› nodal

1921 Gallows Road, 3rd Floor
Tysons Corner, Virginia 22182
p: 703-962-9800
f: 703-962-9850
www.nodalexchange.com

part of eex group

October 7, 2022

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

Via CFTC Comments Portal: https://comments.cftc.gov

Re: Request for Information on Climate-Related Financial Risk

Dear Mr. Kirkpatrick:

Nodal Exchange, LLC ("Nodal Exchange") and Nodal Clear LLC ("Nodal Clear") (collectively "Nodal") appreciate the opportunity to respond to the Commodity Futures Trading Commission's ("CFTC" or "Commission") Request for Information on Climate-Related Financial Risk (the "RFI").[1] Nodal also commends the CFTC and Chairman Behnam for the creation of the Commission's Climate Risk Unit ("CRU") in March 2021 "to focus on the role of derivatives in understanding, pricing, and mitigating climate-related risk, and supporting the orderly transition to a low-carbon economy through market-based initiatives."[2] Nodal stands ready to provide information and support to the Commission and the CRU as it seeks to understand climate-related risk issues faced by the futures industry. The Commission's leadership in assessing the risks on commodity derivatives markets is important to the overall U.S. response to climate change risks.

Nodal Exchange is a CFTC designated contract market ("DCM"). Nodal Clear is a wholly owned subsidiary of Nodal Exchange and a CFTC registered derivatives clearing organization ("DCO"). Nodal is part of the EEX Group of companies owned by the European Energy Exchange ("EEX"). Nodal Clear is the clearinghouse for Nodal Exchange and Coinbase Derivatives Exchange.[3]

Nodal Exchange is at the forefront of innovation in both environmental markets and electric power locational (nodal) futures contracts, offering the world's largest set of derivatives products in each

[1] 87 FR 34856 (June 8, 2022).
[2] Rostin Behnam, Chairman, CFTC, State of the CFTC, Testimony Before the H. Comm. on Agric, 117 Cong. (Mar. 31, 2022), at https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam22
[3] Coinbase Derivatives Exchange is a registered DCM under LMX Labs LLC, formerly doing business as FairX.

of those markets. During the last two decades, evolving regional environmental policies have shaped new markets and created new segments for sustainable products and services. These markets span across renewable energy, carbon, renewable fuels, and pollutants like sulfur dioxide and nitrogen oxide. Renewable energy generation is increasing across geographies and is attracting an increasing number of diverse market participants, expanding green finance and creating new trading opportunities. A growing consensus for solving the carbon challenge is the drive to "electrify everything", cementing the links between power and environmental markets and policy. Nodal Exchange, in cooperation with its collaborators IncubEx and Net Zero Markets, aims to develop and offer products and services that best meet the growing and evolving needs of the North American electric power markets, environmental markets, and global voluntary carbon markets. Nodal Exchange's parent, EEX, is also a leader in European environmental markets.

I. General Comment

Nodal's product listings and margin practices are driven by experience in the fundamentals of the markets and prudent risk management according to the Core Principles of the Commodity Exchange Act ("CEA") and accompanying Commission Regulations.[4] As an exchange and clearing house in the environmental and U.S. power futures markets, Nodal is well versed on climate risk and potential impacts in these markets.

Nodal appreciates the Commission's commitment to studying the existing and prospective risks within the derivative and spot markets related to climate change issues. The Commission noted that the derivatives markets it oversees are "affected with a national public interest" because they facilitate risk management and price discovery "through trading in liquid, fair and financially secure trading facilities."[5] As such, Nodal is confident that the Commission, consistent with the public interest and within its jurisdictional reach, will continue engaging with the various market participants in a public discussion on the impact of climate change on the U.S. commodity and financial markets. Nodal welcomed the publication of this RFI as well as CFTC's 2020 report on Managing Climate Risk in the U.S. Financial System where many of the topics were first introduced that are subsequently addressed in the RFI.[6]

Nodal believes the Commission's existing regulatory framework provides appropriate guidance and flexibility by requiring DCMs to protect the markets and market participants and DCOs to manage risk with appropriate scenarios and stress testing while recognizing the expertise of the DCMs and DCOs in the products they list and clear. Nodal Exchange and Nodal Clear encourage

[4] 7 USC § 1 *et seq*.
[5] RFI at 34858.
[6] https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf

the Commission's continued commitment to its principles-based regulatory approach that has proved effective for many decades, especially when CFTC regulated entities and market participants are appropriately accounting for climate-related financial risks among all other types of risk. A move away from a principles-based regulatory approach could hamper the ability of registered entities to respond to and address new types of risks as they arise.

