

October 7, 2022

Climate Risk Unit
Commodity Futures Trading Commission
Three Lafayette Centre
1151 21st Street NW
Washington, DC 20581

Re: 87 FR 34856 Request for Information on Climate-Related Financial Risk

Dear Deputy Abigail S. Knauff,

I am writing on behalf of AllianceBernstein L.P. (“AB”) in response to the request for information from the Commodity Futures Trading Commission (the Commission) regarding climate-related financial risk. AB is a global asset-management firm with more than 4,000 employees across 25 countries and jurisdictions. We serve our clients by providing asset management, independent sell-side research and brokerage, and wealth management services. With \$647 billion in assets under management (AUM) as of June 30, 2022, we deliver solutions across the capital structure, from fixed income and equity to private alternatives and multi-asset solutions. Our broad range of investment expertise spans portfolio construction and management; fundamental, quantitative, economic and multi-asset research; wealth planning; and trading.

Background

In line with our broader responsibility practices and environmental, social and governance (ESG) research and integration approach, AB, along with hundreds of our peers, clients and portfolio issuers,¹ is committed to net zero and to playing our role in reducing greenhouse gas emissions in order to keep global temperatures in line with a 1.5-degree Celsius increase by 2050. As investors, our approach to responsibility and ESG research and integration helps to ensure that we’re accurately forecasting cash flows and valuations by incorporating climate risk and opportunity considerations when optimizing risk and return for our clients.

AB supports the Paris Agreement, which includes in Article 6 of that Agreement with important provisions to facilitate the international trading of emissions reductions with a view towards limiting global warming and thus the more catastrophic impacts of climate change. Article 6, and the commensurate “Article 6 Rulebook” that was produced at the 26th UN Climate Conference of the Parties (COP26) in November 2021² does not regulate voluntary carbon markets, which are the markets without official government oversight found in the compliance carbon markets. However, it is clear that

¹ Net Zero Tracker. Net Zero Stocktake 2022. <https://zerotracker.net/insights/pr-net-zero-stocktake-2022>. June 2022.

² United Nations Framework Convention on Climate Change. COP26 Outcomes: Market Mechanisms and Non-Market Approaches (Article 6). <https://unfccc.int/process-and-meetings/the-paris-agreement/the-glasgow-climate-pact/cop26-outcomes-market-mechanisms-and-non-market-approaches-article-6>. Date N/A.

the crediting mechanism created under Article 6, which requires countries to adjust their emissions tally any time credits are transferred to a different jurisdiction, will likely have a significant impact on the trading of offsets.

The Commission's Role & Current Market Landscape

We agree with Commission Chairman Rostin Benham's assertion earlier this year that the derivatives markets are implicated in the voluntary carbon markets, and that the Commission must build its capacity to ensure the integrity of these markets, which includes the promotion of responsible innovation and fair competition and the identification and resolution of potential fraud or abusive practices in the underlying markets.³ We believe the Commission is uniquely positioned within the US financial system as the regulator to deter disruptions to market integrity, ensure the financial integrity of transactions, avoid systemic risk, and promote responsible innovation and fair competition. Specifically, we'd like to address the Commission's questions regarding which aspects of the voluntary carbon markets we believe are susceptible to fraud and manipulation and how the Commission could enhance the integrity of the voluntary carbon markets.

Firms and individuals increasingly turn to the derivatives markets to mitigate physical and transition risk and opportunities stemming from climate change and to seek price discovery for new and evolving risk management products. The value of traded carbon credits in voluntary carbon markets stood at nearly US\$2 billion at the end of 2021, more than triple the value traded in 2020.⁴ This increase has occurred despite many challenges, including a lack of integrity around carbon credits and misaligned incentives for market participants, which in turn have caused a lack of investor confidence in these markets.

