February 10, 2023

Japanese Bankers Association

JBA comments on the Discussion Paper “Voluntary Carbon Markets” by the International Organization of Securities Commissions (IOSCO)

Questions	Comments
1. Is the description of the issuance of carbon credits accurate? Are all key market participants properly reflected?	・ It is critical to set out the role (including intention/financing) of project developer. ・ The sequestration period (particularly for nature-based offsets) should also be included, because we should consider the financing of ‘carbon assets’ at the project developer stage with ex-ante verification vs. offsets verified ex-poste the sequestration period. This varying time horizon introduces financial risk given the price volatility/non-permanence/regulatory risks that can occur in between. ・ We also suggest that the various offset platforms should be distinguished and explained here (auction, two-way, bilateral) and the price determination for each platform type. ・ Include the role of offset ratings providers such as Sylvera who can play an increasingly important role in market transparency. ・ The description of the issuance and key market participants are accurate. However, other information needs to be reviewed as it is sometimes inaccurate or misleading. - *“In voluntary carbon markets, purchasers will offset their emissions by purchasing the reductions stemming from a third-party climate change mitigation project.”* This implies that there is no other option than offsetting when purchasing a credit, which is not the case (trading is possible). - *“In many circumstances, the project will need to demonstrate qualities such as additionality, permanence, and independent auditing, to name but a few.”* This implies that this is not always the case. We would argue that this is always the case for internationally recognized VCM carbon offset programs as of today. - *“Given the difficulty in assessing projects, certification companies have also emerged as a key player.”*

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	True, but their role is primarily to be independent, which gives confidence to investors that the project actually achieves its objectives. - *"They will typically consider criteria such as…"* True, but certification companies base their evaluation on the criteria provided by carbon offset programs. (e.g., The assessment will be slightly different for a GS project or a Verra project.) - *"further announcements are expected from the United Nations on the practical aspects of such implementation and will likely impact the functioning of the voluntary markets over time."* Not the UN, but the COP. The rulebook for corresponding adjustments has been approved as of COP26 in 2021. - *"Issuances, which have outpaced retirements every year, have begun to dramatically outstrip them, resulting in an increasingly high surplus of voluntary credits.":* True, but not for all credits. There is high demand for removals while there is less demand for avoidance credits. We would argue that the analysis provided is very shallow and gives the wrong impression about the market. (Oversupply and pricing are not the issue. Quality is.)
2. Has the consultation identified the relevant vulnerabilities? Are there any others that should be considered? Please explain.	• We think the following points should be highlighted regarding the lack of certainty as to the legal nature and treatment of carbon credits, the lack of certainty as to the accounting treatment of carbon credits and the lack of certainty as to the capital (risk-weighting) treatment of carbon credits. • Platform risks - This is mentioned later in the paper, but worth including sooner to highlight the risks of trading through non-regulated/observed platforms. • Regulatory and policy risks - In the absence of a global cohesive UN registry and enforceable policy, FIs can be subject significant losses in the net present value of carbon offsets for early project financing in particular. • Lack of standardised methodologies - Methodologies are provided by carbon offset programs to determine baselines scenarios. The determination of additionality is much more challenging than determining the baseline.

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	• Permanency - *"In terms of temporality, reducing emissions elsewhere rather than at home is indeed equivalent if the project financed leads to an immediate reduction in emissions."* This is not the common understanding of market participants. - *"Hence, permanence of GHG reductions or removals is a necessary requirement for offset projects to serve their ultimate goals."* True, but only for removals. - Steps have been taken to de-risk permanence risks with carbon offsets programmes. We strongly recommend that IOSCO looks into measures taken by Verra and GS, among others. • Double counting - *"projects may be recorded on several registries that do not speak to one another.":* True, but 1. It is unlikely that GS and VCS, for example, will not check if another project is implemented at the same facility (additionality checks require this), and 2. The World Bank is currently undertaking the development of a metaregistry, which will enhance crosschecks between registries. - *"In addition, there are still questions about how and whether a credit can be used by a corporate and simultaneously claimed against a country's national determined contributions (NDC).":* Not true or misleading. Article 6 and rules agreed upon in COP26 require corresponding adjustments for sectors included in NDCs. While those are mentioned, we believe this section is misleading and should be revised. • Transparency - This section is misleading at best. Standardized methodologies are used across carbon offset programs, with no major differences for well-established sectors. These have been established since the CDM and revised according to best practice. When this is not the case, methodologies undergo an extensive (and lengthy) review by an expert panel. This applies to all major carbon offset programs. The carbon market cannot be liable to less-known, minor players that do not use these methodologies and do not put their own through thorough peer reviews. Regarding

