



INSTITUTE OF
INTERNATIONAL
FINANCE



February 10, 2023

Via electronic mail

Mr. Martin Moloney, Secretary General

International Organization of Securities Commissions (IOSCO)

Calle Oquendo 12

28006 Madrid

Spain

Re: IIF and ISDA Public Comment on IOSCO Discussion Report on Voluntary Carbon Markets (VCM) and Consultation Report on Compliance Carbon Markets (CCM)

Dear Mr. Moloney,

The Institute of International Finance (IIF), the International Swaps and Derivatives Association (ISDA) and their respective members, which broadly represent the global financial services industry, appreciate the opportunity to provide public comments to the International Organization of Securities Commissions (IOSCO) on both its Consultation Report on Compliance Carbon Markets (“CCM report”) and Discussion Paper on Voluntary Carbon Markets (“VCM paper”).¹

The IIF, ISDA, and their members welcome IOSCO’s holistic approach to fostering the development of sound and well-functioning compliance and voluntary carbon markets. We strongly believe that both voluntary carbon markets (VCMs) and compliance carbon markets (CCMs) can be useful market-based solutions that can help to channel and increase flows of capital to finance greenhouse gas (GHG) emissions reductions and removals in an efficient and robust manner, making them a critical component of the global response to climate change and the Net-Zero transition.

¹ More information about the IIF and ISDA is provided in Annex 3.

In delivering on its core mandate of facilitating standard-setting and supporting cross-jurisdictional coordination, IOSCO can play a key role in supporting the development of high-integrity VCMs, as well as supporting the continued expansion of CCMs.

With the aim of supporting IOSCO's efforts on promoting sound and transparent CCMs and enhancing the resilience and integrity of VCMs, we would encourage IOSCO and its members to consider the following actions:

- **Focus guidance on market integrity dimensions, reflecting regulatory mandates:** Given IOSCO's mandate, its guidance on carbon markets should ideally focus on how securities and financial regulators can and should use their expertise, authority, and scope of influence to enhance market functioning, trust, and overall market integrity, recognizing the limits of such regulators with respect to dimensions of environmental integrity concerns per se.
- **Leverage the work of key VCM governance bodies to support greater standardization and strengthen supply and demand-side integrity:** We would encourage IOSCO and its members to draw on the ongoing work of key VCM initiatives, including the Integrity Council for the Voluntary Carbon Market (ICVCM) and the Voluntary Carbon Markets Integrity Initiative (VCMI), as well as the work of international associations (such as ISDA) on market infrastructure and trading considerations.
- **Clarify the legal and regulatory treatment of carbon credits:** The regulatory and legal categorizations of carbon credit are not yet clearly established in most jurisdictions, but have significant implications. The legal classification influences how carbon credits may be created, bought, sold and retired, and how they are treated in insolvency (including with regard to netting). The regulatory classification determines whether they may fall under existing regulatory regimes or restrictions. It is important to clarify the regulatory and legal categorizations, and to preserve the distinction between the two. It is also important to distinguish between the legal nature and regulatory status of VCMs themselves and the nature of transactions in VCMs (e.g., derivatives transactions with a VCC underlying such as listed futures or OTC forwards or options).
- **Consider interactions between VCMs and CCMs as they develop further:** IOSCO and relevant authorities should continue to monitor the development of and linkages between CCMs and VCMs to ensure that as these markets develop, and as links develop and strengthen between them, any regulation remains appropriate and fit for purpose.

The remainder of this letter sets out comments on both the CCM report and VCM paper. Our feedback is structured in four parts: (1) overarching messages, which are relevant to the VCM and CCM papers, addressing the potential role of regulatory and supervisory authorities with respect to aspects of these markets; (2) market trends in CCMs and VCMs, and their relevance in the context of the Net-Zero transition; (3) feedback on specific questions in the CCM report, in Annex

1; and (4) feedback on specific questions in the VCM paper, in Annex 2. Further detail about the IIF and ISDA is provided in Annex 3.

1. Overarching messages

a. The role of different regulatory and supervisory authorities across the carbon credit value chain

By bridging environmental, economic, and financial spheres, carbon markets have links to an array of policy and regulatory objectives, including GHG emissions reductions, environmental conservation and pollution abatement, economic and social development, and financial market efficiency, safety, and stability. Considering the diverse approaches to carbon market design and governance structures, and the varied interests of corporate and financial actors across the carbon market value chain, different official sector bodies – including environmental, industrial, and securities and financial regulators and supervisors – may consider aspects of carbon market development as relevant to their mandates and strategic objectives.

We support IOSCO’s view that market integrity and environmental integrity are separate concepts which may warrant specific consideration by different entities. Firstly, market integrity addresses the need for robust market design and high-functioning market infrastructure capable of delivering adequate and consistent levels of transparency, liquidity, and security. On the other hand, environmental integrity refers to matters related to the project activities, attributes, and characteristics that validate a claimed emission reduction, removal, or avoidance as being real, additional, permanent, and verified, entitling a carbon credit to be issued. Environmental integrity should, therefore, be the domain of subject matter experts in environmental performance and emission reduction pathways—e.g., the [expert panel](#) of the ICVCM.

Multiple dimensions of environmental and market integrity – including conduct – may arise as potentially relevant to different types of authorities, as carbon credits are originated, transacted, and retired. In VCMs, there is a complex and currently fragmented architecture of market-based standards in place and in development across this value chain; as such, ascertaining the potential role of regulators with respect to these standards is important. For instance, standards to ensure the environmental integrity of carbon credits in VCMs, and oversee the monitoring, measurement and verification of emissions reductions, have developed over many years, and are undergoing ongoing refinement and harmonization (notably by the ICVCM in the development of the [Core Carbon Principles](#) (CCPs)). At the retirement stage in the value chain, when a financial or corporate owner of a carbon credit retires it against a specific emission (or considers the carbon reductions associated with a credit in the context of a claim pertaining to emissions reductions goals) questions of conduct integrity may arise—especially as standards for such practices are still at an early stage of development.

