ISDA Safe, Efficient Markets
Celebrating 40 Years

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Response to Voluntary Carbon & Nature Markets: Raising integrity

The International Swaps and Derivatives Association, Inc. (ISDA) welcomes the opportunity to respond to the Government's consultation on Voluntary Carbon and Nature Markets (VCNM). ISDA is highly supportive of the development of VCNMs and welcomes the UK's principles.

ISDA believes that a robust voluntary carbon market (VCM) plays an important role in delivering a reliable, market-based approach for investment opportunities that reduce greenhouse gas emissions and remove carbon from our atmosphere. We have a strong interest in the development of a robust VCM that will strengthen the functioning of the carbon derivatives markets and enable the continued development of liquidity in derivatives products so that market participants can appropriately manage their business risks. Facilitating trading in carbon derivatives that serve as a hedge for climate mitigation projects will contribute to the development of deep and liquid voluntary carbon credit (VCC) markets.

ISDA's interest in the VCMs stems from its members: ISDA members trade VCCs, and ISDA members have made net-zero commitments. ISDA members are also interested in investing in projects that achieve elimination or reduction of greenhouse gas. ISDA members would therefore benefit from increased consistency, comparability and clarity in the VCM.

We have chosen to focus on answering certain questions around Principle 6 (and Q1 and Q9 outside of that).

Q1) Do you agree with the Government's proposal to recognize VCMI's Claim Code as representative of international best practice?

Whilst we welcome the development of international standards to promote high-integrity voluntary carbon and nature markets, we think it is too early for the UK Government to recognise or endorse the VCMI's Claims Code of Practice as representative of international best practice. The framework is still in an early phase of implementation, with limited market uptake and several unresolved challenges. This, combined with its stringent requirements on Scope 3 emissions, makes it difficult in practice to achieve the higher-tier labels under the framework.

We therefore urge the Government to limit endorsement to a non-binding recognition of the VCMI Code at this stage. While the framework reflects a commendable level of ambition, adoption remains uneven across sections and jurisdictions, and many companies are still evaluating how to operationalize its requirements. Mandating use, either explicitly or via disclosure frameworks, risks creating disproportionate compliance burdens without materially advancing climate goals.

It is worth noting that members see the VCMI Code as having very narrow scope. This very narrow scope may explain why today very few companies use the Code. The VCM is a nascent market, and stringent eligibility criteria, complex reporting requirements and/or labels may discourage companies' efforts. The scope for the use of credits is limited as well as the scope of eligible projects as the Code only captures projects that meet the ICVCM Core Carbon Principles ("CCPs"). We do not want to restrict eligible projects to only those very few ones which meet the ICVCM CCPs.

More broadly, ISDA members are concerned that diverging national endorsements of different standards could lead to market fragmentation. To avoid this outcome and foster a coherent and efficient global carbon market, it is essential that the UK Government coordinates closely with other jurisdictions as it considers the role of the VCMI Claims Code in its policy framework.

Finally, we would also recommend a benchmarking or gap analysis with other claims frameworks currently being negotiated (such as the EU's Green Claims Directive, a proposed legislative framework aimed to combat greenwashing with strict environmental claim verifications) to also ensure alignment, consistency and international operationality across regimes.

Q9) Do you have any concerns with, or feedback related to the proposal to endorse ICVCM's CCP and their accompanying Assessment Framework as representing a minimum quality requirement?

We very much welcome the development of the ICVCM's Core Carbon Principles (CCPs)[1] and their accompanying Assessment Framework. Members recognise the CCPs as a valuable initiative that strengthens the integrity of the VCM by providing a science-based, credible benchmark for high-quality carbon credits.

We note the CCPs represent a widely supported framework for ensuring supply-side integrity, grounded in core quality principles such a additionality, permanence and avoidance of double counting. These principles are consistently reflected across all major standards currently being developed or implemented.

The majority of ISDA members would therefore support a high-level endorsement of the CCPs by the UK Government. Such an approach should not preclude use of an alternative standard by companies at this stage while preserving flexibility and recognising that other high-quality and credible crediting programmes, such as PACM as well as integrity labels like CORSIA and ICROA, also play an important role in upholding credit quality.

It is equally important to acknowledge the current fragmentation across carbon credit standard setters, each operating with different methodologies and frameworks. While the ICVCM plays a critical role in driving supply-side integrity, it does not consolidate the entire ecosystem. Greater coordination across these standard setters will be essential to streamline the carbon credit assessment process, avoid conflicting integrity claims, and establish a coherent and reliable quality benchmark. We encourage continued collaboration between governments and the various international standard setters to help achieve this outcome. Such an approach would

[1] ISDA has integrated ICVCM's CCPs in its industry documentation for trading verified carbon credits.

also allow the UK Government to continue working closely with international standard setters and acknowledge the complementary roles of methodologies, methodology-based assessment frameworks, and project-based assessments in characterizing credit integrity.

Principle 6: Co-operate with others to support the growth of high integrity markets

Q28) How could global carbon market capacity building be more effectively and efficiently deployed?

