



PUBLIC CONSULTATION ON THIRD-PARTY CRYPTO INSTRUMENTS AND TOKENS

3 August 2022

1. INTRODUCTION

This document relates to Verra's public consultation on third-party crypto instruments and tokens. The consultation opens on the date of this document (Wednesday, 3 August 2022) and runs for 60 calendar days until Sunday, 2 October 2022, at 11:59 pm Eastern time.

For the purposes of this document, crypto instruments and tokens are considered together on the basis that these types of instruments exist as entries recorded on a blockchain and represent underlying Verra-issued units. For ease of reference, this document refers to Verified Carbon Units (VCUs) as the underlying Verra-issued units, but the principle applies to other Verra-issued units such as credits issued by the Plastic Waste Reduction Program or assets issued by the Sustainable Development Verified Impact Standard (SD VISta).

This document refers to crypto instruments and tokens that are issued by third parties. It does not preclude any future initiative of Verra to issue its own native crypto instrument or token.

In launching this consultation, Verra emphasizes that it has not yet taken any conclusive decision on whether or how to permit the association of third-party crypto instruments and tokens with VCUs.

2. CONTEXT

Verra's objective in conducting this consultation is to seek information and views on how to identify and implement anti-fraud measures relating to the potential association of VCUs with crypto instruments and tokens.

In conducting this consultation, Verra is mindful of the urgency of constructing an appropriate legal and policy framework to govern the creation, marketing, and use of crypto instruments and tokens. Potential risks of an ill-designed framework include:

- **Fraud.** Although crypto instruments and tokens are not inherently fraudulent, the exotic and technical nature of this sector can create an elevated risk of unscrupulous entities taking advantage of unsuspecting people.
- **Environmental integrity.** Crypto instruments and tokens add routes in which environmental integrity may be compromised, including:
 - Double-issuance, whereby more crypto instruments or tokens are issued than the corresponding quantity of underlying VCUs;
 - Double-use, whereby a crypto instrument or token is consumed more than once to offset emissions;
 - Abstraction from the underlying VCUs, such that the characteristics of the underlying mitigation activity may be less visible to holders of crypto instruments and tokens; and
 - Energy consumption, whereby the act of creating and transacting in crypto instruments or tokens may lead to a significant energy footprint.

- **Regulatory uncertainty.** The regulatory status of creating, marketing, and transacting crypto instruments and tokens varies based on local law and requires appropriate due diligence to ensure compliance with all legal and regulatory requirements.
- **Anonymity of entities.** Currently, all accountholders in the Verra Registry are subject to know-your-client (KYC) checks as well as anti-money laundering, anti-bribery and corruption, anti-terrorist financing, and sanctions compliance requirements. Further, all accountholders are subject to the Verra Registry Terms of Use.¹ Platforms that do not subject the holders of crypto instruments or tokens to KYC checks may provide a route for malevolent entities to gain access to instruments and increase risks of fraud.
- **Legal uncertainty.** There are general issues of legal uncertainty in the event of the insolvency of a crypto instrument or token issuer or holder, whether and how holding such an instrument would give rise to any claim to the underlying VCU, and whether such an instrument should allow for physical delivery and the obligations that this may impose on Verra.

3. PRELIMINARY PROPOSAL

Verra considers it important that any possible approach to this issue requires that the underlying VCUs be “live” rather than retired. On this point, Verra notes that one method previously used to tokenize VCUs was the use of the retirement function in the Verra Registry, whereby VCUs were retired, an alphanumeric code was assigned, and crypto instruments were issued based on these codes. It is Verra’s view that this resulted in market confusion: the concept of retirement is intended to represent the consumption of a VCU’s environmental benefit and, in so doing, permanently withdraw that VCU from the market.

Retiring VCUs to create crypto instruments or tokens, while not maliciously motivated, redefines the concept of retirement away from the consumption of an environmental benefit and toward what is effectively a conversion of a VCU into another instrument whose environmental benefit remains unconsumed. Verra reflected on this situation and found that the reputational risk was significant, in that VCUs – once retired – are no longer eligible for transaction yet remain seen as backed by Verra. Accordingly, Verra banned any model of crypto instruments or tokens backed by retired VCUs.²

Verra also considers it important for underlying VCUs to be immobilized in the Verra Registry while their associated crypto instruments or tokens remain on the market, in order to prevent these VCUs from being the subject of other transactions in the Verra Registry. If not immobilized, these VCUs could be transferred to other accounts or retired for other purposes, thereby undermining, if not negating, the integrity of their associated crypto instruments or tokens.

Accordingly, Verra seeks information and views on a potential proposal for appropriate guardrails to prevent fraud associated with creating crypto instruments or tokens on the back of immobilized VCUs, thereby providing the transparency and traceability that market participants demand. Any such approach would need to ensure a clear and transparent mapping of crypto instruments or tokens and their underlying VCUs, hence working to eliminate double-issuance and double-use. It would also provide Verra with a degree of control over the process, as the relationship is an ongoing one that can be regulated through agreements and the Verra Registry Terms of Use. It is also worth noting that this immobilization approach is used in other contexts, including stablecoins.

¹ Verra (September 2021), “Terms of Use – Verra Registry” (https://verra.org/wp-content/uploads/2021/10/Verra-Registry-TOU-September-2021_FINAL.pdf).

² Verra (25 May 2022), “Verra Addresses Crypto Instruments and Tokens” (<https://verra.org/verra-addresses-crypto-instruments-and-tokens>).

4. TOPICS FOR CONSULTATION

This public consultation seeks information and views on the topics identified in this document, including the following topics:

- a) Measures to associate Verra instruments with crypto instruments and tokens;
- b) KYC checks;
- c) Amendments to the Verra Registry Terms of Use relating to anti-fraud.