II. Data

As is well established, the CEA gives the Commission exclusive regulatory jurisdiction with respect to commodity derivatives markets[7] (*i.e.*, "commodity interests")[8] and enforcement authority over underlying commodities markets.[9] As such, the Commission's particular expertise is naturally in these derivative markets. Nodal understands that certain physical commodities impact "commodity interests" to such an extent that the Commission's interest in prosecuting fraud and manipulation with respect to these physical commodities may be heightened. To fulfill its mission in this regard, the Commission requires a number of reports to be filed.[10]

Given the Commission's jurisdictional scope, Nodal understands the Commission may consider whether the collection of data relating to environmental commodities is necessary, but Nodal would prefer the Commission consider if the existing data reporting requirements of registered entities provides the relevant climate data before proposing any changes to those reporting requirements. While Nodal appreciates and applauds the Commission's goal of understanding the climate-related financial risks, we believe attempting to decern the specific data or methods of identifying such data that could appropriately inform the Commission on the broader climate risk that may impact particular entities in the industry would be extremely difficult. Attempting that type of data collection would be an enormous undertaking, as would any appropriate analysis of such data, including the determination of how such an analysis would be best utilized. Nodal would support further study by the Commission of the necessity of data standards or definitional changes, within its scope of authority. Additionally, Nodal would support the Commission working with and engaging other US agencies that may be better positioned to gather such data for the Commission through existing or new Memorandums of Understanding ("MOUs") with such agencies.

Nodal believes the collection of information relating to commodities that do not serve as an underlier to "commodity interests" and do not otherwise have direct or a quantifiable indirect impact on "commodity interests" should be carefully considered and discussed further through

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[7] Sec. 2(a)(1) and Sec. 4b-1 of the CEA.
[8] 17 CFR Sec. 1.3 defining "Commodity Interest".
[9] Sec. 1a(9) of the CEA.
[10] https://www.cftc.gov/IndustryOversight/MarketSurveillance/CFTCMarketSurveillanceProgram/index.htm

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appropriate forums, in the context of the Commission's concerns for the "national public interest" in the derivatives markets.

III. Scenario Analysis and Stress Testing

Nodal Clear is responsible for, among other things, identifying the variables that impact the price of the products that it clears and estimating the possible amplitude of those variables and their price impact. Accordingly, Nodal Clear believes that any prudent DCO that clears a product where weather can impact prices is already utilizing stress testing scenarios that account for climate-related risk over the relevant period of risk (typically less than 5 days in the futures market), including both historical scenarios and hypothetical scenarios designed by the DCO. For example, Nodal employs stress testing that considers long-run price histories (when available) and such price history directly reflects the historic impact of weather and other factors on the price of electric power futures products. Furthermore, Nodal constructs hypothetical stress scenarios based on fundamental drivers (e.g., average temperatures) of the relevant markets under the impact of extreme weather caused by climate change. In addition, environmental derivatives face significant non-weather-related risks stemming from federal and often state-level regulatory/legislative initiatives—new limits, new requirements, and changes to existing regimes—that can have profound impacts on the supply and/or demand for these products. Deep knowledge of these markets is therefore critical in constructing the appropriate model and inputs to manage the risks posed to the DCO and the markets it clears.

In sum, Nodal Clear's portfolio of stress test scenarios reflects, and is informed by, Nodal's expertise in the products that it clears. Additionally, Nodal Clear, as a CFTC registered entity, routinely updates its risk management processes as new risks arise. Therefore, Nodal Clear believes the Commission's current regulations allow a DCO to implement stress testing scenarios that account for the impact of climate-related financial risks where appropriate and that creating specific rules calling for climate-related stress testing is unnecessary.

Further, Nodal does not believe that long-term (e.g., 30-year or 50- year) stress testing scenarios are currently relevant for the products cleared by Nodal. In general, DCO stress scenarios capture price risk events that occur over a short timeframe. For example, the impact of weather on electric power prices is reflected most acutely in the near term. Products that expire in the longer term (i.e., more than two months) are less sensitive to the impact of weather (excluding, of course, lasting impacts on physical energy infrastructure).

IV. Risk Management

Organized derivatives markets are at the core of risk management for businesses on both the buy side and the sell side alike, as well as those businesses participating in compliance and voluntary markets. Futures and options markets help address price, credit, and liquidity risk for the markets they serve. Commodity derivatives markets perform a forward price discovery function for products such as carbon, renewable energy certificates, and other environmental commodities. Well-functioning derivatives markets help businesses quantify and mitigate risks and meet their regulatory objectives related to their climate change risk. In fact, Nodal considers the core risk management functions of derivatives markets to be essential to a robust global response to climate change. Nodal has always taken great pride in the high quality of its risk management methods and principles.

Nodal believes current Commission regulations permit a DCO to employ risk management programs that address applicable climate-related risks. DCO Core Principle D (Risk Management) and Commission Regulation 39.13 require all DCOs to have appropriate risk management practices, tools and procedures while generally granting DCOs discretion as to how they address specific risks. Nodal currently employs risk management practices that consider the impact of climate-related risk (e.g., scenario analysis and stress testing) and therefore sees no benefit in separately identifying climate-related risk in the Commission's risk management regulations.

