

Commodity Futures Trading Commission

1155 21st Street, NW

Washington, D.C., 20502

RE: Request for Information on Climate-Related Financial Risk (CFTC RFI 6351-01-P)

Dear CFTC Commissioners,

The International Emission Trading Association (IETA) and its members welcome the opportunity to share our views with the Commodity Futures Trading Commission (the “Commission”) in response to its request for information (RFI) on climate-related financial risk. We would also welcome the opportunity to meet with you and the Commission staff to discuss these topics in more detail.

Ensuring quality and integrity in the voluntary carbon market is a priority for IETA and the International Carbon Reduction and Offset Alliance (ICROA), a non-profit initiative housed within IETA; together IETA and ICROA represent over 250 organizations actively participating in carbon markets and are involved in every aspect of the value chain from supply to verification, certification, intermediation, advisory, and end-user demand for carbon credits. One of our roles is to promote best practices in voluntary carbon management and offsetting through [ICROA’s Code of Best Practice and Accreditation Program](#). Our member companies are committed to responsible and ambitious climate action, and we stand for high integrity on both the supply and demand side of these markets.

IETA’s input is structured around two main sections: **Section 1** features high-level priority input to guide the Commission’s request for information on climate-related risks pertinent to the derivatives market. We provide a brief introduction of IETA and what our organization stands for, leading to a discussion of current/ongoing Voluntary Carbon Market (VCM) initiatives and provide recommendations for where the Commission could seek to contribute/add to these existing efforts. **Section 2** contains more detailed input addressing specific questions raised in the Commission’s RFI.

## SECTION 1: High-Level Priority Input

### Introduction to IETA

The International Emissions Trading Association is a non-profit business organization, established in 1999 to serve businesses engaged in market solutions to tackle climate change.

IETA's core objective is to build robust policy and market frameworks for reducing GHGs at the "lowest cost" while facilitating and accelerating the global net zero transition. Our proven record as the multi-sector business champion on all aspects of carbon pricing, markets and climate finance means that IETA members are at the global forefront of policy evolution, innovation, and workable solutions. IETA's breadth of member companies includes some of the world's leading corporations, representing global leaders in oil, electricity, cement, aluminum, chemical, and other industrial sectors, as well as leading firms in GHG data verification and certification, brokering and trading, legal, finance, technology, and consulting businesses. With deep relationships across the world's key policy centers and commercial arenas, IETA is the collective voice for the full range of businesses involved in carbon markets and management worldwide.

For over a decade, IETA has convened expert forums on carbon markets and climate finance. These were produced in collaboration with the UN Framework Convention on Climate Change (UNFCCC), the World Bank and International Finance Corporation, the Asian Development Bank, the African Development Bank and other multilateral development banks. The forums include Innovate for Climate (I4C), Carbon Forum Asia Pacific, the African Carbon Forum, the Latin American and Caribbean Carbon Forum and Carbon Forum North America. They have featured heads of state, ministers, CEOs, financial executives, and market visionaries. Given the far-ranging locations of the forums – and the national and regional contexts in which they were produced – we have developed strong skills across different cultural and political contexts.

In addition, IETA regularly facilitates smaller working groups of members and sister organizations to develop solutions to market or policy issues. Through these experiences, we have developed extensive expertise in forging consensus in the business community on the challenge of climate finance.

IETA has deep domain expertise in carbon market policies and operations. We have been an accredited observer organization to the UNFCCC for over 20 years, most recently in frequent engagement on advocacy and design support of Article 6 of the Paris Agreement and its recently adopted Rulebook at COP26. We have contributed policy proposals dating back to Kyoto Protocol's Clean Development Mechanism (CDM) and Joint Implementation (JI) programs.

Our policy recommendations have made significant impact and are well-regarded by national and state-level officials across key markets – including, but not limited to, the EU Emissions Trading System (EU ETS), California-Quebec's Western Climate Initiative (WCI), the Regional Greenhouse Gas Initiative (RGGI), the Korea Emissions Trading System (KETS), and China's national Emissions Trading Systems. IETA regularly convenes experts across the growing and evolving voluntary carbon market as well as the new Carbon

Offset Reduction Scheme for International Aviation (CORSlA) market established by the UN International Civil Aviation Organization (ICAO). Collectively, IETA's expertise on carbon markets ranges from international to national, regional, state, and corporate levels.

