

October 7, 2022

VIA ELECTRONIC SUBMISSION

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

Re: Request for Information on Climate-Related Financial Risk

Dear Mr. Kirkpatrick:

I. INTRODUCTION

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP submits this letter in response to the request for information from the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**") regarding climate-related financial risk (the "**RFI**").¹ The Working Group appreciates the opportunity to provide input and actively participate in the important public policy debate relating to the systemic threat that climate-related risks and the energy transition pose to the U.S. financial system and, more specifically, to CFTC-jurisdictional markets, registrants, and end-users.

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group advocates regarding regulatory, legislative, and market developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

¹ See Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856 (June 8, 2022), *available at* <https://www.govinfo.gov/content/pkg/FR-2022-06-08/pdf/2022-12302.pdf>.

II. COMMENTS OF THE WORKING GROUP

A. The Commission's Role in the Energy Transition and Effort to Mitigate Climate-Related Risks.

The Working Group supports and encourages the Commission's efforts to better understand its role and the role that its jurisdictional markets play – and can play - with respect to the ongoing energy transition and efforts to mitigate the associated systemic threats to the U.S. and global financial system. Among the focus of the Commission's efforts is assessing how the Commission can facilitate the development of, and promote innovation in, Environmental Commodity² markets, including voluntary carbon markets, through its existing authority under the Commodity Exchange Act ("**CEA**").³

The Commission's issuance of the RFI and its formalized assessment of these issues is very timely. The public policy debate regarding physical, financial and transition risks threatening the U.S. financial system related to climate change has reached an inflection point reflected by (i) the recent enactment of the landmark Inflation Reduction Act of 2022⁴ and (ii) a continued, growing trend in the private sector to implement voluntary environmental, sustainability and governance ("**ESG**") policies intended to facilitate a material reduction in greenhouse gas emissions and mitigate climate change related risk.

Public efforts to reduce greenhouse gas emissions and mitigate the impacts of climate risk are not new and have grown to involve a complex, fragmented and decentralized web of federal and state laws and regulations. In addition to the Commission, several federal agencies are actively involved in these efforts, including the Environmental Protection Agency, Securities and Exchange Commission, Federal Trade Commission, and the Federal Energy Regulatory Commission (collectively, the "**Federal Regulators**"), each acting within the scope of their respective statutory authority.

The Working Group believes that the Commission can make a material and positive contribution to efforts to mitigate the risks to commodity markets associated with this changing landscape by (i) continuing to allow private sector-led initiatives, including with respect to the development of voluntary carbon markets, to organically evolve and (ii) using its existing authority under the CEA to assist these efforts by:

- Identifying and implementing market innovations, designed to enhance liquidity and price discovery and promote risk management in the Environmental Commodities derivatives markets;
- Removing unnecessary regulatory barriers in an effort to attract and expand capital flows into Environmental Commodity markets and related derivatives

² The Working Group uses the term Environmental Commodities to refer to the universe of intangible assets that represent various renewable, sustainable, and green attributes associated with various types of energy products. Environmental Commodities include mandatory carbon allowances, mandatory and voluntary carbon offsets, renewable identification numbers ("**RINs**"), renewable energy credits, as well as a host of other similar environmental attributes.

³ 7 U.S.C. § 1 *et al.*

⁴ See Pub.L. 117-169.

markets. Doing so will help facilitate sustainable investments that will aid in the transition towards a lower carbon economy; and

- Protecting the integrity of Environmental Commodity markets and related derivatives markets from fraud, manipulation and other forms of market abuse.

Absent a grant of expanded statutory authority through new legislation, the Commission should refrain from efforts focused on establishing new rules for purposes of regulating Environmental Commodity markets and the participants in such markets in a manner that departs from the boundaries of its existing authority under the CEA. For example, the proposal in the RFI to require registration for verification providers and participants in voluntary carbon markets would stifle innovation and would not appear to be rooted in existing authority. Any attempt, public statement or other action by the Commission implying that it presently possesses inherent authority to do so will harm the development of these markets by injecting regulatory uncertainty and confusion among market participants and other regulatory authorities alike.

Notwithstanding the statutory boundaries imposed by the CEA, the Working Group supports continued efforts by the Commission to work closely with Federal Regulators and state authorities to share information regarding, and gain a better understanding of, the voluntary carbon markets. Such knowledge development activities will be vital for the future development of such markets as financial risks and commercial challenges brought on by climate change and the energy transition increase and market-based solutions are brought forward.

B. The Commission's Primary Policy Objective Should be on Protecting the Integrity of Voluntary Carbon Markets.

As noted above, the RFI contains a number of questions and statements regarding voluntary carbon markets. A foundational element to the continued development of liquid voluntary carbon markets where trading activity is both fair and orderly is protection from fraud, manipulation and other forms of market abuse. With the exception of markets for RINs administered by the U.S. Environmental Protection Agency under its Renewable Fuel Standard program, the complex web of federal laws focused on reducing carbon emissions and mitigating the impacts of climate change risk does not provide a single regulator with comprehensive authority to regulate the trading of voluntary carbon offsets.