Many companies and industries will be unable to remove, reduce or avoid significant portions of their emissions footprints due to the inherent nature of their business activities and therefore will continue and increasingly resort to the purchase or development of carbon offsets in order to manage risk stemming from climate change and to meet net zero commitments.⁵ However, we agree with Chairman Benham's assertion⁶ that offsets should only be utilized to address residual emissions that cannot be reduced, removed or avoided. Despite this imperative, AB also acknowledges that these carbon offsets and the voluntary carbon markets are nascent, fragmented and opaque, with significant variability in governance, quality, pricing and sourcing. Increasing transparency around offsets is critical to

³ CFTC. Opening Statement of Chairman Rostin Benham at the CFTC Voluntary Carbon Markets Convenin.: <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060222>. June 2022

⁴ Ecosystems Marketplace. Value of Global Voluntary Carbon Markets Nearly Quadruples in 2021 Towards \$2 Bn, Driven by Nature-Based Solutions and Rising Prices. <https://hubs.ly/Q01kGp0L0>. August 2022.

⁵ AllianceBernstein. Six Best Practices for Carbon Offsets. <https://www.alliancebernstein.com/library/six-best-practices-for-carbon-offsets.htm?>. December 2021.

⁶ CFTC. Opening Statement of Chairman Rostin Benham at the CFTC Voluntary Carbon Markets Convenin.: <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060222>. June 2022.

determining whether an issuer is managing the risk of climate change to its business, particularly transition risk.⁷

Recommendations for Improving the Voluntary Carbon Markets

In light of this context, AB encourages the Commission to consider the following three approaches with regards to its role in strengthening the voluntary carbon markets:

1. **Collaboration to develop and implement global standards:** AB applauds, and encourages, the Commission's continued collaboration with international bodies that are endeavoring to provide transparency, oversight and standardization to these instruments and markets, particularly the work of Integrity Council for the Voluntary Carbon Market (ICVCM)—an independent governance body for the voluntary carbon markets. The ICVCM closed in September 2022 a public consultation on the draft set of Core Carbon Principles (CCPs), Assessment Framework (AF) and Assessment Procedure, which will establish threshold standards for high-quality carbon credits globally.⁸ For more details on our comments, please see the Appendix. We believe the Commission should act to improve investor confidence in carbon credits by supporting these global standards, which should focus on ensuring that underlying assets are not fraudulent.
2. **Defining deliverables:** the Commission should help define the deliverable in a carbon future contract. Today, the range of assets deliverable for voluntary carbon derivatives is very broad. Additionally, there is very little visibility around the prices of spot carbon contracts. The Commission should take appropriate steps to narrow the definition of the deliverable in a carbon contract and improve transparency on the spot market, which could also help rationalize the price range at which those deliverables trade.
3. **Determine position limits:** We would encourage the Commission to conduct market surveillance to help determine the appropriate position limits for anyone participating in the carbon derivatives market, given the relatively small size of the underlying market for carbon credits. Such limits should help mitigate risk in both the carbon credit and derivatives markets. This issue is particularly relevant as financial services firms continue to develop approaches to carbon offsets as an investable asset class.⁹

We expect developments around voluntary carbon markets to further evolve at COP27, and hereby request the CFTC to monitor the evolution in order to align the voluntary carbon markets with global standards and best practices moving forward.

⁷ AllianceBernstein. Comments on U.S. Securities and Exchange Commission's Proposed Rules to Enhance and Standardize Climate-Related Disclosures for Investors. <https://www.alliancebernstein.com/content/dam/corporate/corporate-pdfs/ab-dol-climate-disclosures.pdf>. June 2022.

⁸ ICVCM. Public Consultation. <https://icvcm.org/public-consultation/>. July 2022.

⁹ AllianceBernstein. Are Carbon Offsets the Next ESG Investing Frontier? <https://www.alliancebernstein.com/library/are-carbon-offsets-the-next-esg-investing-frontier.htm>. June 2022.

We welcome the Commission's efforts to help mitigate climate-related financial risk by enhancing the integrity of the voluntary carbon markets. We sincerely appreciate the opportunity to provide our recommendations and your consideration of our perspective. We believe the recommendations above will support the Commission's efforts in this area and would welcome any opportunity to discuss further. Please feel free to reach out to Salima Lamdouar at salima.lamdouar@alliancebernstein.com or +44207-173-9930 or Sara Rosner at sara.rosner@alliancebernstein.com or +1-212-756-4335.

