WORLD FEDERATION OF EXCHANGES

Response: IOSCO Voluntary Carbon Markets Consultation Report

29 February 2024

Background

Established in 1961, the WFE is the global industry association for exchanges and clearing houses. Headquartered in London, it represents over 250 market infrastructure providers, including standalone CCPs that are not part of exchange groups. Of our members, 34% are in Asia-Pacific, 45% in EMEA and 21% in the Americas. WFE's 90 member CCPs and clearing services collectively ensure that risk takers post some $1.3 trillion (equivalent) of resources to back their positions, in the form of initial margin and default fund requirements. WFE exchanges, together with other exchanges feeding into our database, are home to over 50,000 listed companies, and the market capitalisation of these entities is over $100 trillion; around $140 trillion (EOB) in trading annually passes through WFE members (at end 2022).

The WFE is the definitive source for exchange-traded statistics and publishes over 350 market data indicators. Its free statistics database stretches back more than 40 years and provides information and insight into developments on global exchanges. The WFE works with standard-setters, policy makers, regulators and government organisations around the world to support and promote the development of fair, transparent, stable and efficient markets. The WFE shares regulatory authorities' goals of ensuring the safety and soundness of the global financial system.

With extensive experience of developing and enforcing high standards of conduct, the WFE and its members support an orderly, secure, fair and transparent environment for investors; for companies that raise capital; and for all who deal with financial risk. We seek outcomes that maximise the common good, consumer confidence and economic growth. And we engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in a globally integrated financial system.

If you have any further questions, or wish to follow-up on our contribution, the WFE remains at your disposal. Please contact:

Simrita Lota, Regulatory Affairs Manager: slota@world-exchanges.org

Victoria Powell, Senior Regulatory Affairs Manager: vpowell@world-exchanges.org

Richard Metcalfe, Head of Regulatory Affairs: rmetcalfe@world-exchanges.org

or

Nandini Sukumar, Chief Executive Officer: nsukumar@world-exchanges.org.

General Comments

The World Federation of Exchanges welcomes the opportunity to respond to IOSCO's consultation on Voluntary Carbon Markets.

We have previously shared feedback around Voluntary Carbon Markets with IOSCO, namely, concerns around the ambiguity around the legal nature of offset credits, insufficient verification systems, and fragmentation risks, among others and we have noticed IOSCO's efforts in addressing such concerns.

The World Federation of Exchanges had also suggested the need for a principles-based approach to be taken by IOSCO, given the early stages of market growth that Voluntary Carbon Markets (VCMs) are in. As stated in the response to IOSCO relating to its 2023 Voluntary Market consultation, the World Federation of Exchanges believes that IOSCO's principles have the potential to support scaling up of VCMs, and reduction in market fragmentation.

Detailed Comments

1) **Does the Consultation Report use the correct and commonly accepted terminology? Are terms defined appropriately in the report and its glossary? Does the Consultation Report acknowledge all instances of inconsistent and conflicting terminology used in the industry? Are there any terms that have not been defined but which should be defined or alternatively, that should not be defined by IOSCO?**

   The glossary is comprehensive; it is useful for an international organization such as IOSCO to define key terms, in order to help aid global harmonization in the use of key terms.

   The descriptions are comprehensive and clear.

2) **Is the description of the issuance of carbon credits accurate? Are all key market participants properly reflected in the Consultation Report?**

   It's great to see IOSCO take into account the various stakeholders that are in the VCM ecosystem, including NGOs providing emission calculations, validation/ verification bodies, carbon registries and standard setters.

   IOSCO can further expand the description by stating that VCMs can promote the creation of carbon credits to potential issuers.

   Exchanges play a key role in supporting fair and transparent trading and have the potential to help with an accurate carbon price formation. These regulated marketplaces are accessible, and have the potential to play a key role in the scaling of VCMs, for example by providing a trusted infrastructure. We recommend highlighting the role that exchanges already play, but also have the potential to play in the VCM ecosystem.

3) **Is the description of secondary market trading of carbon credits accurate? Are all key market participants properly reflected?**

   In addition to the comments in response to question 2, exchanges can also provide key services that can be used in conjunction with services provided by other data providers to provide market participants with good quality information on which they can base decisions.

   We highlight the role that exchanges already play, but also have the potential to play in the VCM ecosystem such as providing the infrastructure for VCMs.

   Additionally, it is important to note that the prospect of efficient secondary carbon markets requires standardisation of both the legal treatment of VCMs and the nature of their transactions at a national level.

   We would also like to point out that the guidance covers futures and spot trading on exchanges but there is no guidance on carbon credit Exchange Traded Funds (ETFs). It would be helpful if IOSCO could provide guidance around the use and disclosure, as well as general guidance, around carbon credit ETFs.

4) **Should carbon credit ratings and data product providers fall within the scope of the recommendations within IOSCO's Report on ESG Ratings and Data Product Providers?**

N/A – not directly relevant to WFE members.

5) **Is the description of the use and disclosure of use of carbon credits accurate? Are the related supply and demand issues appropriately captured?**

It's good to see the alignment of the guidance to IFRS Accounting Standards, US GAAP and ESRS; the WFE has previously advocated for the benefits of harmonisation in reporting guidance/ regulations, including reduced reporting costs for issuers and ease of comparability for investors.

The supply/ demand issues are appropriately captured.

6) **Is the description of Article 6 mechanisms and its potential relationship to VCMs accurate? If not, please provide additional information.**

The WFE agrees with the descriptions provided.

