



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Baroness Worthington,  
House of Lords  
London  
SW1A 0PW

25 May 2023

Dear Baroness Worthington,

**FINANCIAL SERVICES AND MARKETS BILL: CARBON AND NATURE OFFSETS AND CAPITAL RISK REQUIREMENTS**

Thank you for your letter dated 20 March regarding amendments 168 and 241FC which you tabled at Committee stage of the Financial Services and Markets Bill, relating to capital risk requirements and carbon and nature offsets, respectively. During the debate you asked that I write about the role of international processes in developing standards and oversight around voluntary carbon markets. I am grateful for the background information you provided ahead of the debate on those amendments.

Amendment 168 – Capital risk requirements

As I indicated in the debate, I take seriously your concerns regarding the adequacy of the Prudential Regulation Authority's (PRA's) and the Bank of England's work on climate.

The PRA is taking important steps to improve its understanding of climate risk and how they should be reflected in micro and macro prudential regimes. As you may know, the PRA has recognised the need to develop both its own understanding and that of other

regulators on the links between climate and the capital framework, commissioning a call for research and hosting a conference on the issue in 2022.

Moreover, the PRA's current framework goes beyond the modelling of climate risks in the Climate Biennial Exploratory Scenario (CBES) and includes issuing supervisory expectations (Supervisory Statement SS3/19) for firms to build the capability to mitigate climate risk and to take responsibility for ensuring they are not undercapitalised for climate risk.

In addition, the Basel Committee on Banking Standards is currently conducting work on the assessment, measurement and mitigation of climate-related financial risks and what this means for the banking sector. The PRA is an active participant in these discussions and it is right that this work develops internationally, to ensure a coordinated approach, and is considered in the UK in due course.

#### Amendment 241FC – Climate and nature offsets

You asked about the role of international processes in developing standards and oversight around voluntary carbon markets. You also noted the importance of countries not waiting for global consensus to emerge but acting now to show leadership and ensure integrity.

The key international framework on carbon markets is Article 6 of the Paris Agreement, which provides a framework for voluntary international cooperation on emissions reductions and carbon markets, allowing states to meet their Nationally Determined Contributions (NDCs). Agreeing rules around these markets was a key achievement of the UK's COP26 Presidency and we continue to engage as a Party to the United Nations Framework Convention on Climate Change (UNFCCC) as Article 6 is operationalised. This international architecture is key to ensure a coherent link between voluntary carbon markets in the private sector and how privately produced and purchased offsets are accounted for in national emissions calculations.

Your letter references the work of the Integrity Council for the Voluntary Carbon Market (ICVCM) and the Voluntary Carbon Markets Integrity Initiative (VCMI). Both were launched under the UK's COP26 Presidency and incorporate expertise from industry, civil

society, governments, regulators, and academia across jurisdictions. This was a response to the lack of a transparent and inclusive international process for ensuring integrity in voluntary carbon markets.

The Government provided initial support to both initiatives and officials remain in regular dialogue with both to ensure they are delivering integrity and to help facilitate ambition. As the initiatives move into implementation phase, governments can play a key role in supporting implementation within respective jurisdictions, and it will be important that there is continued dialogue between governments to optimise international coherence. To this end, the UK Government continues to play a key role in supporting VCMI with its country engagement strategy, through the VCMI Country Contact Group.

I fully agree with your view that it is important for the Government to show leadership in ensuring the integrity of markets. That is why the Government committed in the recently updated Green Finance Strategy to consult on voluntary markets later this year, with a view to ensuring that markets are mobilising additional finance whilst protecting against greenwashing. This will provide an opportunity to consider specific interventions needed across issues such as credit quality, intermediaries selling or offering credits, corporate usage and transparency. I would welcome your engagement with this consultation when it is published.

Importantly, the Government will consider as part of this consultation how ICVCM (which launched its Core Carbon Principles on 29 March) and VCMI outputs could be potentially adopted and applied in the UK market and regulatory context. As I confirmed in the debate on amendment 241FC, the Financial Services and Markets Act 2000 and the Financial Services and Markets Bill provide HM Treasury with powers to bring financial services activities associated with voluntary offsets and trading in VCM carbon units or allowances (similarly to the position for ETSs) within the scope of UK financial services regulation, should it conclude that this is appropriate. However, I also noted that the challenges of voluntary carbon market integrity are broader than financial regulation.

I hope this letter addresses the concerns you have raised and explains why the government considers these amendments unnecessary. However, as you suggest, I would be happy to meet with you to discuss both of these issues further.

I am copying this letter to other Peers who spoke during the Grand Committee debates on these amendments, and I am placing a copy in the Library of the House.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'PENN', with a stylized, cursive flourish.

**BARONESS PENN**