ISDA Safe, Efficient Markets

February 2024

2022 ISDA Verified Carbon Credit Transactions Definitions ("**VCC Definitions**") FAQs

ISDA has prepared this list of frequently asked questions to assist in your consideration of the VCC Definitions. Unless otherwise defined herein, capitalized terms used in these FAQs have the meanings given to them in the VCC Definitions.

Introduction

Following the publication of ISDA's *Legal Implications of Voluntary Carbon Credits*[1] whitepaper in December 2021 (the "**VCC Whitepaper**"), as supplemented in November 2022 by an additional paper[2] exploring the legal nature of voluntary carbon credits under French, Japanese and Singapore law, in order to help facilitate the secondary market trading of verified carbon credits ("**VCCs**"), ISDA published the VCC Definitions and accompanying template confirmations in respect of physically settled spot, forward and option transactions. Version 1.0 of the VCC Definitions was published in December 2022 and subsequently updated by the publication of Version 2.0 in February 2024.

The VCC Definitions are part of ISDA's broader effort to support the transition to a green economy by developing robust legal and risk management standards for markets related to environmental, social and governance activities.

1 https://www.isda.org/a/38ngE/Legal-Implications-of-Voluntary-Carbon-Credits.pdf
2 https://www.isda.org/a/PlcgE/Legal-Nature-of-Voluntary-Carbon-Credits-France-Japan-and-Singapore.pdf

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Questions and Answers

1. **What are the VCC Definitions?**

   The VCC Definitions are a definitional booklet that provides a set of standardized terms for the trading and retirement of VCCs in the secondary market.

   The VCC Definitions have been designed to operate as a global document, meaning they are not specific to any particular jurisdiction, region or Carbon Standard (please see Question 7 (*What types of VCCs can be the subject of a transaction incorporating the VCC Definitions?*) below). As well as providing a set of standardized terms that parties can use for transactions relating to VCCs, the VCC Definitions also allow parties to document bespoke transactions as required.

2. **How can the VCC Definitions be used?**

   To use the VCC Definitions, parties should incorporate the VCC Definitions into the Confirmation for a transaction. ISDA has published template confirmations for physically settled spot, forward and option transactions (please see Question 6 (*What types of transactions do the VCC Definitions cover*?) below).

3. **What is a VCC?**

   A VCC is a unit with a unique serial number, measured in tCO2e, that represents a reduction, sequestration, removal or avoidance of greenhouse gas (or GHG) emissions from the atmosphere. That reduction, sequestration, removal or avoidance is generated by a project certified by a Carbon Standard. One VCC corresponds to one metric ton of carbon dioxide equivalent reduced, sequestered, removed or avoided.

   There are two main types of VCCs:

   (i) *removal or sequestration credits* - where the certified project absorbed GHG emissions out of the atmosphere. These projects include reforestation and direct air capture initiatives; and

   (ii) *reduction or avoidance credits* - where the certified project prevented the release of GHG emissions into the atmosphere. These projects include renewable energy projects such as installations of solar panels and windfarms.

   VCCs are issued by a Carbon Standard that is responsible for verifying and approving the relevant project, in accordance with its rules. Once issued, they are recorded on a Registry that monitors the issuance, transfer, retirement and cancellation of VCCs, again in accordance with its rules (please see Question 5 (*What are Carbon Standards and Registries and what role do they play in the voluntary carbon market?*) below).

VCCs can be used by market participants to offset their GHG emissions and can be traded on the secondary VCC market. Once a VCC has been used to offset a GHG emission, the VCC is retired and can no longer be circulated in the market.

For more information on the legal nature of VCCs, please see the VCC Whitepaper and supplemental whitepaper.

