

Investment Funds and Carbon Credits

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On October 31, 2021 the 26th UN Climate Change Conference (COP26) kicked off in Glasgow, Scotland. The event brings together the countries that signed the 2015 Paris Agreement to discuss actions for development and preservation of the environment, and for reduction of emissions of gases that cause the greenhouse effect and global warming.

With the environmental issues at the center of the international debates, and governments and businesses assuming commitments to preserve forests and reduce emission of gases into the atmosphere, carbon credits have been attracting increasing attention from investors as well.

Carbon credits are internationally-recognized digital assets generated by not emitting carbon into the atmosphere. More properly, each metric ton of carbon dioxide (CO₂) that is not emitted can be represented by a "certified emissions reduction" (CER), and CERs can be sold between companies or traded on stock markets.

Since some countries and companies have emissions reduction or compensation targets, investing in these credits has also become a business, with the prospect of attractive returns, given the growing demand for decarbonization of the global economy. Direct investment, however, is not accessible to ordinary investors, and one alternative is collective, professionalized investment, through investment funds.

Discussion over the possible ways to invest in the carbon market is not recent in Brazil. The matter was first raised before Brazil's securities and exchange commission, the CVM (*Comissão de Valores Mobiliários*) long before the Paris Agreement was made (CVM Proceeding RJ 2009/6346). The dispute in that case turned essentially on whether CERs were securities and whether they could be acquired by funds in Brazil. The CVM's Commissioners found, in a decision dated July 7, 2009, that carbon credits were "mere assets that may be traded to achieve carbon emissions reduction targets or for investment purposes" but that they were not securities. The CVM made it clear, however, that CERs could be considered "financial assets" for the purposes of CVM Instruction 409/2004 (which has since been replaced by CVM Instruction 555/2015) and thus could be part of investment fund portfolios in Brazil, although the investment must comply with the requirements for investment in foreign assets, given that CERs are issued outside Brazil. The CVM also considered the possibility of local funds acquiring not CERs themselves but derivative instruments traded in Brazil or in other countries.

Despite this theoretical discussion, for many years Brazil saw no more than a few funds investing in shares or other securities issued by companies committed to sustainability and emissions reduction, and, in 2012, the launch of an exchange-traded fund on B3, Brazil's stock exchange, which tracks B3's "Efficient Carbon Index", ICO₂ (Índice Carbono Eficiente), created in 2010.

But 2021, the year of COP26, may mark the beginning of a new era of carbon

funds in Brazil: in this year alone three managers began to offer multimarket funds to the public, including retail clients (i.e. not limited to "qualified" or "professional" investors), which invest in carbon credit futures in Europe and/or the United States, with or without exchange rate hedges, depending on the fund's regulations.

Since they are open to the public in general, only 20% of these funds' net assets may be invested outside Brazil. The percentage increases to 40% if the funds are directed to qualified investors, and 100%, in the case of professional investors. To keep the main focus on carbon credits, the portfolio managers have been investing the remaining resources of the funds in fixed-income products in Brazil.

This year also saw registration of the first private equity fund (FIP) that invests in a Brazilian company that buys and sells carbon credits. In its initial offering, the fund attracted 91 investors, according to information provided to the CVM.

With the growth of the ESG agenda and the need to transition globally to a low-carbon economy, the COP26 discussions will certainly boost Brazilian investment funds' interest in the carbon credit market.

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