We believe that securities and financial regulators and supervisors can play an important role in promoting market integrity, enhancing transparency, and supporting the uptake of common standards among market participants. Given IOSCO’s mandate, its guidance on carbon markets should ideally focus on how financial regulators can and should use their expertise, authority, and scope of influence to enhance market functioning, trust, and overall market integrity – with due consideration of the evolving suite of market-based standards in development. It is our view that the multifaceted nature of carbon markets (including with respect to environmental integrity) means that securities and financial regulators are best suited to provide oversight in concert with other institutions. Securities and financial regulatory bodies play a vital role in overseeing and ensuring the integrity of markets through efforts to ensure transparency and traceability, enforce anti-fraud and non-manipulation rules, and support rules-based market exchange platforms, price discovery standardization, and contract benchmarking. We believe that certain interventions could be undertaken to improve trust and transparency in carbon markets, as discussed later in this response.

b. Importance of leveraging the work of different stakeholders to support market-based standards

Despite significant efforts by multiple public and private sector authorities, some barriers to the development of robust VCMs for high-integrity carbon credits remain, including fragmentation and a lack of standardization, transparency, and liquidity. Underlying these barriers, structural environmental integrity challenges persist, including ensuring that carbon credits meet standards for additionality, permanence, and leakage. Defining benchmark standards for quality is a core aim of the Integrity Council for the Voluntary Carbon Market (ICVCM). The mandate of the ICVCM² is (i) to establish, host, and curate a set of CCPs, which will set new threshold standards for high-quality carbon credits and define which carbon-crediting programs and methodology types are CCP-eligible; (ii) to provide governance and oversight on standard setting organizations for adherence to the CCPs as well as on market infrastructure and participant eligibility; and (iii) to help to coordinate and manage interlinkages between individual bodies, and define a roadmap for the responsible growth of VCMs. In conducting its work, the ICVCM collaborates with a constellation of other initiatives working across the value chain including the Voluntary Carbon Markets Integrity Initiative (VCMI), the Science-Based Targets Initiative (SBTi), and the Glasgow Financial Alliance for Net Zero (GFANZ).

Potential activities by IOSCO and its members to address issues of market integrity in VCMs should consider both supply and demand-side issues as well as potential interactions between

² The ICVCM is the governance body established in September 2021 following recommendations of the Taskforce on Scaling Voluntary Carbon Markets, initiated by Mark Carney (Co-chair, GFANZ and UN Special Envoy on Climate Action and Finance), and sponsored by the IIF.

VCMs and CCMs. IOSCO can play a role in ensuring market structures are aligned globally, and supportive of initiatives to improve demand and supply side integrity.

- The **supply side** of the market requires clear criteria and guidance for ensuring that carbon credits (and their respective underlying projects) are a trustworthy representation of a reduction or removal initiative. In that context, policymakers can build on the previous work of independent governance bodies. In particular, the ICVCM has focused on providing the market with a set of [Core Carbon Principles, an Assessment Framework, and an Assessment Procedure](#) which are designed to inform and guide the assessment of carbon-crediting programs and different types of carbon credits. The aforementioned ICVCM consultation provides a summary of considerations that market and policy stakeholders may need to account for when engaging in this kind of investment, such as quantification protocols and criteria for emissions reductions and removals from mitigation activities, and a description of the several ways to address additionality (i.e., assessment of financial additionality, barrier analysis, performance-based tests and common practice analysis).
- From the **demand perspective**, integrity issues reflect on the trading environment, buyers' and sellers' conduct when they operate, how participants are using the carbon credits they purchase, and how are they accounting for and reporting them. In a general sense, the market agents need to be sure that the credit that has been generated from a carbon offset project will comply with its initial value proposition.

From a market perspective, greater standardization and transparency is crucial to supporting the scaling up of VCMs. Achieving necessary market integrity will require that the currently fragmented landscape of multiple standards and certification frameworks is appropriately harmonized. Firstly, it is well understood that standardization of contractual arrangements for the secondary market can help enhance market confidence in derivative products, and support liquidity by enhancing market efficiency and price discovery. On the other side, there is a need for the adoption of leading standards and practices that could help to enhance the quality of carbon credits and establish credibility of their usage.

- **Standardization efforts in secondary markets, including derivatives, are at an early stage.** Increasingly, there is a range of unique attributes in each carbon credit that purchasers value and sellers want to uniquely price such as co-benefits, process considerations, methodology and project type, and community relations issues. **Identifying new mechanisms to deepen secondary market liquidity through a set of standardized instruments is an important priority.** In this context, ISDA has aimed to address the lack of standardization in secondary market trading of VCCs through the publication of its 2022 [Verified Carbon Credit Transactions Definitions](#) which aim to support the trading of carbon credits across carbon standards and registries. In that context, support from securities

regulators in favor of these trading standardization practices will promote and increase interest and participation in this market.

- The ICVCM recently concluded a consultation on a set of [draft CCPs](#), which are intended to provide a “*credible, rigorous, and readily accessible means of identifying high-quality carbon credits that create real, additional and verifiable climate impact with high environmental and social integrity.*”³ **We would encourage IOSCO and other international standard-setting bodies to take fully into account the CCPs in any efforts to provide guidance to members on their potential roles and responsibilities with respect to VCMs.** We believe that widespread market adoption of the CCPs will be essential to enhancing market integrity. (However, it is important to recognize that the CCPs will intentionally go beyond existing market best practice and may require existing carbon crediting standards entities and verification bodies to implement methodological and programmatic enhancements).

2. The role of carbon markets in the context of the Net-Zero transition: market and regulatory developments

We have set out below an overview of the key features of compliance and voluntary carbon markets, based on information gathered by the IIF.⁴

Continued expansion of both CCMs and VCMs could see coverage of global emissions more than double, from 24% of global emissions today, up to 52% of global emissions in 2030. The total value of VCMs has grown rapidly since 2017. Recent estimates put the current market value of VCMs at over \$2 billion—quadruple their size in 2020, and it is expected that they will grow to over \$50 billion by 2030.⁵ Compliance market coverage could expand from 21% today to 47% of global emissions in 2030, and voluntary market commitments could grow from covering 9% of corporate emissions today to 23% of corporate emissions by 2030.⁶

Building and scaling robust and mature VCM infrastructure will be a fundamental element to market-driven decarbonization, and the Net-Zero transition creating a channel for investment in carbon emissions reduction projects. In the near term, VCM transactions can channel capital to support conservation of natural capital and biodiversity, and crowd capital into innovative emission reduction and removal projects that are currently difficult to commercialize. VCMs can also help close the funding gap for mitigation activities in emerging markets, especially

³ Following the consultation, the ICVCM expects to start publishing outcomes in Q1 2023. working in a staggered manner to reflect the relative urgency of issues and to manage the market impact. Currently, the ICVCM is targeting the second half of 2023 for labels to start appearing in the market.

⁴ In case this is useful, the European Commission has also published its annual Carbon Market Report on the functioning of the EU ETS from the beginning of the fourth trading phase in 2021 until mid-2022.

⁵ Institute of International Finance (IIF). [Voluntary Carbon Markets Update - Q3 2022](#)

⁶ Note that the combined total is lower to account for potential overlaps between these markets.

those disproportionately affected by climate change. The purchase and retirement of VCCs will play a significant role in the Net-Zero transition; as such, developments in VCMs may be considered of relevance to financial regulators' broader strategies and actions on sustainable finance.