Finally, IETA has deep familiarity with the World Bank's programs on carbon markets and climate finance. In addition to our collaboration on the Innovate for Climate annual global forum, we have worked in close collaboration with the Partnership for Market Readiness (PMR) and launched the aligned "Business Partnership for Market Readiness" (B-PMR) in 2014 – an initiative focused on building business readiness for carbon pricing and market programs with partner countries and recipients of PMR funding. In 2022, IETA launched the Business Partnership for Market Implementation (B-PMI) reflecting the new generation of business capacity-building efforts in close alignment with the World Bank's newly-launched Partnership for Market Readiness (PMI) initiative. In addition, IETA has participated in the World Bank's Networked Carbon Markets (NCM) roundtables, including leading a research project for the NCM with the Harvard Project on Climate Agreements. We are also a founding member of the Carbon Pricing Leadership Coalition (CPLC). Most recently, we have consulted with the World Bank Climate Warehouse on commercializing new global carbon market architecture to support private sector cooperation as envisioned by Article 6 of the Paris Agreement.

### Initiatives to Self-Regulate the Voluntary Carbon Market

Carbon markets—especially the VCM—serve as tools to scale cost-effective natural climate mitigation measures, renewable energy technology, and carbon capture technology by providing a direct bridge between projects and financial markets. Demand for high-integrity credits across the world's hyper-evolving Voluntary Carbon Market has soared in recent years,<sup>1</sup> representing significant potential to meaningfully drive global decarbonization efforts. As more corporates create commitments related to decarbonization, there will be increasing demand for voluntary offsets.

The VCM has been markedly introspective with the launch of several initiatives directed at the integral development of high-quality credits (supply), the integral usage of credits towards corporate targets (demand) and the scaling of the market to reach impacts in accordance with the Paris Agreement. There are three key initiatives that the Commission should be aware of:

1. **[Taskforce on Scaling Voluntary Carbon Markets \(Scale\)](#)**

The Taskforce on Scaling Voluntary Carbon Markets (TSVCM) is a private sector-led initiative aimed at increasing the scale and efficiency of the VCM to help meet the goals of the Paris Agreement. In January 2021, the TSVCM published its **[blueprint](#)** on creating a large-scale, transparent carbon credit trading market.

2. **[Integrity Council for the Voluntary Carbon Market \(Supply\)](#)**

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<sup>1</sup> "The VCM grew in value towards \$2 Billion in 2021. ... [Q]uadrupling in market value from 2020." Source: **<https://www.ecosystemmarketplace.com/articles/the-art-of-integrity-state-of-the-voluntary-carbon-markets-q3-2022/>**

The Integrity Council for the Voluntary Carbon Market's (IC-VCM) is an independent governance body for the voluntary carbon market, with IETA forming part of the executive secretariat. The IC-VCM's purpose is to ensure the voluntary carbon market accelerates a just transition to 1.5 degrees<sup>2</sup> by: 1) creating a set of Core Carbon Principles, 2) providing governance and oversight over the standard setting organization on adherence to the Core Carbon Principles and 3) coordinating and managing interlinkages between individual bodies for responsible growth of the VCM.

The [Core Carbon Principles](#) (CCP) seek to provide market players with guidelines addressing quality standards, integrity, and accountability which has recently undergone public consultation. The purpose of the CCPs and the IC-VCM's Assessment Framework is to provide a credible, rigorous, and readily accessible means of identifying carbon credits with high environmental and social integrity that create real, additional, and verifiable climate impacts. The IC-VCM intends to assess crediting programs and credit types against the benchmark, and clearly identify those that meet it.<sup>3</sup> The CCPs have recently undergone public consultation that closed on 27 September. The CCPs and Assessment Framework will be updated and revised by the IC-VCM in response to public feedback.

### 3. [Voluntary Carbon Market Integrity Initiative](#) (Supply & Demand)

The Voluntary Carbon Market Integrity Initiative (VCMI) is a multi-stakeholder initiative set around a shared vision to establish the VCM as a key enabler of climate action to limit the rise in global temperatures beyond 1.5C. The VCMI focuses on two key areas that require additional work to achieve this goal: 1) promoting demand-side integrity to ensure meaningful use of carbon credits within the VCM and 2) promoting supply-side integrity and access as countries develop policy options and strategies around the VCM. The key working order for the VCMI has been their Claims Code of Practice (CoP). The CoP aims to guide companies to make transparent and credible claims about their progress towards long-term net zero commitments.<sup>4</sup> The [Provisional CoP](#) has recently undergone a public consultation through August.