These topics are further considered in the annex to this document.

5. CONSULTATION PROCESS AND TIMELINE

Comments should be submitted via email to info@verra.org by the deadline. Verra will consider these comments when preparing its policy on crypto instruments and tokens.

The timeline for the consultation is set out in Table 1 below.

Table 1: Timeline

Activity	Date
Opening of public consultation	Wednesday, 3 August 2022
Consultation webinar	TBD: Tuesday, 30 August 2022, 11 am-12:30 pm Eastern time (tentative); confirmation of the webinar date and time, including registration details, will be available on the Verra website (www.verra.org) approximately one week in advance
Deadline for comments	Sunday, 2 October 2022, 11:59 pm Eastern time
Release of policy	October-December 2022

ANNEX

1. MEASURES TO ASSOCIATE VCUS WITH CRYPTO INSTRUMENTS OR TOKENS

1.1. Proposal

Verra seeks information and views on potential measures to ensure that live, unretired VCUs are responsibly associated with crypto instruments or tokens:

- Account holders would immobilize the VCUs by transferring them to dedicated immobilization sub-accounts in the Verra Registry.³ The association of crypto instruments or tokens with the underlying VCUs would be recorded and made publicly available by both Verra and the issuer of crypto instruments or tokens.
- Verra would require transaction information from tokenization platforms, including at a minimum information on the creation and use of VCU-backed crypto instruments or tokens. Information may also be required on the fractionalization of crypto instruments or tokens and/or their transfer between holders on tokenization platforms.
- Provision could be made to allow the reactivation of the underlying VCUs to support instances where the owner wishes to exercise rights over the underlying VCUs instead of the crypto instruments or tokens. In this case, the crypto instruments or tokens would need to be destroyed without the use of their environmental benefit.
- Verra is preparing a template agreement governing participation in this area, which entities must sign, and which will cover issues such as:
 - a. Eligibility criteria for engaging in transactions relating to crypto instruments or tokens
 - b. Requirements for the retirement of VCUs
 - c. Requirements for tokenization platforms to implement KYC standards (see Section 2 below)
 - d. Requirements for communications and information exchange.

1.2. Requested Input

Verra requests input on this topic, including on the following questions:

- Q1. Regarding the creation, transfer, and use of VCU-backed crypto instruments and tokens, what safeguards should be implemented by Verra to ensure environmental integrity, particularly to prevent double-issuance and double-use?
- Q2. What infrastructure and processes do entities participating in the immobilization approach need from Verra?

³ Verra (25 May 2022), "Verra Addresses Crypto Instruments and Tokens" (<https://verra.org/verra-addresses-crypto-instruments-and-tokens>).

- Q3. Is there a market need to provide for the reactivation of immobilized VCUs, as long as any related crypto instruments or tokens were not used for any other purpose and are destroyed as part of this reactivation?
- Q4. What are the legal and operational implications of a crypto instrument or token being fractionalized?

2. KNOW-YOUR-CLIENT REQUIREMENTS

2.1. Proposal

Know-your-client (KYC) practices are used by organizations needing to exercise reasonable care and effort when opening and maintaining client accounts. Verra conducts KYC checks on all accountholders in the Verra Registry. These checks relate to the identity of each accountholder to ensure that Verra knows the entity that is dealing in the instruments that Verra issues and stands behind. Such KYC checks are also important in the carbon market context to know who claims the environmental benefit represented by VCUs toward an environmental target or other purpose.

Verra will undertake KYC checks on platforms wishing to issue VCU-backed crypto instruments or tokens as part of its broader due diligence and prior to entering into agreements with them. This may include, for example, an analysis of its legal foundations and an evaluation of its business model.

Verra further proposes to require such platforms to undertake KYC checks on, at a minimum, the entities that receive newly issued crypto instruments or tokens, the entities that ultimately use these crypto instruments or tokens, and the beneficiaries of such use. Verra seeks input on whether such platforms must also undertake KYC checks on holders of crypto instruments or tokens other than those listed above.

KYC checks would apply not only to holders of crypto instruments or tokens issued on the back of VCUs, but also any holders of crypto instruments or tokens that are issued on the back of those crypto instruments or tokens, and so forth.

2.2. Requested Input

Verra requests input on this topic, including on the following questions:

- Q5. What KYC checks (and in relation to which jurisdictions) should Verra apply to platforms before authorizing them to issue, market, and/or transact in crypto instruments or tokens that are backed by VCUs?
- Q6. Should platforms be required to apply KYC checks on all entities that hold crypto instruments or tokens, or just on the entities that receive, use, or are the beneficiaries of such instruments?
- Q7. What, if any, information on crypto instrument or token holders should be made publicly available?

3. AMENDMENTS TO THE REGISTRY TERMS OF USE RELATING TO ANTI-FRAUD

3.1. Proposal

The Verra Registry Terms of Use requires entities to seek and obtain Verra's consent to create, market, or transact in related instruments. It also introduces sub-registers, which may be used to structure accounts to hold

VCUs that have been immobilized. These Terms of Use may, however, need further amendment to address anti-fraud considerations related to this subject, including to:

- Establish provisions to address erroneous or fraudulent dealings;
- Clarify what accounts constitute immobilization accounts and what transactions may be performed in them (e.g., retirements, reactivations if the environmental benefit of associated crypto instruments or tokens has not been used and such instruments or tokens are destroyed).

3.2. Requested Input

Verra requests input on this topic, including on the following questions:

- Q8. What textual amendments are advisable to address anti-fraud considerations related to the association of third-party crypto instruments and tokens with VCUs?