August 18, 2023

Hon. Chairman Benham
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

submitted via CFTC online portal

RE: Second Voluntary Carbon Markets Convening on July 19, 2023

In addition to submitting information detailing voluntary initiatives on carbon credit integrity as presented during the CFTC's Second Voluntary Carbon Markets Convening held on July 19, 2023, and attached hereto as Exhibit A, EDF respectfully offers these follow up comments to highlight potential fraud and manipulation around social and co-benefits and offer suggestions for subsequent CFTC action on oversight of the voluntary carbon markets.

Statements relating to social and co-benefits are material, subject to fraud

In our first set of comments to the CFTC on voluntary carbon markets, we identified numerous opportunities for fraud and manipulation that undermine confidence in voluntary carbon markets. Establishment of the Environmental Fraud Task Force within the Division of Enforcement, and publication of the June 20, 2023 CFTC Whistleblower Alert: Blow the Whistle on Fraud and Market Manipulation in the Carbon Market are welcome efforts leveraging CFTC's expertise and authority to address these opportunities and build integrity and confidence in the voluntary carbon market.

The Whistleblower Alert articulates several types of misconduct of interest, including "fraudulent statements relating to material terms of the carbon credit, including but not limited to: quality, quantity, additionality, project type, methodology substantiating the emissions claim, environmental benefits, the permanence or duration, or the buffer pool."

We note that material terms of carbon credit contracts often include specification of co-benefits or contributions towards the United Nations Sustainable Development Goals (SDGs). Carbon credits may be marketed and sold with explicit or implicit claims regarding positive impacts other than direct GHG emissions mitigation resulting from carbon mitigation projects. These co-benefits can address educational, non-climate environmental, economic or social outcomes, and are generally used to justify a price premium.

At a minimum, crediting standards require that projects do no harm and that projects must demonstrate how they comply with social and environmental safeguards, and publicly disclose which institutions, processes and procedures are used to implement, monitor and enforce safeguards to manage social and environmental risks.[1] Anecdotal evidence indicates that failure to deliver promised co-benefits and maintenance of safeguards to manage social risks is distressingly prevalent in the spot market underpinning nature- and CORSIA-based futures contracts. CFTC's Environmental Fraud Task Force should remain alert for egregious instances of fraud involving illusory social and co-benefits.

[1] See, e.g. ICAO Document – CORSIA Emissions Unit Eligibility Criteria, Element pg. 4; https://www.icao.int/environmental-protection/CORSIA/Documents/ICAO_Document_09.pdf

CFTC oversight of environmental integrity of credits should be complemented by actions to secure market infrastructure and address chronic information asymmetries

EDF commends the CFTC's efforts to highlight voluntary collaborative work to address the environmental integrity of carbon credits. This focus is welcome and necessary but will not be sufficient to build transparent and well-functioning voluntary carbon markets. Scaling voluntary carbon markets requires robust and functioning market infrastructure and transaction mechanics to remedy information asymmetry, especially around price transparency and broker/intermediary behavior.

In a 2022 survey of over 200 environmental and sustainability leaders across various industries and sectors globally, dissatisfaction with the lack of price transparency was the top source of market friction.

In a 2023 survey of business leaders conducted on behalf of Conservation International and We Mean Business Coalition, almost 9 in 10 indicated that carbon credits would remain an important component of corporate sustainability strategies. When asked to identify primary concerns about the voluntary carbon market that prevented deeper investment, 38% identified "lack of regulation and transparency requirements." (CI-WMB, 2023, pg. 16, Fig. 9).

Business leaders further identified improvements in price and intermediary transparency as threshold matters that would increase engagement with carbon credits as part of wider sustainability strategies. Specifically, most organizations wanted: clarity in the use of carbon offset revenue (53%); more transparency in claims (43%) and more transparent pricing (37%). (CI-WMB, 2023, pg. 16, Fig. 10).

This sentiment is consistent with recommendations from external experts on enabling conditions for a well-functioning voluntary market. The Taskforce on Scaling Voluntary Carbon Markets recommended five key actions essential to deliver high-functioning and effective voluntary carbon markets, including actions to improve market infrastructure and data management (Recommended Action III) and to provide market integrity (Recommended Action V) in order to improve liquidity, market functionality and transparency. Likewise, the World Economic Forum issued five key recommendations to scale responsible engagement in the carbon market, including "create market transparency through corporate disclosures on climate and nature impact, project types, pricing and transaction costs and flows." (WEF, Action 4, 2021)

Lack of price transparency and market integrity assurance affects both credit sellers and buyers, and has significant ramifications for justice and equity outcomes. Because 90% of intermediaries don't disclose fees or profit margins, the exact amount of climate investment reaching climate projects and Indigenous Peoples and local communities (IPLCs) is not clear. (CarbonWatch, 2023). Pricing information available is either behind a paywall or significantly outdated. This means that farmers, foresters, Indigenous Peoples, and local communities can't negotiate for fair benefit sharing and payment terms, project developers have a difficult time obtaining fair financing and negotiating reasonable fees, and buyers can't be sure they're maximizing climate impact and co-benefits from carbon credit investments.

