

# ValoreCO2 comments on Public Consultation: Verra's Approach to Third-Party Crypto Instruments and Tokens

## ABSTRACT

ValoreCO2 is an Italian company founded in 2021 to promote the sustainable development of industries by supporting companies to use carbon credits to promote decarbonisation. ValoreCO2 believes that using tokens associated with carbon credits can simplify and make the VCU market more accessible. Over the last few years, ValoreCO2, the law firm Act Legal Us Avvocati and the innovative SME Apio have been working on a platform suitable for managing tokens derived from Carbon Credits using Blockchain technology.

The absence of standard tokenisation procedures within the registries forced the working team (ValoreCO2, Act Legal Us and Apio) to study strategies of immobilisation or transfer to accounts involving contracts between the owner of the Carbon Credits and ValoreCO2 (the company that offers the tokenisation service). Therefore seeing the Verra's public consultations and our experience on these issues, we believe that creating standard tokenisation procedures is a crucial step to implementing a valuable link between blockchain platforms and VCUs registries. The standard implementation can open up a market that can disintermediate the tokenisation business by making the process secure and verifiable, opening up new business models in several industries (and beyond).

ValoreCO2 is an innovative company, part of a strong industrial Group with background in sustainable products alternative to the mineral oil based, founded in 2021 with the mission to create value by promoting CO2 savings industrial programs, based on certified Carbon Footprint and Verified Emission Reduction (VER) projects to be written on public registers to generate carbon credits. By using a proprietary platform based on blockchain, Valore CO2 will issue tokens backed by Carbon Credits (1VACO2 = 1ton of CO2 saved or not emitted).

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Act Legal Us Avvocati is a boutique law firm based in Milan, member of the Act Legal alliance that includes law firms from nine different countries in Europe, act Legal Us Avvocati offers to its clients a unique multidisciplinary and cross-country approach. The firm's practice areas range from M&A to litigation, from real estate to banking and finance, from employment to data protection, IT, new technologies, privacy and compliance issues. For these reasons, Act Legal-US is driving the legal strategy for ValoreCO2.

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Apio is an Innovative SME that wants to become one of the top European Innovators in providing technology for a transparent energy transition. Apio's outstanding know-how on Blockchain technologies is confirmed by patents and scientific articles. For these reasons, Apio is driving the technical strategy for ValoreCO2.

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## MEASURES TO ASSOCIATE VCUS WITH CRYPTO INSTRUMENTS OR TOKENS

Service Providers that want to provide tokenisation services for their users must be registered as Blockchain Service Providers (BSP) and authorised by Verra. During the registration process, the BSP must present to Verra an “agreed-upon procedures” (APU) that detail how to verify that the BSP is operating correctly and there are no issues (double issuance or double use). The APU must detail at least the following:

- Blockchain Used: It is crucial that the Blockchain is eco-friendly and that don't have a substantial environmental impact. For example, it follows eco-friendly blockchains like Polygon or Celo. We also suggest accepting EVM-compatible blockchain initially because there is some standard Smart Contract that can be used (See for example NFT, ERC-20 token or Multi-Token);
- Smart Contract Address: The BSP must communicate the Smart Contract address to avoid confusion regarding smart contracts accepted by VERRA;
- Smart Contract functions (ABI): The smart contract should implement the functionalities described below (Rules for issuance and burn). Given the importance of the matching project, vintage period and carbon credits, we suggest the implementation of ERC-1155 tokens;

### Rules for issuance and burn

To issue and burn tokens, the BSP must implement (in the Smart Contract) a two-factor procedure. More specifically, when issuing:

- Users registered in Verra require tokenisation for a batch of carbon credit, using one of the BSP (users must indicate the wallet where the token must be accredited);
- The BSP then create the representation of the request in Blockchain (for example, token mint) and forward the transaction to Verra;
- If Verra confirms the BSP transfer unlock the token.
- Tokenised VCUs must be blocked in a frozen sub-accounts owned by the BSP.

When burning:

- Users require Offset through a function in Smart Contract;
- The BSP send the request to Verra;
- If Verra confirms the BSP burn the token and receive the retirement certification and send it to Users.

If a User that uses the services of the BSP wants to burn a token and receive back carbon credit, the user that made the request must have an account on Verra and provide BSP information on that.

## Infrastructure and processes from VERRA

We suggest a process to verify BSP and then implement procedures, in the registry, for freeze carbon credit and mint tokens. The mint process will be made by the BSP (as aforementioned) but verified by VERRA. Using Verra Registry, we can suppose that the best way is to implement another Account type (Frozen or something similar); this Account can be used according to the aforementioned procedures.