4. **Why are VCCs described as 'Verified Carbon Credits' rather than 'Voluntary Carbon Credits' in the VCC Definitions?**

The term 'Verified Carbon Credits' rather than 'Voluntary Carbon Credits' was used to reflect a growing preference in the market for the term. This preference reflects the fact that the project generating the relevant reduction, removal, sequestration or avoidance of GHG emissions from the atmosphere must be verified by a Carbon Standard before a VCC is issued (please see Question 3 (*What is a VCC?*) above and Question 5 (*What are Carbon Standards and Registries and what role do they play in the voluntary carbon market?*) below).

5. **What are Carbon Standards and Registries and what role do they play in the voluntary carbon market?**

Carbon Standards are issuing bodies that set the rules that a project must follow in order to be certified. Once a project is assessed and certified by a Carbon Standard, the Carbon Standard will issue to the project developer one VCC for each metric ton of GHG emissions removed, sequestered, reduced or avoided. For a project to generate VCCs, it must typically demonstrate that the GHG removals or reductions are real, measurable, permanent, additional, independently verified, unique and traceable. Projects also need to demonstrate that appropriate safeguards are in place to assess and mitigate any other potential environmental or social risks relating to the project.

Registries are electronic databases that are established by, or operated pursuant to, a Carbon Standard into which VCCs are issued. Each VCC is assigned a unique serial number and the Registry tracks the VCC throughout its life cycle, such as any change in ownership of the VCC following Delivery (please see Question 9 (*How do parties Deliver Required VCCs under the VCC Definitions?*) below) and the Retirement of the VCC (please see Question 10 (*How do parties Retire Required VCCs under the VCC Definitions?*) below).

6. **What types of transactions do the VCC Definitions cover?**

The VCC Definitions can be used for physically settled spot, forward or option transactions and ISDA has published template confirmations for all three types of transaction. While there is a possibility of Retirement (please see Question 10 (*How do parties Retire*

Required VCCs under the VCC Definitions?) below), the VCC Definitions do not contemplate cash settlement.

7. What types of VCCs can be the subject of a transaction incorporating the VCC Definitions?

The VCC Definitions have been designed to support transactions over VCCs across different Carbon Standards and Registries since the VCC Definitions are Carbon Standard and Registry agnostic (please see Question 9 (*How do parties Deliver Required VCCs under the VCC Definitions?*) below).

The VCC Definitions give parties the flexibility to accept as wide or as narrow a pool of VCCs as they wish by specifying in the Confirmation the required attributes for VCCs to be Delivered or Retired (as applicable) under a VCC Transaction. This is known as the Agreed VCC Specification. The Delivering Party can only Deliver or Retire (as applicable) a VCC under the relevant VCC Transaction that meets the Agreed VCC Specification.

To assist parties with defining their Agreed VCC Specification, a non-exhaustive list of definitions for different Carbon Standards, Registries, VCC types, Co-Benefit Programs[3] and Carbon Standard Labels[4] has been included in Section 10 of the VCC Definitions. All of these are examples of attributes that the parties may wish to include in the Agreed VCC Specification (please see Question 15 (*What changes have been made in Version 2.0 of the VCC Definitions?*) below).

Parties will also specify in the Confirmation the number of Required VCCs that must be Delivered or Retired (as applicable) by the Delivering Party.

8. What is the difference between the physical Delivery of VCCs and Retirement of VCCs?

Under the VCC Definitions, the Required VCCs may either be physically Delivered (please see Question 9 (*How do parties Deliver Required VCCs under the VCC Definitions?*) below) or Retired (please see Question 10 (*How do parties Retire Required VCCs under the VCC Definitions?*) below).

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3 A Co-Benefit Program is an environmental standard, program, certification, scheme or protocol that recognizes the positive contributions of the underlying project (other than GHG emission reductions) to the achievement of the Sustainable Development Goals set out by the United Nations in its "2030 Agenda for Sustainable Development" dated 21 October 2015.

4 A Carbon Standard Label is a label or tag applied to a VCC which indicates that the VCC, or the underlying project, has complied with the requirements of a Carbon Standard for a given market or certification scheme (including any Co-Benefit Program).