Uniquely positioned as s a financial market regulator, CFTC holds enforcement authority to address anti-fraud and anti-manipulation issues identified by voluntary carbon market stakeholders as obstacles to scaling. The Commission should focus its climate-impact efforts around the voluntary carbon markets on interventions that leverage those unique capacities and authorities. Specific recommendations for such interventions are described in detail below.

Recommendations for future CFTC action

Build out Commissioner Goldsmith Romero's proposals for oversight of Environmental/Climate-Related products

In her remarks to the International Swaps and Derivatives Association's ESG Forum on March 7, 2023, Commissioner Goldsmith Romero proposed that the Commission should follow a similar oversight and approach to Environmental/Climate Related products as those adopted for digital assets. The Commissioner further articulated five pillars to this approach: (1) consumer education; (2) asserting legal authority; (3) market intelligence; (4) robust enforcement; and (5) government-wide coordination. While all five pillars have substantial merit and should be explored in the context of voluntary carbon markets with opportunities for public comment, we provide additional supportive comments on pillars (2), (3) and (5) below.

Assert Legal Authority: CFTC should clearly articulate the legal status of carbon credits, and other key components of voluntary carbon markets such as registries and outline logical ramifications thereof under current CFTC legislative authority and regulatory frameworks. EDF understands carbon credits to be commodities in the U.S., and carbon-credit backed futures contracts to be subject to "the same regulatory oversight" and "options for trade execution, counterparty risk protections, and delivery mechanisms as any other physically delivered exchange cleared contract."[2] Accordingly, registries may be defined as, and subject to oversight as, delivery points in some scenarios. Guidelines for price benchmarking applied in other commodity markets, such as the IOSCO principles for financial benchmarking, should be used in the creation of price benchmarks for key carbon credits. Guardrails around brokers and intermediaries transacting in the voluntary carbon market should be established based on existing frameworks and clarified. At a minimum, CFTC should publicly articulate its understanding of the above concepts and allow affected stakeholders to provide feedback on these and any other regulatory interpretations.

Market Intelligence: Information asymmetry is a systemic market failure plaguing the voluntary carbon market, and well within CFTCs regulatory remit. We strongly concur with Commissioner Goldsmith Romero's assertion that "[i]ncreased market intelligence would also help ensure that derivatives markets are providing appropriate price discovery. A lack of transparency through consistent, comparable data can

[2] ISDA, Voluntary Carbon Markets: Analysis of Regulatory Oversight in the U.S., (June 2022); www.isda.org/a/93WgE/Voluntary-Carbon-Markets-Analysis-of-Regulatory-Oversight-in-the-US.pdf citing Sammann, supra note 50, at 143, www.cftc.gov/sites/default/files/2021/08/1629999884/eemactranscript060321.pdf

present challenges to proper market function, including price discovery." CFTC should assess and propose strategies to improve market intelligence both for its own regulatory and enforcement oversight, and also for market participants.

Government-wide coordination: We commend CFTC's efforts to highlight carbon market-related efforts and insights from the U.S. federal government, including the Departments of Transportation, Treasury, State and Agriculture. Going forward, CFTC should consider additional dialogue with the Federal Trade Commission and joint action to clarify scope and focal areas for each entity. In the voluntary carbon market integrity space, the Integrity Council for Voluntary Carbon Markets (ICVCM) and Voluntary Carbon Markets Integrity Initiative (VCMI) work in parallel to provide guidance to the supply-side and buy-side of carbon market transactions, respectively. In the regulatory space, CFTC and FTC mirror roughly similar oversight roles. Publicly clarifying these roles, identifying areas of overlap, and maintaining open dialogue about regulatory activity may help alleviate confusion and uncertainty.

Additionally, because the voluntary carbon market involves participants from multiple jurisdictions, we encourage the CFTC to continue its work coordinating with International Organization of Securities Commissions (IOSCO) and its members to ensure globally consistent and predictable (but appropriately tailored to national contexts) regulatory regimes.

