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Promoting financial integrity and transparency in voluntary carbon markets

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Chair

Good afternoon,

It is a great pleasure to join you today at this ISDA conference on 'Completing the Carbon Pricing Framework'. In recent years, ESMA has become more and more involved in the topic of carbon markets, as their intersection with traditional financial markets has become more pronounced. Our work has primarily been related to the European Union's Emission's Trading System (ETS), Europe's compliance carbon market, where in 2021 we undertook a comprehensive study of the functioning of the EU ETS market in the context of rising energy prices, at a time where emission allowances' prices had increased three-fold.

Financial regulators around the globe have been taking an increasing interest in carbon markets. Given the increased traction and attention these markets had been garnering, regulators wanted to look more closely into the functioning and potential risks and vulnerabilities in these markets. For this reason, the International Organisation of Securities Commissions (IOSCO) established a workstream to explore the functioning of these markets further. With carbon markets expected to play a key role globally in supporting the transition to net-zero, we felt it was important to help identify vulnerabilities and contribute to their sound functioning.

Over the past three years, I had the pleasure of co-chairing this work, alongside the Chairman of the U.S. Commodities Futures Trading Commission (CFTC) Rostin Benham, and it is mostly in this capacity that I will focus my remarks today. After publishing a first Report in 2023 on developing sound and well-functioning compliance carbon markets, IOSCO has just recently published second Report on promoting the financial integrity and orderly functioning of the Voluntary Carbon Markets (VCMs). Alongside this report, is the announcement of a new partnership between IOSCO and the World Bank, in which both organisations commit to work hand in hand to assist jurisdictions looking to establish and enhance carbon markets in their countries.

We gather at a pivotal time for voluntary carbon markets. These markets have existed for over two decades, and their potential to mobilise private finance for climate action is great. Yet, their growth has been hindered by challenges that compromise their integrity and trustworthiness. IOSCO's work represents a step forward in addressing these challenges by presenting a framework that seeks to enhance financial integrity in VCMs, fostering the trust and stability necessary for these markets to scale.

The State of Voluntary Carbon Markets Today

The demand for carbon credits has been mainly driven by corporate commitments to net-zero and the pressing need for financing to support scalable climate solutions. Alongside this, rising awareness of climate change among individuals has increased interest in carbon credits, as they may provide a tangible way for people to maintain their lifestyle while taking responsibility for their emissions. VCMs are uniquely positioned to channel resources into these projects – often in the Global South – that reduce, avoid, or remove emissions. These projects range from reforestation initiatives to technological solutions for carbon capture.

However, despite their promise, VCMs face systemic vulnerabilities. Criticisms surrounding the environmental integrity of some credits have drawn significant attention. Another area of concerns stems from risks related to financial integrity: a lack of transparency, legal ambiguity, conflicts of interest, and insufficient oversight. These issues undermine trust in the market and deter investment at a time when every cent of climate finance counts.

As securities regulators, we bring a distinct perspective to this conversation. While we are not climate policymakers, we are custodians of market integrity. Our expertise lies in ensuring that markets are transparent, efficient, and free from abuse. The principles of sound financial regulation can and should be applied to voluntary carbon markets to create a stable foundation for growth.

Why Financial Integrity Matters

Why is financial integrity so critical? Simply put, without it, the market cannot scale. Transparency and governance issues discourage both investors and observers. Legal uncertainty creates hesitation among investors. Poor market conduct – whether fraud, insider trading, or manipulation – undermines confidence.

When we address these challenges, we unlock the potential for VCMs to become robust, credible tools in the fight against climate change. One key underpinning of financial integrity in the carbon credits market is the environmental integrity of those credits. For us as financial regulators, it is therefore critical that a robust framework is in place to ensure that the underlying carbon projects effectively deliver the environmental outcomes claimed by the carbon credits. That is why we see positively developments to enhance the quality of carbon credits - policy efforts such as the EU adoption of the Regulation on the Carbon Removal and Carbon Farming Certification Framework or the UK Government work on Principles for Voluntary Carbon and Nature Market as well as private-led initiatives such as the Integrity Council for the Voluntary Carbon Market. Together, these twin pillars – environmental and financial integrity – can create markets that are not only scalable but also credible.

The IOSCO Good Practices

Over the past three years, IOSCO has engaged extensively with stakeholders across the VCM ecosystem. This collaboration has informed the 21 Good Practices which were published on 14th November, designed to enhance transparency, governance, and oversight. These principles are not binding standards; rather, they are a guide for jurisdictions and market participants to promote integrity while adapting to local contexts.

Let me take a moment to walk you through the core objectives and principles of these Good Practices, which can be broadly grouped into five key areas.

Firstly, at the heart of any well-functioning market, is the need for **robust infrastructure**. In the case of VCMs, this means developing reliable systems for the custody, trading, and settlement of carbon credits. Much like traditional financial markets, participants need confidence that transactions will be secure, transparent, and efficient. This is foundational for building trust among market participants.

For example, market operators should ensure that credits are tracked from issuance through trading and eventual retirement. This reduces the risk of double counting or fraud, both of which have plagued markets in the past.

Secondly, is the need for **transparency**, which is the cornerstone of market integrity. Too often in carbon markets, critical information about the quality, origin, and trading of credits is opaque or inconsistent. This creates an uneven playing field and fosters scepticism among stakeholders.