The Working Group is concerned that this regulatory gap could leave developing voluntary carbon markets and other voluntary Environmental Commodity markets open to forms of abusive or unlawful market behavior that could undermine the integrity of such markets and the related derivatives markets. With the exception of limited reservations of exclusive jurisdiction for other Federal Regulators, the Commission undoubtedly has oversight authority over fraud and manipulation in cash markets for commodities.⁵ Specifically, it is well established that the Commission has broad authority under CEA Sections 9(a) and 6(c), as well as CFTC Regulation 180.1, to police such cash commodity markets to protect against

⁵ Environmental Commodities transacted in voluntary carbon markets are cash commodities (*i.e.*, intangible, non-financial commodities) that are sold in interstate commercial transactions and, therefore, are excluded from swap or other forms of derivatives regulation as forward or spot contracts. See CEA Section 1(a)(47) and CFTC Regulation 1.3.

actual or attempted fraud and manipulation.⁶ As noted in Section II.A., above, the Working Group believes that a core – if not the primary – mission of the Commission should be to utilize its enforcement resources in an appropriately coordinated manner with other Federal Regulators to protect voluntary carbon markets from fraud and manipulation.

C. Fair and Orderly Environmental Commodity Markets and Removal of Unnecessary Regulatory Barriers Will Encourage Market Innovations and Attract Capital Focused on the Mitigation of Climate Risk.

The Biden Administration identified energy and climate change as priority policy objectives with the focus squarely on encouraging the development of new renewable energy resources, the creation of good paying technical and union jobs, mitigating climate change risk through net zero emissions policies, and promoting environmental justice.⁷ By prioritizing the policing of abusive behavior in Environmental Commodity markets as a policy goal, the Commission will promote continued public confidence in these markets. This confidence in turn will have the incidental benefits of (i) encouraging the development and implementation of market innovations, and (ii) attracting new capital investment in carbon reduction initiatives and infrastructure, including clean energy resources.⁸

Current leadership at the Commission has recognized this need and expressed strong support for the Administration's energy and climate change policy priorities. Commission leadership has already committed to playing a role – consistent with the *CFTC's existing statutory mandate* – to help further these policies. With respect to policy implementation, the Chairman has publicly stated that "meeting these goals ... means answering the President's global call to tackle climate change by reinforcing the role of derivatives in confronting climate-related risks and supporting market innovations that address these risks."⁹ Additionally, Chairman Behnam has remarked that:

Financial markets, particularly the derivatives markets overseen by the CFTC, are used for hedging a myriad of risks in the traditional commodity as well as interest rate, foreign exchange, credit, and equity markets. They also serve as powerful information resources for hedgers and investors alike when it comes to price discovery, market transparency--and, perhaps most importantly for our purposes today-- facilitating the allocation of capital towards sustainable investments and to financial, agricultural, and industrial sectors as they

⁶ CEA Section 8(d) also provides the Commission with authority to investigate the market conditions of commodities and commodity products and byproducts, including supply and demand for these commodities, cost to the consumer, and handling and transportation charges.

⁷ See THE WHITE HOUSE, FACT SHEET: PRESIDENT BIDEN SETS 2030 GREENHOUSE GAS POLLUTION REDUCTION TARGET AIMED AT CREATING GOOD-PAYING UNION JOBS AND SECURING U.S. LEADERSHIP ON CLEAN ENERGY TECHNOLOGIES (2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/22/fact-sheet-president-biden-sets-2030-greenhouse-gas-pollution-reduction-target-aimed-at-creating-good-paying-union-jobs-and-securing-u-s-leadership-on-clean-energy-technologies/>.

⁸ See Public Statements & Remarks, Commodity Futures Trading Comm'n, Testimony of Commissioner Rostin Behnam before the House Select Committee on the Climate Crisis (Oct. 1, 2020), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabeenam16>.

⁹ See Public Statements & Remarks, Commodity Futures Trading Comm'n, Keynote Address of Chairman Rostin Behnam at the ABA Business Law Section Derivatives & Futures Law Committee Virtual Winter Meeting (Jan. 27, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabeenam19>.

manage the impact of physical risks and transition towards a lower carbon economy.¹⁰

As commercial energy firms that are both exposed to, and taking the lead on, the energy transition, the Working Group fully supports the broad policy direction articulated by Chairman Behnam subject to the limited caveats discussed herein. However, there are additional steps that the Commission can also take to remove unnecessary regulatory burdens to better (i) promote market innovations, (ii) attract and allocate capital for sustainable financial solutions, and (iii) facilitate the use of derivatives markets to manage climate risk.

For example, the Commission can mitigate the burdens imposed by a registration requirement for market participants intermediating swaps where the underlying commodity is an Environmental Commodity. Such relief would allow OTC markets to form and grow to a sufficient size that registered markets would be viable. The Working Group also recommends that the Commission re-examine the capital and margin requirements associated with Environmental Commodity derivatives. In this respect, The Working Group believes, as ISDA has stated, that “the conservatism of Basel III capital requirements for carbon credits could impair the...transition to a sustainable economy.”¹¹ By taking these suggested actions, the Commission will mitigate systemic threats to the financial system and, more broadly, the national economy through the implementation of thoughtful regulation that will help Environmental Commodity markets generally, and voluntary carbon markets specifically, evolve organically.

III. CONCLUSION

The Working Group appreciates this opportunity to comment in this proceeding and looks forward to working with the Commission as it considers new policy initiatives or regulatory proposals resulting from this Request for Information that are focused on voluntary carbon markets and mitigation of climate change risk. The Working Group reserves the right to further supplement its comments filed herein.

If you have any questions, please contact the undersigned.

Respectfully submitted,
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¹⁰ See Public Statements & Remarks, Commodity Futures Trading Comm’n, Opening Statement of Acting Chairman Rostin Behnam before the Energy and Environmental Markets Advisory Committee (June 3, 2021), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060321>.

¹¹ Scott O’Malia, *Progressing on Carbon Trading*, ISDA (Apr. 28, 2022), <https://www.isda.org/2022/04/28/progressing-on-carbon-trading/>.