13 April 2022

To
Shri Alok Kumar, Secretary (Power)
Ministry of Power, Government of India
Shram Shakti Bhawan
Rafi Marg, New Delhi - 110001

Submitted via email to: secy_power@nic.in
Cc: Shri Govind Kumar <ecdivision-mop@nic.in>
Re: ASIFMA's response to draft Carbon Credit Trading Scheme (CCTS) in India

Dear Sir(s),

The Asia Securities Industry & Financial Markets Association ("**ASIFMA**")[1], on behalf of its members welcomes the opportunity to respond to the **Draft Carbon Credit Trading Scheme (CCTS) in India** ("**Draft CCTS**")[2]. ASIFMA commends the Government of India leadership and commitment towards achieving its climate related goals articulated and put across at the 26th session of the Conference of the Parties (COP26) to the United Nations Framework Convention on Climate Change (UNFCCC)[3], followed by the amendment of the Energy Conservation Act in December 2022, in force as of 1 Jan 2023. Alongside other goals, the amended Act aims to promote renewable energy and develop the domestic carbon market to combat climate change and introduce new concepts such as carbon trading.

The Draft CCTS provides clarity of definitions and transparent understanding of the roles and responsibilities of new governing bodies, which is appreciated and commended. In particular our members are encouraged by the inclusion of multiple ministries and regulatory stakeholders in the Indian Carbon Market Governing Board (ICMGB). Establishing a clear governance structure is of paramount importance for the successful development and implementation of the Indian Carbon Market (ICM). To further strengthen this framework, members suggest financial regulators are also involved in the ICM governance structure and the industry continue to be consulted with on specific aspects of the ICM going forward.

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1 ASIFMA is an independent, regional trade association with over 170 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive, and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the Global Financial Markets Association ("GFMA") alliance with the Securities Industry and Financial Markets Association ("SIFMA") in the United States and the Association for Financial Markets in Europe ("AFME"), ASIFMA also provides insights on global best practices and standards to benefit the region.

2 The information and opinion commentary in this ASIFMA [insert paper name] was prepared by the Asia Securities Industry and Financial Markets Association (ASIFMA) to reflect the views of our members. ASIFMA believes that the information in the Paper, which has been obtained from multiple sources believed to be reliable, is reliable as of the date of publication. As estimates by individual sources may differ from one another, estimates for similar types of data could vary within the Paper. In no event, however, does ASIFMA make any representation as to the accuracy or completeness of such information. ASIFMA has no obligation to update, modify or amend the information in this Paper or to otherwise notify readers if any information in the Paper becomes outdated or inaccurate. ASIFMA will make every effort to include updated information as it becomes available and in subsequent Papers.

3 India committed to (a) reach 500GW non-fossil energy capacity by 2030; (b) meet 50 per cent of its energy requirements from renewable energy by 2030; (c) reduce total projected carbon emissions by one billion tonnes from the date of COP-26 to 2030 (d) Reduce carbon intensity of the economy by 45 per cent by 2030, over 2005 levels and (e) achieve net zero emissions by 2070.

ASIFMA's members also welcome the discussion of both Compliance and Voluntary Carbon Markets simultaneously, supporting the view that both have a role to play in achieving cost effective decarbonisation and should not be considered in isolation. In 2021 our parent organisation, GFMA, published a report on Unlocking the Potential of Carbon Markets to Achieve Global Net Zero, which we hope will inform and assist the ICM[4]. This highlighted the need to scale emissions trading systems which have the potential to scale far more than voluntary carbon markets alone.

We also recommend that international standards, best practices and lessons learned are taken into consideration when developing the ICM framework. In the past decade and in particular in the last few years, various jurisdictions in Asia and beyond have pioneered, tested and established both compliance and voluntary carbon markets. In addition, international standard setting bodies, like IOSCO have taken a closer look at the matter, signalling that cross-border cooperation between countries would be required if these markets are to fulfil their full potential. We would therefore encourage ICBGM to seek to capitalise on these lessons learned and experience gained.

We also encourage continued consultations with a broader stakeholder group including financial sector regulators and participants when developing the specific facets, methodologies and regulatory requirements of the ICM. Making sure a consensus and capacity is built among the key stakeholders is often a precursor of success. We, on our side, remain committed to engage further and to share our knowledge and observations whenever is deemed appropriate.