In order for the VCM to reach its maximum potential, there must be a robust secondary market for VCCs. Secondary markets have the potential to enhance clarity and comparability by providing greater price discovery and opportunities for hedging, liquidity, standardization and regulatory oversight, all of which are critical in scaling the VCM.

Expanded Use of Derivatives

At present, the VCM is focused on physically settled spot and forward transactions. Where possible, expanding the use of cash-settled derivatives in the secondary market could improve price transparency, support risk management and increase liquidity.

Market participants have indicated that the lack of price transparency is one of the key concerns limiting engagement in the VCM. Derivatives impact their underlying markets by playing an important role in price discovery, providing insights into expected future prices, offering participants a clearer signal about market trends and potential risks. Enhancing pricing discovery enables traders to make better assessments of risk, portfolio management and budget planning decisions. Market participants predict future prices of underlying assets by looking to activity within the derivatives market for such assets. This transparency reduces spreads resulting from the "uncertainty premium" that investors might otherwise demand due to the opaque nature of current spot and forward markets. By aligning price discovery in emerging carbon markets with that of more mature markets (e.g., capital markets, commodities, energy), participants will be able to make more informed investment decisions, resulting in more efficient capital allocation and promoting deeper market participation.

Additionally, derivatives are commonly used in financial markets as a tool to hedge risk. The availability of derivatives in a given market can encourage investment in that market because market actors are more likely to participate when they are able to adequately hedge their exposures.

Cash-settled forwards and futures could enable investors to engage in the market without having to take possession of carbon credits, reducing transaction costs and complexities; while the use of carbon options could be useful in allowing investors to manage price risk without committing to transactions. Options provide the right—but not the obligation—to transact, allowing market actors to more carefully calibrate their risk tolerance, for example, mitigating downside risk while preserving some upside potential.

Notably, prices of innovative derivative instruments, like credit default swaps (CDS), can provide investors with additional signals regarding the private information held by other market participants, improving the market's informational efficiency. Specifically, in the case of CDS, studies indicate that the CDS market processes credit-related information efficiently, often reacting well before credit rating downgrades are officially announced. Similarly, in the VCM, enhanced price discovery provided through secondary markets could precede shifts in market fundamentals, reduce uncertainty, improve liquidity, and help investors more accurately value carbon credits, ultimately fostering more informed investment decisions. Further, a financial instrument could be developed for carbon credits leveraging the "cheapest-to-deliver" model that would allow parties to agree that the delivery obligation under a contract could be satisfied by delivering any carbon credit that satisfies certain agreed criteria. This would require robust criteria and information to address the fraud risks unique to the VCM. Alternatively, such delivery obligations could reference credits included in an index of most commonly traded credits.

The market has already seen innovative advances that can help scale the VCM. These financial market developments support the shared goal of growing the VCMs and accelerating the transition to a sustainable economy.

ISDA Definitions and Standardization

In pursuit of the goals of consistency, comparability and clarity, ISDA has been working to bring greater standardization to the VCM from a transactional documentation perspective. In 2022, ISDA published industry documentation for trading carbon credits, including the VCC Definitions, which are definitions and related template confirmations for spot, forward and options contracts, integrating the ICVCM's Core Carbon Principles. The documents are designed to allow parties to accept a wide pool of verified carbon credits for delivery or to specify particular attributes the verified carbon credits must satisfy (for example, linkage to a particular registry or project). Because the ISDA VCC Definitions are designed for transactions in "verified carbon credits," which could include a mandatory or voluntary GHG program, certification, scheme, or protocol ("Carbon Standard"), the definitions serve to link the mandatory and voluntary markets. This linkage is similar to the way in which the Article 6 definitions support the convergence of compliance and VCMs through the Article 6.4 framework.

Greater interoperability between mandatory and voluntary markets would open up new opportunities for trading and risk management. The ability to use standardized contracts across different carbon credit registries and projects will also reduce the fragmentation in the market, helping participants operate with greater confidence and efficiency. As the market continues to grow, standardized ISDA contracts can serve as the foundation for more sophisticated derivative products, promoting further market depth and enhancing the scalability of the VCM.

Rating Agencies

The UK Government makes welcome references to project-level analysis via independent carbon ratings throughout the consultation which we welcome. Rating agencies play an important role in helping assess the impact of a project or a future project (e.g. CO_2 reduction expected performance), the useability of an applied methodology and navigate risks, however they remain at an early stage and cannot define on their own the integrity of the related credits. It is critical that ratings agencies are independent actors, with strong conflict-of-interest management, high technical standards and robust, transparent rating methodologies. We therefore believe that the UK Government should actively explore the regulation of carbon credit ratings agencies. Moreover, we believe there would be merit in the UK Government assessing a requirement for project level ratings to be disclosed alongside other project information, as a means to substantiate integrity at a project-specific level and allow the market to better understand, compare, and contrast the environmental integrity of retired credits. As mentioned above, such an approach could allow the UK Government to acknowledge the complementary roles of standards, methodologies, methodology-based assessment frameworks (CCPs) and project-based assessment frameworks (ratings) in characterising credit integrity.

Reporting and Consistent Data Standards

The spot VCM could significantly benefit from a centralized structured reporting framework. Private reporting solutions could help establish credibility and trust within the market Innovative partnerships could increase transparency and credibility in the market, attracting a broader range of investors and supporting the overall growth and stability of the VCM.