## IETA's Task Force on Integrity in Digital Climate Markets

In response to the rapid expansion of the use of distributed ledger technology and new digital approaches to monitoring, reporting, and verification as a tool for scaling the voluntary carbon market, IETA has created our [Task Force on Integrity in Digital Climate Markets](#) (the "Task Force"). The Task Force exists to examine new trends in digital climate markets and recommend steps to ensure integrity in this growing field. A centerpiece of the Task Force has been the creation of a Code of Best Practice for the tokenization of voluntary carbon market registry credits. The code of best practice is currently under review by IETA membership.

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<sup>2</sup> <https://icvcm.org/about-the-integrity-council/>

<sup>3</sup> [https://icvcm.org/public-consultation/?utm\\_source=Linkedin+&utm\\_medium=Organic&utm\\_campaign=ICVCM\\_public\\_consultation](https://icvcm.org/public-consultation/?utm_source=Linkedin+&utm_medium=Organic&utm_campaign=ICVCM_public_consultation)

<sup>4</sup> <https://vcmintegrity.org/>

## The Commission Should Leverage Existing VCM Initiatives and Literature

Given the breadth and capacity of current market initiatives, IETA believes any role or involvement of the Commission should be additional to the ongoing efforts in the VCM. The Commission should avoid duplication of efforts to enhance the integrity of the VCM. There has already been substantial work undertaken to ensure that the VCM is a market of integrity with high-quality credits and trades that represent real reductions and mitigations of greenhouse gases. However, there is still significant work needed to scale the impact of the voluntary market internationally. Nonetheless, much of this work has resulted in comprehensive and extensive documentation outlining high-quality offset credits, comprehensive schematics to scaling markets, and integral usage of credits that should be leveraged by the Commission as it discerns its role and function within these market systems.

## Section 2: Answers to Select Consultation Questions

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**IETA prepared this response to the Commission’s RFI on Climate-Related Financial Risk with the above context and perspective in mind, which led us to provide responses to the following questions:**

- Question 18
- Question 20
- Question 23

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### **18-1. What derivatives products are currently used to managed climate-related financial risk, facilitate price discovery for climate-related financial risk, and/or allocate capital to climate benefiting projects? Please explain how these products are used, negotiated, and traded.**

Market participants trade a range of derivatives referencing or correlated to carbon market commodities, including futures, options and swaps, to “facilitate the raising and allocation of capital towards investments, help market participants hedge risk related to environmental, social and governance factors, facilitate transparency, price discovery and market efficiency, and contribute to long-termism.”<sup>5</sup> The underlying assets referenced by such derivatives products are tied to either compliance carbon markets or voluntary carbon markets.

In compliance market settings, derivative products are currently used by companies to hedge against price volatility or variable compliance costs relating to expected emissions from future production. For example, a regulated facility may have to purchase emissions allowances (i.e. permits) to cover its compliance obligation in the current year and the future year. The owner of that facility may choose to enter into a

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<sup>5</sup> <https://www.isda.org/a/soigE/Role-of-Derivatives-in-Carbon-Markets.pdf>

derivative contract tied to emission allowances to offset the risk of a future increase in emission allowance prices.

In voluntary market settings, presently trading occurs both at the spot market level and through Commission-registered exchanges and over the counter (OTC) at the derivatives level.<sup>6</sup> As spot carbon offsets expand in volume and integrity, there are currently an increasing number of physically-settled derivative products being offered to meet the needs of market participants seeking to mitigate risks. As the VCM continues to evolve, efforts are underway to establish a self-regulatory framework that both ensures the integrity of the underlying offsets while also enhancing the standardization and transparency of the market.

Market-driven efforts like the Voluntary Carbon Markets Integrity Initiative (VCMI) and the Science Based Targets Initiative (SBTI) have been working to define what the integral usage of voluntary offsets towards corporate targets and goals are. With the establishment of effective governance for the accountable usage of offsets comes increasing market-driven demand for derivatives products to aid in facilitating corporate management of their net-zero strategies. For example, companies with aggressive net zero commitments may want to ensure price certainty for any future offsets as part of their carbon offset price risk mitigation processes.