7) **Are the Good Practices set out under the section on Regulatory Frameworks appropriate? Is there anything else IOSCO should take into account?**

In WFE's 2023 response to IOSCO's consultation on VCMs, we mentioned the need for a principles-based approach rather than a rules-based approach, due VCMs being fairly new markets; it's good to see IOSCO acknowledge that global legal/ regulatory frameworks guidance would be difficult given variations in legal regimes by jurisdiction.

Encouraging an approach consistent with IOSCO's principles for derivatives markets have the potential to bring a similar level of integrity to carbon markets as financial markets.

Registries have a large role to play in building transparency in VCMs; WFE believes that IOSCO is best placed to develop standard operating principles for carbon registries that are used for settlement in carbon credit derivative contracts. The WFE would welcome further work by IOSCO on custody and registries for carbon credits, building on IOSCO principles for digital assets as well as IOSCO principles for PRAs. Our members therefore agree that within reason global consistency in terms of principles is important in scaling up carbon markets.

Exchanges have access to both investors and issuers; they have the potential to support regulators in implementing education initiatives to develop the public's knowledge of carbon markets and encourage market participation. The crucial role of exchanges in providing infrastructure to VCMs can also be emphasized. In addition to this, exchanges' contribution to standardization of both the legal treatment of VCMs and the nature of transactions should be stressed.

8) **Are the Good Practices set out under the section on Primary Markets appropriate? Is there anything else IOSCO should take into account?**

Good practice no.5 includes the recommendation that regulators/ other authorities can engage with exchanges to standardize a taxonomy of carbon credit attributes, strengthen verification methodologies and streamline a verification process; this has the potential to bring integrity to VCMs and exchanges, which have the relevant expertise to bring value to such a discussion.

The WFE also believes that increased disclosure is likely to bring increased transparency and trust in VCMs.

9) **Are existing disclosures, third-party standards, and/or industry best practices sufficient to ensure that investors are not misled as to the environmental or carbon emissions reductions benefits? Please identify specific regulations, standards, or practices and why they are sufficient.**

There is scope for increased harmonisation among standards. There are benefits of this for investors (such as enhancing ease of comparability) and for issuers (such as reduced cost of compliance).

10) **Are existing standards for certifying voluntary carbon credits sufficient to promote robust validation and verification of GHG emissions reductions/removals at the project level?**

N/A – not directly relevant to WFE members.

11) **Are there existing accounting-based approaches for establishing baseline scenarios for nature-based projects to help ensure the additionality of projects and avoid double counting?**

Currently, there is no specific accounting guidance for carbon offsetting credits under IFRS. In addition to the legal nature of such credits, there is also ambiguity around the accounting nature and hence accounting treatment of such credits. For example, one jurisdiction may treat a credit as an intangible asset whilst another as a financial instrument.

12) **Are there existing best practices for modeling carbon emissions reductions related to nature-based projects that take into account the effects of climate change that could affect project permanence and efficiency in terms of meeting carbon objectives?**

N/A – not applicable to WFE members

13) **Where issuance and trading of voluntary carbon credits is not subject to comprehensive regulation, how can the accuracy of disclosures around the carbon emissions reductions benefits of voluntary carbon credits be more transparent to regulators?**

Standard setters such as IFRS can provide specific guidance on disclosure around carbon emission reductions and IAASB can provide specific guidance around carbon accounting assurance.

Adherence to guidance from key standard setters can be seen as a sign of high-quality reporting, where related regulations do not yet exist.

14) **To address risks that low-quality projects could result in voluntary carbon credits that do not represent their promised carbon emissions reductions benefits, are disclosure-based standards sufficient to mitigate against misleading investors? Are there cases where even robust disclosure as to the underlying project quality, and therefore the quality of the carbon credits based on such project, would be insufficient to protect investors?**

In addition to disclosure-based standards, assurance-based standards are likely to help mitigate against misleading investors.

In addition to the above, education initiatives for both investors and issuers would help.

15) **Are the Good Practices set out under the section on Secondary Markets appropriate? Is there anything else IOSCO should take into account?**

The good practices are generally comprehensive. However, the term 'trading venues' is very broad; IOSCO could detail their definition of a trading venue and differentiate between exchanges and other trading venues.

The crucial role of that the exchanges' knowledge/ experience can play in providing infrastructure for VCMs can be emphasized.

16) **Are the Good Practices set out under the section on governance and risk management appropriate? Is there anything else IOSCO should take into account?**

Good practice 16 suggests that exchanges should be required to have effective enterprise risk management frameworks in place to address potential operational or technological risk associated with trading carbon credits.

Exchanges generally already have similar risk management systems in place; extending such systems to include risk from trading new products such as carbon credits, is a natural progression.

17) **Are the Good Practices set out under the section on market abuse appropriate? Is there anything else IOSCO should take into account?**

The practices are clear and comprehensive. However, the term 'trading venues' is very broad; IOSCO could detail their definition of a trading venue and differentiate between exchanges and other trading venues.

18) **Are the Good Practices included in this Consultation Report appropriate? Are there any Good Practices that IOSCO should consider modifying, removing, or adding in the final report? Please provide commentary on each of the Good Practices. Please explain your rationale**

As mentioned in responses to the above questions, the WFE is in general, supportive of the recommendations by IOSCO. There are certain areas, where the role of exchanges can be highlighted due to the fact that exchange have the potential to play a key role in scaling up VCMs, such as by enhancing integrity, good quality data and enhancing investor/ issuer education; such areas are highlighted above in the responses around the relevant 'good practice' section.