Our detailed considerations and general suggestions on the development of the ICM are highlighted in the next section of this letter. We very much appreciate the opportunity to comment on **Draft Carbon Credit Trading Scheme** and look forward to engaging with the relevant bodies further as may be helpful.

If you have any questions, or you would like to discuss the points raised in this letter, please feel free to contact us.

Yours faithfully

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[4] https://www.gfma.org/wp-content/uploads/2021/10/unlocking-the-potential-of-carbon-markets-to-achieve-global-net-zero-executive-summary-vfinal-with-link.pdf

General Comments

We understand that the Bureau will develop methodologies and procedures for registration of projects and issuance of carbon credit certificates, however we would like to confirm if this would include the review of carbon removal (i.e., permanence, additionality, etc.). It would also be useful to understand who will be responsible for reviewing / accrediting carbon removal projects, especially for voluntary credits.

We encourage the Ministry of Power, the newly established Indian Carbon Market Governing Board (ICMGB) and the other administering bodies to reference the below guiding principles when developing the Indian Carbon Market (ICM):

- effective carbon markets, whether compliance-based or voluntary, should adhere to science-based decarbonisation principles.
- successful markets are reliant upon collaboration between policymakers, regulators, market participants and other stakeholders to promote best practice and neutralise the risk of greenwashing, [5] carbon leakage [6] and double-claiming [7].

Globally consistent approaches are key to bring investment and new technologies to support country's transition to a clean and climate resilient economy.

Compliance Carbon Markets

Compliance Markets must be underpinned by the same core principles that underpin any sound and robust regulated market: (i) transparency; (ii) integrity; (iii) stability; and (iv) accountability. Without a set of core principles that promote consistency and interoperability of standards and price discovery, Compliance Markets are vulnerable to instability and misuse and will also be less effective in realising their ultimate goal of reducing carbon emissions.

The integrity of any Compliance Market relies on comprehensive regulatory oversight, robust trading infrastructure and consistency in the enforcement of applicable rules. Fundamentally, we can only reduce global emissions to the extent that we can:

- accurately (and consistently) measure, monitor and record: (i) the volume of carbon emitted; and (ii) the volume of carbon allowances created, traded and surrendered; and

- leverage Compliance Markets effectively to enforce a permanent reduction in carbon emissions (e.g., by the Compliance Markets determining benchmark prices for carbon allowances that have a significant economic impact on entities that generate excess carbon emissions).

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[5] Greenwashing refers to the act of providing misleading or false information about the environmental impact of an entity's products and operations.

[6] Carbon leakage occurs when carbon generating activities are relocated to a jurisdiction which has a more lenient regime in respect of carbon emissions.

[7] In this letter 'double-claiming' refers to where the benefit of a particular carbon allowance is claimed by: (i) a country; and (ii) a natural or a legal person, as part of their respective emissions reduction commitments under the Paris Agreement.

Having regard to the foregoing, members wish to share the experience gleaned from existing (and more mature) Compliance Markets as an important resource, including, for "cap and trade" emission trading systems as regards:

- the development of a comprehensive legal framework to underpin the regulation of Compliance Markets;
- the application of a rule-based approach that follows a clear process, including as regards dispute resolution;
- the establishment of a common registry on a single technology platform with real time data flows and robust cybersecurity;
- setting accurate and dynamic baselines. Collecting verified annual emissions data (as close to the next compliance period as possible) to help calculate the future allocation of, and market cap on, carbon allowances;
- the design and supervision of the scheme resting with entities that have experience in Compliance Markets (noting that the demand for carbon allowances is artificially constructed by the compliance obligation, and the volume of available carbon allowances is set accordingly);
- adjusting the supply of allowances during a compliance period without altering the predetermined cap to accommodate changes in the economic environment (thereby ensuring that over-supply of carbon allowances does not drive down the price of a unit of carbon and disincentivise decarbonisation);
- achieving legal certainty as to the nature and treatment of carbon allowances;
- promoting market confidence and market integrity;
- the classification of carbon allowances as regulated instruments as a means to help safeguard Compliance Markets from abuse or misconduct (i.e., by bringing such instruments within the jurisdiction of regulators);
- transitioning away from free allocation of carbon allowances to a solely auction-based system as a means to incentivise decarbonisation and raise necessary capital to support net zero ambition;
- implementing a market stability reserve to help address surpluses (and shortages) of auctioned carbon allowances, thereby supporting a stable price for a unit of carbon; and
- regular assessment (and adjustment) of the ambition level of Compliance Markets to ensure alignment with global decarbonisation targets, including accelerating the pace of cap reductions and expanding the entity and industry sector coverage of Compliance Markets.

