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International Organization of Securities Commissions (IOSCO)

Ms Kris Nathanail

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Re: Voluntary Carbon Markets Consultation Report CR/06/23

Dear Ms Nathanail,

The European Financial Markets Lawyers Group (the “**EFMLG**”) is a group of senior legal experts from the EU banking sector dedicated to making analysis and undertaking initiatives intended to foster the harmonization of laws and market practices and facilitate the integration of financial markets in Europe. The members of the Group are selected on the basis of their personal experience amongst lawyers of major credit institutions based in the EU active in the European financial markets. The Group is hosted by the European Central Bank.

The EFMLG welcomes the publication of the IOSCO Voluntary Carbon Markets (“**VCMs**”) consultation report (the “**Report**”) and the opportunity to provide its views on it. As you may know, during the last years the EU has moved towards putting in place an ambitious climate policy with the aim to remove as many carbon dioxide emissions as it produces by 2050. Following this path, many private sector entities have made public commitments to become net zero by 2050, in line with the targets set out in the Paris Agreement.

In this context, VCMs are becoming increasingly important in the EU. It is essential that financial markets and their stakeholders can rely on robust and reliable markets as an integral part of their decarbonization strategy. Furthermore, in order to increase transparency and reliability of VCMs as well as to avoid the emergence of markets segmented on national/regional lines, we believe that an improvement of the regulatory framework, also in terms of enhanced consistency and alignment across different jurisdictions, should be pursued. This would also provide more legal

In this regard, and in connection with the content of the Report, we would like to share with you the following points:

0.-Definition of Voluntary Carbon Market (VCM)

We would suggest amending the definition of VCM provided for in Appendix 2.-Glossary by including an explicit reference to the use of carbon credits as a means of claiming contribution to climate change mitigation. The underlying rationale of this suggestion is to consider those scenarios where the purchaser (be it an individual or an entity) of carbon credits is willing to claim a contribution to the above-mentioned purposes, albeit not having specific emissions to be offset by these credits. The ultimate aim pursued by this broadened definition would be to enhance the “deployment potential” of the carbon credits and of the related market.

The proposed, amended definition would read as follows: “A type of carbon market where entities voluntarily buy credits generated from projects that either (i) avoided CO₂ emissions, (ii) assisted in the reduction of emissions, or (iii) permanently removed emissions from the atmosphere, thereby allowing these buying entities to offset some or all of their own carbon emissions or contribute to climate change mitigation”.

1.- Need to increase reliability of VCMs

As stated in section 6.1 of the Report, “*Legal and regulatory uncertainty regarding the creation and use of carbon credits is another issue clouding the development of VCMs*”.

The EFMLG considers that a robust regulatory framework should be the cornerstone of VCMs development. In this regard, we envisage two lines of action:

a) Regulation, supervision and oversight of the issuance, trading and retirement of carbon credits

As of today, VCMs rely on private entities and NGOs without specific regulatory framework or supervision. This can cause potential problems since there is a clear conflict of interests between the various parties involved, i.e., project developers, third-party entities, carbon crediting programs, registries, carbon credit rating companies and data product providers (as defined in the Report). Should a problem arise with one of these entities (either by actual or potential fraud and/or negligence) this could cause serious detriment in market confidence. In order to avoid this there should be a robust regulatory framework that provides legal certainty to market participants. This would also be in line with the fact that some of these actors play similar roles to those of other supervised entities in traditional financial markets (i.e.: registries vs. custodians, data product providers vs. ESG rating agencies, intermediaries vs. financial institutions). Hence, the measures driven to ensure proper behavior and robustness of the different market participants should be similar as well.

In this regard, it is important that third-party entities, carbon crediting programs, registries, carbon credit ratings and data product providers are subject to a registration/authorization obligation, comply with specific organizational obligations (mainly driven to avoid fraud, conflict of interest, misuse and/or abuse) and are supervised by competent authorities. This would reduce the risk of fraud and greenwashing, and also contribute to the development of a transparent, liquid and environmentally robust market.

In addition, a certification framework is also needed to ensure that the methodologies supporting the creation of carbon credits are reliable, accurate and comparable. This is important not only to avoid fraud and greenwashing, but also to promote fungibility and a fair comparison among different carbon credits thereby contributing to a solid, liquid and robust primary and secondary market with proper pricing of the credits.

The EFMLG considers that the proposal of Regulation of the European Parliament and of the Council establishing a Union Certification Framework for Carbon Removals (with the objective to facilitate the deployment of carbon removals by operators or groups of operators, establishing a voluntary Union framework for the certification of carbon removals) is highly positive. Any other analogous proposal in other jurisdictions will likewise be very welcome and we strongly encourage IOSCO to promote similar initiatives in other regions.