A future carbon market that can support the achievement of global Net-Zero goals will depend on progress on three common key factors. These are clarity on international transfers; mature financial infrastructure; and transparent high-integrity credits paving the way for demand commensurate with achieving Net-Zero emissions. These elements are already emerging, but further progress is necessary for a fully realized carbon market to emerge.⁷

At the international level, global bodies such as the International Sustainability Standards Board (ISSB), have referenced the work of the ICVCM and the VCMi on supply- and demand-side integrity. For instance, the ISSB issued a staff paper in October of 2022 submitting recommendations on how to disclose the use of carbon credits.⁸ In the context of its work on sustainability and climate-related disclosure standards, the ISSB has referred to the necessity of disclosing the use of carbon credits in the context of the entity's emissions target strategy, and the adoption of the carbon credit definition.

At the jurisdictional level, the European Financial Reporting Advisory Group (EFRAG) disclosure standards proposed to the European Commission in December 2022 define how the use of carbon credits should be disclosed in the European Union (EU)⁹, aligning the EU technical standards with the proposed ISSB approach as mentioned above. Among others, EFRAG requires that the undertaking shall not include GHG removals, carbon credits or avoided emissions as a means of achieving the GHG emission reduction targets, and that these should be disclosed separately. In addition, the undertaking shall explain the credibility and integrity of the carbon credits used, and whether and how its claims of GHG neutrality neither impede nor reduce the achievement of its GHG emission reduction targets.

Market-based standards are also advancing views on questions pertaining to the use of carbon credits. For instance, GFANZ has encouraged financial firms to articulate whether and how they intend to use carbon credits,¹⁰ and recognized the statement published on the IIF website for a "*High Ambition Path to Net-Zero*" as optimal when companies can decarbonize, and neutralize, and compensate all emissions on the path to Net-Zero.¹¹ GFANZ will also be focusing on the significant potential for emerging markets to leverage VCMs to attract more finance for critical climate investments in nature-based solutions and the energy transition.¹²

⁷ IIF. Getting to Net-Zero: The Vital Role of Global Carbon Markets

⁸ IFRS Sustainability. Staff paper October 2022. Pp. 15-16

⁹ Draft ESRS E1 Climate change

¹⁰ GFANZ. Financial Institution Net-zero Transition Plans. November 2022. Pp. 34

¹¹ IIF. [Calling for a High Ambition Path to Net-Zero](#).

¹² GFANZ. Actions to Mobilize Capital to Emerging Markets and Developing Economies. Pp. 8

Considering the multiple non-governmental initiatives actively working to develop new standards to strengthen the integrity of VCMs, and clarify how such credits may be used in the context of Net-Zero target setting and related activities (including transition planning), the IIF and ISDA would encourage IOSCO and its members to actively leverage the work of these existing technical workstreams to support international coordination among financial regulatory authorities as they engage with carbon markets.

Thank you for your consideration of these comments. We would be happy to discuss any of these matters further and if you have questions or comments we would invite you to contact Sonja Gibbs (sgibbs@iif.com) and Andres Portilla (aportilla@iif.com) at the IIF, and Roger Cogan (rcogan@isda.org), Peter Werner (pwerner@isda.org) and Stevi Iosif (siosif@isda.org) at ISDA.

Yours sincerely,

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Cc: Mr. Rostin Behnam, Chairman of the Commodity Futures Trading Commission (CFTC) and Co-Chair, IOSCO Sustainable Finance Task Force Carbon Markets Workstream

Cc: Ms. Verena Ross, Executive Director of the European Securities and Markets Authority (ESMA) and Co-Chair, IOSCO Sustainable Finance Task Force Carbon Markets Workstream

Cc: Ms. Kris Nathanail, Senior Policy Advisor, IOSCO

ANNEX 1

Responses to questions on compliance carbon markets

Question 1: What are the benefits and risks of linking frameworks? How can these benefits be enhanced and these risks be mitigated?

Question 2: What should be the conditions underpinning a decision to link frameworks?

We agree with the benefits of linking frameworks identified in the Consultation Report—that linking markets should promote trading and lower the overall cost of reducing emissions, leading to a global carbon market for emission allowances. If frameworks are linked effectively, this should create a stable environment for investment into low-carbon alternatives and align decarbonisation pathways between the linked jurisdictions, allowing both jurisdictions to reach Net-Zero faster and more cost effectively.

We also agree with the potential risks as identified by IOSCO, specifically that differences in the markets being linked may result in market disruption.

One way of mitigating these risks would be to have harmonised conditions for linking frameworks. However, it may be too early in the development of Emissions Trading Systems (ETS) to work towards harmonised conditions for linking—at this stage it may be more appropriate to develop harmonised conditions for such systems to meet, with harmonised conditions for linking to follow once a majority of systems meet similar conditions.

If harmonised conditions for linking are to be developed, a starting point will be assessing the comparability of the markets being linked. The conditions underpinning a decision to link frameworks should identify key characteristics that are common to both frameworks (or all frameworks, if more than one framework is being linked), or that are important to one or both parties. For example, as noted in the Consultation Report, the criteria that the EU ETS legislation sets for linking with other compatible emissions trading systems include:

- That the systems have the same basic environmental integrity and a tonne of CO₂ in one system is a tonne in the other system. this will be a key factor, otherwise you are not comparing like with like;
- The mandatory nature of the system – again, a key factor for comparability will be eligibility of the credits for compliance with mandatory emissions schemes, whether the credits themselves are issued under the mandatory scheme or whether they are VCCs that have been determined to be eligible for the mandatory scheme (although it may be necessary to set some criteria around eligibility of VCCs);
- The existence of an absolute cap on emissions – this will be relevant to assessing the likely price stability of credits in the linked system;

- Inclusion of aviation – this is clearly a factor that is important to the EU, but is not a fundamental measure of the comparability of any two given frameworks.

However, it is important to note that while it may be possible to identify a framework for use when considering linking two markets, the differences between the existing compliance markets means that it may not be possible (or appropriate) to develop a single set of criteria for assessing whether or not any two markets should be linked.

In addition to assessing the comparability of frameworks, it will also be necessary to understand whether linking the frameworks may result in disruption to the relevant markets, including:

- Reduction in integrity of either or both of the linked markets;
- Reduction in transparency;
- Increased risk of a disruption to one market resulting in disruption to the other (e.g., as a result of price disruption, technological disruption, manipulative behaviour, settlement disruption etc);
- Uncertainty regarding effectiveness of transfers (e.g., as a result of legal uncertainty regarding the nature of ownership interests, poor record keeping or uncertainty regarding settlement finality).

Question 3: Do you agree these IOSCO principles are appropriate for carbon markets? Explain your response.

Questions 4: Are other IOSCO principles relevant for application to these markets?

