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Carbon Market Watch response to the CFTC's proposed guidance on Voluntary Carbon Credit Derivative Contracts

Carbon Market Watch welcomes the opportunity to provide feedback on the United States' Commodity Futures Trading Commission's (CFTC) proposed guidance on the voluntary carbon market (VCM).

Regulating financial transactions in the VCM, including but not limited to futures transactions, is important to plug some of the most gaping holes in the current VCM infrastructure. Financial transparency and integrity is currently direly lacking in the VCM, and rules to address this should focus both on the quality of the assets and financial products being traded, as well as the transparency of the trades.

The CFTC's proposed guidance is a step in the right direction, but it does not go far enough. Some elements covered by the guidance lack specificity, and some issues that weigh on the VCM's reputation are not addressed in the current proposal.

Robust quantification

The proposed guidance on robust quantification would be strengthened by being made more specific. This section of the guidance states the following: "The Commission believes that a Designated Contract Market (DCM) that lists a carbon credit derivative contract should consider whether the crediting program[me] for the underlying VCCs [voluntary carbon credits] can demonstrate that the quantification methodology or protocol that it uses to calculate emission reductions or removals for the underlying VCCs is robust, conservative, and transparent".

However, there is no clear definition of what robust, conservative and transparent mean.

Confusingly, that same section mentions that "a robust, conservative, and transparent quantification methodology or protocol helps to ensure that the number of VCCs that are

issued for a project or activity accurately reflects the level of GHG emission reductions or removals associated with the project or activity".

This conflates conservativeness with accuracy. Given the high degree of uncertainty in the quantification of emission reductions and removals using existing VCM methodologies, "conservativeness" is a better principle to apply than "accuracy". It should be interpreted as ensuring that the quantification of mitigation outcomes is more likely to underestimate these outcomes than to overestimate them.

Moreover, there is no clear specification of what is meant by "transparency" in this section. At a minimum, it is important that all calculations necessary for an external party to reproduce the quantification exercise of a given mitigation activity be publicly available. Mere transparency on the registry or methodology used is not sufficient, as it does not allow a buyer to carry out a proper due diligence assessment to evaluate the quality of the asset that is being sold.

Provisions from the ICVCM Assessment Framework are a good starting point on this, as per criterion 3.1 of the ICVCM Assessment Framework.

ICVCM Assessment Framework Criterion 3.1 on information

a) In addition to CORSIA requirements, the carbon-crediting program shall ensure that in relation to each mitigation activity that requests registration or that is registered, all relevant documentation relating to the mitigation activity is made publicly available (subject to confidentiality and proprietary, privacy and data protection restrictions) including:

1) all necessary information, such as spreadsheets used for calculations, to enable third parties to assess the social and environmental impacts of the mitigation activity and to replicate the GHG emission reduction or removal calculations (including baseline quantification), and assessment of additionality;

2) a mitigation activity design document that includes:

- *i. a non-technical summary;*
- *ii. detailed information on the mitigation activity, including its location and proponents;*
- *iii. a description of the technologies or practices applied;*
- *iv. the environmental and social impacts;*
- *v. the methodology used;*

vi. information on how the methodology is and has been applied for the purpose of determining the baseline, demonstrating additionality and quantifying GHG emission reductions or removals;

3) For Categories listed in 9.1 b) 1, information relating to the monitoring and compensation period.

b) The carbon-crediting program shall ensure all relevant program documents are publicly available and have processes to ensure that where requests are made in relation to information that is missing from its website and/or registry , that information is provided (subject to confidentiality and proprietary, privacy and data protection restrictions) and made public alongside other relevant public information.

Financial transparency

Transparency requirements should extend beyond credit integrity in order to ensure that voluntary carbon markets are effective and efficient at fulfilling their mission. Despite the VCM being promoted as a tool to finance climate action - in particular in developing countries - there is little to no evidence available about the volume of finance that is actually being channeled to such mitigation action[1]. This is because there is no transparency regarding the number of times and the price at which credits are changing hands, nor on the amount of money that the project developer initially received at the point of the first sale of the credit, let alone what local communities might receive[2]. The result is that the VCM is a market whose effectiveness is impossible to measure, as it is not possible to tell what share of the finance circulating in the market actually serves to implement climate action on the ground.