Another area for enhancement is enhanced consistency in data standards. Currently, it is difficult to compare different projects registered in different registries in part because of the lack of standardization in project criteria, which translates to a lack of standardized data about the projects and a lack of fungibility between data fields in respect of different registries. In order to support efficient and transparent markets, the flow of information about carbon credits needs to be enhanced. This can be done by strengthening data system interoperability, taking stock of and coordinating existing data interoperability efforts, ensuring alignment and avoiding duplication and fragmentation across the sector.

Continued Engagement with the Official Sector

Collaboration with regulators across the globe is important, as the VCM is inherently international, involving diverse stakeholders and jurisdictions. We acknowledge the work that the UK Government has done, including engagement with regulators in emerging markets and developing economies.

Aligning regulatory standards will encourage market participation while also ensuring compliance with regional and global environmental policies. Moreover, consistent principles-based regulatory oversight helps to promote fairness, protect investors and create a standardized framework that encourages greater participation, innovation and investment in high-quality carbon reduction projects.

Q29) Do you see any role for additional initiative(s) to support global interoperability of carbon markets?

Disclosure and reporting

Our members support the efforts of both the UK and the EU to lead and align the international efforts to drive up the levels of disclosure and reporting from carbon projects, and to bring proportionate standardisation to the reporting as much as possible. This is an important step leading to having a vibrant secondary market. Driving up reporting standards is critical to this.

Linking voluntary and compliance carbon markets

While voluntary and compliance carbon markets are conceptually distinct, it is possible for them to be linked through a universal framework. This occurs where obligations under a compliance scheme (e.g., to acquire emissions allowances equivalent to an entity's annual carbon emissions) can be reduced by acquiring carbon offsets in the voluntary market. For example, as discussed below, under the Carbon Offsetting and Reduction Scheme for International Aviation ("CORSIA"), VCCs may be used to satisfy mandatory obligations so long as the credits comply with identified eligibility requirements.

While several compliance schemes across the world are linked to the voluntary market in this way, it should be noted that the EU's Emissions Trading System ("ETS") is not. Further, the EU's carbon border adjustment mechanism (the "CBAM"), as enacted, also does not envisage use of VCCs at this time. Nonetheless, ISDA is encouraging the EU to revisit the utility of

VCCs in the context of the upcoming reviews of the EU ETS and the EU CBAM to the extent a common framework can be developed that accommodates the gaps between the two markets and overcomes issues such as a lack of consistency, comparability and clarity by looking to a framework of its own.

We believe that the further development of carbon markets will require both scaling up VCMs, where companies can buy verified carbon credits (i.e. carbon reduction, carbon removal, and carbon offsets), and maximising the reach and impact of compliance markets.

The EU and UK ETS

Although the EU ETS framework is not directly applicable to the VCM, it may provide valuable insight into how to shape a carbon credit framework.

Under the EU ETS, by April 30th of each year, in-scope entities are required to surrender a number of emission allowances ("EUAs") equal to that entity's emissions during the preceding calendar year. Failure to comply is subject to strict penalties. EUAs may only be issued under the EU ETS (by EU Member States' competent authorities). The total quantity of allowances issued each year is capped at a certain level, and that level decreases year by year. EUAs may be acquired in primary markets (either through free allocation or auctioning of allowances), and subsequently traded in secondary markets, either OTC or on exchanges, such as the European Energy Exchange. The aim of this "cap-and-trade" approach is to require in-scope market participants to effect reductions of GHG gas emissions in a cost-effective and economically efficient manner.

Prior to 2020, the EU ETS integrated carbon offsets generated under the flexibility mechanisms in the compliance framework under the Kyoto Protocol (which, in many ways, are analogous to VCCs). However, the EU does not allow the use of international credits generated under the Kyoto Protocol for EU ETS compliance after 2020 due to concerns regarding the quality and integrity of those credits., The recent European Commission legislative proposal for a 2040 climate target proposes to reserve a 3% share of its 1990 emissions baseline for international carbon credits as part of an overall 90% emissions reduction goal, while keeping those units out of the scope of the EU's ETS. It only allows the inclusion of domestic permanent carbon removals in the EU ETS. We encourage the EU to consider their inclusion already in the 2026 EU ETS revision, notwithstanding this must be done carefully to preserve system integrity and must include safeguards to prevent removals from offsetting necessary emissions reductions or weakening price signals.