We agree that the IOSCO’s existing Principles for Market Intermediaries are appropriate for carbon markets. However, IOSCO’s existing Principles for the Secondary Market may be more appropriate for an established, mature market such as securities secondary markets, rather than a nascent, developing market such as compliance carbon credits. In particular:

- Requiring trading systems to be subject to regulatory authorisation and oversight will only be appropriate where compliance carbon credits are already categorised as a regulated financial instrument¹³, as the regulatory requirements for authorisation as a securities trading venue are typically too strict for most new market entrants to be able to comply.
- Regulation promoting transparency of trading should be calibrated to ensure that any transparency requirements do not present increased risk for market participants in potentially illiquid markets. If IOSCO intends to apply this principle to trading in compliance carbon credits it should clarify what type and level of transparency is intended here. For example, pre-trade transparency aimed at price discovery is unlikely to be

¹³ For example, both the EU and UK currently categorise compliance credits issued under their respective mandatory schemes as regulated financial instruments.

appropriate for an illiquid, primarily OTC market whereas transaction reporting for derivative transactions in compliance carbon credits may give regulators sufficient information to exercise oversight over these markets without exposing market participants to undue risk.

Similarly, some of the Principles for the Regulation and Supervision of Commodity Derivatives Markets identified in the Consultation Report would also need to be adapted for a developing market. In particular, the requirements for on-exchange transactions should be clarified to confirm that they would only apply to trading of compliance carbon credits or carbon credit derivatives on a regulated exchange, and the requirements in relation to market abuse should also clarify that they would only apply to trading activity that either takes place on a regulated trading venue or that has the capacity to impact trading on a regulated trading venue (in line with other existing market abuse regimes).

While the Principles identified could form the starting point for regulation of market conduct in trading of carbon credits, they would not address the concerns discussed elsewhere in our response in relation to environmental integrity and the lack of reliable and verifiable information on carbon credits. A lack of reliable information in carbon markets could influence supply and demand dynamics, affecting levels of investment and market liquidity. Information asymmetries that investors face when trading in carbon markets suggests that there is room to support the standardization of the terms and conditions of the creation process of carbon credits, the environmental integrity of these instruments, and the use that corporations are making of them. Regulators should focus on harmonizing these aspects to scale up a VCM and enhance market efficiency.

Question 5: Do you agree the rules currently in place across key jurisdictions are helpful for scaling of carbon markets?

Question 6: Are there any other aspects of compliance markets that could benefit from regulatory oversight?

We agree that rules for existing compliance markets currently in place across key jurisdictions are helpful for identifying best practice for developing compliance markets. While existing compliance markets are dealt with in a range of different ways for regulatory purposes, there are some features that are common to most regimes which could be adapted as appropriate depending on the categorisation of compliance credits in each jurisdiction. In particular, we agree that any regulation of compliance markets should address the following issues:

- Rules of general good conduct, such as the prevention of conflicts of interest;
- Rules to promote transparency, oversight, and monitoring of trades (although as discussed above it would be necessary to clarify the type of transparency that is intended);
- Rules to prevent fraud, insider trading and price manipulation.

Question 7: Are the recommendations appropriate for the compliance market?

We welcome the fact that the consultation report clearly indicates the importance of secondary markets in market efficiency. In our view, secondary market liquidity is absolutely critical to a functioning market, so policymakers should avoid introducing regulatory limitations or constraints to the access and development of this market. As an example, the EU ETS has run well partly because it is backed by a strong legislative framework, in this case, EU decarbonization goals, and a cap-and-trade format, which gives validity to the market.

We comment on each of the proposed recommendations below:

- *Recommendation 1: Relevant authorities should increase predictability and transparency in primary market decisions.*

We agree with this recommendation.

- *Recommendation 2: To foster fair, stable and competitive markets, relevant authorities in charge of primary market issuance should place greater reliance on auctions over free allocation.*

We agree with this recommendation.

- *Recommendation 3: Relevant authorities should consider setting frequent auctions.*

If the recommendation here is that relevant authorities should consider the frequency with which they hold auctions (but are not required to hold them with any specified frequency) then we agree with this recommendation. However, we consider that the frequency of auctions should be a matter for the relevant authority holding the auctions to determine.

- *Recommendation 4: When relevant authorities establish market stability mechanisms, any market intervention should be rule-based to allow for better predictability.*

We understand that the intention of this recommendation is that where market stability mechanisms are introduced in order to manage detrimental levels of volatility, these mechanisms should be expressly described in relevant legislation or regulation, either by way of ex-ante controls and measures or by way of emergency legislation introduced in response to the relevant disruption event, rather than left to the discretion of a relevant authority. If our understanding is correct, then we would support this recommendation.

- *Recommendation 5: Relevant authorities should consider allowing the participation of non-compliance firms in primary markets.*

We agree that relevant authorities should consider allowing the participation of non-compliance firms, in order to build liquidity in these markets. The fact that liquidity is enhanced by the participation of non-compliance entities is supported by research into the

operation of compliance markets by entities including ESMA¹⁴ (in connection with the EU ETS).

- *Recommendation 6: Relevant authorities should define the legal nature of allowances in their jurisdiction.*

We agree strongly with this recommendation. The legal nature of carbon credits will determine how ownership rights can be created and transferred, and will also affect what type of security can be taken and enforced and how that can be achieved, as well as how carbon credits would be treated following an insolvency (including with regard to netting).

We would also note that it is important to preserve the distinction between the legal nature of carbon credits and the regulatory treatment of those credits. For example, the legal characterisation will address what rights you acquire when you buy a carbon credit under the law of the relevant jurisdiction – do you obtain property rights or some other form of ownership right or claim? This will be relevant for determining issues such as how to take security over the relevant asset, or what claim you would have in the insolvency of a counterparty. The regulatory categorisation would address whether the asset is a security, a commodity, or some other form of regulated financial instrument, or whether it is outside the scope of regulation. This would be relevant to issues such as prospectus requirements, cross-border marketing and licensing.

- *Recommendation 7: Relevant authorities should encourage the scrutiny of auction performances.*

We agree strongly that auction performances should be kept under regular review in order to identify any unusual activity or potential manipulative behaviour.

- *Recommendation 8: Relevant authorities should consider establishing clear and robust frameworks for conducting market surveillance, overseeing of entities' behaviour in spot and derivatives carbon markets and ensuring appropriate enforcement.*

We agree that relevant authorities should consider establishing frameworks for market surveillance, oversight and enforcement. However, they should consider carefully whether measures such as position limits, reporting or position management controls are appropriate, particularly in jurisdictions where compliance markets are a recent development. Imposing requirements of this sort will increase the compliance burden on market participants, and potentially exclude smaller market participants from the market.

¹⁴ https://www.esma.europa.eu/sites/default/files/library/esma70-445-38_final_report_on_emission_allowances_and_associated_derivatives.pdf

- *Recommendation 9: Relevant authorities should ensure that the relevant market infrastructures (e.g., trading venues, auction platforms, central counterparties, registries) are robust and properly regulated.*

As discussed above, relevant authorities should consider carefully what level of regulation to apply to trading venues – if compliance carbon credits are not regulated as financial instruments in the relevant jurisdiction, then it may not be appropriate to seek to regulate carbon credit trading venues in the same way as securities trading venues, for example.