The imperative for companies to achieve their net zero goals continues to intensify – as does the need for transparency and accountability. As each becomes more pervasive across all sectors of the economy, companies across the spectrum of industries will have a need to hedge and manage their climate-related financial risks (e.g. transition risks) by using insurance and derivative products. As market pricing for carbon-intensive goods and services increase as the world warms, the operational risks inherent in the transition to a low carbon business or alternative will also increase, making derivative products tied to underlying carbon assets a useful tool for net zero risk management. The infrastructure to accommodate the increased utilization of derivatives tied to underlying carbon commodities will include an expanded array of products offered on and off exchanges.

## **18-2. What, if any, conditions, including market practices and/or regulatory requirements, may constrain or promote their expanded use or development to address climate-related risks?**

As with the evolution of all commodity markets, the carbon markets have undergone a maturation process over the last twenty years. Today, there are significant developments being undertaken, both in compliance markets and voluntary markets, to provide oversight and standards to support scaling and liquidity of carbon markets as a tool to achieve more rapid and effective decarbonization of the economy. These developments are creating the conditions for increased utilization of derivative

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<sup>6</sup>[https://www.fia.org/sites/default/files/2020-08/FIA%20Climate%20Change%20Policy%20Paper\\_0.pdf](https://www.fia.org/sites/default/files/2020-08/FIA%20Climate%20Change%20Policy%20Paper_0.pdf)

products to address a range of climate related risks, which IETA expects to increase as the infrastructure for managing transition risk continues to mature. Below we outline some of the more recent developments in the voluntary and compliance markets giving rise to an increased need for and utilization of derivative hedging products.

## Voluntary Market

Restricting this question to the scope of the VCM, IETA has identified three critical areas where market practice and/or regulatory requirements may constrain or promote the expanded use and development of derivatives, in addition to the work undertaken by the integrity initiatives we have discussed above.

### 1. Addressing accurate accounting as a market risk

Accurate accounting is critical to ensuring the quality of credits in the VCM and is key to expanding the use of derivatives in the market. The final Article 6 (A6) text of the Paris Agreement (approved at the Conference of the Parties in Glasgow) requires that all A6 emission reductions undergo corresponding adjustments (CAs); however, it does not state that the trading of other voluntary emission reductions in the VCM is not permitted. Nonetheless, voluntary market reductions may be affected by A6 decisions. A6 does not directly regulate the VCM, but it is conducive to an increasing convergence of Paris Agreement activities and the voluntary markets.<sup>7</sup> The use case for voluntary offsets and company reporting requirements needs to be defined, noting the ongoing work by the VCMI to define how companies should best utilize voluntary carbon credits as part of their emissions reduction strategies. There are ongoing processes undertaken both by the Conference of the Parties and voluntary initiatives to determine how to accurately account for carbon credits affected by A6.

### 2. Addressing quality as a market risk

The quality of credits and companies participating in the market can be reinforced through participation in programs and third-party audits against industry best practice. ICROA administers a Code of Best Practice and regularly verifies entities' compliance to the Code through an independent accreditation provider. The ICROA Accreditation program facilitates the environmental integrity of voluntary corporate action and high-quality carbon credits which enable critical finance.<sup>8</sup> The ICROA Accreditation Program defines and promotes best practice in the financing of high-quality emissions reductions and use of carbon credits as an effective carbon management tool. Application for the accreditation label is open to all organizations who provide a carbon offsetting service.

<sup>7</sup> [https://www.icroa.org/files/ugd/653476\\_4cb8eae730b04813b63180619f16ae5b.pdf](https://www.icroa.org/files/ugd/653476_4cb8eae730b04813b63180619f16ae5b.pdf)

<sup>8</sup> [https://www.icroa.org/files/ugd/653476\\_451f03d2215f445ebc743f4c10c872d3.pdf](https://www.icroa.org/files/ugd/653476_451f03d2215f445ebc743f4c10c872d3.pdf)

The ICROA Accreditation Label represents adherence to ICROA’s Code of Best Practice and therefore, the highest environmental integrity and quality in the VCM. The label certifies that the company is compliant with the ICROA Code through an annual cycle of third-party audits.<sup>9</sup>

Corporates must start by measuring and publicly reporting their emissions, covering the 3 scopes, following recognized standards such as ISO/GHG Protocol, as per ICROA’s Code of Best Practice. Corporations must also commit to abating their emissions in line with science and the goals of the Paris Agreement, adopting a transparent and third-party verified emission reduction roadmap to bring down emissions aligned to a net-zero pathway by 2050 or earlier. The roadmap must include interim short- and medium-term targets that ensure action now and along the way.

