News on the CO□ Act: Standstill or departure for new shores?

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Key takeaways

- **Following the rejection of the totally revised CO□ Act in the referendum of 13 June 2021, a transitional law came into force at the beginning of the year.**
- **This means that proven instruments for reducing greenhouse gas emissions, such as emissions trading, continue to be available.**
- **The CO□ Ordinance was amended, among other things, to make changes concerning compensation projects to increase the sink capacity and climate protection projects abroad.**

Introduction

After the Swiss people voted to reject the totally revised CO□ Act on 13 June 2021, Swiss Parliament adopted a transitional law to continue the existing and proven instruments for reducing greenhouse gas emissions. Politicians plan to replace this transitional law with a new law from January 2025.

One of the tried and tested instruments for reducing greenhouse gas emissions is trading in emission rights and certificates. The CO□ Ordinance, which was amended with effect as of 1 January and 1 June 2022, contains new provisions on certificates for projects in Switzerland and abroad. In this legal update, we explain these changes and at the same time provide an overview of the markets for trading in emission rights, known as ‘carbon markets’.

Emissions trading markets

Emissions trading schemes and registries

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Newly issued emission rights by the federal government are allocated or auctioned via the Emissions Trading Scheme (ETS). However, the subsequent trading of these emission rights does not take place on a trading venue (e.g. an energy exchange such as the European Energy Exchange (EEX) based in Leipzig), but over the counter (OTC) and purely bilaterally between the parties involved. At least the transactions are tracked in an emissions trading registry (EHR) operated by the federal government. At present, 95 emission-intensive industrial plants are included in the Swiss ETS; in return, their operators are also exempt from the CO levy under the transitional law. The Swiss market is thus very small, especially compared to the market in the EU, which operates the largest emissions trading system in the world (EU ETS). More than 10,000 industrial plants and 350 aircraft operators are currently connected to the EU ETS. The Swiss ETS has been connected to the EU ETS since 1 January 2020, enabling Swiss market participants to benefit from the greater liquidity and opportunities offered by the EU market as well. Since this date, Swiss aviation has also been integrated into the ETS, analogous to the regulations in the EU. In any case, Swiss companies are well advised to keep an eye on the international markets, ultimately also because many of the emission-reducing projects take place abroad.

Rights, certificates and attestations

What exactly is traded on the carbon markets? First and foremost, emission allowances, i.e. the rights issued or auctioned free of charge by the state to companies to emit a certain amount of CO over a certain period of time (Art. 2 para. 3 CO Act). These rights are tradable: If a company exceeds its greenhouse gas emissions allowance, it must purchase the missing emission rights on the market. If it emits fewer greenhouse gases, it can sell the surplus rights. On the EU ETS, it is even possible to buy or sell emission rights via futures contracts.

In addition to emission allowances, the CO Act also recognises ‘emission reduction certificates’ and ‘attestations’. Emission reduction certificates are tradable certificates for reductions in greenhouse gas emissions achieved abroad, as issued for emission reduction projects in accordance with Art. 6 and 12 of the 1997 Kyoto Protocol (Art. 2 para. 4 CO Act). This market segment is known as the Clean Development Mechanism (CDM). In addition, the old CO Act already provided for the possibility of the Confederation issuing attestations for climate protection projects implemented in Switzerland. In this way, emission reductions achieved voluntarily by domestic projects could be certified for foreign projects with emission certificates in analogy to the old regulation of the Kyoto Protocol.

This threefold division of emission certificates in the broader sense is reflected in the three market segments into which the international carbon markets are readily divided:

Compliance markets	International carbon markets	Voluntary carbon markets

• State-organised; mandatory participation for certain categories of issuers • Partial crediting of certificates from the CDM	• Certificates according to Art. 6 and 12 of the Kyoto Protocol (CDM) or new Article 6 of the Paris Agreement • Possibility of international transfer of CO reductions	• Voluntary commitments • Variety of international industry standards
• Covers 8-15% of global emissions (with China)	• Large market; relaunch with the Paris Agreement	• Mainly for the implementation of CSR strategies
• Emission allowances	• Emission reduction certificates; attestations	• Attestations (Voluntary Carbon Credits)
• State regulated	• International standards	• International standards
• High liquidity	• Medium liquidity	• Low liquidity

Source: CFA Institute, Climate Change Analysis in the investment process, 2020 (adapted).

Professionalisation in these markets is increasing in that more and more concepts are adopted from traditional financial markets. As reported by the European Securities and Markets Authority (ESMA), most secondary trading in emission allowances (compliance market) takes place via derivative contracts. Many companies apparently enter into long forward contracts with investment firms to purchase emission allowances instead of buying them on the spot market. Large holdings of emission allowances in the trading accounts of investment firms with the EU Registry then appear to be strongly correlated with short positions that these firms take in the derivatives markets for emission allowances. According to estimates, however, the so-called voluntary carbon markets in particular could gain many times their current volume in order to achieve the 2050 net zero target. Hence, at least internationally, there is no question of a standstill. Depending on a company's circumstances, it may be worth considering a look to new shores.

Partial revision of the CO Ordinance

The Federal Office for the Environment FOEN no longer issues approval letters for emission reduction certificates (Art. 2 para. 3 CO Act) based on climate protection projects abroad in accordance with the rules of the Kyoto Protocol. The relevant provisions (Art. 4 and 4a) of the CO Ordinance were deleted. In future, only international attestations will be issued in accordance with the rules of the Paris Convention (Art. 6; cf. Art. 5 et seq. of the CO Ordinance). The FOEN issues national attestations for projects or programmes in Switzerland and international certificates for those abroad, provided that they meet the requirements set out in Art. 5. These include, but are not limited to, evidence of the effectiveness of measures that lead to a reduction in emissions (keyword: carbon reduction) or an increase in sink performance (keyword: carbon removal/sequestration). Furthermore, the projects should be effective according to the principle of additionality. This means that the emission reductions would not have been carried out anyway.

Existing emission reduction certificates from the CDM can only be used to offset deviations from targets in 2021 and can no longer be offset thereafter (see the transitional provision in Article 146l of the CO Ordinance).

Next steps

Companies that are pursuing an active net zero strategy or want to start doing so should address the issue of (international) attestations. Voluntary carbon markets can also be a useful tool for asset managers managing a portfolio marketed as sustainable (cf. the transparency requirements under Art. 8 of Regulation (EU) 2019/2088 (SFDR)).

This includes understanding the requirements for domestic and foreign projects and programmes that are necessary for certification by the FOEN.

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No legal or tax advice

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