## Operational implications of fractionalized token

One of the most exciting parts of Blockchain Technologies is the possibility of mixing different protocols and smart contracts to create something new. Fractionalizing a Ton of Carbon Credits in fully fungible ERC20 tokens is one of these disruptions.

In our humble opinion, Verra must check and consider the integrity of three functionalities that need the implication of the registry:

- Issuance (From Carbon Credits to Token):
  - Users registered on VERRA must have Carbon Credits in an Active Account (Primary or Sub-Accounts);
  - Users in VERRA must use the registry to start the tokenisation process with one of the Authorized BSPs;
  - Users then use the BSPs service to redeem the token;
  - When Verra confirms the operation the tokens are transferred from the BSP to the User's wallet.
- De-Tokenisation (From Token to Carbon Credits):
  - User that have token and want to receive Carbon Credit must be registered on VERRA and have an Active Account;
  - User through the BSP platform ask to start a de-tokenisation process. Tokens (at least one VCUs) are transferred from the user's wallet to the Smart-Contract;
  - BSP forwards the request to VERRA through an API;
  - When Verra confirms the BSP burn token and Verra give the frozen Carbon Credit to the User.
- Retirement (From Token to Carbon Credits Offset):

- User through the BSP platform ask to start the Offset process. Tokens (at least one VCU) are transferred from the user's wallet to the Smart-Contract;
- The BSP forwards the request to Verra;
- When Verra confirms the BSPs burn the token and transfer the Offset Certification (or number) to the User that made the original request.

If the BSP respects these functionalities and those are coordinated with the registry correctly, new business models on crypto may leave the registry's authority.

## KNOW-YOUR-CLIENT REQUIREMENTS

From a technical point of view the Know Your Client requirements must apply for the BSPs and for the Users that require Tokenisation and De-Tokenisation process.

As the European Parliament recognised in a recent motion for a resolution of 4 April 2022 (20121/2201 - INI), crypto-assets are becoming increasingly important in international finance, forcing tax administrations to adapt current tax practices to new challenges and needs.

The EU Commission in July 2021 presented a package of legislative proposals to strengthen the EU rules on anti-money laundering and countering the financing of terrorism (AML/CFT). Furthermore, on 14 March 2022, the European Parliament's Committee on Economic and Monetary Affairs (ECON) adopted its negotiating position on the text of the proposed MiCA (Market in Crypto Assets) Regulation on crypto assets with the aim to provide a Europe-wide regulation of cryptocurrency activities.

With reference to the first proposal, on anti-money laundering regulation, a provisional agreement was reached on 29 June 2022 between the Council and the Parliament, with the stated aim of extending the anti-money laundering rules to cryptocurrency transfers.

Specifically, the aim is to ensure financial transparency on crypto-asset exchanges and to provide the EU with a framework in line with the highest international standards in the field.

Although NFTs were excluded from the proposed regulation MiCA, the provisional agreement stipulated that within 18 months, the European Commission will be tasked with preparing a comprehensive assessment and, if it deems it necessary, a specific, proportionate and horizontal legislative proposal to create a regime for NFTs.

Until a more specific regulation is adopted and even if NFTs are excluded from the MiCA Regulation, in the EU the trend is in the direction that BSP platforms adopt KYC procedures inspired by those provided by the Anti Money Laundering Directives.

In this regard, the Fifth Anti-Money Laundering Directive - Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and amending Directives 2009/138/EC and 2013/36/EU - extended the AML due diligence obligations on service providers relating to the use of virtual currency, also stipulating that member states must provide for a special registration procedure for exchange and e-wallet providers.

In Italy, implementing EU Directive 843/2018 on Anti-Money Laundering and Know Your Customer measures, would have included in the definition of "virtual currency" also digital representations of value not used as means of exchange, but held for investment purposes,

provided that they are transferred, stored and exchanged electronically, therefore, also NFTs.

In light of the above, Verra should consider to carry out KYC checks as much possible in line with the above mentioned AML regulation on BSP platforms before authorising them to issue, market, and/or transact in crypto instruments or tokens that are backed by VCUs. Verra could also check whether the platforms have proportionately and consistently taken appropriate and adequate KYC measures to deal with the associated money laundering and terrorist financing risk of their customers that receive, use, or are the beneficiaries of such instruments that and also of those that hold crypto instruments or tokens.

The checks mentioned above shall also be made in compliance with GDPR and privacy regulations.

## AMENDMENTS TO THE REGISTRY TERMS OF USE RELATING TO ANTIFRAUD

*What textual amendments are advisable to address anti-fraud considerations related to the association of third-party crypto instruments and tokens with VCUs?*

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