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# BRAZIL'S NEW CARBON LAW AND FORESTS

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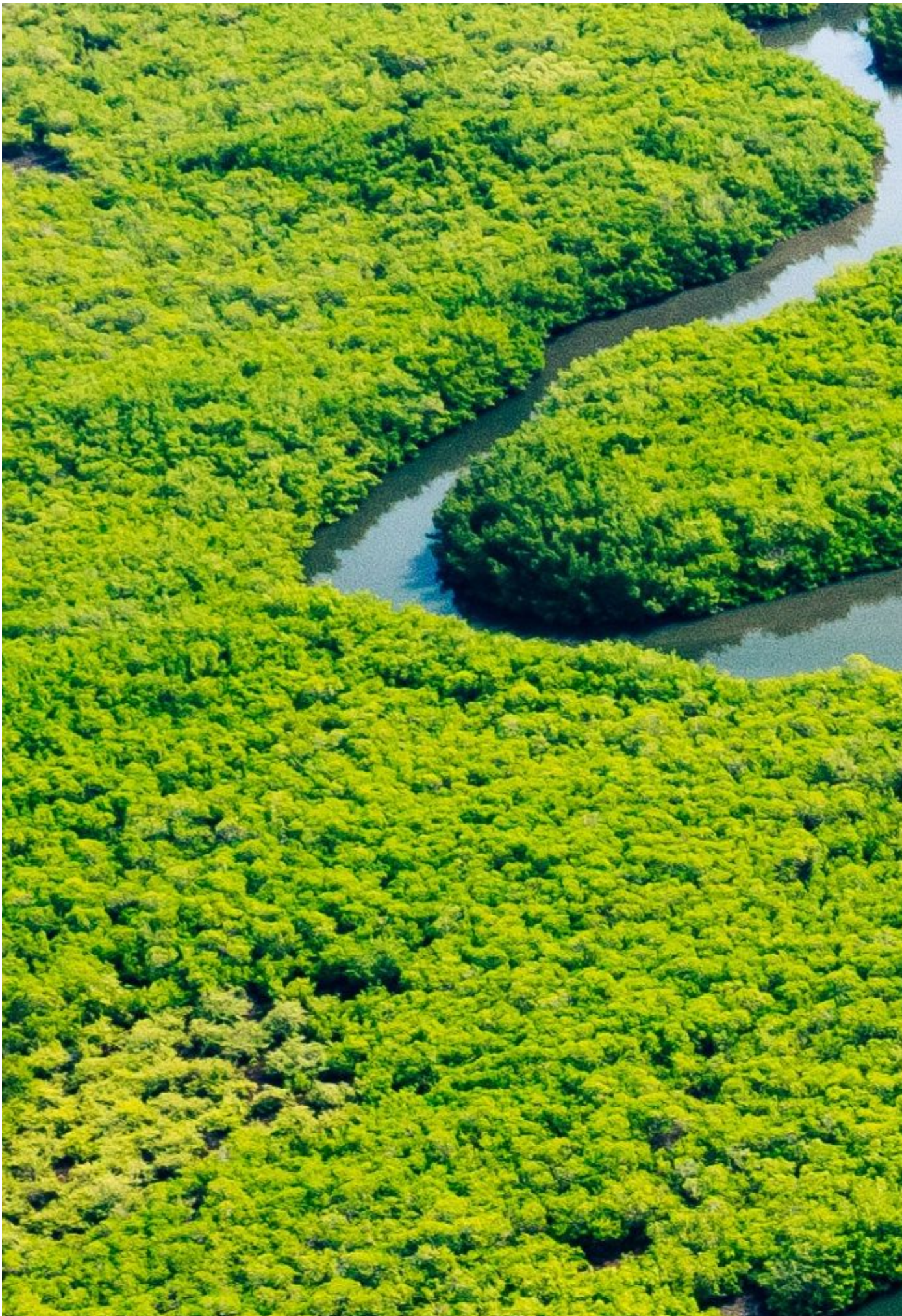

On December 12, 2024, Law 15.042 was signed by Brazilian President Luiz Inácio Lula da Silva, establishing the Brazilian Greenhouse Gas Emissions Trading System (SBCE). But what does this mean?