This matters because the carbon credit market is fundamentally different from other markets in that its objective is not so much to buy an asset but rather to channel finance. The purchase of a carbon credit is a means to an end, rather than the end itself. Without more transparency about the financial flows of the VCM, it is not possible to truly assess its success.

[1] Carbon Market Watch (2023): "*Secretive intermediaries: are carbon markets really financing climate action?*"

[2] Carbon Market Watch (2023): "*A fair share of the voluntary carbon market?*"

The proposed guidance should therefore include provisions to support the market towards best practice and beyond. For example, existing standards such as the UK Woodland Carbon Code and the Global Carbon Council make publicly available information about registry account holdings. A welcome step towards more transparent tracking of credit ownership and transactions.

No double counting

The current provisions on double counting should be extended to ensure that a given emission reduction or removal leads to the issuance of only one carbon credit, and is counted only once by a given entity.

The risk of double claiming can manifest itself in many ways, including some that are not currently covered by the proposed guidance. For example, a given emission reduction could be claimed by multiple actors. This can happen because both the country where the reduction takes place, and the buyer of the credit, claim ownership of the emission reduction, or because various financers of the mitigation action claim the same ownership (for example, a bank that issues a loan to the project and a company that purchases carbon credits from the project). The first issue is indirectly covered by an agreement reached at COP27, when countries agreed to name emission reduction credits that are not subject to a corresponding adjustment under Article 6 of the Paris Agreement as “mitigation contribution units”. While this is not a binding rule that prevents double claiming, it is a clear signal that emission reductions for which no corresponding adjustment was applied should not be used to offset a company’s or country’s emissions.

Additionality

Provisions on additionality could be more specific, including by providing more details on what additionality entails and how it is assessed. At a minimum, it should be clear that additionality applies first and foremost to the emission reductions or removals achieved, rather than to the project that achieves them. The proposed guidance is not sufficiently clear on this. For example, one of the questions to guide the public comments refers to additionality being applied to projects, while the additionality section itself seems to refer to a mix of projects and outcomes.

Emission reductions could be non-additional even if the project that delivers them is additional. For example, if a certain technology is adopted which reduces emissions and

which would not have been adopted without revenues from carbon credits, this project is additional. However, it could be that the same reductions could have been delivered by a different technology, which is not additional because it is very cheap for example. This is why additionality should be assessed at the level of the emission reduction or removal, and not just at the level of the project.

Permanence

In the absence of stricter requirements regarding permanence - such as stipulating that carbon should be stored on a timescale that is relevant for the climate - a minimum requirement should be included regarding transparency.

One option is to ensure that the expected durability of a storage type is clearly communicated. This can be done through a "durability" tag on a programme registry, or through any other means that achieves a comparable level of transparency. Without this, it is very difficult for investors and buyers to make informed choices, as they lack information about the true durability they can expect from the assets they are purchasing.

Safeguards and sustainable development

The current draft guidance is missing provisions on safeguards and sustainable development benefits. Both of these, and safeguards in particular, are inherent quality criteria for carbon credits. Projects should be expected to deliver sustainable development benefits beyond their climate benefits, and at a very minimum transparently communicate whether and how they are delivering any such benefits. In addition, and separately, robust safeguards should be in place to avoid harm and remedy it should it occur. This includes having proper processes to consult with and include local stakeholders and indigenous peoples in project development and implementation. It should also include a functioning and accessible grievance mechanism in place.

Overarching comment on the enforcement of the guidance

Throughout the document, the guidance is articulated around provisions which DCMs "should consider". It is often unclear how the criteria are supposed to be interpreted, let alone how the guidance could be enforced. For example, the proposed guidance states that DCMs should consider whether crediting programmes make available "detailed information [...] such as relevant project documentation, publicly available in a searchable and comparable manner".

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But it does not define what “relevant” means, nor to what extent the documents need to be comparable. In fact, documentation available on registries today is chaotic, lacks structure, consistency, and a common nomenclature, and is frequently incomplete.

The same applies to most of the elements covered by the proposed guidance, including on key integrity criteria such as additionality, robust quantification, permanence, double counting and transparency.

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