In the case of physical Delivery, the Delivering Party will transfer the Required VCCs from its Registry Account to the Receiving Party's Registry Account on the Delivery Date.

By contrast, in the case of Retirement, no Required VCCs are transferred to the Receiving Party. Instead, the Delivering Party (who has a Registry Account) will instruct the Registry to Retire the Required VCCs on behalf of the Receiving Party (who may not have a Registry Account).

Regardless of whether the Required VCCs are physically Delivered or Retired, the Receiving Party will pay to the Delivering Party the VCC Purchase Price (in the case of a VCC Forward Transaction or VCC Spot Transaction) or the VCC Strike Price (in the case of a VCC Option Transaction), in each case multiplied by the Number of VCCs. The VCC Purchase Price or the VCC Strike Price are specified in the Confirmation.

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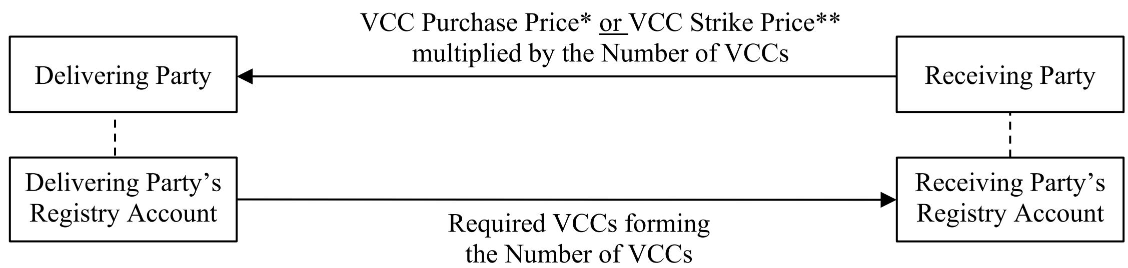
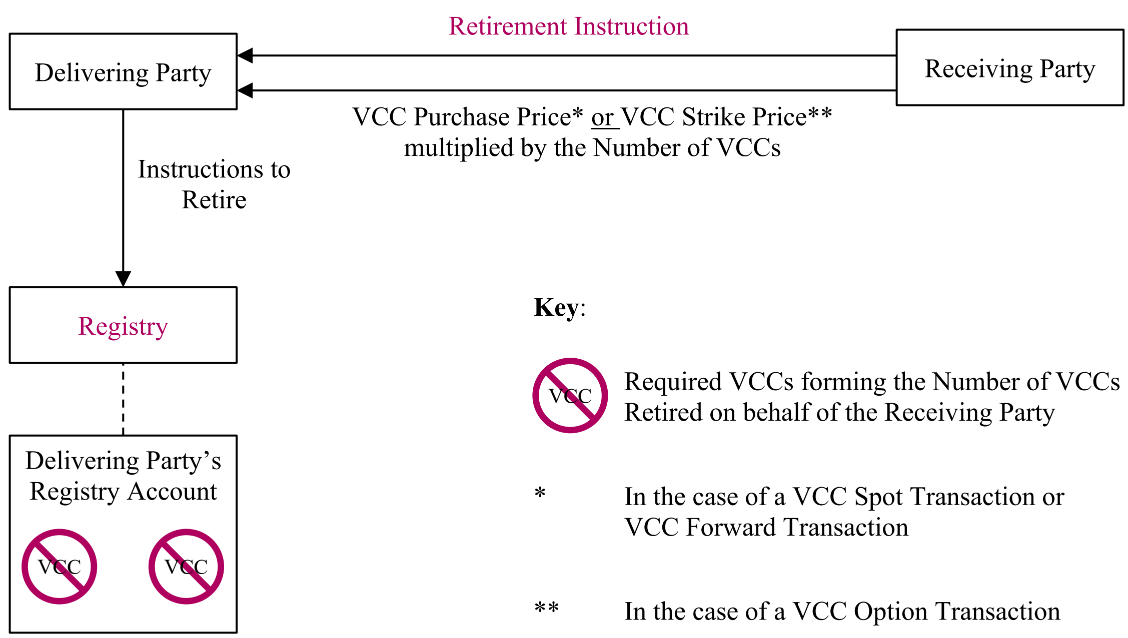
Physical Delivery of Required VCCs *versus* Retirement of Required VCCs

