As the global effort to combat climate change gains momentum, the establishment of a reliable carbon market has become increasingly important to achieving net-zero greenhouse-gas (GHG) emissions. While Malaysia is committed to reducing emissions to net-zero by 2050, there is no stringent legal framework for carbon trading in the country to support such a target.

Despite this regulatory gap, Malaysia is well-positioned to be a potentially ideal hub for carbon-related initiatives since it has a dual advantage: a demand for carbon offsets, primarily from its industrial and petrochemical sectors, and the capacity to supply these offsets due to its abundant natural resources. In fact, Malaysia has the potential to generate carbon credits by up to 40 million tons of CO2 every year through Nature-based solutions (NBS) projects.[1] Nonetheless, despite its potential, without the necessary legal and regulatory framework, realizing a net-zero emissions target by 2050 remains a tough call.

Existing Regulatory Framework for Carbon Trading

At the federal level, there is currently no specific carbon trading law in place. While there are limited reporting and disclosure requirements for specific entities, such as listed companies and financial institutions, they primarily focus on sustainability reporting rather than carbon trading specifically.

For listed entities in Malaysia, Bursa Malaysia has implemented enhanced sustainability reporting requirements in the Main Market Listing Requirements and the ACE Market Listing Requirements, which include the disclosure of a sustainability statement covering aspects like governance and strategies. Additionally, financial institutions are expected to follow the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations, with mandatory disclosure based on TCFD recommendations starting in 2024.

The TCFD framework focuses on providing effective financial disclosures related to climate, encompassing governance, strategy, risk management, and metrics and targets.

Regulated carbon trading activities are primarily observed within the Bursa Carbon Exchange (BCX). While the BCX Rules provide clear guidelines and standards for carbon trading transactions within the exchange, they only govern the operational aspects of the exchange and is only applicable to its participants (i.e., operators, traders, suppliers, brokers). It definitely does not fulfil the broader governance framework required to cater to the carbon market players as a whole.

Key Governance Aspects in the Legislative and Regulatory Framework for Carbon Trading

A well-functioning carbon market relies heavily on having a clear, consistent, and credible legislative and regulatory framework in place. This framework should cover several key aspects that require governance as follows :

i. registration and licensing of businesses involved in carbon trading;

ii. standardized carbon accounting procedures;

iii. reporting obligations for greenhouse gas (GHG) emissions;

iv. establishment of a national carbon registry to record and monitor carbon credits;

v. implementation of carbon taxes; and

vi. enforcement mechanisms to ensure transparency and accountability.

(a) Registration and licensing of businesses involved in carbon trading

The first step in regulating the carbon marketplace involves the mandatory application to obtain a license prior to engaging in any carbon trading activities.

This step is crucial for the oversight, management, and regulation of carbon-related activities within a designated environmental zone. Obtaining a license also ensures compliance with reporting and monitoring obligations, ensuring accurate recording and disclosure of environmental and carbon-related information, thus promoting transparency and accountability.

(b) Standardized carbon accounting procedures

Carbon accounting is crucial for measuring the impact of greenhouse gas emissions as it provides a structured way to measure these emissions, helping set targets to control and reduce them. Similar to financial accounting, which tracks cash flow, carbon accounting tracks emissions and holds entities accountable. Different carbon accounting frameworks are used globally, depending on their purpose. Countries follow guidelines from the Intergovernmental Panel on Climate Change (IPCC) for national-level emissions reporting. [2] However, these guidelines may not be suitable at an entity-level to measure emissions accurately. Therefore, entities often use alternative frameworks such as the Greenhouse Gas Protocol, EPA GHG Inventory Guidance, Climate Registry General Reporting Protocol, or ISO Standard 14064 to measure their own emissions.[3]

To ensure consistency and accuracy across industries, there is a growing need for a standardized carbon accounting framework at the federal level to be integrated into the legislative/regulatory framework.

(c) Reporting obligations for greenhouse gas (GHG) emissions

Carbon credits are typically generated through projects that directly reduce or offset GHG emissions. The most crucial factor for buyers before purchasing carbon credits is having a reliable monitoring, reporting, and verification (MRV) framework to ensure that the credits they purchase provide measurable benefits. To generate carbon credits, emission reduction projects must demonstrate how much GHG emissions they have reduced or avoided. Thus, the relevant regulatory and reporting systems and infrastructure need to be in place to support credible GHG reporting by entities.