To address this, our Good Practices call for clear and detailed disclosure requirements. Project developers, for instance, should provide comprehensive information about the methodologies used, project locations, and expected climate impacts. Similarly, trading platforms should offer real-time or near-real-time data on pricing, volume, and credit quality. Such transparency not only improves market efficiency but also instils confidence among participants and observers.

Importantly, companies that use carbon credits to meet emissions targets should also be transparent about how they are doing so. This includes clear reporting on the credibility and environmental integrity of the credits they are purchasing, as is required under the EU's Corporate Sustainability Reporting Directive for example.

Thirdly, our Good Practices emphasise the need for **strong governance and risk management standards** across the carbon credit ecosystem – from project developers to registries and trading platforms.

Registries, for instance, should implement robust systems to ensure the accuracy and completeness of their records. Regular reconciliation processes, sound cybersecurity measures, and policies to address conflicts of interest are critical. These safeguards not only protect market participants but also ensure the long-term sustainability of the market itself.

At a broader level, market participants should establish clear policies to manage risks such as fraud, operational failures, and cyber threats. Sound governance frameworks provide the discipline needed for voluntary carbon markets to evolve into mature, stable markets.

Like all financial markets, VCMs are vulnerable to misconduct, including fraud, insider trading, and manipulation. To address this, our **fourth** focus is on **robust surveillance mechanisms** to monitor market activity. Regulators and trading platforms should actively detect and address irregularities to prevent abuses that can damage the market's reputation and deter participants.

For example, trading platforms should implement real-time monitoring tools to track suspicious trading patterns, while regulators can utilize position and transaction data to enforce compliance. These measures, familiar to securities regulators, are equally critical in carbon markets, where the consequences of misconduct can undermine broader climate efforts.

Finally, the Good Practices emphasise the importance of **open, accessible, and standardised markets**. Standardization, whether in contract terms, pricing methodologies, or credit classifications, can help reduce barriers to entry and improve liquidity.

Together, these good practices reflect the principles that have long underpinned healthy financial markets. By applying them to VCMs, we can foster a fair, transparent, and efficient marketplace.

Collaboration with the World Bank

Looking ahead, while the Good Practices offer a roadmap, translating them into actionable frameworks requires expertise, resources, and support. To this end, I am pleased that IOSCO and the World Bank have put in place a practical collaboration. Together, both organisations will work to assist jurisdictions with the implementation of voluntary carbon markets, using the Good Practices as a basis.

This partnership combines IOSCO's expertise in financial market regulation with the World Bank's deep experience in capacity building and technical assistance. Our shared goal is to help jurisdictions, especially in developing countries where most of the projects are located, establish the necessary foundations needed to operationalise high-integrity carbon markets.

By doing so, we can help these markets unlock their full potential to channel private finance into climate action.

Through this initiative, we aim to foster greater consistency and harmonisation across jurisdictions, ensuring that voluntary carbon markets grow in a way that is both credible and inclusive.

EU perspective

The EU ETS, as the largest compliance carbon market globally in terms of traded volumes, plays a central role in the EU's climate strategy, covering approximately 40% of its greenhouse gas emissions. In our recently published first annual report on EU carbon markets, we estimated that EU ETS trading amounted to EUR 648 billion in 2023. This compares to combined volumes of EUR 111 bn for other major carbon markets. In contrast, the trading of voluntary carbon credits in Europe amounts to a small fraction of global activity, with much larger volumes observed in other regions, particularly the U.S.

However, the importance of the compliance carbon market in the EU does not make voluntary carbon markets irrelevant here. Rather, they play a more complementary role in scaling climate finance for areas beyond the scope of the ETS.

Furthermore, the maturity of the ETS can also provide lessons for the development of VCMs in Europe and seems likely to influence it. For example, ESMA's carbon market report documents the existence of a well-established derivatives markets for EU emission allowances and the central role played by financial intermediaries and trading platforms in bringing liquidity and expertise to the market. This can serve as a template for the development of carbon credit markets.

As carbon credits grow in integrity and trust, they could become more integrated into the EU's broader climate strategies. Carbon removals will play an important a role in the EU's 2040 target, but these technologies need to be scaled up, which requires financing. In this respect, the EU's new Carbon Removal and Carbon Farming Certification Regulation, which establishes a regulatory framework for high-quality voluntary carbon removals, helps by paving the way for the future development of a high-quality carbon credit market.

COP29 Milestone

A final word before concluding – as much as I would like to say that the IOSCO Report was the highlight for participants interested in carbon markets at COP29 recently, I am nonetheless glad to have seen it being overshadowed by the deal on implementing Article 6 of the Paris Agreement. This landmark agreement establishes a centralised, UN-supervised framework for carbon trading, which includes standards for measuring, reporting, and verifying carbon credit projects. Although the implementation details still need to be defined, this progress sets an important precedent by establishing a global architecture for the international trading of carbon credits.

The Path Forward

As the global community works to accelerate the low-carbon transition, both IOSCO and ESMA will continue to play our part. Together with other ongoing initiatives to improve environmental integrity, develop standardisation and enhance credibility in voluntary carbon markets, IOSCO's Good Practices can serve as a practical support in a journey toward building markets that serve the public good.

In conclusion, I would like to thank all those who have contributed to this work, including my colleagues in IOSCO and the many stakeholders who have shared their insights. I believe the Good Practices we present today will serve as building blocks for a market that can scale responsibly and with integrity.

Thank you.