Physical Delivery of VCCs



Retirement of VCCs (**only** if "Retirement" is specified as applicable in the Confirmation)



9. How do parties Deliver Required VCCs under the VCC Definitions?

Required VCCs are Delivered under the VCC Definitions in accordance with the Carbon Standard Rules and Registry Rules applicable to the Required VCCs.

The provisions relating to the Delivery of VCCs in the VCC Definitions have been drafted intentionally broadly to be Carbon Standard and Registry agnostic. Each Carbon Standard and Registry has different rules and requirements relating to transfer, which may change in the future.

Both the Delivering Party and the Receiving Party must therefore comply with the Carbon Standard Rules and Registry Rules relevant to their VCC Transaction. Otherwise, a failure to Deliver or a failure to receive may occur (please see Question 13 (*What are the disruption events under the VCC Definitions?*) below).

10. How do parties Retire Required VCCs under the VCC Definitions?

Retirement can be elected if the Receiving Party wishes to purchase the Required VCCs to immediately offset its GHG emissions rather than to hold or onsell them.

The following steps need to be taken:

(i) The parties must specify "Retirement" as applicable in the Confirmation.

(ii) The Receiving Party must give a Retirement Instruction (a form of which is appended to the VCC Definitions) to the Delivering Party specifying the Number of VCCs to be Retired and any other information required by the Registry. It can be given in respect of some or all of the Required VCCs.

(iii) If a Retirement Instruction is effective on or prior to the Retirement Cut-Off Time, the Delivering Party will:

(a) confirm receipt of the Retirement Instruction;

(b) hold, as of the Delivery Date, the Required VCCs to be Retired for the benefit of the Receiving Party and to the Receiving Party's order; and

(c) instruct the Registry to irrevocably Retire, and to record in the name of the Receiving Party as Retired, the Required VCCs forming the relevant Number of VCCs to be Retired.

Once Retired, all rights to the Required VCCs are extinguished and the Required VCCs are no longer transferrable.

The default position is that the Retirement Cut-off Time will be 4pm in the Delivering Party's Location on:

(i) in respect of a VCC Spot Transaction, the Trade Date,

(ii) in respect of a VCC Forward Transaction, the Business Day falling 10 Business Days prior to the Delivery Date, or

(iii) in respect of a VCC Option Transaction, the Exercise Date.

This position can be changed in the Confirmation.

If the Retirement Instruction is not effective, the VCCs must be physically Delivered by the Delivering Party to the Receiving Party (please see Question 9 (*How do parties Deliver Required VCCs under the VCC Definitions?*) above) rather than Retired.

11. Are any additional representations required to be given under the VCC Definitions?

Yes, there are additional VCC specific representations in:

(i) Section 3 of the VCC Definitions, which apply to VCC Transactions to be settled by physical Delivery <u>or</u> Retirement; and

(ii) Section 4 of the VCC Definitions, which <u>only</u> apply to VCC Transactions to be settled by Retirement.

Both parties must represent that they have satisfied the relevant Carbon Standard Rules and the Registry Rules.

The other additional representations are only made by the Delivering Party. They include representations regarding the ownership by the Delivering Party of each Required VCC Delivered (or Retired, as applicable), and the compliance of each Required VCC Delivered (or Retired, as applicable) with the Agreed VCC Specification. Parties can elect in the Confirmation to either disapply some or all of the representations or qualify them such that the representations are only made to the best of the knowledge and belief of the Delivering Party.

Further additional representations from the Delivering Party are required in the context of Retirement.