Similar reporting systems and infrastructure have already been established by our neighbouring countries. In Singapore, registered corporations are obligated to annually compile and submit an Emissions Report for each facility covered by their Carbon Pricing Act 2018. This submission process is conducted through the Emissions Data Monitoring and Analysis system. Meanwhile, in the Philippines, efforts are being made to institutionalize the GHG inventory management and reporting system. The Philippine GHG Inventory and Reporting Protocol Manual for Business offers guidance to companies and enterprises on the accounting and reporting of greenhouse gas emissions at the organizational level.[4]

(d) Establishment of a national carbon registry to record and monitor carbon credits.

In the context of VCM, the prevailing issues of transparency and accountability have necessitated the establishment of a National Carbon Registry.[5] This online database operates in accordance with both national and international standards for quantifying and validating greenhouse gas emissions reduction projects. It comprehensively covers key aspects such as the issuance, ownership, transfer, acquisition, cancellation, and retirement of emission reduction credits.

Through the registry, information on the carbon credits is made publicly accessible, and companies intending to purchase them can verify their legitimacy, enabling them to make informed decisions and eliminate the risk of purchasing fraudulent credits.

(e) Implementation of carbon taxes.

Carbon pricing, in essence, involves assigning an economic value or cost to carbon emissions. A straightforward approach to instituting carbon pricing is by introducing a tax based on the amount of carbon dioxide equivalent (tCO2e) emitted per tonne. For example, Singapore imposes a uniform tax on all entities, irrespective of their industry sectors, emitting 25,000 tCO2e or more annually. Domestically, the impact of carbon pricing will primarily affect industries characterized by a substantial carbon footprint or those with high energy consumption.[6] The main goal of the carbon tax is to create a financial incentive for businesses and industries to reduce their carbon emissions. By increasing the cost of

carbon-intensive activities, the tax encourages the adoption of cleaner energy sources, energy efficiency measures, and the reduction of overall carbon emissions.

(f) Enforcement mechanisms to ensure transparency and accountability.

Strict enforcement of the carbon marketplace is required to ensure confidence in the market. This can be achieved by making contravention of regulations punishable offenses. By holding carbon market participants accountable for their actions, ensuring transparency, and deterring misconduct, strict enforcement helps build trust among stakeholders, encourages investment in emission reduction projects, and ultimately contributes to the effectiveness of carbon trading in addressing climate change challenges.

Sarawak's Carbon Trading Framework and Governance

Sarawak has taken a pioneering step in Malaysia by enacting legislation that allows for nature-based solutions, such as forest carbon activities and carbon projects, as well as the repurposing of abandoned oil wells for carbon storage, ultimately leading to the generation of carbon credits for trading. This commitment was realized through the passing of the Forests (Amendment) Bill, 2022, and the Land Code (Amendment) Bill, 2022.

These legislative amendments empower the Sarawak Government to regulate forest carbon activities by issuing forest carbon licenses and overseeing land usage for carbon storage through the issuance of licenses for carbon storage. Detailed procedures and requirements for obtaining these licenses are provided for in subsidiary legislation, namely the Land (Carbon Storage) Rules, 2022, and Forest (Forest Carbon Activity) Rules, 2022, which received approval from the Majlis Mesyuarat Kerajaan Negeri on 8th December 2022. Upon reviewing the above rules, it is evident that the key governance aspects essential for a thriving carbon trading marketplace have been covered, and now it is only a matter of cascading the groundwork laid in Sarawak to the other states in Malaysia and coordinating it at a national level.

Conclusion

Stakeholders, including shareholders, investors, and financial institutions, have long awaited for a dependable and commercially viable carbon marketplace. Recent news of the proposed implementation of the National Carbon Policy ("**NPC**") later this year is a positive sign of Malaysia's commitment to addressing this need. The NPC is set to provide guidance for carbon trading at the state level, and the Malaysia Climate Change Action Council is spearheading these efforts. Active discussions with state governments are underway, recognizing their pivotal role in land use for carbon storage. Although we may be a step behind other countries, the NPC is seen as an important step moving forward and once in place, is seen as an important step moving forward.

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