Moreover, ISDA supports the integration of high-quality international credits into the EU ETS, as a complementary tool with robust safeguards in place, provided they meet strict environmental and methodological standards. Under Article 6 of the Paris Agreement, high-quality international credits could support additional climate finance, particularly for the Global South. Policy mechanisms like those used in Japan and South Korea, where international credits must be linked to domestic corporate involvement, could help address concerns around economic opportunity cost. Additionally, we welcome the outcome of the EU-UK Summit held on 19 May 2025 and strongly support the decision to move towards linking the UK and EU ETS schemes. A key motivation for linking ETSs is to harmonise the price of one tonne of CO_2 across jurisdictions. This helps prevent implicit subsidies, ensures a level playing field across regions, and promotes fair competition among all market participants. Linked ETSs need compatible (not identical) rules on market stability, allowance banking/borrowing, and participation. Alignment prevents arbitrage, volatility, and disruption, while supporting price stability, smooth trading and investor confidence across systems. The EU-UK ETS linking would bring substantial mutual benefits: it would enhance confidence in both carbon markets, reduce compliance costs for covered entities, improve price discovery, and enable participants to manage their carbon exposure more effectively. The UK has announced that it will introduce a UK CBAM from January 1, 2027, one year later than the EU CBAM's commencement. It is thus essential that the future agreement to link the UK ETS and EU ETS creates the conditions for goods originating in both jurisdictions to benefit from mutual exemptions from the respective EU and UK CBAMs subject to compliance with the relevant provisions of EU and UK legislation.

The EU CBAM

The EU's CBAM is, like the EU ETS, a compliance scheme that seeks to ensure that carbon pricing for certain imports is equivalent to that of EU domestic products. It does so by requiring importers of in-scope goods to become authorized,[2] to quantify and declare on an annual basis the total quantity of imported in-scope goods and the total embedded emissions of those goods, and to surrender a number of CBAM certificates, which are issued by EU Member States, that correspond to the embedded emissions declared. CBAM comes into effect in 2026, and the first CBAM declaration for calendar year 2026 should be submitted by May 31, 2027. Once in effect, the CBAM will be a transformational change.

Under CBAM, VCCs cannot be surrendered instead of CBAM certificates. Further, it is unlikely that VCCs could be used to reduce the amount of total embedded emissions in respect of which CBAM certificates need to be surrendered. This follows from the drafting of the relevant legislation,[3] as well as the underpinning policy: the CBAM complements the EU ETS by addressing the issue of carbon leakage, i.e., the risk that businesses in certain industry sectors or subsectors transfer production to other countries or imports from those countries replace equivalent products that are less intensive in terms of GHG emissions, for reasons of costs related to climate policies. As such, the CBAM mirrors the EU ETS's approach to VCCs as it does not currently envisage their use, in contrast with other jurisdictions' carbon tax regimes, which allow a limited use of VCCs to offset taxable emissions.

We believe the EU should consider the potential role of high-integrity international credits in its CBAM, alongside a regulatory architecture that addresses issues of consistency, comparability and credibility to achieve its 2040 climate goal. ISDA's work – especially in connection with globally consistent concepts and quality standards – may be a valuable contribution towards enabling a common, unified framework and thus opening a path towards using VCCs in compliance markets.

CORSIA

CORSIA is an example of a quasi-voluntary system that supports interoperability with the global voluntary carbon market. CORSIA serves as a positive example of how compliance and VCMs may look to one another in support of the growth of the VCMs. While emissions from domestic aviation are calculated as part of national GHG inventories and included in national

[2] Commission Regulation 2023/956, art. 4, 2023 O.J. (L 130).

[3] The relevant mechanism under the CBAM depends on a "carbon price paid in the country of origin" and requires documentation of legislation of that country and certification by authorities of that country, so it seems that, at the very least, state-controlled schemes, such as the EU's upcoming EU's CRCF Regulation, would be required

totals under the Paris Agreement Under the United Nations Framework Convention on Climate Change (the "Paris Agreement"), emissions from international aviation are not included in such totals. The International Civil Aviation Organization ("ICAO"), launched CORSIA to keep global net CO_2 emissions from international aviation at 2019 levels, by implementing requirements for offsetting of carbon emissions. 126 countries have elected to participate voluntarily in the first phase of the CORSIA program, requiring their airlines to comply with CORSIA standards mandating purchase of carbon credit offsets that comply with CORSIA eligibility criteria. In later phases beginning in 2027, participation will generally be mandatory for all ICAO member countries, subject to certain exemptions.[4] The CORSIA program identifies eligibility requirements and accepts credits issued by different registries, providing a model for how voluntary credits could be used in compliance schemes more broadly.

Overall, ISDA welcomes further interlinking across jurisdictions and between compliance and VCMs. This would incentivise the broader adoption and use of VCCs, and hence the flow of finance towards carbon removal projects. Encouraging transparent standards across registries and aligning with principle-based eligibility criteria on exchanges increases opportunities for interoperability and creates confidence in the VCM, even where registries are not wholly harmonized.

Q30) For existing initiatives, do you see any barriers that would stop your organisation, or others, from participating?

Improvement is needed in the below six key areas, the lack of which act as barriers to participating in this market:

1. A lack of globally consistent concepts and quality standards (see below).
2. A lack of a sound legal framework (please see our response to Q31 below).
3. A lack of clarity on accounting and tax treatment (please see our response to Q33 below).
4. An appropriate prudential capital treatment to enable and encourage more market participants to hold and intermediate such products (please see our response to Q33 below).
5. A lack of some of the features of a liquid secondary market (including the use of derivatives, rating agencies, a centralised reporting framework and improved price discovery) (please see our response to Q28 above).
6. A lack of aligned regulatory standards.

We emphasise the importance of the UK adopting a whole-of-government approach, so that the various frameworks and standards covered in 1-6 above are aligned, in order to promote the development of carbon markets.