12. What is "VCC Netting"?

If "VCC Netting" is specified as applicable, if VCCs of the same Agreed VCC Specification (please see Question 7 (*What types of VCCs can be the subject of a* *transaction incorporating the VCC Definitions?*) above) are deliverable by each party on the same date and between the same pair of Registry Accounts then each party's Delivery obligation is discharged and, if applicable, replaced by an obligation on the party responsible for delivering the greater number of those VVCs to deliver the net number.

This application of VCC netting is separate, and in addition, to the usual payment netting under Section 2(c) of the ISDA Master Agreement, which will continue to apply in respect of the payment obligations between the parties.

13. What are the disruption events under the VCC Definitions?

There are three disruption events to address VCC specific issues that may occur.

These disruption events relate to the occurrence of a:

(i) VCC Settlement Disruption Event;

(ii) failure to Deliver; and

(iii) failure to receive.

A. What is a VCC Settlement Disruption Event?

A VCC Settlement Disruption Event is similar to a Force Majeure Event under the ISDA 2002 Master Agreement. It is an event or circumstance:

(i) beyond the control of the SD Affected Party;

(ii) that the SD Affected Party, using all reasonable efforts, cannot overcome; and

(iii) which makes it impossible or impracticable for the SD Affected Party to Deliver, Retire or receive (as applicable) VCCs under the relevant VCC Transaction.

For example, a VCC Settlement Disruption Event may occur if an issue at the Registry prevents the Delivering Party from Delivering the Required VCCs on the Delivery Date.

Upon the occurrence of a VCC Settlement Disruption Event:

(i) each party shall, promptly upon becoming aware of it, notify the other party in writing of the occurrence of the VCC Settlement Disruption Event;

(ii) the SD Affected Party shall use all reasonable effort to overcome the VCC Settlement Disruption Event; and

(iii) the Delivery (or Retirement, if applicable) and payment (unless payment has already been made) obligations of the parties under the VCC Transaction will be deferred until the VCC Settlement Disruption Event ceases to exist.

If the VCC Settlement Disruption Event ceases to exist:

(a) subject to (b) below, the Delivery Date shall be deemed to be the date falling no later than five Delivery Business Days later and (unless payment has already been made) the Payment Date shall be deemed to fall two Currency Business Days after such Delivery Date; or

(b) if "Prepayment" applies (please see Question 15 (*What changes have been made in Version 2.0 of the VCC Definitions?*) below) and payment has not been made before the occurrence of the VCC Settlement Disruption Event, the Payment Date shall be deemed to be the date falling no later than five Currency Business Days later and the Delivery Date shall be deemed to fall two Delivery Business Days after such Payment Date.

If the VCC Settlement Disruption Event continues to exist on the SD Longstop Date (the default position being 30 days following the occurrence of the VCC Settlement Disruption Event), an Additional Termination Event (under the 1992 ISDA Master Agreement) or an Illegality (under the ISDA 2002 Master Agreement) is deemed to have occurred.

B. What is a failure to Deliver?

A failure to Deliver occurs when the Delivering Party fails to transfer the Required VCCs to the Receiving Party's Registry Account on the Delivery Date. If the Receiving Party notifies the Delivering Party of a failure to Deliver, the Delivering Party has two Delivery Business Days (unless another period is specified in the Confirmation) to remedy the failure.

If the failure to Deliver is remedied (and payment has not already been made), the Receiving Party will make the relevant payment to the Delivering Party.

If the failure to Deliver is not remedied, the Receiving Party may by written notice to the Delivering Party:

(i) terminate the VCC Transaction; and

(ii) notify the Delivering Party of the Receiving Party's Early Termination Value.

The Receiving Party's Early Termination Value is calculated by reference to the price payable for a Comparable VCC in the market. The assessment as to what constitutes a Comparable VCC will be driven by the specifications agreed by the parties at the outset of the VCC Transaction.