- *Recommendation 10: Relevant authorities should encourage the development of standardised derivatives contracts.*

ISDA has been actively involved in the development of standardised derivatives contracts for both compliance credits and VCCs. ISDA's US and EU/UK Emissions Allowance Transaction Documents support industry efforts to harmonise documentation approaches to trading in compliance credits and are intended to apply to transactions for the purchase, sale, or exchange of specified compliance credits on a spot or forward basis, or as an option to purchase, sell or exchange.

- *Recommendation 11: Relevant authorities should consider public disclosures about aggregate positions, as well as periodic public reporting derived from regulatory data.*

When considering whether or not public disclosure of positions is appropriate, relevant authorities should consider carefully the depth of the relevant markets. Where markets are illiquid and there are only small numbers of participants, even aggregate position level data may expose market participants to undue risk.

It will also be important to establish how aggregate position disclosures would operate for entities holding both compliance and voluntary credits, particularly where the voluntary credits are eligible for inclusion in a compliance scheme, and to understand the risks and potential impacts of the proposed approach. For example, should both voluntary and compliance credits be reflected in an aggregate position disclosure? Would disclosure be on a net or gross basis, and if so, what instruments can be netted off for these purposes?

- *Recommendation 12: Relevant authorities should set clear lines of responsibilities and cooperation between authorities in charge of compliance markets at primary and secondary market level, including both environmental and financial agencies as appropriate and promoting regulatory coordination between these entities.*

We strongly agree that where different authorities are responsible for compliance markets at primary and secondary market level there should be clear lines of responsibility and clear commitments in relation to cooperation and information sharing. Considering the diverse approaches to carbon market design and governance structures, and the myriad interests of corporate and financial actors across the carbon market value chain, different official sector

authorities – including environmental, industrial, and securities and financial regulators and supervisors – may consider aspects of carbon market development as relevant to their mandates and strategic objectives.

We support IOSCO’s view that market integrity and environmental integrity are separate concepts which may warrant consideration by different authorities. Market integrity addresses the need for credible market design modalities and high-functioning market infrastructure capable of delivering adequate and consistent levels of transparency, liquidity, and security. On the other hand, environmental integrity refers to matters related to the project activities, attributes, and characteristics that render a claimed emission reduction, removal, or avoidance as being real, additional, permanent, and verified, entitling a carbon credit to be issued; it should, therefore, be the domain of subject matter experts in environmental performance and emission reduction pathways.

Multiple dimensions of environmental and market integrity – including conduct – may arise as potentially relevant to different types of authorities, as carbon credits are originated, transacted, and retired. In VCMs, there is a complex architecture of market-based standards in place and in development across this value chain; as such, ascertaining the potential role for regulators with respect to these standards is important. For instance, standards to ensure the environmental integrity of carbon credits in VCMs, and oversee the monitoring, measurement, and verification of emissions reductions, have developed over many years, and are undergoing ongoing refinement and harmonization. At the retirement stage in the value chain, when a financial or corporate owner of a carbon credit retires it against a specific emission, or considers the carbon reductions associated a credit in the context of a claim pertaining to emissions reductions goals, questions of conduct integrity may arise – especially as standards for such practices are still at an early stage of development.

Securities and financial regulators and supervisors can play an important role in promoting market integrity, enhancing transparency, and supporting the uptake of common standards among market participants. Given IOSCO’s mandate, its guidance on carbon markets should ideally focus on how financial regulators can and should use their expertise, authority, and scope of influence to enhance market functioning, trust, and overall market integrity – with due consideration of the evolving suite of market-based standards in development. Securities and financial regulatory bodies play an important role in overseeing and ensuring the integrity of markets through efforts to ensure transparency and traceability, enforce anti-fraud and non-manipulation rules, and support rules-based market exchange platforms, price discovery standardization, and contract benchmarking.

However, while there are clearly features of the securities markets that may provide a useful template for regulation of carbon credits, regulators and legislators should consider

carefully whether or not it is appropriate for a nascent market to be subject to securities-type regulation, or whether this may result in a reduction in liquidity and barriers to accessing the market.

Question 8: Are there any other aspects that the recommendations should address? If so, please state which ones and explain your reasoning.

IOSCO and relevant authorities should continue to monitor the development of and linkages between CCMs and VCMs to ensure that as these markets develop, and as links develop and strengthen between them, any regulation remains appropriate and fit for purpose.

ANNEX 2

Responses to questions on voluntary carbon markets

Question 1: Is the description of the issuance of carbon credits accurate? Are all key market participants properly reflected?

We consider that the description of the issuance of carbon credits is accurate. We also consider that all key market participants in the trading ecosystem are properly reflected.

However, while we generally agree with the description, we would like to note a couple of points:

- The Discussion Report states on page 15 that market participants include "speculators that purchase and sell emission reductions to take advantage of market-price distortions and arbitrage possibilities". While there is some interest in this market from investors, the majority of interest in this market is currently from entities and individuals looking to take steps to reduce their carbon footprint, as well as purchase and retire credits to compensate, and in the future neutralize, carbon emissions, in line with voluntary commitments such as the Net-Zero commitments and transition plans. In any event, interest from investors is a normal part of trading in healthy markets, and describing this activity as "taking advantage" of market price distortions and arbitrage possibilities is potentially unhelpful and may be used as some regulators to justify restricting access by investors to VCMs.
- Paragraph 1.1 of the Discussion Report states that "there are significant links between VCMs and both compliance emission trading schemes and compliance offset credit markets as a result of Article 6 of the Paris Agreement". We would like to note that this is only correct where a particular jurisdiction authorises a voluntary carbon credit's associated mitigation activity for Article 6 purposes. Article 6 of the Paris Agreement has not automatically led to "significant links" between VCMs and CCMs, and is not expected to do so in the near future. If this is a key factor in IOSCO's approach to how these markets could be regulated we would ask IOSCO to bear in mind that while there are connections between the voluntary and compliance markets, they are not so similar or so interlinked that they should automatically be regulated in the same way.

Furthermore, on the topic of the potential integration of VCMs and CCMs, we highlight the need to appreciate the presence of different compliance markets, from carbon allowances issued under emission trading schemes (i.e., EU ETS and China's ETS), to carbon taxes (e.g., Singapore and Indonesia). For example, from 2024, Singapore will allow for up to 5% of a large emitter's carbon tax to be offset by VCCs. While one-size-fits-all approach for linking voluntary to compliance markets is unlikely to be feasible considering differences in carbon market design across jurisdictions, guidance on options for optimal connectivity between these two markets could potentially add value.

