

August 18, 2023

Mr. Rostin Behnam
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre 1155 21st Street, NW
Washington, DC 20581

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

Clean Air Task Force (“CATF”) wholeheartedly supports the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) efforts to gather perspectives on how the CFTC can promote integrity for high quality carbon credit derivatives. Without substantial oversight, the carbon credit derivatives market has the potential to incur a large amount of risk, misinform or defraud investors, and create a net negative impact on the climate. We are grateful for the opportunity to submit information on this topic and look forward to ongoing engagement with the Commission on these efforts.

CATF is a nonprofit organization working globally to safeguard against the worst impacts of climate change by catalyzing the rapid development and deployment of low-carbon energy and other climate-protecting technologies. With over 25 years of internationally recognized expertise on climate policy and law, and a commitment to exploring all potential solutions, CATF is a pragmatic, non-ideological advocacy group with the bold ideas needed to address climate change. CATF has offices in Boston, Washington, D.C., and Brussels, with staff working remotely around the world.

We are pleased that the CFTC has sought information about how the Commission should engage with climate-related financial risk. These comments offer support and suggestions to inform the Commission’s efforts to promote the integrity of voluntary carbon markets, and foster transparency, fairness, and liquidity in those markets. CATF also submitted related comments to the Commission in October of 2022, in response to the Request for Information on Climate-Related Financial Risk.¹

I. The CFTC’s regulation of carbon credits is both authorized and necessary.

The CFTC has authority under the Commodity Exchange Act (“CEA”) to regulate the commodities upon which futures and derivatives are based,² and where a market for futures

¹ Clean Air Task Force & NCX, *Comment for Orders and Other Announcements 87 FR 34856* (Oct. 7, 2022), <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70861&SearchText=Clean%20Air%20Task%20Force>.

² 7 U.S.C. § 5(b); *see also* 7 U.S.C. § 4a(j) (“It is the purpose of this chapter... [t]o foster these public interests, it is further the purpose of this chapter to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to this chapter and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets; and to promote responsible innovation and fair competition among of trade, other markets and market

based on a good, service, right, or interest exists, such underlying items may be regulated by the CFTC as a commodity.³ This broad authority to regulate commodities supports the Commission’s power to regulate so as to prevent fraud and misrepresentation in the carbon credit market. And, as multiple federal courts have held, the CEA grants CFTC the authority to regulate various nonagricultural, intangible commodities that are similar to carbon credits.⁴

CFTC regulation of carbon credits is necessary because the use of carbon credits to offset emissions, particularly in the context of net-zero claims, is susceptible to fraud.⁵ Especially vulnerable are sectors in which greenhouse gas emissions are hard or expensive to abate and in which buyers may seek lower cost options for meeting their targets. This demand, together with a lack of regulatory oversight and shortcomings in the current approach to certification, can create a market for tranches of low-cost, low-quality, or fraudulent carbon credits with impacts on consumers, prices, and liquidity.

The underlying commodity markets’ vulnerability to misrepresentation reverberates directly into the derivatives market, as derivatives based on standardless commodities may lack actual value. In fact, the purchase of derivatives based on misrepresented commodities can inflict serious losses on a purchaser and can cause miscalculations in risk hedging and management. Moreover, the lack of oversight in carbon credit derivatives and spot markets discourages innovation and creates a strong potential for price distortion and fraud. Ultimately, the risk and volatility associated with derivatives based on carbon credits is borne out of the transactions’ vulnerability to fraud and misrepresentation.⁶ This vulnerability, currently exacerbated by a lack

participants.”); *CFTC v. McDonnell*, 287 F. Supp. 3d 213, 225 (E.D.N.Y. 2018) (“The CEA covers intangible commodities.”).

³ 7 U.S.C. § 1a(9) (“The term ‘commodity’ means wheat, cotton, rice... and all other goods and articles, except..., and all services, rights, and interests (except...) in which contracts for future delivery are presently or in the future dealt in.”); *McDonnell* at 227 (explaining where “a futures market exists for a good, service, right, or interest, it may be regulated by CFTC, as a commodity”); see also *CFTC v. My Big Coin Pay, Inc.*, 334 F. Supp. 3d 492, 497-98 (D. Mass. 2018) (describing CEA definition of “commodity,” legislative history, and caselaw); cf. *United States v. Reed*, No. 20-cr-500, 2022 U.S. Dist. LEXIS 35089, at *10-11 (S.D.N.Y. Feb. 28, 2022) (ruling defendant had fair notice that cryptocurrencies were commodities because of statutory definition and rulings by other courts).

⁴ See, e.g., *CFTC v. Trade Exch. Network Ltd.*, 117 F. Supp. 3d 29, 37-38 (D.D.C. 2015) (ruling that certain contracts based on questions about weather events or economic statistics were currencies within the CEA’s definition); *Reed*, 2022 U.S. Dist. LEXIS 35089, at *10-11 (explaining that cryptocurrency is a commodity given that contracts for future delivery are based on cryptocurrency).