To ensure quality in the VCM, corporates are encouraged to work with ICROA Accredited organizations to use carbon credits from ICROA-approved standards for the following uses: 1) To offset some/all of their emissions beyond a science-based reduction pathway; and 2) To offset residual emissions in the net zero years through removals.

### 3. Addressing integrity as a market risk

Ensuring the integrity of claims and credits is critical to scaling the market as this can provide a high level of confidence to market participants. IETA submitted a response for the public consultation of the [Core Carbon Principles draft](#), as have several of the ICROA-endorsed carbon standards. IETA recognizes the need to build a robust and mutually assured oversight mechanism to ensure standardization in the market for high-integrity credits in the absence of a regulatory body. However, IETA members have raised concerns over the practical application of criteria and requirements as laid out by the Assessment Framework and Assessment Procedure. There is a danger that, as proposed, the Assessment Framework will have the counter impact on the market to that intended by the IC-VCM. Members felt that the recommendations are not practical to implement in a timely manner highlighting that no existing credit programme can meet CCP guidelines as currently laid out. This will erode trust in voluntary carbon markets, thereby slowing down rather than accelerating climate finance. More credence needs to be given to existing standards and assessments. Assessing every credit type will be a slow process that has the potential to significantly hamper the market. To help address these concerns, IETA has recommended the IC-VCM to shift focus towards crediting programmes and embedded best practices.

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<sup>9</sup> [https://www.icroa.org/files/ugd/653476\\_d76cf631001143069f0d64a075d90efd.pdf](https://www.icroa.org/files/ugd/653476_d76cf631001143069f0d64a075d90efd.pdf)



### 18-3. Are there ways in which Commission regulation or guidance could better address particular considerations relating to the listing of these types of products for trading?

Derivatives market participants have understood for years that the Commodity Exchange Act of 1936 (“CEA”) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) have left certain transactions outside of the Commission’s scope of regulation – particularly spot and forward transactions in which the parties intend to make or take immediate physical delivery of a commodity.<sup>10</sup> Commission guidance on this issue as it pertains to carbon commodity transactions could help address many outstanding questions related to listing derivative products tied to underlying physically-settled carbon credits.

In discussing environmental commodities in the CFTC and SEC’s joint final rules defining certain terms in the Dodd-Frank Act, the Commission noted that it:

“understands that market participants often engage in environmental commodity transactions in order to transfer ownership of the environmental commodity (and not solely price risk), so that the buyer can consume the commodity in order to comply with the terms of mandatory or voluntary environmental programs. *Those two features—ownership transfer and consumption—distinguish such environmental commodity transactions from other types of intangible commodity transactions that cannot be delivered, such as temperatures and interest rates.* The ownership transfer and consumption features render such environmental commodity transactions similar to tangible commodity transactions that clearly can be delivered, such as wheat and gold.

As a result, the CFTC found that ‘environmental commodities can be nonfinancial commodities that can be delivered through electronic settlement or contractual attestation. Therefore, an agreement, contract or transaction in an environmental commodity *may qualify for the forward exclusion from the swap definition if the transaction is intended to be physically settled.*’

Conversely, as described by an industry participant, to the extent that emissions allowances, carbon offsets/credits and RECs [renewable energy certificates] are not physically settled (*i.e.*, consumed), but traded in secondary market fashion like a stock or bond, the forward exclusion would likely not apply to the transaction. Moreover, the CFTC has stated that, if a contract were to include the right to unilaterally terminate an agreement under a pre-arranged contractual provision permitting financial settlement, the forward exclusion would not apply.”<sup>11</sup>

Any additional guidance from the Commission would be beneficial in providing clarity to the regulatory treatment and exemption of physically-settled spot transactions. Moreover, such guidance will be useful as more derivatives products are offered tied to underlying physical carbon credits, and as the market

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<sup>10</sup> Matthew F. Kluchenek, *The Status of Environmental Commodities Under the Commodity Exchange Act*, Harvard Business Law Review Online, 39 (2015).

