

INSTITUTE FOR AGRICULTURE AND TRADE POLICY - FRIENDS OF THE EARTH  
MARYKNOLL OFFICE OF GLOBAL CONCERNS  
MISSIONARY OBLATES - PUBLIC CITIZEN

December 17, 2010

Mr. David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Via electronic submission

Dear Mr. Stawick,

We are pleased to provide comments to the CFTC and the interagency working group for its forthcoming study on the oversight of existing and prospective carbon markets. While it is not our intent to express either support or opposition for carbon trading, we support the efforts of the working group to understand and manage the potential effects that carbon trading could have on the broader economy and systemic financial integrity.

The Frank-Dodd Act instructs the working group to develop recommendations to ensure that carbon markets are efficient, transparent, and secure. We strongly urge the working group to adopt an additional regulatory objective: to ensure environmental effectiveness. Achieving this objective may require making decisions in favor of bona fide hedgers over Wall Street speculators, as regulators seek to ensure market stability, security, and environmental effectiveness; over innovation, liquidity, and liberalization. [Question 1, other regulatory objectives]

Establishing robust regulations towards these ends is critical, but how carbon markets are fundamentally designed likely will have more impact on their integrity than how they are regulated. If markets are designed to be massive and complex, then they will be easier to game and harder to regulate. Indeed, past federal climate legislation has proposed establishing carbon markets that mimic the problems of other commodity markets, which are excessively financialized. As Mid-American Energy pointed out in Congressional testimony, "Under the Waxman-Markey bill, utilities – the ones that actually need the allowances for compliance – will be forced to compete with Wall Street investment banks, hedge funds and speculators."<sup>1</sup> [Question 2, market design]

The working group should therefore consider prohibiting certain activities such as long-only index investing, high-frequency trading, naked shorting of carbon, and other purely speculative carbon trading practices. Moreover, all trading of emissions allowances, offsets, credits and related investment instruments and products, including options, swaps and derivatives, should be standardized and conducted on open, transparent and regulated exchanges. [Question 5: regulatory methods & tools]

In addition, the CFTC, SEC and other regulatory agencies should be endowed with additional statutory authorities that allow them to intervene in markets for the purpose of meeting its public policy

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<sup>1</sup> Written Testimony of William J. Fehrman, President, MidAmerican Energy Company, Senate Environment and Public Works Committee, August 6, 2009 at [www.midamericanenergy.com/include/pdf/fehrman\\_testimony.pdf](http://www.midamericanenergy.com/include/pdf/fehrman_testimony.pdf)

objective. For example, legislators should consider giving the CFTC additional authority, if needed, to take corrective actions and make interventions when exchanges do not uphold their own standards. [Question 4: additional statutory provisions]

Regulatory capacity and coordination will also be critical. The long value chain in carbon, from international offset credits to structured derivative products, presents significant opportunities for gaming, fraud and manipulation. Therefore, it will be critical to involve a host of domestic and international regulatory and law enforcement bodies, all of which have varying jurisdictions, and to ensure adequate coordination. Given the fact that the effectiveness of new U.S. regulations over Foreign Boards of Trade has yet to be tested, and global derivatives regulation is far from being realized, international coordination is particularly important. [Question 7 & 8: unified regulatory oversight and interaction with foreign regulators]

Finally, in making its recommendations, we urge the working group to consider not only the lessons learned from state/regional programs and the European Union Emissions Trading System, but also to project how carbon markets might look in 5, 10, or 40 years in the future. Taking a longer term view will allow the working group to consider what types of regulations may need to be in place to effectively govern a market that will likely become more mature, global, complex and financialized. [Question 9 & 10: experiences of other trading programs]

Thank you for your consideration; please contact Michelle Chan of Friends of the Earth ([mchan@foe.org](mailto:mchan@foe.org) or 415 544 0790) if you have any questions.

Sincerely,

Institute for Agriculture and Trade Policy  
Friends of the Earth  
Maryknoll Office of Global Concerns  
Missionary Oblates  
Public Citizen