Formally explore the suggestion to use the self-regulatory organization framework in the voluntary carbon markets context

CFTC should evaluate how the self-regulatory organization framework can be applied to the voluntary carbon market. As the market for voluntary carbon credit-backed derivatives is increasingly used as a risk-mitigation and investment tool, it would be helpful for CFTC to explore oversight approaches that address market infrastructure, clarify transaction expectations and provide some enforcement authority around fraud and manipulation, including in environmental outcomes. We note that this proposal was first raised by ISDA in June 2022 and later in a joint report by the Bipartisan Policy Center and Carbon Direct, Inc., *Government Intervention in Support of Quality Carbon Credits*, released April 20, 2023, and is receiving increasing traction among stakeholders. Formation of a self-regulatory organization could allow for flexibility in oversight of the carbon credit transactions, while maintaining a government-established floor for participant rules and federal backstop for enforcement actions. It is possible that rulebooks and registration requirements that reference existing integrity standards such as ICVCM and VCMI may leverage stakeholder expertise and maintain more flexibility than formal regulations in this context. This framework is worth CFTC's consideration and further public discourse.

Environmental Defense Fund encourages the CFTC to act with urgency on this matter and stands ready to assist CFTC and other key stakeholders with efforts to establish efficient, effective oversight activity for the voluntary carbon markets.

Respectfully submitted,

Pedro Martins Barata
AVP, Carbon Markets and Private Sector Decarbonization
Environmental Defense Fund

EXHIBIT A

Testimony of Pedro Martins Barata, AVP Carbon Markets and Private Sector Decarbonization
CFTC Second Voluntary Carbon Markets Convening
July 19, 2023

Introduction

Thank you, Nat. Environmental Defense Fund appreciates and encourages the Commissioners' continued engagement in this topic and is pleased to join other panelists today to discuss strategies the CFTC can take to build confidence, transparency and liquidity in the voluntary carbon market. I will describe two carbon credit integrity initiatives in which EDF is involved, the Carbon Credit Quality Initiative and the Tropical Forest Credit Integrity Guide. I'd also like to note that EDF's Angela Churie Kallhauge is on the Governing Board, and I am one of the co-chairs of the Expert Panel of the ICVCM, which was just described by Annette Nazareth.

Carbon Credit Quality Initiative

The Carbon Credit Quality Initiative (CCQI) was founded by EDF, World Wildlife Fund U.S. and Oeko-Institut to provide transparent information on the quality of carbon credits to help carbon credit programs and buyers understand what carbon credit quality means, and which project types are more likely to deliver actual emission reductions as well as social and environmental benefits. The CCQI provides a free, easy to use online scoring tool that can be used by carbon credit buyers and traders as part of their due diligence efforts.

The CCQI assessment methodology is science-driven, and strongly draws on available research on carbon credit quality. For each of the six criteria or sub-criteria, our assessment methodology identifies which of these factors are most significant for carbon credit quality, and then evaluates the criterion or sub-criterion at these levels. For example, the criteria for "robustness of the quantification of emission reductions" is mainly assessed by evaluating the detailed provisions of the quantification methodologies applied, whereas the robustness of third-party auditing is assessed by evaluating the carbon crediting program's rules on third-party auditing.

This approach allows our assessments to cover a large share of carbon credits available on the market. It does not, however, necessarily account for the unique conditions of each individual project. For example, the sustainable development benefits of an afforestation activity will strongly depend on how the activity is designed. To date, more than 10,000 mitigation projects are registered under carbon crediting programs. Assessing each individual project would provide the best picture of carbon credit quality – but would require considerable resources. For this reason, CCQI focuses on scoring different *types* of carbon credits. An Excel tool is available for individual project assessment for users with a high degree of expertise, and some grading services are offered for a fee by for-profit entities such as Calyx Global, Sylvera or BeZero.

A type of carbon credit represents a specific combination of components: the project activity (like cookstoves, or landfill gas utilization), the carbon crediting program under which the carbon credits are issued (like the Verified Carbon Standard), the quantification methodology that has been applied, and the country where the project is located. Each of these components are used to define, and then score, types of carbon credits.

CCQI scores represent the likelihood or confidence that the quality objectives or criteria are met. The carbon credit quality of individual projects could vary considerably from our scores. Scores are provided on an interval scale of 1 to 5, rather than binary "pass-fail" assessments to reflect the varied nature of credits and buyer priorities, and should be considered as a starting point for further due diligence. To date, CCQI scores are available for nine project types, and are currently assessed across five carbon crediting programs. Moving forward, CCQI seeks to assess more project types and programs.