V. Product Innovation

Nodal Exchange currently offers the world's largest set of environmental contracts in addition to contracts on electric power, and natural gas. Each product category is currently used to manage climate-related financial risk, facilitate price discovery, and/or allocate capital to climate benefiting projects. For example, Nodal's power futures contracts are used to hedge the price of electric power at hundreds of distinct locations (nodes) in the North America enabling participants like wind farm developers or operators to have greater certainty regarding the price they will receive for the power that they produce. Additionally, renewable energy certificates generated under voluntary standards determine the price premium of "green energy" originated beyond the obligatory quantities of Renewable Portfolio Standards in compliance markets. Such price certainty enables the wind farm developer to obtain financing for their wind farm and enables further development of green energy projects. Nodal's suite of futures products can be used in a complimentary manner to help make climate benefitting projects, such as wind farms, solar plants, and stationary battery storage facilities, more financially viable.

Nodal believes that futures products, such as those noted above, that are listed on the derivatives markets have a strong track record of success in scaling high-integrity markets for a variety of asset classes, with exchanges often acting as standard-setters to deploy industry-led solutions effectively and transparently. CFTC regulated exchanges are able to effect solid and integral markets by relying on existing governance and regulatory bodies that have been proven to be both agile and responsible. Nodal is confident that the current rules and oversight mechanisms of the Commission will also apply well to any future derivative contracts on environmental products.

VI. Voluntary Carbon Markets

In addition to Nodal's carbon compliance markets, Nodal Exchange lists a comprehensive suite of voluntary carbon futures contracts that were introduced this summer[11] and will look to develop other products and services to the North American environmental markets.

Voluntary carbon products allow channeling of much needed private investments into carbon abatement projects using project-based offsets which are then separately governed by a defined, transparent methodology and help to accelerate the achievement of global climate related targets. The standardization and listing of voluntary market contracts on regulated trading venues supports the development of liquidity and benefits from proven industry risk management standards.

Voluntary carbon markets exemplify innovation in financial markets which may provide the global economy the means to help address climate-related risks. Nodal supports the cooperation between public and private resources to develop voluntary carbon markets of the highest integrity and transparency. Regulatory certainty, both within the U.S. and globally, is necessary for robust participation in voluntary carbon markets.

Given the global nature of this market, Nodal would encourage the Commission, and all global regulators, to study their treatment of voluntary carbon credits with the aim to align these programs across jurisdictions. Nodal welcomes the leadership of the CFTC in this regard. Given the comprehensive set of regulations to which derivatives products are already subject in the jurisdictions which follow the IOSCO principles, we are open to the possibility that minimum supervisory standards set by IOSCO could be of value, as they exist for clearing. This could also benefit cross-jurisdictional trading, should that become more prominent in the long term.

Harmonization across jurisdictions, within the US and globally, is imperative to the scaling of these markets in order to meet the goals of a lower carbon global economy. Nodal would encourage the Commission to coordinate with regulators, both in the U.S. and globally, prior to taking any regulatory action in this space.

VII. Public-Private Partnerships/Engagement

Nodal is uniquely situated, from its own business focus and through its ownership relationship with EEX, to understand the particular challenges related to the physical climate markets. These challenges may include a lack of commonly shared standards and criteria for carbon offsets or credits, or that carbon registry rules are not commonly aligned. Such markets are still growing and adapting to market demands, which should be encouraged by regulators. The Commission

[11] https://www.nodalexchange.com/nodal-exchange-successfully-lists-new-environmental-futures-and-options/

should continue acting as a thought leader in these carbon environmental markets and help promote responsible innovation.

Since voluntary carbon credits receive ever-increasing attention by corporate businesses, the need for consistent guidance and reassurance on what is still a highly complex and fragmented segment is crucial. A private sector shift towards further standardization will support investments while at the same time ensuring the integrity of the market. Any potential regulatory initiative should therefore aim to complement and strengthen the already ongoing private initiatives.

VIII. Capacity and Coordination

As noted above, Nodal supports the Commission working with the private sector with a global perspective to ensure applicable laws and regulations avoid unnecessary conflicts and support market-driven solutions. A hodgepodge of jurisdictional solutions would impair growth in environmental markets by creating challenges for liquidity providers and higher regulatory risk as businesses try to comply with the multiple, and perhaps inconsistent, climate regulations.

Nodal commends and supports Chairman Behnam's leadership as the co-chair of the International Organization of Securities Commissions (IOSCO) Sustainable Task Force's (STF) Carbon Markets Workstream. Additionally, we support the Commission's continued recognition that a favorable regulatory framework is necessary in order to support liquidity and further development of these products in the derivatives markets. The Commission can, and should, play an important role in the global discussion by encouraging consistency in policy actions across jurisdictions, by listening thoughtfully to diverse industry input, and by providing sufficient time to accommodate any legitimate industry concerns before creating any new rule or regulation.

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Nodal appreciates the opportunity to respond to the RFI and looks forward to working with the Commission in the future regarding these important issues.

Respectfully submitted,

/s/ Anita Herrera

Anita Herrera
General Counsel &
Chief Regulatory Officer
Nodal Exchange and Nodal Clear

And

/s/ Cody Alvarez

Cody Alvarez
Chief Compliance Officer &
Corporate Counsel – Nodal Clear