<sup>11</sup> *Id.* at 48–49 (emphasis original); see, also, 77 Fed. Reg. at 48,233–35.

begins to use such products to help manage their net zero strategies and climate change-related financial risks. The Commission certainly should also continue work through existing subcommittees, the Market Readiness Advisory Committee, and otherwise, to engage with civil society market actors as market standards and criteria best practices emerge.

## 20. Are there any potential innovations in climate-risk-related technology that could shape derivatives product innovation or are otherwise likely to impact the derivatives markets overseen by the Commission?

### World Bank Climate Warehouse

The World Bank has developed a metadata layer called [Climate Action Data \(CAD\) Trust](#) to provide a platform for international accounting to prevent double counting and track corresponding adjustments. In summary, CAD is a global public meta-data layer empowering a new global carbon market infrastructure through a decentralized information technology platform built on blockchain technology. It aims to mobilize climate action toward the Paris Agreement's objectives by enhancing transparency and environmental integrity of carbon credit transactions and international carbon markets. By providing open access to data on carbon markets, it brings more simplicity to entities seeking to understand and track data on carbon credits, and also aims to unleash private sector innovation to deliver the required services for the market to grow, such as forecasting, ratings, due diligence checks, and certifications.

## 23. What measures and mechanisms are in place to ensure that fraud or manipulation does not occur in the VCM?

To minimize fraud and manipulation in the VCM, transparent mechanisms for documentation and secure IT systems are needed. Available documentation gives stakeholders the confidence to review projects, and quality IT systems protect from cyber-attacks that could erode trust. Additional measures taken by Standards to minimize fraud and manipulation include:

- 1. Ensuring the right number of credits are issued**
  1. Project Proponents (PP) engage an independent third-party auditor known as a VBB (Validation and Verification Body) to ensure the accuracy of the volume of credits that are issued.
  2. All issuance requests have the underlying documents and calculations reviewed by the VBB to ensure the traceability of the data provided for every request. The review also includes confirming the identity of the project proponent.
- 2. Ensuring strict controls over who can access registry accounts**

1. The various Standards and their registries have different processes in place to control who can access registry accounts. For example, the Verra Registry is subject to a bi-yearly independent System and Organization Control audit. Such audits assess the registry system's security, availability, and processing integrity.
  2. Many registries are improving security checks to include Multi-Factor Authentication to authenticate account holders and users. Account holders and users are categorized upon registration to delineate project proponents, credit traders, end-users, etc.
  3. High-quality Standards are implementing Know Your Customer (KYC) checks to validate entities creating registry accounts.
- 3. Minimizing the chance of manipulation of projects**
1. Project documents undergo rigorous third-party validations and verifications to ensure the emission reductions are real, permanent, and additional (meaning they would not have occurred without the incentive of the carbon credit).
  2. These third-party validations and verification are subject to completeness checks by Standard employees. Reviews of projects are carried out by the Standards during the validation process and the verification process to ensure all required documents are submitted.
  3. Public consultations are opened on projects to give stakeholders an opportunity to comment on concerns identified with the project.
- 4. Ensuring transparency in the marketplace**
1. Registries ensure every credit has a unique serial number that can be tracked from issuance through retirement.
  2. Registries are increasingly requiring publication of the name of the company on behalf of whom credits are retired
  3. Registries have checks in place to confirm projects are not listed on multiple registries to ensure multiple credits are not issued for the same emission reduction.

Once again, the [International Emissions Trading Association](https://www.ieta.org/) appreciates this opportunity to share input on the Commission's Request for Information on Climate-Related Financial Risks. We look forward to further engagement during subsequent phases of this important and ongoing discussion surrounding the VCM. If you have questions or require further information on IETA's insights and discussion, please contact Tom Lawler, Washington DC Lead ([lawler@ieta.org](mailto:lawler@ieta.org)) and Sam Grootelaar, Analyst ([grootelaar@ieta.org](mailto:grootelaar@ieta.org)).