In short, the law is an essential step toward decarbonizing the Brazilian economy. However, it will take many years to implement and the legislation poses risks for the most important mechanism for attracting climate finance in the coming years: Jurisdictional REDD+ (JREDD+) programs. The regulatory process will be crucial to mitigate this risk.

The SBCE will be a national carbon market in the form of a "Cap & Trade" system inspired by international systems such as the EU ETS (European Union Emissions Trading System) and California's Cap & Trade Program. In this system, the targets for reducing greenhouse gas emissions will be linked to a maximum limit - the "cap" - for each regulated sector for a commitment period, following an Allocation Plan. This cap will be reduced at each new period, contributing to the decarbonization of the Brazilian economy.

The reduction targets per sector will be converted into emission quotas (allowances), which will have to be reconciled by the entities in these regulated sectors with their emissions equivalent in quotas. It will also be possible to compensate emissions with carbon credits through an "offset" mechanism subject to criteria and limits that have yet to be defined. As in other systems, participation in the SBCE will be mandatory for entities emitting above a certain level. In the case of SBCE, the initial limit will be 25,000 $tCO_2e$ per year.

The implementation of the SBCE will be gradual, and it will take several years to operationalize it fully. The SBCE law establishes two years for its regulation period, then three years for methodological definition and emissions reporting. After that,

there will be a phase with no deadline defined, in which all quotas will be distributed free of charge, resulting in few allowance transactions and low demand for carbon credits. If this experimental phase lasts two years, the SBCE will begin to generate carbon pricing incentives for emissions after a process totaling at least seven years.

The scope of the SBCE covers all sectors of the economy except agriculture and forestry, which account for around 70% of Brazil's national emissions. Governance of the SBCE will be overseen by the Interministerial Committee on Climate Change (CIM), with the participation of regulated entities through a Permanent Technical Advisory Committee and a Regulatory Affairs Chamber.

The law lacks specific targets for emission reductions for the capped sectors and fails to delineate how the mandatory minimum reduction levels will be apportioned across sectors. It omits crucial details such as the duration of each commitment period and other essential guidelines for implementing the SBCE effectively. These critical definitions will be finalized through the regulatory process over the next year or two.

This new legal framework also regulates the supply of carbon credits to other markets. It defines the legal nature of carbon credits and their administration in the financial market and other regulatory issues related to generating and trading these credits, including delegating the authorization of ITMOs (Internationally Transferable Mitigation Outcomes) to the SBCE managing body. ITMOs will be traded between countries under Article 6 of the Paris Agreement on climate change. Since these rules also affect the voluntary and international carbon markets, there is great concern that excessive or vague regulation could generate more uncertainty than legal certainty.

The text of the law also places great emphasis on regulating the supply of Jurisdictional REDD+ (JREDD+) credits for both the

SBCE and other carbon markets. However, unfounded fears among the agricultural sector and carbon project developers that public JREDD+ programs could impede the development of private REDD+ projects have led to the inclusion of several limitations/barriers to JREDD+.

These barriers include the requirement that rural landowners may opt out of JREDD+ programs, the prohibition of selling credits from these landowners within the scope of JREDD+ marketing, and the criteria for sharing benefits with rural properties. This resistance reflects, in part, excessive concern due to the lack of understanding about the differences between private REDD+ projects and JREDD+ programs, especially concerning additionality and benefit-sharing criteria. JREDD+ programs and forest carbon projects can coexist without the risk of double counting their credits. Perhaps behind this controversy, there are also concerns about the competition of JREDD+ in the voluntary market, where a recent depreciation of private carbon credits related to conservation has been observed.

However, the volume of resources flowing to finance sustainable practices in agriculture and the number of beneficiaries could be significantly higher in JREDD+ programs compared to private REDD+ carbon projects.

As with the implementation of the SBCE, the regulatory process of the law will also be essential to increase understanding of these issues related to REDD+. JREDD+ programs are crucial to achieving national goals for controlling and reducing emissions from deforestation and forest degradation.

Thus, the regulatory process of the new law will face the challenge of creating a regulatory environment with legal certainty and low transaction costs, which allows the coexistence of different forms of carbon credit generation. This environment must emphasize rules that guarantee and prioritize climate, environmental, and social integrity in generating carbon

credits from these mitigation actions.