described above, the instruction to deal in any way with the secured A6.4ERs must be the exclusive right of the Pledgee. Any dispute resolution process in respect of the pledge should be a matter between the Pledgor and the Pledgee and must be independent of the SBM and the RA, and conducted in accordance with chosen dispute resolution procedures agreed to in the relevant security agreements. It may be useful to indicate acceptable arbitration rules and include ICSID, PCJ, UNCITRAL, ICC, HKIAC, LCA. Local courts should also be acceptable dispute resolution fora. The chosen dispute resolution process is highly contingent on the nature of the dispute and relevant applicable laws including the governing law of the security agreements and should not be predetermined by the rules of the registry. The RA should only act on an instruction of the Pledgee or an arbitration or court order.

e. *Any pledged A6.4ERs remain subject to the RA's authority to execute required actions under mechanism rules*: The rules need to be express as to the extent of this authority and should not be implemented at the discretion of the SBM or the RA as this would undermine the value of the pledged A6.4ERs as security and also the value of the A6.4ERs themselves. It would also undermine the presumption of ownership required to allow the Pledgor to pledge the A6.4ERs. Our understanding is this could only be done under specific circumstances, for example a withdrawal of authority from the Party authorising the account or certain defined project related events. The relevant terms and conditions should be clear on the parameters of the RA authority to execute required actions under the mechanism rules and such terms should include an express transfer of such authority from the presumed owner to the RA.

4. **Alternative forms of pledge and security arrangements**

    a. **Prepay and pledge**. In carbon markets a common financing tool is the prepay purchase and financing structure where the investor pays cash for the units, which is then used to commission the project. When credits are issued in respect of the project these are delivered to the investor. In the case of a prepay purchase and financing structure, it may be sufficient for the investors to have control over the distribution of A6.4ERs by appointment of a focal point that represents the investors. However, such forms of financing would be further supported through effective Pledge arrangements implemented pre-issuance, where it is assured that pre-pledged A6.4ERs would be directed either to the Pledgee account or into a pledged sub-account on issuance.

    b. **Mature market financing tools and scaling the market.**

        i. There are multiple other financing tools that are commonly used in facilitating investment in mature markets. In order to support the scaling of carbon markets facilitating such other forms of security arrangements should be considered. For example, collateral arrangements under market standard trading documents such as the ISDA or a repo inventory financing or Letters of Credit. The type of preferred security arrangement depends on the specific circumstances of each secured liability.

        ii. We understand this poses an additional issue for the RA of managing the administrative burden of performing the tasks necessary to give effect to or enforce this range of security arrangements. There are entities that are set up to provide custody and other such services, including entities such as Bank of New York Mellon, Citi Bank, State Street and many others. The registry rules and protocols should be continually reviewed and developed to accommodate these important market participants.