In this respect, it is worth noting the efforts of authorities in certain jurisdictions to take steps to enable greater oversight of VCMs and relationships to compliance markets, such as the European Commission's Proposal for a Regulation of the European Parliament and of the Council establishing a Union certification framework for carbon removals.

- In the absence of mandatory regulation dictating the quality and character of VCCs, a variety of carbon offset registries has emerged. Each of these registries has (i) its own standards governing the eligibility of projects to receive offsets and the quantification, verification, and monitoring of project-based emission reductions and (ii) its own terms of use specifying the conditions under which users may access and use the registries as well as title and ownership of assets and agreement to transfer assets.
- Although the ICVCM definition cited in the Discussion Report defines carbon credits as "a tradable financial instrument", we understand that ICVCM did not intend to use the term "financial instrument" to indicate that these are securities or regulated financial instruments in any particular jurisdiction. While it may be helpful or appropriate to regulate trading in these assets in a similar way to trading in securities or other regulated financial instruments, it does not automatically follow that these assets should be categorised as securities or other regulated financial instruments, as discussed further in our response to question 6.

Question 2: Has the consultation identified the relevant vulnerabilities? Are there any others that should be considered? Please explain?

We agree that the vulnerabilities identified in the Discussion Report (listed below for reference) are the key vulnerabilities.

- Integrity concerns at issuance
 - Carbon credit quality – no uniform definition of a "high quality carbon credit";
 - Additionality and lack of standardised methodology to calculate the baseline scenarios;
 - Permanency and risk of reversal;
 - Collateral effects (e.g., shift in pollution) and risk of leakage of GHG emissions.
- Double counting and absence of centralised registries
 - Sale of carbon credits that either do not exist or belong to someone else;
 - Transparency and accuracy of emissions reduction calculations;
 - Verification and oversight;
 - Transparency and conflicts of interest;
 - Interaction with private initiatives.

The Discussion Paper comments (at paragraph 2.3) on the fact that most trading of carbon credits is currently executed via OTC markets with little public pricing information available. While the Discussion Paper does not suggest that the lack of public pricing information is a vulnerability in the VCMs, we would like to reinforce this point and note that while OTC markets (not just VCMs) typically have less publicly available pricing information than exchange-traded markets, **this is generally considered to be appropriate given the bilateral and negotiated nature of transactions in OTC markets**. If regulators conclude that pricing information should be publicly available, it would be necessary to consider carefully what the impact of this might be on the nascent VCM, and whether a more effective approach might be to enable more trading to take place on trading venues where more pricing information is publicly available. Addressing the vulnerabilities identified in the Discussion Paper would support increased trading on trading venues, as would addressing the lack of standardisation and fungibility in the VCMs. We discuss this further in our response to questions 10 and 11.

It will also be important for each jurisdiction to determine which regulator or authority is best placed to address these vulnerabilities, and to carefully delineate the roles and powers of the different authorities.

We would also strongly support the statement in paragraph 2.3 that "financial intermediaries play an important role in facilitating trades between buyers and sellers. Intermediaries can pool different orders to facilitate trading activity, provide clients with market information not readily accessible to many participants, and provide liquidity by bridging the gap between bids and offers". Again, we discuss this further in our response to questions 10 and 11.

We would also flag the following additional points:

- The lack of uniformity of the general trading terms of carbon credit contracts, which adds to fragmentation and illiquidity in the VCM. ISDA's work in this area is an important step towards developing this uniformity.
- The lack of accessible market and reference data is also a vulnerability. GHG program registries do not track prices, and provide very limited availability of price, volume, or transaction data for market participants.

Question 3: What kind of role could IOSCO play in coordinating the actions of industry-specific organisations and public authorities?

Question 4: How do you think IOSCO should achieve these objectives?

IOSCO has a strong track record in developing high quality international standards that have become a basis for robust regulation in major jurisdictions, and we consider that IOSCO could play a valuable role in coordinating the actions of industry-specific organisations and public authorities. In particular, IOSCO may wish to consider the following:

- **Working to align the verification standards for issuance of carbon credits in VCMs.** One of the key difficulties in scaling VCMs is the lack of fungibility between carbon credits issued by different issuers, and the lack of interoperability between different carbon registries. Increased alignment in verification standards could go some way to mitigate this.

This is also an issue of environmental integrity. It would be helpful for IOSCO to consider a range of supply and demand-side issues in efforts to support the development and functioning of VCMs, as well as potential interactions between VCMs and CCMs. The ICVCM CCPs, Assessment Framework, and Assessment Procedure are designed to inform and guide the assessment of carbon-crediting programs and different types of carbon credits. The aforementioned ICVCM Consultation provides a summary of considerations that market and policy stakeholders may need to account for when engaging in this kind of investment, such as quantification protocols and criteria for emissions reductions and removals from mitigation activities, and a description of the several ways to address additionality (i.e., assessment of financial additionality, barrier analysis, performance-based tests and common practice analysis).

- **Increasing the amount and quality of publicly available information on carbon credits.** A lack of reliable information in carbon markets could influence supply and demand dynamics, affecting levels of investment and market liquidity. Information asymmetries that investors face when trading in carbon markets suggests that there is room to support the standardization of the terms and conditions of the creation process of carbon credits, the environmental integrity of these instruments, and the use that corporations are making of them. Regulators should focus on harmonizing these aspects to scale up a VCM and enhance market efficiency.

Regulators may also wish to focus on establishing enforceable frameworks for robust disclosure and reporting on the purchase and use of carbon credits. As the discussion paper notes, standardized disclosure that is accurate and complete helps to align market expectations and contributes to capital allocation since stakeholders will have sufficient information for decision-making. For that reason, and to avoid the risk of potential greenwashing concerns, regulators could potentially consider the endorsement of aspects of global disclosure standards (e.g., as developed by ISSB) relevant to VCMs, and by considering consequences if regulated entities fail to report and disclose the use of the carbon credits in an adequate manner.

- **Publishing guidance for regulators around best practice for secondary trading in VCMs.** While a full securities-style regulatory framework around secondary trading in VCMs (e.g., including a market abuse regime) is likely to be premature given the early stage of development of this market, guidance around best practice may be helpful in

fostering confidence in trading these assets, which in turn would help the market to grow and mature.

Question 5: Should IOSCO seek to collaborate more closely with these private initiatives? How might such a collaboration function?

