What is a Carbon Credit?

A practical explainer, with Malaysia, UK and EU regulatory context

A carbon credit is a way of accounting for real, verified reductions in greenhouse gas emissions. At its simplest: **One carbon credit represents one tonne of carbon dioxide (or equivalent greenhouse gases) that has been avoided, reduced, or removed from the atmosphere.** It's best thought of as a verified receipt for an emissions reduction that has already happened somewhere else.

How carbon credits are created (the same everywhere, but regulated differently)

01

A cleaner project replaces a higher-emissions alternative

Carbon credits come from projects that reduce emissions compared to what would normally happen. Examples include:

- Renewable energy replacing fossil fuels
- Energy efficiency upgrades
- Cleaner industrial processes
- Nature-based solutions such as reforestation

The essential test is this: Would the emissions reduction have happened without carbon finance?

> **Advisory note (all regions):** This is known as additionality. It's a cornerstone of credibility and a key focus of regulators and auditors.

02

Emissions savings are calculated and documented

Specialist methodologies are used to compare:

- A "business-as-usual" scenario
- The lower-emissions outcome from the project

The difference becomes the emissions reduction.

> **Advisory note:** Not all methodologies are equal. Regulators increasingly expect companies to understand the assumptions behind the numbers, not just buy credits blindly.

03

Independent verification takes place

An accredited third-party auditor verifies that:

- The project exists
- The data is robust
- The emissions reductions are real and measurable

This step is non-negotiable.

04

Credits are issued through recognised registries

Once verified, the emissions reductions are issued as carbon credits and recorded in recognised registries, each with a unique ID.

> **Advisory note:** Traceability matters. If you can't clearly see where a credit came from and how it was verified, it's a red flag.

The most important takeaway (for boards and leadership)

Carbon credits are not a licence to pollute. They are best used as:

- A temporary support tool
- A way to fund real-world emissions reductions
- Part of a clearly articulated transition plan

Used carefully, they can add credibility. Used casually without a robust ESG & Sustainability Operational plan, they can undermine trust.

How carbon credits are treated by regulators

This is where Malaysia, the UK, and the EU begin to differ.

Malaysia – Bursa Malaysia, NSRF & emerging expectations

In Malaysia, carbon credits sit within a rapidly evolving regulatory landscape.

Key regulatory context

- Bursa Malaysia's National Sustainability Reporting Framework (NSRF)
- Phased adoption of IFRS S1 and S2 for listed companies
- Increasing scrutiny on climate claims by regulators and investors

What this means in practice

- Carbon credits do not replace emissions reductions
- Companies must first measure and disclose Scope 1, 2 and (increasingly) Scope 3 emissions
- Any use of carbon credits must be clearly explained and separated from actual emissions reductions

Malaysia advisory note: Carbon credits can support transition strategies, but companies should avoid implying they have "solved" emissions through offsets alone. Transparency is key.

United Kingdom – FCA, ISSB alignment & greenwashing rules

The UK takes a strong stance on claims and language.

Key regulatory context

- FCA anti-greenwashing rule
- Alignment with ISSB (IFRS S1 and S2)
- Growing focus on transition plans and credibility

What this means in practice

- Claims like "carbon neutral" or "net zero" must be accurate, balanced, and evidence-based
- Carbon credits must be:
  - High quality
  - Verified
  - Clearly distinguished from emissions reductions
- Companies must explain why credits are used, not just that they are used

UK advisory note: The biggest risk isn't buying credits — it's overstating what they achieve. Regulators care deeply about how claims are worded.

European Union – CSRD, ESRS & tightening controls

The EU has the strictest expectations of the three.

Key regulatory context

- CSRD and European Sustainability Reporting Standards (ESRS)
- Strong emphasis on transition plans, not just outcomes
- Increased enforcement against misleading environmental claims

What this means in practice

- Carbon credits cannot be used to claim emissions reductions within core disclosures
- They may be referenced as part of a broader climate strategy, but:
  - Only after real reductions are prioritised
  - With clear separation from operational emissions data
- Nature-based credits face particularly close scrutiny

EU advisory note: Under CSRD, carbon credits are a supporting mechanism, not a substitute for decarbonisation. Over-reliance is likely to be challenged.

Using carbon credits responsibly (across all regions)

What regulators expect to see

- Clear emissions measurement first
- Reduction plans with targets and timelines
- Carbon credits used only for residual emissions
- Full transparency on:
  - Type of credit
  - Standard and registry
  - Retirement status

Where organisations commonly get into trouble

Across Malaysia, the UK and the EU, the same issues keep appearing:

- Treating credits as a shortcut to net zero
- Using vague or absolute language in marketing
- Failing to explain limitations and trade-offs
- Mixing credits into emissions figures without clarity

Advisory note: Most enforcement actions focus on communication failures, not the technical use of credits.