The Receiving Party's Early Termination Value can be an amount payable by either party unless the parties have agreed to apply "One-way RP ETV" in the Confirmation. If this election is specified as applicable, the Receiving Party's Early Termination Value will only be payable if it is a positive number meaning it can only be payable by the Delivering Party. However, before applying "One-way RP ETV", parties should consider the impact a one-way payment may have on the netting and regulatory capital treatment.

C. What is a failure to receive?

A failure to receive occurs when the Delivering Party is unable to Deliver the Required VCCs due to a failure by the Receiving Party to take the steps required to enable the Delivering Party to Deliver, and the Receiving Party to receive, the Required VCCs. These steps may vary across Registries. For example, it may be that the Receiving Party is required to notify the Registry of its consent to receive VCCs from the Delivering Party's Registry Account.

The consequences of a failure to receive are similar to the consequences of a failure to Deliver set out in Question 13B (*What is a failure to Deliver?*) above. The Receiving Party is given an opportunity to remedy the breach and if it fails to do so, a Delivering Party's Early Termination Value is payable.

D. What happens if a Delivering Party fails to Retire?

Although both a failure to Deliver and a failure to receive are VCC Disruption Events rather than Events of Default, a failure by the Delivering Party to Retire Required VCCs in accordance with the VCC Definitions will be an Event of Default under the ISDA Master Agreement.

14. When do the Confidentiality provisions in Section 8 of the VCC Definitions apply?

Parties can elect in the Confirmation whether to apply the Confidentiality provisions in Section 8 of the VCC Definitions to the relevant VCC Transaction.

If Section 8 is applicable, parties will not be able to disclose or use any information obtained as a result of entering into a VCC Transaction which relates to (i) the existence, the provisions of, or any negotiations relating to, the relevant VCC Transaction, or (ii) the business, financial or other affairs of the other party. However, disclosure is permitted in certain circumstances, such as the disclosure being required by law, the information becoming publicly available or the other party giving written consent.

15. What changes have been made in Version 2.0 of the VCC Definitions?

Version 2.0 allows parties to specify a fixed Payment Date (rather than payment occurring a certain number of days after Delivery) and, in respect of a VCC Spot Transaction or VCC Forward Transaction, to apply "Prepayment" so that payment will take place before Delivery. The default position was also updated so that, unless otherwise specified in the Confirmation, payment must occur two (instead of five) Currency Business Days after Delivery of the VCCs.

Version 2.0 also expanded the non-exhaustive list of definitions in Section 10 of the VCC Definitions to include labels relating to the Core Carbon Principles ("**CCPs**") published in 2023 by the Integrity Council for the Voluntary Carbon Market, making it easier for parties to reference CCP characteristics.

16. How can parties access the VCC Definitions?

The VCC Definitions are natively digital. This means they are published exclusively in digital format via ISDA's interactive web-based user interface, MyLibrary, which is accessible on both mobile devices and desktop computers. The template confirmations can also be accessed on MyLibrary.

The MyLibrary platform allows parties to view different versions of the VCC Definitions in blackline, search within the VCC Definitions and easily access definitions of defined terms by clicking on a hyperlink.

17. How can the VCC Definitions be updated, and which version will apply to a VCC Transaction?

If an update to the VCC Definitions is required, a new consolidated version of the VCC Definitions will be published digitally on MyLibrary, such as with the publication of Version 2.0. Parties can access the latest version of the VCC Definitions at any time, view earlier versions and compare versions to see what changes have been made.

When the VCC Definitions are incorporated into a Confirmation, the most recent version of the VCC Definitions as at the Trade Date (unless otherwise agreed by the parties) will apply.

18. Do parties need to incorporate the 2005 ISDA Commodity Definitions and the VCC Definitions?

No, the VCC Definitions have been designed to operate as a standalone definitional booklet for the purposes of VCC Transactions (please see Question 6 (*What types of transactions do the VCC Definitions cover*?) above).