Despite significant efforts by multiple public and private sector authorities, some barriers to the development of robust VCMs for high-integrity carbon credits remain, including fragmentation and a lack of standardization, transparency, and liquidity. Underlying these barriers, structural integrity challenges persist, including ensuring that carbon credits meet standards for additionality, permanence, and leakage. Defining a benchmark standard for quality is a core aim of the Integrity Council for the Voluntary Carbon Market (ICVCM)¹⁵. The mandate of the ICVCM is (i) to establish, host, and curate a set of CCPs, which will set new threshold standards for high-quality carbon credits and define which carbon-crediting programs and methodology types are CCP-eligible; (ii) to provide governance and oversight on standard setting organizations on adherence to the CCPs as well as on market infrastructure and participant eligibility; and (iii) to help to coordinate and manage interlinkages between individual bodies, and define a roadmap for the responsible growth of the VCM. In conducting its work, the ICVCM collaborates with a constellation of other initiatives working across the value chain including the Voluntary Carbon Markets Integrity Initiative (VCMI), the Science-Based Targets Initiative (SBTi), and the Glasgow Financial Alliance for Net Zero (GFANZ).

IOSCO should consider collaborating more closely with the private market-led initiatives that have been created to promote the growth of VCMs, including ICVCM and other private-sector initiatives, the global financial industry, regulators and authorities, and other relevant stakeholders that are examining these topics to deliver a holistic regulatory approach to ensure market integrity and resilience with regard to the supply and demand sides of carbon markets, and the market infrastructure. Many of these initiatives have been working for some years on their particular focus area and have accumulated significant expertise and industry engagement, and they would be able to provide IOSCO with a valuable perspective on any standards or guidance that IOSCO may intend to develop.

For example, IOSCO should at a minimum identify any initiatives that are relevant to standards or guidance that IOSCO is seeking to develop and should engage with them at an early stage to understand their level of engagement to date and willingness to collaborate with IOSCO.

Where possible, IOSCO should not seek to reinvent the wheel—if there is existing research that can be leveraged, or existing standards that are fit for purpose (or would be fit for purpose with some amendment), IOSCO should aim to leverage that research or endorse those standards.

¹⁵ The ICVCM is the governance body established in September 2021 following recommendations of the Taskforce on Scaling Voluntary Carbon Markets, initiated by Mark Carney (Co-chair, GFANZ and UN Special Envoy on Climate Action and Finance), and sponsored by the IIF.

However, IOSCO's role should be to identify the key factors and best practice relevant to the standards and guidance that it intends to develop. Ideally the outcome would be a single best practice standard for the industry or regulators to adopt in a given area, whether this is an existing standard or a new one published by IOSCO (or by another standard setting body, or by a group of bodies acting collaboratively).

Where there are multiple existing (and potentially competing) standards, achieving this harmonisation may require collaboration from the bodies that have set those existing standards. Again, where work has already been carried out to harmonise multiple existing standards, IOSCO should aim to leverage and endorse that work if appropriate.

Question 6: What, in your view, is the legal nature of an offset credit? Should IOSCO recommend a specific approach to relevant authorities?

ISDA has commented on this issue in its December 2021 paper "[Legal Implications of Voluntary Carbon Credits](#)". We have set out an overview of the key comments below, but please see the full paper for more detail.

In particular, we would like to flag that it is critical to distinguish between the legal characterisation of an offset credit (i.e., what it is as a matter of law in the relevant jurisdiction – is it property or some other kind of right) and the regulatory characterisation (i.e., what sort of asset is it – is it a security, a commodity or some other kind of instrument). We do not agree with IOSCO's statement that "the general tendency is to categorise carbon credits as a commodity". In our experience the regulatory categorisation of VCCs is not yet clearly established in most jurisdictions, let alone the legal categorisation.

The possible legal nature of a carbon credit currently differs across jurisdictions. In some jurisdictions they may be viewed as a form of intangible property, while in others they may be viewed as a bundle of contractual rights. As with any intangible asset, much depends on the legal treatment: different rules could apply regarding how a VCC may be created, bought, sold, and retired, what type of security may be taken, how security may be taken and how they are treated on insolvency (including with regard to netting) and what rights of redress are available in the event of a dispute.

Similarly, the regulatory nature of a carbon credit will differ across jurisdictions, with arguments being made for treating these assets as securities, commodities, digital assets, or another type of unregulated asset. The regulatory categorisation of these assets will also determine whether VCMs may fall under existing regulatory regimes or restrictions. For example, if they are categorised as securities then they may fall within existing market abuse regimes, public disclosure regimes, prospectus regimes and licensing regimes. These requirements and restrictions will vary depending on the relevant jurisdiction, so it may be more helpful for IOSCO to identify clear regulatory categorisation of these assets as a key feature of robust VCM markets rather than to seek to harmonise regulatory categorisation at an international level.

In particular, as mentioned above, it is possible to regulate an asset in a similar way to securities without the asset becoming categorised as a security itself.

It is also important to distinguish between the legal nature and regulatory status of VCMs themselves and the nature of transactions in VCMs (e.g., derivatives transactions with a VCC underlying such as listed futures or OTC forwards or options). Robust regulation of derivatives already exists in all major jurisdictions and any regulation of VCCs as an asset class should not duplicate or undermine this regulation.

Question 7: What is the role of blockchain and distributed ledger technology in voluntary carbon markets?

At present, blockchain and distributed ledger technology (DLT) is planned to be deployed in certain VCMs. The Bank for International Settlement's [Project Genesis 2.0](#) explored the technical feasibility to digitize green bonds with carbon forwards (also known as mitigation outcome interests (MOIs)). As part of the project, two prototypes were developed to track, deliver, and transfer digitized MOIs with the use of blockchain, smart contracts, and other related technologies.

Question 8: What are the benefits and vulnerabilities of using tokenisation over relying on more traditional market infrastructure? Do these benefits outweigh how energy-intensive the use of blockchain is?

As discussed above, one of the key issues to be resolved in order to build a more robust market in VCMs is security of transfer and in particular the need to obtain good title over assets upon a transfer and to ensure that the assets will not be subject to claw back in circumstances such as the insolvency of a counterparty.

One way to increase security of transfer would be for jurisdictions to introduce statutory protections for transfers of VCMs (e.g., by extending protections that already exist for other assets). A range of legal enablers including e-signatures legislation may be needed to ensure that DLT-based solutions are legally effective.¹⁶ For example, for DLT arrangements that rely on a consensus algorithm to effect settlement finality, there may not necessarily be a single point of settlement finality and the applicable legal framework may not expressly support finality in such cases.¹⁷ However, even absent these statutory protections, blockchain and distributed ledger technology (DLT) could provide additional certainty around reliable records of ownership and transfer.

The use of immutable, DLT-based market infrastructure for transacting tokenized environmental assets could improve market transparency, traceability, and trust. DLT solutions can be deployed to improve the interoperability of existing registries and exchanges and to create a more

¹⁶ IIF, [Decentralized Finance: Use cases, Challenges and Opportunities](#), November, 2022, p. 36.

