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Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission (CFTC)
Three Lafayette Centre, 1155 21st Street NW
Washington, DC 20581

Submitted via CFTC Comments Portal to **https://comments.cftc.gov/**

Re: Climate-Related Financial Risk RFI dated June 2, 2022

Dear Secretary Kirkpatrick,

The American Petroleum Institute ("API") appreciates the opportunity to respond to the ''Climate-Related Financial Risk RFI'' published on June 2nd, 2022. We are submitting this comment letter, rather than responses to individual questions in the RFI, in order to provide feedback that is higher level and conceptual in nature.

API represents all segments of America's oil and natural gas industry. Its over 600 members produce, process, and distribute most of the nation's energy. The industry supports millions of U.S. jobs and is backed by a growing grassroots movement of millions of Americans. API was formed in 1919 as a standards-setting organization. In our first 100 years, API has developed more than 700 standards to enhance operational and environmental safety, efficiency, and sustainability.

API and its members support the ambitions of the Paris Agreement and are committed to delivering solutions that reduce the risks of climate change while meeting society's growing energy needs. Addressing this dual challenge requires new approaches, new partners, new policies, and continuous innovation. API believes that the pace of global action to reduce greenhouse gas ("GHG") emissions and effectively mitigate climate change will be determined by government policies and technology innovation. To that end, we have laid out a Climate Action Framework that presents actions we are taking to accelerate technology and innovation, further mitigate GHG emissions from operations, advance cleaner fuels, drive comparable and reliable climate reporting, and, importantly, endorse a carbon price policy.

The Growth of a Voluntary Carbon Market is Critical for Addressing Climate Change Challenge

Well-designed and transparent carbon markets, whether voluntary or mandatory, are important tools in reducing GHG emissions across a large set of market participants. However, for a voluntary carbon market (VCM) to play an impactful role in addressing climate change, it is necessary to ensure that a VCM is transparent, liquid, global, and represent high-integrity carbon offsets.

Such a VCM can accelerate GHG emission reductions and other GHG mitigation, in the absence of a global mandatory carbon price, as companies, investors, and policymakers work to advance and scale up important investments in low-carbon and carbon-free solutions. A robust VCM provides individual companies an opportunity to contribute to global GHG emissions mitigation efforts and to reduce their individual carbon footprint cost-effectively.

API supports the growth of the voluntary carbon market, as increased liquidity will help market participants achieve more efficiency and the maximum environmental benefit.

The CFTC Should Focus on Issues Within Its Jurisdiction, Avoid Duplication and Premature Action

The VCM is rapidly growing, and the total market value exceeded $1 billion in 2021.[1] As the size of the market increases, transparency and confidence in the market and underlying carbon offsets becomes even more important. API believes that generation of carbon offsets must adhere to robust, widely-recognized quantification methodologies to ensure their integrity, credibility and permanence. A robust VCM governance framework will ensure that the use of carbon offsets to achieve voluntary goals remains a credible approach to reducing GHG emissions. We also recognize that carbon futures and derivatives products can provide the transparency and liquidity needed for market participants to manage their climate risks effectively.

While the API believes that the CFTC is uniquely positioned to support the growth of the global VCM for maximum GHG mitigation by developing procedures to address fraud and manipulation in such a market in due time, we are concerned that most of the questions included in the RFI either fall outside of the CFTC traditional role and jurisdiction or would imply premature involvement that would likely harm the growth and maturation of the voluntary carbon market.

As the CFTC considers potential actions it can take to bring further transparency and reliability to the futures and derivatives products that support the VCM, we urge the CFTC to recognize the market is still evolving and exercise caution – if regulatory requirements are prematurely prescriptive and implemented too early while the market is still relatively small and maturing, they could undermine market growth in the U.S. The market needs to mature in its own right.

Premature Involvement Will Harm VCM Growth. API urges the Commission to avoid prematurely creating barriers to market entry (e.g., difficult entity reporting/registration requirements) and to avoid implementing regulatory obligations that would result in significant cost burdens for market participants, which could keep smaller entities out of the market (e.g., through complex and granular reporting requirements, risk management requirements, margin and capital requirements).

Introducing barriers to market entry before the market is further developed could impede market growth and limit participation only to large entities that might have resources in place to comply with any potential requirements. A market will only be relevant and attractive to investors if it is liquid and includes a robust and diverse number of market participants.

In response to the individual subjects included in the RFI, API recommends the following:

[1] https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/energy-transition/111121-cop26-voluntary-carbon-market-value-tops-1-bil-in-2021-ecosystem-marketplace

- *Scenario analysis & stress testing:* The VCM is small compared to other markets, though it has grown rapidly and continues to grow. Its current size makes scenario analysis and stress testing extremely challenging because the small size of the market makes it difficult to draw robust conclusions. Such requirements could also deter new participants from entry, potentially hampering market growth, liquidity and transparency. *The CFTC should not require stress testing or scenario analysis*.