The VCM has struggled with a lack of consistent standards. For example, there are currently four major standard setters, each with separate standards for reviewing VCC projects and assuring their quality. This fragmented patchwork of certification has led to significant market confusion about the quality of various types of credits and uncertainty regarding which types of credits are helpful for entities looking to employ VCCs as an emissions mitigation strategy. Without clear, verifiable standards, the VCM remains susceptible to the concerns flagged by the CFTC in their 2023 Whistleblower Alert, including "ghost" credits, double counting of

[4] Eklavya Gupte, *Demand for CORSIA Carbon Credits Unlikely to Match Supply Until 2030: Abatable*, S&P GLOB. (May 14, 2024), https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/energy-transition/051424-demand-for-corsia-carbon-credits-unlikely-to-match-supply-until-2030-abatable.

credits and concerns as to veracity of claims made about the material terms of the credits (e.g., with respect to quality, quantity, additionality, project type, methodology substantiating the emissions claim, environmental benefits, permanence and the buffer pool). As such, the VCM continues to stagnate.

To enhance credibility and transparency of VCCs, and to minimize the risk of greenwashing, consistent definitions are needed. This begins with a globally consistent definition of what "a ton of CO_2" means, including consistent criteria for baseline setting (i.e., determining the impact of a given project by assessing the impact of its absence), leakage (i.e., whether a voluntary carbon project leads to an increase in emissions outside of the project), additionality (i.e., for calculating a project's baseline emissions), quantity (i.e., quantification of emission reductions or removals), permanence (i.e., mitigating the risk, and monitoring the occurrence of, reversal), and avoidance of double-counting (including double issuance, double claiming, and double use).

At present, standard setters broadly align in terms of the high-level criteria applicable to carbon credits, but comparability issues arise because of nuanced differences in the methodologies underpinning these criteria. For instance, both the American Carbon Registry (ACR) Standard and the VCS (Verra) Standard incorporate additionality as one of the criteria applicable to carbon credits, but there are subtle, yet important, differences in how the respective methodologies assess additionality. Both standards, for example, generally require, in order to satisfy the additionality requirement, that projects must go beyond the standards required by applicable laws and regulations. However, the VCS Standard allows for an effective exception to that requirement where non-high-income countries are concerned, and there demonstrably exists systematic non-enforcement and widespread non-compliance with mandatory legal or regulatory requirements. Differences such as this make it difficult to compare credits issued under different standards, and while encouraging standard setters to publish their methodologies in a transparent manner is a good start, it does not fully rectify this concern.

Beyond that, aspects of the VCM requiring consistency to flourish include governance of carbon-crediting programs (e.g., well-defined and transparent governance arrangements that ensure independence and address conflicts of interest, adequately qualified directors and officers, appropriate audit arrangements, etc.), the effective operation of registries (e.g., operational resilience frameworks and safeguards against various forms of double counting, such as arrangements for retirement of carbon credits), provision and publication of information and documentation (e.g., mitigation activity design and methodology, spreadsheets used for calculations, etc.) and independent third-party validation and verification (e.g., accreditation of validation and verification bodies, processes for managing performance of validation and verification bodies, etc.).

There are, in principle, different ways by which such consistency could be achieved. Ultimately, the VCM would benefit from a standardized framework that would permit participants in the VCM to evaluate whether two different VCCs, or even two different registries, standard setters or standards, are the same or, if not, if they can be harmonized. If under the framework, it is clear that two items are not the same, the framework should also guide market participants to understand the extent to which they are different and whether this is because they were born of standards that do not meet certain commonly agreed criteria. Ultimately, it may be acceptable for a VCC to be reliant on a different standard, so long as all market participants are able to transparently identify what the standard is, and in a way that can be quantified and measured against other VCCs.

In addition, scrupulous governance is important as to whether a carbon credit registry is managed by a country (e.g., the EU registry or the UK registry in connection with the EU ETS and the UK ETS) or operated by a carbon crediting system (e.g., Verra, American Carbon Registry, Gold Standard or Climate Action Reserve). Functions like carbon credit issuance, tracking and retirement of credits may be handled by a variety of actors, from, e.g., UNFCC Certified Emission Reductions, which are cancelled via a cancellation contract between purchaser and provider, to, e.g., credits purchased directly from suppliers in registries, such as Verra, American Carbon Registry, Gold Standard and Climate Action Reserve, where retirement occurs according to a process specified by each registry.

We support Good Practice 8 (Soundness and accuracy of registries) in IOSCO's final report on VCMs, so that registries serve as reliable sources of information regarding the attributes, issuance, ownership, transfer and retirement and/or cancellation of carbon credits. Registries are critical to the carbon market infrastructure and are involved in every stage of a carbon credit's lifecycle. However, registries are not currently subject to oversight or standard operating principles proportionate to the impact of their operations. An internationally coherent oversight framework for registries is vital for scaling well-functioning carbon credit markets.

The confusion and redundancy that may be caused by the number of actors in the VCM is especially pronounced in trading, where different platforms or intermediaries operate simultaneously (e.g., VCCs are often traded OTC but may also be traded on a variety of exchanges).