These new proposed pieces of legislation should include transitional periods to ensure that current market participants have enough time to adapt to the new requirements and to avoid any market fragmentation coming from the existence of different regulatory requirements.

b) Legal nature and regulatory treatment of carbon credits

As stated in different sections of the Report, the legal nature of carbon credits has not been determined by any specific legislation or authoritative statement of law in most jurisdictions (either in statute or court precedent). This situation gives rise to uncertainty on a number of relevant legal issues (i.e. ownership and security transfer, conflict of laws, netting, security arrangements, potential restrictions to trade with certain counterparties, etc.) which negatively affect the ability of stakeholders to acquire these rights and trade them in the market.

The EFMLG welcomes the UNIDROIT and UNCITRAL initiatives to analyze the private law aspects and the legal treatment of carbon credits and encourages IOSCO to closely follow their developments and take them into account in further reports¹. In this regard, the possibility for carbon credits to qualify as financial instruments should be especially explored. Notwithstanding

¹ We understand that this is not an easy task and will certainly take time. In the meanwhile, regulators and supervisors could assess in which areas they could provide further clarification in the short term. An example of a potential quick win could be, for instance, specifying, based on the outstanding financial regulation, which is the frontier between spot and derivatives over carbon credits. As of today, we understand that market practice is defining a spot trade as a transaction with settlement within 5 business days, but confirmation by IOSCO and/or financial market supervisors will foster legal certainty in this regard.

the complexity around this measure and the need for previous steps to be taken (in line with point 1a above), classifying carbon credits as financial instruments would not only provide certainty regarding their legal nature, but would also provide a clear and known regulatory framework for a robust primary and secondary market.

2.- Dependencies, consistency and cooperation

a) Dependencies

The Report highlights various areas, mainly in the secondary market, with room for improvement in terms of access to VCMs, public reports, pre and post trade disclosure etc.

Whilst we agree on the diagnosis, our understanding is that some of these features characterize a mature market while VCMs are not at this stage yet. The different problems should be tackled successively. As already explained, the priority should be to build market confidence and avoid current risks of fraud by regulating and supervising the different actors in the carbon credit cycle and having common and approved calculation methodologies.

Only once that framework is built, further steps should be taken. Otherwise, the information disclosed to the public about pre and post transparency, trading volumes, bid-ask spreads may not be representative and may mislead market participants.

To sum up, regulations around VCMs should be introduced gradually and regulators should avoid imposing obligations currently applicable to asset classes and markets which are much more mature, as these are not appropriate to VCMs at this stage.

b) Consistency and cooperation

We fully agree with IOSCO Good Practice 3 regarding the need for relevant regulators and authorities to consider seeking domestic and international consistency and alignment when developing their regulatory approach to VCMs. As stated in the Report, global consistency is an important component of scaling carbon markets as fragmentation in the market could create diverse and different liquidity pools. In this regard, implementing consistency among the different regulatory frameworks (as mentioned above) should be key.

It is also important to ensure cooperation among the different public and private organizations which are working towards the same objective of creating a robust and reliable VCMs. Although the specific goal of these organizations might be different, it is important that they all have a holistic and coordinated approach in the analysis of VCMs and their needs². In this regard, it is important to bear in mind that projects, trading behaviors, decarbonization objectives or the

² By way of example, whilst some organizations are taking a very narrow approach to the potential activities around VCMs, restricting the target market for this product based on integrity of demand drivers, IOSCO has taken a wider and more comprehensive approach, considering also as legitimate purchasers short term trading buyers and buyers willing to contribute to the planet aside net zero objectives.



need/possibility to reduce carbon emissions are not (and cannot be) homogeneous across the world and this heterogeneity should be considered by such public and private organizations when making public recommendations or trying to create market standards.

3.-Disclosure

We also concur with IOSCO Good Practice 21 regarding the need for relevant regulators and other authorities to promote disclosure of the use of carbon credits, consistently with their respective mandates as well as their jurisdiction's laws and domestic legal requirements. The degree of transparency existing at present within VCMs i) is seemingly relatively low, ii) prevents market participants from achieving full visibility of key financial metrics, market dynamics and market products and iii) hinders these participants' ability to forecast market trends.

In this respect, we appreciate the reference made by IOSCO to i) the Delegated Acts on the European Sustainability Reporting Standards and, in particular to ii) the circumstance that they include standards for carbon credits disclosure. We consider that these legislative instruments represent a valid benchmark and serve as point of reference [for similar initiatives] in the field of disclosure [in other jurisdictions].

The EFMLG remains at your disposal for any assistance or support you may need on this matter.

Yours faithfully,

Fernando Conlledo

Vice Chairman of the EFMLG