



WFE Response: IOSCO Compliance Carbon Markets Consultation

8 February 2023

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 compliance 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.

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.

The carbon markets are currently evolving rapidly and there is a need to foster greater transparency in these markets. Given the early stages of the development of these markets, WFE members support legislators developing guardrails for these markets in the form of guidance and principles rather than firm rules at this time.

Answer to Questions

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

The benefits of linking frameworks include the development of broader and deeper markets, the enhancement of liquidity and the creation of opportunities for more participants to trade in these markets. It would be beneficial for the growth of these markets if pricing mechanisms and corresponding adjustments¹ could converge and equivalence measures be developed so that further interaction between the established (and any new) compliance markets can be encouraged. The development of IOSCO guidelines in this area could foster greater interoperability amongst existing and new compliance markets and also between compliance and offset markets.

We are aware that certain domestically generated voluntary carbon market credits are eligible within the respective national or regional compliance carbon markets. Relevant to the linking of such markets are the conditions under which this is possible. International cooperation on this topic is desirable, to which IOSCO could lend its support. This is also relevant for developments within the context of Article 6.4 of the Paris Agreement and the use of domestically created carbon credits.

As noted, we believe that the benefits can be enhanced. Risks can be mitigated. Existing methodologies for managing some of the risks identified already exist in different market structures as originally established by IOSCO Principles.

¹ Article 6 of the Paris Agreement established an accounting mechanism known as corresponding adjustment to ensure that double counting does not take place.

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

Some of the conditions that might require further elaboration include the need for similar pricing structures, similarity of registry arrangements, payment system equivalence and robust governance and risk management structures across jurisdictions. IOSCO could support these initiatives by laying down recommendations on aspects of oversight as proposed in the consultation paper.

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

Yes, these principles have proven effective over the years when applicable to, for example, commodity markets. Whilst similar high levels of oversight and infrastructure are relevant to carbon markets, it should be noted, however, that these markets are very bespoke in their structures and functioning and therefore caution is merited when determining whether and how to apply such principles to carbon markets. By its nature, compliance markets are already regulatory in nature and subject to dedicated climate-related regulations.

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

Yes, we would advise that the IOSCO 'Principles for Oil Price Reporting Agencies' are also relevant. Whilst these principles are intended to promote the reliability of oil price assessments that are referenced in derivatives contracts subject to regulation by IOSCO members, IOSCO has encouraged all Pricing Reporting Agencies (PRAs) to implement these principles more generally to any commodity derivatives contract that references a PRA-assessed price without regard to the nature of the underlying. As a result, these principles could also inform practices in the compliance carbon markets.

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

As noted in the consultation, currently there seems to be fragmentation of oversight. For example, some jurisdictions treat spot allowances as financial instruments, whilst other jurisdictions do not. International cooperation in CCMS might benefit from more consistent regulatory frameworks across jurisdictions, ie, good conduct rules (including conflicts of interest), transparency and monitoring of: trades, fraud, insider trading and price manipulation. IOSCO guidelines could be relevant in this regard.

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

We believe the key aspects of compliance markets that could benefit from regulatory oversight at this stage of the development of these markets have been identified by IOSCO.

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

Yes, these recommendations seem reasonable and appropriate. However, review of aspects of the recommendations that would foster greater convergence and thus reduce fragmentation should be considered.

We would like to add a few suggestions to further improve the data quality and market transparency of compliance carbon markets. Relevant authorities in charge of primary issuance of emissions allowances are encouraged to:

1. Consider issuing guidance governing the trading of carbon emissions allowances and increased penalties for data fraud.

2. Continue working to strengthen capacity building of market participants to enhance their operational capacities.
3. Consider bolstering the construction of information disclosure mechanisms and credit systems, working with relevant agencies or organisations in order to supervise the data transparency and quality.

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

For the next phase of the functioning of the markets – relevant authorities should ensure that governance, conduct risk, and reporting become the focus to ensure the robustness of the market as it develops further.