Notably, the variety of actors operating in a tight space may create conflicts of interest. Just as credits themselves can benefit from increased transparency, accountability and quality, so too can the governance of the multitude of players in the VCM. Transparent, accountable and high-quality governance helps market participants to assess with whom they are getting involved and further provides assurance that these entities are operating in a way that minimizes conflicts of interest. Governance in the VCM goes beyond standard corporate governance – entities in this space should also strive to ensure that credits are properly tracked, using registries, should provide transparent information on all mitigation activities and should ensure that projects are subject to robust independent third-party validation and verification. Ultimately, engaging in these governance practices would increase confidence in the VCM.

To date a number of international bodies and initiatives have progressed towards achieving consistency in the VCM such as the mechanism under Article 6.4 of the Paris Agreement.

Q31) Do you think the legal status of credits in the UK is sufficiently clear? Please explain your answer and include examples where possible?

Yes, to the extent that this area is best left to incremental development under English common law, the market in VCCs already operates on the basis that the legal status of VCCs amounts to a form of intangible property in English law.

We note that VCCs could potentially fall within the scope of the recent draft Property (Digital Assets etc) Bill. The draft Bill simply provides that a thing (including a digital or electronic thing) will not be deprived of legal status as an object of personal property rights merely by reason of the fact that it is neither a thing in action nor a thing in possession. It doesn't go any further than this. It does not: (i) say which things would fall within this 'third' category of personal property; nor (ii) address the implications of a thing falling within this category. The Explanatory Notes provide that these matters are left to be developed by common law. It would be for courts to decide whether this is the case or whether, for example, carbon credits fall within one of the other categories of personal property rights.

We previously responded to the Law Commission consultation on Digital Assets, and our thoughts remain similar. ISDA welcomes the approach taken in the Bill – attempting to define what falls in the third category may give rise to difficult boundary issues, in particular with respect to VCCs / EUAs, especially as in many instances, the market in VCCs and EUAs already operates on the basis that these instruments amount to a form of intangible property as a matter of English law.

We believe that there a strong case for concluding that a third category of property already exists under English law. However, we acknowledge that there are benefits in recognizing a third category of property to avoid any perceived or residual uncertainty on this matter.

The legal categorization of VCCs determines how they are treated as collateral in the event of insolvency and bankruptcy scenarios. For example, under the U.S. bankruptcy regime, emissions credits or allowances like VCCs are treated as part of a debtor's estate as an asset and liability which allows for their transfer during insolvency subject to standard bankruptcy limitations. Such a regime provides assurances to investors that they can obtain good title to VCCs upon transfer which further encourages their participation in the VCM. As such, ISDA encourages jurisdictions to develop consistent legal frameworks that cover the exchange of VCCs during insolvency.[5]

Extending Financial Collateral protections to voluntary carbon (and emission allowances)

It should be considered to extend the scope of the Financial Collateral Arrangements (No.2) Regulations 2003 ("FCARs") to cover VCCs provided as collateral. The European Commission has consulted on expanding the scope of the EU Financial Collateral Directive (upon which the FCARs are based) to capture emission allowances, which are financial instruments. This proposal was overwhelmingly supported by respondents. Any future extension of the FCARs should also consider the situation of VCCs (especially those that are held in a registry by the collateral receiver or which are flagged as pledged within a registry). The FCARs set out exemptions from certain formality requirements, including the requirement to register a charge created by a company. The FCARs also disapply certain mandatory insolvency provisions under UK law. The FCARs generally minimise administrative burdens, reduce the likelihood that financial collateral arrangements will be ineffective and assist with the "rapid" enforcement of security interests in the event of an insolvency. Only arrangements over "financial collateral" can benefit from protection under the FCARs. Financial collateral is defined as "cash, financial instruments or credit claims". VCCs would not constitute cash or credit claims. Nor would they be categorised as "financial instruments", as that term is limited, primarily, to shares and bonds and instruments related thereto.

Extending Settlement Finality protections to transactions in voluntary carbon credits through clearing houses

[5] IOSCO Sustainable Finance Task Force: Scott O'Malia Remarks, ISDA (Sept. 27, 2024), https://www.isda.org/2024/09/27/iosco-sustainable-finance-task-force-scott-omalia-remarks/.

The Settlement Finality Regulations, among other things, protect so-called "securities transfer orders" from insolvency challenges, as regards transactions processed through designated systems such as clearing houses. The definition of “securities transfer orders” for these purposes currently includes emission allowances, but not VCCs. This means that cleared transactions in VCCs, or which settle via delivery of such credits, could potentially be subject to insolvency law challenges (on the basis that the cleared transaction was at an undervalue or otherwise against the interests of creditors). The potential for such challenges is an impediment to market confidence in cleared VCMs, compared to other asset classes. The expansion of the Settlement Finality Regulations to cover such instruments would likely place the UK at an advantage for developing safer, cleared markets in voluntary carbon.

In making the above comments, it would be regrettable to see different legal/property treatments arise for different types of digital assets (crypto, stablecoins, CBDCs, emission allowances, carbon credits, etc) as that could lead to fragmented and inconsistent outcomes for “things” that are essentially similar from a technology and asset/characterisation perspective.