We consider that the following aspects of Compliance Markets could benefit from regulatory oversight:

- licensing and audit of third-party verifiers that create, or verify compliance with, environmental standards;
- capital/risk weighting in relation to funding the acquisition or trade of carbon allowances;
- how carbon and associated costs or taxes (as a 'liability') and carbon allowances (as an 'asset') should be classified and presented from a balance sheet perspective, as a means of cross-checking Compliance Market registry records, promoting transparency as to the volume of carbon emitted

and setting appropriate caps on emissions (as well as adjusting the volume of carbon allowances) within Compliance Markets;

- the extent to which covered entities may be permitted to participate in voluntary carbon markets (and how excess 'offsets' should be classified and presented from a balance sheet perspective);
- implementing mandatory corporate filings for scope 1, scope 2 and scope 3 emissions [8] (and guidance as to the measurement, reporting and verification of scope 3 emissions) with a view to expanding Compliance Market coverage beyond scope 1;
- the use of derivatives to hedge environmental risk;
- combatting greenwashing;
- combatting trading activities that seek to profit from environmental degradation or disaster;
- setting rules (promulgated by an international accounting body such as the IASB or FASB) around accounting for climate-related transactions; and
- developing rules for general good conduct, including as regards avoiding conflicts of interest, fraud and market abuse.

We also consider that market intermediaries have an important role to play in facilitating access to, and generating liquidity within, Compliance Markets, particularly in the context of any auction process for the allocation of carbon allowances.

Given the importance of their role, and to ensure the integrity of Compliance Markets, we recommend that 'dealing in', 'advising on' and 'trading' carbon allowances should be classified as "regulated activities" under applicable laws and regulations and that market intermediaries in Compliance Markets should be licensed accordingly.

We note that some Compliance Markets permit a certain volume of carbon credits (generated within voluntary carbon markets) to be used by obliged entities to offset a (small) proportion of their carbon emissions so that they do not exceed the volume of carbon allowances allocated to them within the Compliance Market.

We consider that this is acceptable in principle provided that the permitted threshold of carbon credits (generated within voluntary carbon markets) available to a obliged entity to offset its emissions over and above the volume of carbon allowances that it has to surrender within the applicable Compliance Market is both limited and closely monitored (to ensure that the offset mechanic does not 'dilute' the compliance obligation or indicate a broader issue to be tacked within Compliance Markets).

We would be interested in understanding if the ICM is intending to take a similar approach.

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[8] Scope 1, scope 2 and scope 3 refer to the classification of emissions pursuant to the Greenhouse Gas Protocol Corporate Standard published (as a joint initiative) by the World Resources Institute and the World Business Council for Sustainable Development to promote best practice for accounting and reporting emissions. Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy. Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions.

We encourage the ICMGBs to consider defining the legal nature of carbon credits and to determine how carbon allowances are regulated. Carbon allowance's legal classification is crucial in determining, for example:

- how title (or ownership) to it is evidenced, transferred and extinguished (upon retirement);
- (subject to applicable law) whether a carbon allowance (or an interest in it) can be held on trust;
- (subject to applicable law) how security can be taken over a carbon allowance and how that security may be enforced;
- how a carbon allowance is treated in the event of the insolvency of a transferor or transferee (including with regard to close-out netting); and
- what rights of redress are available in the event of a dispute.

We would further encourage the ICMGB to consider establishing clear and robust frameworks for conducting market surveillance, overseeing of entities' behaviour in spot and derivatives carbon markets and ensuring appropriate enforcement.

It is our understanding that derivatives play an important role in carbon markets. For example:

- covered entities use carbon derivatives to meet their compliance obligations and manage climate transition risk (including volatility in the cost of carbon allowances) in a cost-effective way;
- investors and market intermediaries use the price signals from carbon derivatives to assess climate transition risk in their portfolios and allocate funds to capitalise on climate transition opportunities;
- policymakers use the price signals from carbon derivatives to assess the effectiveness of their climate related programs; and
- asset managers use carbon derivatives to build portfolios that satisfy their investors decarbonisation goals. [9]

Public Disclosure

We suggest ICMGB consider public disclosures for aggregate positions, as well as periodic public reporting derived from regulatory data.