Sincerely,

Salima Lamdouar

Salima Lamdouar
Senior Research Analyst—2050 Fund

A handwritten signature in black ink that reads "Sara Rosner". The signature is written in a cursive, flowing style.

Sara Rosner
Director of Environmental Research and Engagement—Responsible Investing

Appendix

September 29, 2022

Integrity Council for the Voluntary Carbon Market

Re: Core Carbon Principles Assessment Framework and Assessment Procedure

To Whom It May Concern:

I am writing on behalf of AllianceBernstein L.P. (“AB”) in response to the Integrity Council’s public consultation on the draft CCPs, Assessment Framework and Assessment Procedure. AB is a global asset-management firm with more than 4,000 employees across 25 countries and jurisdictions. We serve our clients by providing asset management, independent sell-side research and brokerage, and wealth management services. With \$647 billion in assets under management (AUM) as of June 30, 2022, we deliver solutions across the capital structure, from fixed income to equity and from private alternatives to multi-asset solutions. Our broad range of investment expertise spans portfolio construction and management; fundamental, quantitative, economic and multi-asset research; wealth planning; and trading.

While having a functioning voluntary carbon market is essential to providing the necessary incentives for decarbonization, the current market has only managed to scale to 1bn USD and faced severe challenges regarding the impact of most of the credits generated in the several years it has been in existence. In that regard, the work undertaken by the Integrity Council is extremely important, but the rethinking should be foundational and not anchored by the current market structure or industry participants. Two central criteria need to be met to for the carbon market to scale and achieve its purpose, in our view:

1. By virtue of it being a voluntary market, stakeholders in this space so far are only participating to protect their reputation, and so integrity through all angles need to be ensured through mechanisms that provide the correct safeguards to avoid participation turning from reputational risk mitigation to reputational risk increase.
2. For the carbon market to function, the financial incentives for the ‘issuers’ of carbon need to make sense. The distribution across the value chain needs to be more equitable.

We believe that rather than merely adding safeguards to current offsets, a radical rethink of these markets is warranted. We are not framing our thinking across vectors of performance, additionality, permanence and co-benefits although these aspects are intrinsically embedded in various elements of our response.

Regardless of whether jurisdictional carbon credits (those issued directly by relevant states/countries) scale or not, we believe that the nesting of existing projects within relevant jurisdictions can provide safeguards against carbon leakage. Proposals to ban or bans of development or sales of offsets abroad by various countries would help begin rationalizing the space.

Fortunately we are at the juncture of many important developments that can provide the appropriate backdrop for the market to flourish. We believe the premise of Paris Articles 5 and 6 represent an ideal setting under which the voluntary carbon market can see the necessary reset it needs to be able to scale and have the intended mitigation impacts.

This is not to say that private developers should not be able to participate in carbon generation. However, this needs to be with the understanding that every project is preliminarily approved by the relevant government, through a royalty or similar type of scheme. This would have multiple benefits including:

1. This ultimately allows for carbon to be treated like a resource much like other commodities (for example, oil reserves tend to be owned by governmental actors with operating licenses granted to various private sector participants).
2. One of the current shortfalls of the market—especially for carbon credits generated in emerging markets—is that extremely high Internal Rates of Return are disproportionately being taken advantage of by developers from developed countries. Having a royalty type scheme would allow for more equitable distribution of financial windfalls to the local stakeholders, which would not only help optimize social cobenefits, but also result in greater buy-in from the local communities and avoid accusations of profiteering from unscrupulous parties.
3. Such a scheme would provide incentives for the relevant countries to strengthen their regulatory frameworks to enable broad-ranging mitigation outcomes, be it through incentivizing industrial decarbonization (through cap-and-trade systems, for example) or through natural capital conservation efforts. Acknowledging that up until now, especially for the latter, the incentives were misaligned in that countries could only directly monetize encroachment on natural capital and have not been rewarded for providing carbon capture for the rest of the world.
4. Conservation of existing ecosystems needs to be a central part of the carbon market. Native tropical reforestation is difficult. It requires years of nannying, careful management plans and intense field work. Financially, it's incredibly difficult to make it work and it can take more than a decade to break even. Reforestation is not impossible, but it is much easier to prevent the loss in the first place amid the right incentives.