Ultimately the legal status of carbon credits needs to be sufficiently clear, so that property and ownership rights are recognized, upheld and enforceable.

Please see further our ISDA paper on the Legal Implications of Voluntary Carbon Credits (December 2021)[6] and our response to the Law Commission’s Digital Assets consultation paper.[7]

Q32) What role, if any, should the UK play in promoting a consistent legal treatment for credits internationally?

The UK should continue to play a leading role in promoting a consistent legal treatment for credits internationally. The UK should continue to work with global legal standard-setters such as UNIDROIT, UNCITRAL and HCCH (Hague Conference on Private International Law) who have a strong track record of working with other inter-governmental bodies and regulators to produce legislative guidance on a range of substantive law issues. The development of a global standard currently underway at UNIDROIT that recognizes VCCs as a form of intangible property would increase legal certainty across all adopting jurisdictions. This, in turn, would facilitate the issuance of positive legal opinions and associated contractual documentation. It would also help clarify the tax and regulatory treatment of VCCs.

This type of legislative framework will also help for environmental products (biodiversity products, plastic products etc.).

Q33) Will the accounting treatment for credits affect your ability to participate in voluntary credits markets? What characteristics of the credit and the market for credits will be necessary to maximise participation?

A significant barrier to scaling the VCM is the lack of uniform accounting principles for carbon credits.[8] Like uncertainty of legal treatment, a lack of uniform accounting principles imperils

[6] Legal-Implications-of-Voluntary-Carbon-Credits.pdf

[7] ISDA-Response-to-the-Law-Commission-Digital-Assets-Consultation.pdf

[8] https://www.isda.org/2023/10/19/accounting-for-carbon-credits/.

clarity in the market. Specifically, although accounting practices have developed for compliance carbon markets, there are no International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (US GAAP), or interpretations of those standards, that relate to carbon credit markets.

At present, the accounting treatment of VCCs is a circumstantial matter determined by questions such as (i) whether credits are purchased together with other goods or services, (ii) whether the credits are purchased with the intention of selling them in the ordinary course of business, (iii) whether the credits are purchased to fulfil any contractual obligations and (iv) whether the credits are purchased for any promotional or advertising activities. For example, if an entity acquires VCCs to offset its own emissions, it may be deemed to derive economic benefits from the ability to offset which would qualify the credits as an intangible asset. Conversely, if an entity acquires VCCs with the intention of selling them in the ordinary course of business or to fulfil contractual obligations with customers, such credits may be deemed as inventory under IFRS guidelines. If a VCC does not qualify as an asset or as inventory for an acquiring entity, it will be recognized as an expense. ISDA has previously explored the treatment of voluntary carbon credits as (i) intangible assets under International Accounting Standard (IAS) 38 (Intangible Assets), using the cost or revaluation model and (ii) inventory under IAS 2 (Inventories).

However, while existing accounting standards provide some reference for the treatment of VCCs, there is no uniform guidance, and many entities continue to have to determine for themselves with limited knowledge and examples how they will account for VCCs.

ISDA continues to encourage collaboration between the International Accounting Standards Board (the standard setting body of the IFRS) and Financial Accounting Standards Board (the standard setting body of US GAAP) to resolve the various accounting challenges presented by VCCs such as demonstrating the economic benefits of VCCs, quantifying their value and expense and providing accounting frameworks for contracts to acquire carbon credits.

ISDA recently wrote[9] to the Financial Accounting Standards Board (FASB) providing our feedback on the FASB's proposed Accounting Standards Update on Environmental Credits & Environmental Credits Obligations. We recommended several clarifications to their proposed accounting guidance for environmental credits so that they could better align and work with existing accounting frameworks, however nothing identified in this letter would affect the ability of firms to participate in voluntary credits markets.

Taxation

On taxation, the UK Government must provide clear and up to date taxation guidance, as products and markets evolve and develop. It is essential that businesses are not left in a position where tax treatment for certain products are open to interpretation as this impacts their ability to operate effectively in these changing markets. This is vitally important as voluntary and compliance carbon markets converge. As an example, the same carbon credits could be cancelled for either voluntary purposes or CORSIA compliance. Credits used for CORSIA compliance purposes may not be considered VCCs (although they may be used also for voluntary purposes) nor emission allowances (UKAs/EUAs).

[9] ISDA-Submits-Letter-on-Environmental-Credits.pdf

This creates uncertainty which may impact the correct VAT treatment, errors on which may result in financial penalties for carbon market participants.

We recommend that the Government take forward:

1) Modernization of the VAT Terminal Markets Order to a principles-based approach so that a VAT zero rate is applied for trading of carbon credits. This would lower the cost of participating VCMs, and encourage investment in high-integrity carbon reduction projects. This approach would prevent unintended financial burdens on VAT-exempt or partially exempt organizations, such as charities and financial services, who cannot recover VAT, and would ensure a level playing field with compliance carbon credits. Note that VAT would still be due on consumption of credits by end users, and where there is not an entitlement to full recovery there would be the appropriate VAT cost for these users.

2) We welcome HMRC's changes to the VAT treatment of VCCs released in September 2024. However, these rules will need clarification to cover where the voluntary and the compliance market converge.