The purpose of Compliance Markets is to permanently reduce carbon emissions. Transparency as to: (i) the volume of carbon emissions generated; and (ii) how carbon emissions reductions are achieved, underpins the credibility and success of Compliance Markets.

Covered entities must prioritise carbon emissions reduction (in alignment with the volume of carbon allowances available to them to surrender) before considering the use of carbon credits (generated within voluntary carbon markets) to offset surplus emissions. We agree that public disclosure is an important tool to reinforce this expectation and require covered entities to defend their emissions reduction strategy.

[9] "Role of Derivatives in Carbon Markets" – International Swaps and Derivatives Association – September 2021.

We suggest considering implementing public disclosure (at regular intervals which allows for: (i) peer to peer comparison; and (ii) comparison against previously disclosed information) including in relation to:

- covered entities actual and projected emissions (as a minimum covering scope 1 and scope 2 emissions);
- covered entities emissions reduction policies and targets;
- the use of carbon credits (generated within voluntary carbon markets) by covered entities (including details relating to the volume, type and standard/grade of carbon credits used); and
- the use of carbon derivatives by covered entities.

We note that bodies such as the International Sustainability Standards Board (**ISSB**) and the International Accounting Standards Board (the standard setting bodies for the IFRS Foundation) have published proposals regarding the disclosure of material information about a company's significant sustainability-related risks and opportunities, and that such proposals have been developed in response to requests from (among others) G20 leaders and IOSCO.

We support the development of such proposals and welcome the finalisation of ISSB's Climate-related Disclosures Standard (IFRS S2).

Public disclosure of (individual or aggregate) positions may not be appropriate where Compliance Markets are illiquid and there are only small numbers of participants. The requirement for public disclosure must be proportionate to each Compliance Market's size, liquidity and maturity.

Voluntary Carbon Markets:

Voluntary carbon markets (**Voluntary Markets**) have an important role to play in supporting the transition to a low-carbon economy by facilitating the trading of carbon credits which are capable of being surrendered to offset a corresponding volume of carbon emissions.

Voluntary markets within the region, and globally have not yet scaled to their full potential. They are highly fragmented and derive from a range of standards which make them vulnerable to criticism for lacking integrity and transparency. Ultimately Voluntary Markets must be underpinned by the same core principles as compliance markets.

We consider Voluntary Markets as important, because they have the potential to support decarbonisation efforts by:

- allowing entities to support projects that avoid, mitigate, remove, reduce or sequester emissions through the sale, purchase and retirement of carbon credits over and above mandated emissions targets;
- allowing entities to realise their individual climate change mitigation objectives by purchasing carbon credits derived from climate change mitigation projects that most resonate with them;
- recognising the value of climate change mitigation projects by monetising their benefits;

- directing capital flows in support of climate change mitigation projects and a 'fair transition' to net zero;
- helping countries to realise their decarbonisation goals and commitments; and
- promoting and preserving natural resources as a valuable commodity and supporting biodiversity.

Within prescribed limits, it is possible for obliged entities to use carbon credits generated within a Voluntary Market in order to help them satisfy their compliance obligations within a compliance carbon market. [10] We consider that the use of carbon credits within compliance carbon markets is acceptable in principle provided that:

- such use is closely monitored; and
- the applicable carbon credits satisfy robust eligibility criteria; [11].

Article 6 of the Paris Agreement has not automatically created "significant links" between Voluntary Markets and compliance carbon markets and is not expected to do so in the near future. Whilst there are connections between the Voluntary Markets and compliance carbon markets, they are not so similar or so interlinked that they should be automatically regulated in the same way.