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	transparency, methodologies are available publicly. There could be more work done to compare the methodologies. But, this is not the responsibility of market players and carbon offset programmes. • Conflict of Interest - The source is from 2009. We do not think this reflects the current state of affairs. - Annual reporting on emission reduction is required to issue credits. (How is that not regular?)
3. What kind of role could IOSCO play in coordinating the actions of industry-specific organizations and public authorities?	• The key priorities would be determination of the legal classification of the asset type and consistency amongst global regulators. It is important to recognize consideration for a new asset class that behaves like a commodity yet is subject to entirely different supply and demand determinants. Second would be clear 'taxonomy' and labelling of offset types and quality levels. This should be mirrored across voluntary and compliance markets in the same jurisdiction, if not globally. • We do understand the merits of better coordination between environmental regulators and securities market regulators. For example, it may be a good step to ensure with environmental regulators that underlying carbon credits used for securities are of good quality (i.e., defining the attributes required for securities).
4. How do you think IOSCO should achieve these objectives?	• Participation in TSVCM, but also engagement through a new NGFS workstream will be important for regulatory harmonisation. The cross-jurisdictional arbitrage today in VCM warrants further research and consideration to support decision making. The significant role of non-FIs investing in project developments directly and/or purchasing large quantities of offsets should be considered, given that they are regulated separately from financial institutions yet contribute meaningfully to global supply/demand dynamics.
5. Should IOSCO seek to collaborate more closely with these private initiatives? How might such a collaboration function?	• Yes. It might be a good opportunity for continued collaboration with TSVCM and VCMI, to hold discussions directly through NGFS for a new workstream/effort, and define environmental attributes based on these organizations' work or together with these organizations.
6. What, in your view, is the legal nature of an offset credit? Should IOSCO recommend a specific approach to relevant	• Yes. It should be treated as a commodity asset class specifically for carbon. Price discovery is entirely different given how supply/demand dynamics and regulated carbon price influences the

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authorities?	market. Consideration or preparation should also be made for the emergence of a 'shadow' VCM where buyers may consider it more efficient to source offsets directly vs. through any regulated forum/platform.
7. What is the role of blockchain and distributed ledger technology in voluntary carbon markets?	• Strong potential. We would recommend including AirCarbon and Carbonplace as some of the more credible blockchain-based offset marketplaces.
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?	• Marginal. The benefits do not outweigh the energy intensiveness and infrastructure required to set it up. A significant level of detail is required to describe some nature-based offsets so digitisation is helpful, but this requires some taxonomy/consistency for tokens to be meaningful. • A key feature for some blockchain exchanges such as AirCarbon is two-way price transparency (and the ability to trade more like a commodity vs. auction marketplaces).
9. Should IOSCO recommend good practices regarding transparency on the use and impact of carbon credits by market players?	• Yes. Any additional support or recommendations on transparency is useful, but should be done in coordination with market players.
10. Are these the key considerations appropriate for the sound functioning of voluntary carbon markets?	• Yes. They reflect key considerations. Now, key consideration 9, especially interoperability with compliance carbon markets, should be taken into consideration very carefully, as those markets depend on local regulations (which often do not allow voluntary credits).
11. What other key considerations may be necessary in order to scale up carbon markets?	• Review, transparency and financial/valuation risks to ex-ante project development investment and trading • Review of insurance products and mechanisms to protect offset buyers • Consistent approach to calculating the net asset value of carbon (given jurisdictional differences in carbon price and offset types) • Considerations on how FIs should consider calculating their Mark-to-market risk of offsets

(End)