- *Risk Management*: We question the CFTC's remit for adopting a risk management or registration framework for physical VCM participants. While many companies have in place robust frameworks for risk analyses and the management of market risks for many products, until there is sufficient price transparency in these markets to, for example, run value at risk (VAR) analytics, it is premature to mandate a risk framework. The CFTC should avoid developing prescriptive guidelines for market participants on how to measure, track, and account for climate-related physical and transition risk while the market is nascent and has few participants – in particular, mandating a one-size-fits-all approach will likely keep smaller players out of the market and impede market growth. It is also premature to introduce capital and liquidity requirements.

- *Registration Framework:* The CFTC *should refrain from* adopting a registration framework for market participants. Similar to the reasons above, if a framework is adopted too early while markets are immature, a registration requirement may stifle market entry for smaller market participants such as farmers and landowners. The voluntary carbon market offers opportunities to individual land and farm owners to generate carbon offsets, but burdensome and premature administrative requirements will likely deter such entities from participating.

<u>The CFTC is Well-Positioned to Address Fraud and Manipulation</u>. Given the increasing importance of the VCM to individual companies that work to reduce their GHG emissions, and the potential positive impact of the VCM on climate change, it is important to help such markets grow in a credible and transparent fashion. The Commodity Exchange Act (CEA) provides the CFTC with broad enforcement authority to pursue claims of fraud and manipulation in the commodities markets, which includes activities that involve commodity derivatives (i.e., futures, options, and swaps). The CFTC can play an important role in ensuring growth of credible, transparent VCM by focusing on identifying and pursuing potential fraud or other abusive practices in carbon offsets derivatives. This focus will help promote fair competition and advance market manipulation prevention, which fall squarely under the CFTC mandate. The CFTC's involvement would help improve confidence in the VCM among the market participants, including smaller landowners and farmers, help improve the liquidity of the market, and enable the US to become a leader in high-integrity VCM growth. We urge CFTC to take actions in this space that are proportionate to actual instances of fraud and manipulation.

<u>The CFTC Should Monitor Ongoing Efforts, Avoid Duplication</u>. There are multiple ongoing efforts to bring further transparency, reliability, and consistency of the global VCM. It would be beneficial for the CFTC to monitor and engage with these and other relevant ongoing efforts and re-evaluate the remaining gaps in light of any finalized guidance and/or rulemaking that might take place in order to avoid duplication of efforts.

The CFTC Can Play an Important Role in Growing a Global, High-Integrity Voluntary Carbon Market

API commends the CFTC for holding the June 2nd Carbon Market Convening, which educated stakeholders on these global markets and the measures being taken to ensure their integrity as a tool to mobilize capital to mitigate climate change and drive investment in low-carbon technology and innovation. The convening also showcased the amount of expertise on carbon offsets and markets amongst the U.S. federal agencies, the financial sector, NGOs, and the industry.

CFTC Can Support Global VCM Harmonization. In the June 2nd Carbon Market Convening, nearly all speakers emphasized the need for global harmonization in the VCMs, which would further spur confidence and participation, enable the markets to be more liquid and resilient, and make larger positive climate impact. The CFTC should work toward global harmonization and a robust U.S. VCM market. The CFTC has a unique opportunity to engage globally with its counterpart commodities markets regulators in other major economies and with the private sector and other private initiatives active on advancing the VCM. An appropriate step would include engagement and collaboration with voluntary initiatives and developers of international and regional VCM guiding principles, as well as open dialogue with the market participants. Furthermore, establishing an ongoing dialogue with the leading carbon registries will help the CFTC to understand the current state of carbon markets, and offer an additional layer of confidence to the market participants.

To conclude, API believes that the CFTC is uniquely positioned to support the growth of the global VCM for maximum GHG mitigation by developing procedures to address fraud and manipulation in such a market in due time, fostering a robust environment for the VCM maturation by mitigating entry barriers, engaging with key market stakeholders such as carbon registries to increase transparency and confidence in the markets, and sharing best practices with its international counterparts to support the harmonization of the global VCM. However, as stated above, we are concerned that most of the questions included in the RFI either fall outside of the CFTC traditional role and jurisdiction or would imply premature involvement that would likely harm the growth and maturation of the voluntary carbon market. We strongly recommend for the CFTC to await the continued development of international rules such as for Article 6 of the Paris Agreement so development of the U.S. market is not competitively disadvantaged versus other international markets.

API stands ready to engage with the CFTC and look forward to the opportunity to discuss this topic with the Commission and its staff.

Sincerely,

Jennifer Stewart
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