The timing for this is especially opportune, as most emerging countries have had cheap access to capital over the past decade and have been able to grow through debt and leverage. However, this era is now coming to an end, with rising interest rates and inflation. This will incentivize these countries to further deplete their natural resources to meet their fiscal and budgetary requirements, which could cause further encroachment on natural capital unless the correct set of incentives is put in place. Having those incentives put in place through credible carbon markets would be a step in the right direction.

This rethinking of carbon markets also comes at a time where the IMF is discussing Special Drawing Rights (SDR) redistribution on the basis of sustainable criteria. Additional sources of revenue for certain countries through carbon markets could provide for one of the only frameworks whereby those SDR reallocations would be justified from a financial perspective, with improved fundamentals for the countries resulting from the windfall of carbon credit sales.

As a consequence, the baseline assumptions for carbon mitigation should be reassessed, in our opinion. For example, the Gabon expected carbon credit sale would not generate a meaningful amount of credits under many of the existing registries. It is counterintuitive that the country should be penalized for having made extensive conservation efforts in the past. A natural pushback would be to say that existing conservation regulation reduces the additionality value of potential offsets produced by this sale, but pressures to change said regulation are high in places for which social advancement still has a long journey ahead. c 10 mn credits a year for a country like Gabon at 25-30 USD per ton represents an incremental 3% contribution to GDP, which is not insignificant. If one assumes a steady increase in the price of these offsets, this number could increase.

Another example that might help illustrate the issues at stake here is the situation regarding drilling rights in the Virunga basin in the DRC. Without engaging and involving the governments in some sort of risk sharing scheme (which can be scaled to all DRC's natural capital) and assuming that crypto groups end up with the right to generate carbon credits, we could see the generation of impactless carbon credits with zero integrity. Instead, we believe that various stakeholders could/should be working with the country to buy sovereign carbon, which will then be allocated to that exploration block.

Another pushback would be to assume that the market could not absorb a potential flood of carbon issuance, particularly from entities that have not historically contributed to climate change in a meaningful way. We would challenge this view, as we believe a market that resonates much more directly from an integrity perspective with corporates and other purchasing entities will result over time in much stronger demand and scale.

Finally, we believe certain risks should be addressed in the market. To provide the backdrop for this market to scale up credibly, we believe that various safeguards should be put in place with regards to:

1. Baselines and performance measurements need to be credible at country level. Various third-party, newly created rating agencies tools for assessing the magnitude of carbon sinks for nature-based carbon capital but complementary verification frameworks could help assess overall carbon emissions/sinks potential at a country level. Using the UNFCCC REDD+ as a starting point and enhancing methodologies with respect to baseline calculations to counter some of the common criticism of these schemes may be warranted.
2. Nationally Determined Contributions (NDC)-based baselines should be ambitious, and NDCs need to continue to be improved at an appropriate pace to align the world with a 1.5-degrees Celsius warming scenario. If this is not done, countries could be incentivized to be water down NDC ambitions to generate excess credits.
3. For nature-based offsets, more emphasis should be put on rich biomes vs monocultures which have higher permanence related risks and arguably less additionality since most of those are financially relevant without the adjacent credit issuance. For example, the Guanare (verra verified) project, which consists of planting short-rotation, non-native Eucalyptus trees for pulp and receiving removal credits has questionable additionality. There are similar plantations all over the surrounding landscapes, which suggests that planting these trees was not a financial hurdle, and may have always happened. These credits sell for less than \$10/tonne, which is not

even one tenth of the money made from the timber and less than one third of the cost to plant the trees.

We welcome the Integrity Council's efforts to provide credible, rigorous and readily accessible means of identifying high-quality carbon credits that create real, additional and verifiable climate impact with high environmental and social integrity. We sincerely appreciate the opportunity to provide our recommendations and your consideration of our perspective. We believe the recommendations above with support the Integrity Council's efforts in this area and would welcome any opportunity to discuss further. Please feel free to reach out to Salima Lamdouar at salima.lamdouar@alliancebernstein.com or +44207-173-9930.

Sincerely,

Salima Lamdouar
Senior Research Analyst – 2050 Fund