¹⁷ BIS Committee on Payments and Market Infrastructures, [Distributed ledger technology in payment, clearing and settlement](#), 2017, p. 16.

harmonized infrastructure for transacting carbon credits. Of course, the extent to which interoperability could be improved is itself of function of how a new system is designed and integrated with this purpose in mind. In respect of environmental integrity, the use of digital technologies (e.g., IoT, AI, DLT, 5G) to meet the data storage and scalability requirements necessary to compile and process high volumes of digital information related to measurement, reporting and verification could enable the secure collection, storage, and certification of data related to carbon credit quality. Therefore, policy frameworks should include consideration of how digital technologies could potentially support the development of enhanced market infrastructure and governance mechanisms. One such example could be the transparency and/or harmonization of data standards that enables open-source access to emission reduction information and traceability of attributes uniquely associated with a given project, credit, or market participant.

It is important to bear in mind that blockchain technologies are still evolving and, depending on their design and accessibility, may suffer from vulnerabilities including around AML/CFT and financial crime risks, data privacy, and cyber, code or governance vulnerabilities. Permissioned or private blockchains may be less vulnerable than permissionless, public blockchains in various aspects, particularly to AML and financial crime risk, but may be less scalable or have less reach. Market participants may also encounter significant costs in integrating DLT-based solutions with non-DLT based back-office systems. Legal frameworks, both domestically and internationally, as they apply to transactions that occur via DLT-based systems and smart contracts are still evolving and will take time to adapt sufficiently to support scale.

We note that while there has been extensive discussion of the energy-intensive nature of mining cryptocurrencies such as Bitcoin, not all blockchain technology is similarly energy-intensive. For example, the move of the (permissionless) Ethereum blockchain from Proof of Work to Proof of Stake was estimated to result in energy savings of some 99.95%.¹⁸ Permissioned blockchains with small numbers of nodes can be expected to be many times less resource-intensive, again on a per transaction basis.¹⁹ That said, other trade-offs exist between a Proof of Work model versus a Proof of Stake model of governance that should be understood independently of energy intensity. The means of transacting should be a decision that counterparties can take for themselves (or with the benefit of appropriate advice) in the same way that they do with other asset classes. Transparency around the advantages and disadvantages of different technologies would help market participants to take informed decisions. The method of transferring or trading these instruments should not be relevant to the way in which they are categorised or regulated.

¹⁸ Explore the Merge with Consensys, accessed September 27, 2022

¹⁹ EU Blockchain Observatory and Forum, [Energy Efficiency of Blockchain Technologies](#), p. 15

Question 9: Should IOSCO recommend good practices regarding transparency on the use and impact of carbon credits by market players?

As mentioned above in our response to question 3, IOSCO has a strong track record in developing high quality international standards that have become a basis for robust regulation in major jurisdictions, and we would welcome IOSCO recommendations or standards aimed at improving transparency in VCMs.

However, we also note that sustainable finance and VCM disclosure and transparency measures are currently being developed both at a national level (e.g., with the EU and UK developing disclosure regimes) and by independent bodies (e.g., the ICVCM). As these measures are finalised and implemented, the most helpful role for IOSCO may be to develop initiatives to align these disclosure and transparency regimes to ensure that they do not lead to barriers to cross-border business or to disproportionately onerous requirements that may act as an impediment to growth of the VCC market.

Question 10: Are these the key considerations appropriate for the sound functioning of voluntary carbon markets?

Question 11: What other key considerations may be necessary in order to scale up carbon markets?

We agree that these are the key considerations appropriate for the sound functioning of VCMs. However, we note and strongly support IOSCO's statement that these are intended to give jurisdictions a starting point and that these considerations may be considered proportionally at different stages of market evolution. The fragmented nature of VCMs means that different market segments may develop at a different rate to others, and while pockets of liquidity may develop around certain assets (particularly if a degree of fungibility can be achieved across multiple VCMs), it is likely that other assets will remain illiquid either because they cannot be adapted to have the features that would make them fungible with other assets or because there is a market for bespoke projects with highly specific terms. In developing a regulatory framework that supports confidence in the VCM and in secondary trading in these assets, it will also be important not to penalise areas of the market that should remain outside of this framework.

An important topic for further development when setting the legal framework of VCMs and CCMs is related to the importance that standardized on-exchange markets play in price formation and liquidity. The existence of proper market infrastructure to trade carbon credits results in a wide variety of positive externalities, such as good reputation (on behalf of those who participate in the market), historical trading information (to help have a better data-based market overview), and fair and best practices for intermediaries.

It will also be important for regulators to understand that some of the key considerations listed in the Discussion Paper are pre-conditions to others. For example, establishing legal certainty and

confidence in VCM issuers' governance and management of conflicts of interest are likely to be issues that need to be resolved before you can consider the relevant VCMs to be sufficiently standardised to be part of any interoperability arrangements between carbon registries or to fall within the scope of any price discovery regime.

In ISDA's view (as also discussed in its December 2021 paper "*Legal Implications of Voluntary Carbon Markets*", linked above), the key issues with scaling VCMs are:

- **Lack of standardisation and fungibility:** ISDA has aimed to address the lack of standardisation in secondary market trading in VCCs through publication of its 2022 Verified Carbon Credit Transactions Definitions²⁰, which aim to support trading of carbon credits across carbon standards and registries. However, this does not address the issues with the underlying VCCs, where significant work still needs to be done to achieve a level of standardisation and fungibility and all the benefits that flow from that, as discussed above.
- **Security of transfer:** As discussed in our response to questions 7 and 8, a key issue to be resolved is security of transfer and in particular the need to obtain good title to assets upon a transfer and to ensure that the assets will not be subject to claw back in circumstances such as the insolvency of a counterparty.
- **Intermediation:** As discussed in our response to question 2, financial intermediaries have a key role to play in any healthy market and particularly in a market which is illiquid and still developing. It will be crucial to ensure that financial intermediaries are not excluded from these markets (e.g., in the interests of controlling perceived "speculative" behaviour).

We consider these points to be fundamental to development of a robust, safe, and efficient VCC market.

²⁰ <https://www.isda.org/2022/12/13/isda-launches-standard-definitions-for-the-voluntary-carbon-market/>

ANNEX 3

About ISDA and IIF

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on [Twitter](#), [LinkedIn](#), [Facebook](#) and [YouTube](#).

About IIF

The IIF is the global association of the financial industry, with about 400 members from over 60 countries, including commercial and investment banks, asset managers, insurance companies, professional services firms, exchanges, sovereign wealth funds, hedge funds, central banks and development banks. The IIF's mission is to support the financial industry in the prudent management of risks; to develop sound industry practices; and to advocate for regulatory, financial and economic policies that are in the broad interests of its members and foster global financial stability and sustainable economic growth.

The IIF is actively engaging on topics related to carbon markets, including through serving on the Board of the Integrity Council for Voluntary Carbon Markets (ICVCM) and through research activities.

For more information about the IIF please visit our website: www.iif.com.