

Submission to the US Commodity Futures Trading Commission

**Concerning the Commission Guidance Regarding the Listing of Voluntary
Carbon Credit Derivative Contracts; Request for Comment**

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For the attention of Mr. Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission

Submitted electronically via comments.cftc.gov

Dear Mr Kirkpatrick

I thank the Commission for the opportunity to comment on the draft Guidance regarding the listing of Voluntary Carbon Credit (VCC) Derivative Contracts.

The Commission has taken an important step as a first regulatory body to consider the requirements of the underlying asset of VCC derivative contracts. The Guidance is thus important beyond ensuring the quality of US-listed carbon derivative contracts; it may well set a benchmark for regulatory regimes for carbon markets elsewhere.

The draft Guidance raises important questions, some of which I have addressed specifically below. Following response to these questions, I make some general observations and comments. I hope these will be received as a constructive contribution to the Commission's work.

A. Specific questions:

1. In addition to the VCC commodity characteristics identified in this proposed guidance, are there other characteristics informing the integrity of carbon credits that are relevant to the listing of VCC derivative contracts?

Yes. One VCC characteristic which has rarely been considered as relevant, let alone essential, has been its ***legality***.

Generation of or trade of VCCs which are illegal can occur through a multiplicity of means, for example: the illegal allocation of land or other assets to offset projects; bribery or other corrupt practices in order to obtain project land or approval; failure to comply with requirements concerning tenure rights; failure to comply with carbon ownership requirements; illegal removal of persons from land allocated to offset projects; failure to comply with project contractual requirements (such as distribution of benefits); tax evasion, and transfer-pricing of VCCs 'exported' to other jurisdictions.

As jurisdictions increasingly adopt specific and detailed legislation concerning the generation and trade of VCCs, so the incidence of illegalities is likely to grow.

Such illegalities in the underlying asset would arguably be subject to Core Principle 12 (A) requiring DCMs to “*establish and enforce rules— (A) to protect markets and market participants from abusive practices committed by any party*”. They could render participants in trade in such VCCs or derivatives subject to various legal provisions, including the Foreign Corrupt Practices Act, and 18 USC Section 2315.

VCC issuance systems and methodologies generally have weak requirements to ensure compliance with the relevant laws in the generation of VCCs. For example, the overall Verra Standard applicable to all projects does not require legal compliance. Its specific sectoral methodologies also mostly lack such explicit requirements¹. Hence, being absent at the systemic level, legal compliance is barely, if at all, considered in Verra’s audit processes of specific VCC-generating activities. As is a recurring theme in this submission, even where issuance systems *on paper* may require compliance with the applicable laws, the extent to which this is assured through the current third-party verification systems is highly questionable.

We believe that ***the characteristic of full compliance with relevant laws should be required by VCC issuing systems*** generating credits underlying derivative contracts, and that auditing processes within those issuing systems should *demonstrably* be adequate to detect and challenge relevant forms of illegalities.

2. Are there standards for VCCs recognized by private sector or multilateral initiatives that a DCM should incorporate into the terms and conditions of a VCC derivative contract, to ensure the underlying VCCs meet or exceed certain attributes expected for a high-integrity carbon credit?

No. While there is clearly a need for contracts to contain requirements for the standards applied to the underlying VCC, no such private sector or multilateral standards have yet been applied and tested. Expectations within the sector are clearly high that the IC-VCMI Core Carbon Principles (CCPs) could serve as such a standard (and we note that there have been various claims that the Commission’s draft Guidance adheres to certain of the IC-VCMI CCPs).

However, it remains very much to be seen:

a/ How rigorously and credibly IC-VCMI applies the CCPs at an *issuing systems level* - i.e., against entire operating systems and standards. For example, in our view, the Verra system as a whole fails against multiple of the CCPs and should not be admitted². It should be noted that key issuing systems, such as Verra, are an integral part of the IC-VCMI standard-setting process, which could therefore be seen as suffering a conflict of interest.

b/ How rigorously and credibly the CCPs are then applied to specific *methodologies* and the *projects* and VCCs deriving from them. It is likely to be several years before empirical research and analysis can determine whether CCP-labelling of VCCs reflects any real improvement in integrity, such as ensuring use of more credible baselines, additionality, treatment of leakage and permanence, and carbon accounting etc.

It would thus be premature for CFTC to align with or advocate use of any current ‘high integrity’ initiative or standard in derivatives contracts, such as the new and untested IC-VCMI.

¹ See Verra Standard [here](#). Gold Standard, by comparison, requires that “*Projects shall be in compliance with applicable Host Country’s legal, environmental, ecological and social regulations*” – see [here](#).

² Survival International’s submission to IC-VCM setting out the reasons for this position can be seen [here](#).

7. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether the procedures that a crediting program has in place to assess or test for additionality provide a reasonable assurance that GHG emission reductions or removals will be credited only if they are additional?