Tropical Forest Credit Integrity Guide

To provide more clarity for companies around what high-quality tropical forest carbon credits look like, 8 norm-setting organizations, including Coordinator of the Indigenous Organizations of the Amazon Basin (COICA), Conservation International, Environmental Defense Fund, The Amazon Environmental Research Institute (IPAM), The Nature Conservancy, Wildlife Conservation Society, World Resources Institute, and World Wildlife Fund, came together to develop the Tropical Forest Credit Integrity Guide (TFCI). The TFCI Guide is designed for companies interested in purchasing carbon credits in the voluntary carbon market to help them differentiate among tropical forest carbon credits by impact, quality, and scale. The TFCI focuses almost exclusively on supply-side integrity, and the intended audience is decision-makers responsible for developing and implementing corporate climate mitigation/net-zero strategies, and consultants who advise on these topics.

Development of the TFCI involved two public consultation periods that engaged diverse stakeholders around the world from December 1, 2021 through February 15, 2022, and in the fall of 2022. Our views were informed and improved as a result of participation and input received, including the identification of areas that required more detailed guidance. Participants from forest communities were an integral part of the authoring committee, and input from Indigenous communities was vigorously solicited and integrated.

The authoring organizations recently released an updated Version 2 of the TFCI in February 2023. Version 2 contains three important components, in layers of increasing detailed guidance. First, six consensus recommendations outline the outcomes we are seeking to achieve and the direction of travel for companies to advance those outcomes. Second, the Guide contains Implementation Guidance that outlines an actionable four-step process to be undertaken by companies choosing to purchase tropical forest carbon credits as part of their climate mitigation strategy. Third, detailed Annexes to each recommendation explain even more nuance to help decision-makers weighing purchase decisions. Annexes to Step 1 and 2 speak to the qualities and attributes integral to high integrity carbon credits.

The Annex to Step 1 describes high forest, low density (HFLD) credits, six reasons for including HFLD credits in their portfolios, and basic eligibility criteria for HFLD credits, which apply in addition to all other TFCI quality criteria.

The Annex to Step 2 provides detailed guidance for selecting credits for purchase, articulating a definition, relevant criteria, and purchasing guidance for three tiers of credits. The Guides also helpfully include a description of nesting approaches in jurisdictional REDD+ standards, and an assessment of standards against TFCI criteria for fully nested criteria. We note that while the Guide is not a standard against which performance can be certified, it is the strong hope of the authoring organizations that those who set relevant standards and establish market governance systems will consider incorporating the recommendations detailed in the guidance.

Limitations and CFTC Ask

The TFCI is part of the evolving ecosystem of initiatives and resources focused on governance of voluntary carbon markets, and we recognize and value the work of the many other initiatives and platforms seeking to improve the integrity of voluntary carbon markets, including those on this panel as well as the Natural Climate Solutions Alliance (NCSA) and the Science Based Targets Initiative (SBTi).

While these, and the other standards initiatives and guides presented by the panel, address the critical and timely issue of credit integrity, the CFTC should be cognizant that credit integrity is not the only feature essential for a trusted, transparent, vital voluntary carbon market. In addition to carbon credit integrity, the Taskforce on Scaling Voluntary Carbon Markets recommended actions to improve market infrastructure and data management, and to provide market integrity (those are Recommended Actions 3 and 5).

I'll provide an example of how improvements in market infrastructure and credit integrity are linked; both critical to ensure that climate capital reaches the intended target.

The TFCI Guide's second recommendation is: "Ensure that essential components of social and environmental integrity are met for all credits purchased." To act in accordance with this recommendation, a purchasing company must perform due diligence to ascertain whether there has been equitable and transparent benefit sharing. This includes fair, transparent and equitable distribution of benefits and revenues developed in consultation with relevant rightsholders, and distribution of benefits, where possible, directly to Indigenous peoples, local communities, women and other underserved communities who protect forests rather than through third-party intermediaries requiring high administrative fees.

However, even in the best-case scenario, a credit purchaser trying in good faith to comply with the TFCI recommendations will find it difficult to ascertain benefit-sharing arrangements because 90% of intermediaries don't reveal the fees they charge or the profits they earn. (This statistic is from an excellent report produced by Carbon Market Watch in February of 2023.)

This is one example of how price transparency and basic market oversight could complement and enhance both confidence in the voluntary carbon market and existing work done to improve carbon credit integrity. We encourage the CFTC to consider strategies to address both.