We would also like to bring your attention to certain potential vulnerabilities identified in other jurisdictions with respect to Voluntary Markets which the ICMGB should consider, namely:

- the lack of standardisation within Voluntary Markets;
- assessing the integrity of carbon credits (including: (i) the 'value' and permanency of the benefits that they generate versus a 'business as usual' base-case; and (ii) their alignment with science-based decarbonisation pathways) in the absence of robust and consistent integrity benchmarks;
- the risks of carbon leakage, double counting and double claiming;
- the lack of transparency as regards the application and enforcement of climate change mitigation 'standards';
- the lack of transparency as regards the methods used to calculate the volume of carbon credits generated; and
- potential conflicts of interest arising between project developers, verifiers, certification standard bodies, traders and investors;

We also wish to highlight the following additional considerations, which might need to be addressed in designing the ICMs:

- create a certainty as to the legal nature and treatment of carbon credits. The legal classification of a carbon credit is crucial in determining, for example:
- how title (or ownership) to it is evidenced, transferred and extinguished (upon retirement);

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[10] For example, eligible credits may be converted into compliance instruments for use by covered entities within the Compliance Market in California.

[11] Such eligibility criteria may include: (i) only the highest-integrity carbon credits may be used; (ii) the project generating the carbon credit has the capacity to permanently remove or reduce carbon from the atmosphere; (iii) the project is assessed as satisfying the requirement for 'value' (or 'additionality') over and above a business-as-usual base-case; and (iv) the offset mechanic attaches only to 'unavoidable' or 'hard to abate' emissions.

- (subject to applicable law) whether a carbon credit (or an interest in it) can be held on trust;
- (subject to applicable law) how security can be taken over a carbon credit and how that security may be enforced;
- how a carbon credit is treated in the event of the insolvency of a transferor or transferee (including with regard to close-out netting); and
- what rights of redress are available in the event of a dispute;
- create a certainty as to the accounting treatment of carbon credits;
- create a certainty as to the capital (risk-weighting) treatment of carbon credits (which may limit the extent to which financial institutions are willing to participate in Voluntary Markets, hold positions in carbon credits or manage portfolios that include carbon credits);
- inconsistent taxonomy and nomenclature creates confusion and results in market fragmentation;
- the potential reputational risk for financial institutions and other regulated entities being associated with 'low integrity' carbon credits or greenwashing (e.g., market manipulation through 'wash' trades, or where the underlying climate change mitigation project does not in fact exist);
- the potential reputational risk for financial institutions and other regulated entities being associated with the parties that verify or certify 'low integrity' carbon credits or that may otherwise be involved in greenwashing;
- the growing litigation risk associated with, for example, greenwashing and the legality of emissions reduction requirements in the context of a 'fair transition' to net zero emissions;
- with the potential for oversupply of carbon credits to lead to market saturation and low pricing. We suggest that market stability mechanisms [**12**] will be important to the overall development of the Voluntary Markets and mitigating pricing volatility;
- the lack of liquidity and price discovery; [**13**]
- clarification as to whether (and, if so, to what extent) carbon credits may be used to offset scope 1 emissions (to the extent that scope 1 emissions are not covered by a compliance carbon market);
- the absence of a clear and streamlined disclosure framework relating to the credentials of climate change mitigation projects and the carbon credits that they generate;
- the integrity (and therefore the 'value') of data 'output' relating to trading carbon credits relies on the integrity of data 'input'. We suggest that ICMGB works with standard-setters to support the development of robust reporting frameworks and disclosure standards;
- the absence of standardised documents and procedures for trading and settlement within Voluntary Markets;

We believe it would be beneficial for the ICMGM to collaborate with bodies such as the Integrity Council and the VCMi in developing India's VCM. These bodies are important because they are driving alignment

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[12] Examples include staged auctions and carbon credit volume thresholds.

[13] There is a lack of publicly available information available in relation to trading carbon credits, particularly over-the-counter trades (due to the bilateral and bespoke nature of over-the-counter transactions).

of climate-related taxonomies [14] with a view to supporting decarbonisation at the scale and speed necessary for countries to meet their emissions reduction objectives under the Paris Agreement. The advent and development of umbrella standards that are championed by bodies such as the Integrity Council and the VCMi are key to standardise the baseline for qualification as a 'high-integrity' carbon credit, which in turn underpins the integrity of, and public confidence in, Voluntary Markets.

Based on our experience with other Voluntary Markets, a balance needs to be struck within Voluntary Markets between: (i) regulation/supervision; and (ii) organic market development. Too much regulation, too early, risks to stifle growth and be 'out of sync' with how Voluntary Markets operate in practice. In addition, until Voluntary Markets reach a certain size and scale, the cost of regulation/supervision (and the resources required to implement the same) may outweigh the benefits.

[14] For example, with through the development of the Core Carbon Principles and guidance relating to the use of carbon credits as part of credible net-zero pathways.