WFE Response: IOSCO Voluntary Carbon Markets Consultation

8 February 2023

WORLD FEDERATION OF EXCHANGES

Background

The World Federation of Exchanges (WFE) is the global trade association for regulated exchanges and clearing houses. We represent the operators of over 250 market infrastructures, spread across the Asia-Pacific region (37%), EMEA (43%) and the Americas (20%), with everything from local entities in emerging markets to international groups based in major financial centres. In total, member exchanges trade around $100 trillion a year and are home to some 60,000 companies, with an aggregate market capitalisation of around $120 trillion. The 50 distinct central counterparty (CCP) clearing services (both vertically integrated and stand-alone) collectively ensure that traders put up $1 trillion of resources to back their risk positions.

With extensive experience of developing and enforcing high standards of conduct, WFE members support an orderly, secure, fair and transparent environment for all sorts of investors and companies wishing to invest, raise capital and manage financial risk.

Founded in 1961, the WFE seeks outcomes that maximise financial stability, consumer confidence and economic growth. We also engage with policy makers and regulators in an open, collaborative way, reflecting the central, public role that exchanges and CCPs play in an internationally 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:

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General Comments

The WFE welcomes the IOSCO consultation on the voluntary carbon markets and values the opportunity to provide input on this important topic.

Exchanges can, and already do, play a central role in the carbon market ecosystem through supporting fair and transparent trading and enabling price formation. As regulated marketplaces, exchanges create access to capital markets by facilitating deep and liquid pools of capital and by enabling price discovery. Exchanges work to ensure that robust infrastructures are in place, including operations to reduce cybersecurity risk and to enhance operational resilience more generally.

The voluntary carbon markets are still evolving and striving to reach a mature state. As they continue to evolve, voluntary carbon markets can assist in the transition towards achieving the climate goals set by international policymakers. An overly prescriptive approach to the development of the voluntary carbon markets at this stage could have the effect of impeding the promise these markets offer to assist the larger community in reaching global emissions reduction targets. We provide greater context and detail in our response.

Both voluntary and compliance carbon markets aim to help the world achieve the Paris Agreement goals, managing risks and returns effectively. Therefore, the WFE supports the development of solutions and systems to ensure that compliance and voluntary carbon markets work in tandem. This will allow investors, companies, and governments to plan transition pathways, give carbon a price to steer investments and adjust business strategies respectively, and also to support reaching the overall climate goals. Carbon markets can significantly improve risk management strategies whilst helping investors and companies manage their transition to net zero.

WFE members are strong proponents of market-based solutions and have been at the forefront of launching voluntary carbon-based contracts. Given the early stages of the development of these markets, WFE members support policymakers in developing guidance and principles rather than firm rules at this time. At this point, we believe that IOSCO should facilitate ongoing discussion on a structure for voluntary carbon markets rather than establish an extensive regulatory framework at too early a stage which could hinder innovation.

Answer to Questions

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

Yes, the elements are reflected accurately, however, further information about carbon credit pricing mechanisms could be included, such as how the initial pricing is established.

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

Yes, the consultation has identified key areas of vulnerability. Governance arrangements throughout the voluntary carbon market system (from project registration to the retirement of credits) do play a strong role.

In the absence of trusted standards and methodologies, accusations of greenwashing may occur where cases of double-counting (which may be unintentional) or insufficient verification or oversight, for example, have taken place.

From the perspective of exchanges, such cases are harmful to overall acceptance and trust in offset markets and could obstruct the growth of these markets. The work being done by existing industry standard-setters on the development of integrity frameworks for the carbon markets is helping to minimise this risk. In its role as facilitator, IOSCO could ensure that measures to minimise greenwashing are adequately discussed.

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

The framework for the spot market for voluntary carbon is continuing to evolve. At this point, we believe that IOSCO should facilitate ongoing discussion and coordinate cross-border engagement across financial regulators on a structure for voluntary carbon markets rather than establish an extensive regulatory framework at too early a stage which could impede innovation.

High integrity carbon markets are crucial and the development of best practice recommendations that different jurisdictions could utilise – pointing to the work that industry-specific organisations have already completed and experiences of different market participants could be helpful.

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

Given the early stages of the development of these markets, WFE members support policymakers in developing guidance and principles rather than firm rules at this time. WFE members stand ready to engage in assisting the development of a framework for this market.

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

Both the primary spot market and derivative markets for voluntary carbon and a related registry framework are continuing to evolve. It would be premature for IOSCO to develop an extensive regulatory framework so as not to inhibit existing industry efforts; however, we do believe that forums sponsored by IOSCO would offer notable opportunities for different industry stakeholders to discuss relevant issues. In this regard, experience from existing private sector initiatives which aim to address many of the identified vulnerabilities, such as the Integrity Council for the Voluntary Carbon Market (ICVCM) on the sell-side or Voluntary Carbon Markets Integrity Initiative (VCMI) on the buy-side, should be built upon.

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

Ambiguity regarding the legal nature of voluntary carbon credits can be a significant challenge and impediment to the growth of this market. It is probably best, however, that individual jurisdictions determine the legal framework for offset credits in their respective jurisdictions. Given the global nature of this market, though, there could by merit in IOSCO facilitating a dialogue on this topic across jurisdictions.

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

The market is currently functioning well without distributed ledger technology (DLT). Whether any market operator chooses to use DLT or some other form of tech is a matter for them. Some tokenised credits without an 'anchor' to physical market prices, can exhibit high volatility and thus introduce some risk for investors. The benefits of DLT are more obvious downstream in B2B2C or retail offset applications (like offsetting taxi rides or airline tickets below a 1,000-tonne lot size), where the fractionalisation of credits can be supported by blockchain traceability back to the original wholesale carbon credit.

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

At this stage, we believe that the benefits of using more traditional market infrastructures would outweigh the vulnerabilities of using tokenisation. Notably, many buyers in the B2B market are permissioned to buy or trade carbon credits as the asset type, but not necessarily to buy or trade a token as an abstraction of the underlying carbon credit. In this way, DLT can add a layer of friction to B2B wholesale credit trade. It may not be the 'vulnerability' of the tokenisation that is the main issue, as the potential inefficiency of interoperability of tokens on different chains, being transferred between platforms and registries. That said, the World Bank meta registry could (or will) benefit from blockchain as the ultimate source of truth of single ownership, by validation 'ping-tests'. Some newer DLT is, by design, very low carbon-intensive compared to say Bitcoin or older protocols.

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

Yes, IOSCO could work on supporting established, trusted international multi-stakeholder bodies, such as the ICVCM, the VCMI, the Science Based Targets initiative (SBTi), the Race to Zero campaign (R2Z) and Oxford University's multi-disciplinary ZERO Institute, to name a few, as they are already working on the appropriate use of credits, or appropriate claims.

Moreover, IOSCO could establish an advisory committee with representatives from different relevant entities to assist with its work in this area.

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

Yes, we believe IOSCO has covered the key considerations appropriate for the sound functioning of voluntary carbon markets.

We note that regulated exchanges could play a significant role in the ongoing development of the carbon markets by working in partnership to create an infrastructure that would help the carbon markets work more efficiently.

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

Eventually, interoperability and the reduction of market fragmentation across jurisdictions will benefit the scaling of carbon markets. However, the voluntary carbon markets are still evolving and striving to reach a mature state. At this stage, an approach to the development of the voluntary carbon markets involving guidance or principles would be recommended. Furthermore, coordination of global action at this early stage by IOSCO, notably when it comes to the financial oversight of these markets, would bring additional trust which would benefit the uptake of carbon markets in a less fragmented manner.