3) Request for introduction of domestic reverse charge on voluntary credits to simplify the VAT regime and align with other similar products.

4) Consideration of how to incentivize reduction of emissions through accelerated amortization/depreciation of carbon credits with taxation savings in earlier years being used to fund decarbonization of the value chain in those earlier years.

Prudential treatment

ISDA has published analysis supporting the need for further revisions to the market risk capital standard for carbon credits[10][11] which will help to avoid disproportionate capital charges relative to the actual risk profile of these assets. The European Commission as part of their consultation on the market risk prudential requirements[12] proposed modifications to the market risk framework that are a positive step in the right direction. We would be supportive of their proposal[13] as this would help incentivize market participation and improve market liquidity to maximise the benefits of carbon credits enabling a smooth transition.

Q34) Do you agree with the functional requirements set out for a high integrity UK market governance framework: standards; assurance; accreditation; and regulatory oversight?

Yes, ISDA agrees with these governance functions.

[10] https://www.isda.org/2021/07/23/implications-of-the-frtb-for-carbon-certificates/

[11] https://www.isda.org/2022/04/21/implications-of-the-frtb-for-carbon-certificates-a-global-perspective/

[12] https://finance.ec.europa.eu/news/commission-launches-consultation-eu-approach-market-risk-rules-banks-2025-03-24_en

[13] https://www.isda.org/2025/04/22/isda-iif-response-to-ecs-consultation-on-the-market-risk-prudential-framework/

We understand that the UK Government may be considering a dedicated regulatory body to oversee carbon and nature markets. Given the number of regulatory bodies that already exist in the UK, it may be simpler if those existing regulatory bodies provide effective oversight, provided that suitable mechanisms for joint regulatory working are in place and coordinate with other international bodies for better global operationalisation, as projects operate globally.

We note that the Government appears to be considering various options for regulatory oversight, and would expect a consultation to the extent specific proposals on regulatory oversight are further developed. In particular, we emphasise that it is essential to ensure that any regulatory oversight is carefully designed to ensure that it is proportionate, does not create additional complexity and reflects and supports the innovative and evolving nature of the market.

Q35) Do you agree that the measures set out in this consultation will help to provide appropriate regulatory oversight for UK VCNMs at their current stages of development? If not, what other interventions may be appropriate?

Our recommendations to regulators to inform well-tailored, effective regulation of the market, with a focus on the following priorities would include:

- ***Principle-based approach to regulation***: ISDA supports a principle-based approach to developing comprehensive regulatory framework for the VCM.

- ***Cross-jurisdiction cooperation to align oversight guidelines and protocols***: ISDA is well-positioned to support the collaboration of the official sector across jurisdictions to avoid regulatory fragmentation and make it easier for market participants to engage in the VCM cross-jurisdictionally in an efficient manner.

- ***Encourage trading of credit on centralized platforms to promote transparency***: Centralized platforms can provide a standardized and transparent trading environment, helping to eliminate information asymmetry, reduce the risk of double-counting and other fraud concerns and build confidence in the VCM.

- ***Better transparency from registries***: Increased transparency from registries and standardization of verification methodologies/quality standards will help address double-counting and other fraud risks, while also allowing for increased standardization of carbon market contracts. This is in support of IOSCO's Good Practice 8[14] (Soundness and accuracy of registries). We support the carbon credit rating agencies themselves when they call for their regulation. Regulation would provide additional confidence that ratings can be trusted to meet high technical standards and are produced by organisations that have appropriate conflict-of-interest management processes to maintain their independence. Regulation would enable ratings to play a core role in market design.

- ***Jurisdictions should encourage companies to use voluntary carbon credits in their transition plans***: VCCs can be a useful tool for companies to meet their climate risk mitigation strategies and emissions targets provided however that these companies have a strict prioritisation of their climate strategy actions, first have significantly reduced

[14] IOSCO, November 2024, Voluntary Carbon Markets: Final Report

their direct and indirect greenhouse gas emissions; and second, have offset residual emissions, which should eventually represent only a small share of the initial emissions, with a demonstrated high quality VCC. As such, jurisdictions should create substantive legal frameworks that resolve current market scepticism of VCCs.

- ***Develop guidelines on collateral management***: VCC trades should be protected by a consistent legal framework that creates certainty over the exchange of collateral and obligations in the event of a counterparty bankruptcy.

- ***Set objective global standards for high-quality voluntary carbon credits***: Principle-based global standards for VCCs increase confidence in the market and pave the way for increased innovation for trading across registries and jurisdictions. ISDA supports initiatives to develop such standards and encourages efforts to foster overarching cooperative frameworks across registries and jurisdictions.

Q36) Do you agree with the considerations for the cross-regulatory working group, and are there any additional priorities for inclusion?

It makes sense for a cross-regulatory working group to be established and for HMT, FCA, DESNZ and other appropriate regulators to set out a formal structure in working jointly. International cooperation is also essential as projects operate cross border and isolated national initiatives will fragment an already complex and nascent market.

Thank you for the opportunity to comment and we remain at your disposal for further engagement.

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About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on LinkedIn, Facebook and YouTube.