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Revolutionizing the Voluntary Carbon Market

The UAE is making significant strides towards its sustainable development and decarbonization efforts in the lead-up to achieving net zero by 2050, with green finance instruments growing at an exponential rate. Fadi Al Shihabi elaborates.

UAE governments understand the need to diversify into new, expanding areas of financial opportunity, such as sustainability and green initiatives. The UAE has declared 2023 as the "Year of Sustainability". The UAE acknowledges that the region has a large carbon footprint and recognizes the importance of developing local carbon trading platforms.

Two of the UAE's biggest players, Abu Dhabi Global Market (ADGM) and the UAE's Security and Commodities Authority (SCA), separately announced ambitions to develop their own carbon trading platforms.

In 2022, ADGM united with AirCarbon Exchange (ACX) to develop the world's first fully regulated voluntary carbon trading exchange and carbon cleaning house. It was the first regulator to develop a mechanism that promotes carbon as a serviceable product and commodity, allowing entities to treat carbon and other greenhouse gases (GHG) as they would financial assets. It should be highlighted that the scheme was anticipated to be launched in 2022. ADGM has not yet released an update.

In addition, the UAE SCA is currently in talks with the Ministry of Climate Change and Environment to establish a carbon trading scheme. The news was announced in January 2023.

The carbon trading exchange/platforms will allow entities to ultimately offset their carbon emissions, by purchasing permits that authorize them to emit a certain quantity of carbon and other GHG, according to the purchased credits. Globally, the voluntary carbon market (VCM) has grown rapidly in recent years but has faced criticism over the fact that purchasing credits do not address carbon emission reduction or removal from the atmosphere. Conversely, it can be argued that opening the VCM redirects finance towards projects and initiatives that would address these key areas of sustainable development.

The global decarbonization landscape

The UN Net-Zero Banking Alliance is working towards facilitating, promoting, and accelerating the deployment of decarbonization initiatives, through the provision of an "internationally coherent framework and guidelines". The Alliance's Finance Initiative is focused on setting climate-related targets within an international framework to collectively contribute towards global climate goals and commitments. The framework emphasizes the crucial role that banks have in supporting and driving global decarbonization efforts. Furthermore, banks are in a unique position, whereby they not only have to be aware of their own environmental, social, and governance (ESG) impact, but also those stemming from their portfolios and value-chain.

It is anticipated that more stringent ESG (non-financial) disclosure requirements will likely be extended to banks. It is imperative they prepare for any regulatory changes and start to identify their gaps, and begin measuring, reporting, and disclosing, to ensure that the sector is ready for future disclosure requirements.

Major banks will benefit from integrating carbon credits and other services into their portfolios. Carbon credits would be an exciting addition to green bonds (sukuks), which are already prevalent in the region. Banks would do well to go above and beyond in extending their ESG criteria across their future and existing portfolios, to address emissions across their value chain (e.g. scope 3 emissions).

Towards a more sustainable future

Given the success of the established carbon credits trading platform in Saudi Arabia, the 'Riyadh Voluntary Carbon Market (VCM)' initiative in 2022, it is expected that the UAE will experience similar triumph. It is anticipated that the UAE, ADGM, and the SCA will announce an update to their prospective platforms during COP 28, which is being hosted across the UAE in late 2023.

Fadi Al Shihabi
Partner, ESG Services Leader

While the VCM and trading platform landscape will play a vital role in the UAE's journey towards net zero by 2050, if the world truly intends to achieve decarbonization and sustainability goals in the long term, it should be highlighted that carbon credits and carbon offsets do not make a direct contribution to emissions reduction. Carbon offsetting should be considered a short-term fix that will eventually need to be phased out of global emissions reduction strategies.

Nonetheless, carbon credits/offsets are an effective way of redirecting finance towards carbon zero or carbon net positive projects and initiatives. They will continue to play a major role in short- to medium-term mitigation strategies, at least until technologies and solutions mature enough to contribute to achieving the ambitious emissions targets currently being set, both locally and internationally.

Strategy

1. How does the bank compare to peers?
2. How is the bank going to meet its public net zero commitments?
3. Are the products offered ready from an ESG perspective?
4. Is the ESG incorporated in the target operating model?
5. How is the bank engaging with its clients and their transition strategies?

Operational effectiveness

1. Is the bank aware of ESG matters across its organization, including processes, systems and controls?
2. Does the functional decision-making take ESG matters into account?
3. Is ESG considered while developing products and services?
4. Are ESG risks and opportunities integrated in procedures and policies?
5. Is the bank taking advantage of the opportunities that IDE policies can bring?

Regulatory compliance and reporting

1. Is the company ready to cope with existing and upcoming regulatory requirements?
2. What are the gaps that can already be identified?
3. Is the company measuring, reporting and disclosing non-financial ESG information that is critical to understanding both strategic intent, risks and opportunities?
4. Who in the bank is responsible for ESG at functional and board levels?