⁵ See, e.g., Ben Elgin, *This Timber Company Sold Millions of Dollars of Useless Carbon Offsets*, Bloomberg (Mar. 17, 2022), https://www.bloomberg.com/news/articles/2022-03-17/timber-ceo-wants-to-reform-flawed-carbon-offset-market?in_source=embedded-checkout-banner; Ben Elgin, *A Top U.S. Seller of Carbon Offsets Starts Investigating Its Own Projects*, Bloomberg (Apr. 5, 2021), <https://www.bloomberg.com/news/features/2021-04-05/a-top-u-s-seller-of-carbon-offsets-starts-investigating-its-own-projects#xj4y7vzkg>; Patrick Greenfield, *Carbon offsets used by major airlines based on flawed system, warn experts*, The Guardian (May 4, 2021), <https://www.theguardian.com/environment/2021/may/04/carbonoffsets-used-by-major-airlines-based-on-flawed-system-warn-experts>; Lisa Song, *An Even More Inconvenient Truth: Why Carbon Credits for Forest Preservation May Be Worse Than Nothing*, ProPublica (May 22, 2019), <https://features.propublica.org/brazil-carbon-offsets/inconvenient-truth-carbon-credits-dont-work-deforestationredd-acre-cambodia/>; Patrick Greenfield, *Revealed: more than 90% of rainforest carbon offsets by biggest certifier are worthless, analysis shows*, The Guardian (Jan. 18, 2023), <https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthlessverra-aoe>).

⁶ See Greenfield, *Revealed*, *supra* note 5.

of oversight, can be mitigated through targeted regulation, enforcement, and reporting requirements – all actions that are squarely within the scope of the CFTC’s authority.

II. CFTC’s call for Whistleblower tips is an appropriate first step towards further regulation of carbon credit-based derivatives contracts.

CATF applauds CFTC’s alert issued on June 20, 2023, calling for tips related to carbon market misconduct.⁷ Whistleblowers play an important role in efficient and accurate agency investigation and enforcement. This action shows that the CFTC takes fraud and misrepresentation in the underlying carbon market seriously and will bolster consumer trust.

Whistleblower incentives will likely prove especially important in the regulation of the carbon credit-based derivatives markets, because unlike with most other commodities such as metals and interest rates, purchasers of carbon credits have substantially less incentive to verify the commodities’ authenticity. If anything, they have an incentive not to investigate whether carbon was actually sequestered, so long as they can claim the credit. Given the gravity of the threats to market liquidity and stability posed by derivatives transactions based on faulty or fictitious carbon credits, in addition to the call for tips, the CFTC should consider bolstering whistleblower regulations to facilitate swift and accurate investigations of misconduct. For example, the CFTC could consider updating the Form TCR to include questions or answer options specifically for whistleblowers ringing the alarm on fraudulent derivatives based on carbon credits.⁸

III. Going forward, the Commission should institute reporting requirements for contracts based on carbon credits to accurately capture associated risk.

The CFTC has long implemented robust and comprehensive reporting requirements for regulated transactions and market participants. To further aid the Commission in maintaining the integrity of carbon credit derivatives markets, the CFTC should set reporting standards for registered entities to foster greater transparency between buyers and sellers of climate-related derivative products generated from carbon credits.

CATF suggests that CFTC reporting standards require parties to transactions in derivatives based on carbon credits (including but not limited to sellers, registered brokers, and derivative clearing organizations) to report such information about the underlying credits as needed to assess the following attributes in the underlying commodity that may import added risk. Leading researchers, non-governmental organizations, and corporations have determined that the quality of offsets can be assessed based on the following attributes⁹:

⁷ CFTC, *CFTC Whistleblower Office Issues Alert Seeking Tips Related to Carbon Markets Misconduct*, Release 8732-23 (June 20, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8723-23>.

⁸ Current Form TCR found at https://www.whistleblower.gov/sites/whistleblower/files/cftc_form_tcr.pdf.

⁹ See, e.g., Meryl Richards et al., *Role of Natural Climate Solutions in Corporate Climate Commitments: A Brief for Investors*, Ceres (May 2021), <https://www.ceres.org/sites/default/files/reports/2021-05/FINAL%20The%20Role%20of%20Natural%20Climate%20Solutions.pdf>; Univ. of Oxford Smith School of Enterprise and the Environment, *The Oxford Principles for Net Zero Aligned Carbon Offsetting* (Sept. 2020),

- (1) **Additionality** – the carbon removed or avoided would not have occurred but for the project generating carbon credits. Additionality is determined through comparison of anticipated emissions or removals to a counterfactual baseline.
- (2) **Durability** – the storage of carbon dioxide removed is measured in years and creates fully delivered, verifiable long-term climate benefits.
- (3) **Measurability** – the measured or estimated volume of carbon removed or emissions avoided uses accounting methodologies that are scientifically robust, are third-party audited, and account for potential risks of reversal and uncertainty.
- (4) **Leakage avoided** – the potential for the project generating carbon credits to result in increased emissions elsewhere is minimized and accounted for.
- (5) **Verifiability** – the attributes above are verified by an independent, qualified, third-party verifier.
- (6) **Double-counting avoided** – the credits have been given a serial number, are tracked, and the underlying offset has been retired so that it is no longer tradeable and cannot be claimed by more than one entity.

IV. Conclusion

CATF again commends the CFTC for taking steps to actively examine the Commission’s role in mitigating risks associated with the Voluntary Carbon Market. Given the rising prevalence of carbon credit-based derivatives, as well as rising incidences of misrepresentation associated with such derivatives, regulatory action from the CFTC on this issue is both necessary and welcome.

Respectfully submitted,

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<https://www.smithschool.ox.ac.uk/sites/default/files/2022-01/Oxford-Offsetting-Principles-2020.pdf>; Microsoft & Carbon Direct, *Criteria for high-quality carbon dioxide removal* (May 2022), <https://query.prod.cms.rt.microsoft.com/cms/api/am/binary/RWGG6f>.