There are widespread problems with additionality within VCC-issuing systems. For example, it is clear that some of the additionality methods included within some Verra-approved methodologies (or sub-methodologies) are extremely weak and unreliable. An example is the 'Northern Kenya Grassland Carbon Project' (NKCP – VCS # 1468)³, a 'Sustainable Grassland Management' project (which also happens to be one of the three projects from which Aspiration has apparently bought large numbers of credits, as has, through Aspiration, Meta Platforms Inc.). This project used a Verra sub-methodology which allowed, in effect, additionality to be claimed simply because there were many barriers to achieving what was wanted by the project, and that it was least like what had happened in the past. Not only does this approach fail to require that the project explicitly demonstrate it is more carbon beneficial than other possible projects or approaches (including the status quo), but also has the highly perverse effect of incentivising an approach (centralized, rigidly planned grazing) that is in fact strongly contrary to the cultural norms of the area's Indigenous pastoralists.

Other Verra-validated projects (which between them have issued tens of millions of credits from projects, and are included in existing US market futures contracts, such as N-GEO), feature highly questionable cases for additionality. Examples include an offset project based on the establishment of a protected rainforest area, even though legal protection of the area had been established and implemented several years before the offset project was even considered⁴; and a scheme which claimed to prevent logging of a rainforest, even though logging in that area had been cancelled and banned before the offset project started⁵.

Such problems raise another wider issue: that the guarantees of additionality (or indeed leakage and reversals prevention, baselines and permanence) depend not only on rigorous methodologies, but also on ***an audit oversight process that ensures application of such methodologies is rigorously assessed and rejected when found to be inadequate***. The NKCP case mentioned above demonstrates clearly that even egregious failures to ensure additionality, baselines, leakage and permanence, were initially rightly challenged by Verra-approved auditors, but then accepted anyway, and then also by Verra. Multiple analyses of other projects point to the same failings⁶.

As will be noted from general observations below, the implication of this is that, for the Commission Guidance to be of practical use, the CFTC will need to undertake and publish independent assessment ***of the quality of each verification system*** in order to determine whether contracts relating to VCCs from these systems can truly guarantee the quality of the underlying asset.

9. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, a crediting program's measures to avoid or mitigate the risk of reversal, particularly where the underlying VCC is sourced from nature-based projects or activities such as agriculture, forestry or other land use initiatives?

³ A detailed analysis of this project is available [here](#).

⁴ See Cordillera Azul National Park REDD+ project case study in the report found [here](#).

⁵ See Mai Ndombe REDD+ project case study in the report found [here](#).

⁶ See for example, 'Quality Assessment of REDD+ Carbon Credit Projects' from researchers at Berkeley University, [here](#).

10. How should DCMs treat contracts where the underlying VCC relates to a project or activity whose underlying GHG emission reductions or removals are subject to reversal? Are there terms, conditions or other rules that a DCM should consider including in a VCC derivative contract in order to account for the risk of reversal?

In the context of increasing global warming, and considering that credited carbon storage should be guaranteed for many decades to come, we believe there are no meaningful mechanisms that can address the serious risk of reversals and non-permanence for the vast majority of **nature-based projects**. For example, according to the United Nations Environment Programme, because of climate change itself, “wildfires are becoming more intense and more frequent, ravaging communities and ecosystems in their path”⁷. Offset projects which claim to avoid emissions from deforestation, or to capture carbon on newly planted tree plantations or forests, represent the majority of nature-based projects. They will face ever-increasing risks of reversal. Such projects should be considered as inherently non-permanent, and **should not be permitted under the Commission’s guidance**.

11. Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a contract’s terms and conditions, whether a crediting program applies a quantification methodology or protocol for calculating the level of GHG reductions or removals associated with credited projects or activities that is robust, conservative and transparent?

The evidence suggests that there are recurrent serious problems of quantification (in relation to, inter alia, faulty baselines and leakage) across entire classes of methodologies within, for example, the Verra system. This applies especially to nature-based methodologies such as those relating to REDD+ projects⁸, but also soil carbon, agriculture and ‘improved cookstoves’⁹.

As with the answer to Question 7, I also point to the extensive evidence that the latest issuance system, that of Verra, is structurally inadequate (and interest-conflicted) in detecting and addressing faulty auditing of faulty quantification. Whilst Verra’s new REDD+ methodology is intended to address one of the most significant areas of historical failure (the use of faulty baselines in REDD+ projects), it is not clear whether it will address others, such as leakage, impermanence and risk-based buffer-stock calculation. Again, it may be several years before it can be determined whether the new Verra REDD+ methodology has genuinely resulted in more robust quantification (and dealt with the intractable and inherent problem of non-falsifiable counter-factual baselines).

12. In addition to a crediting program’s decision-making, reporting, disclosure, public and stakeholder engagement, and risk management policies, are there other criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract’s terms and conditions, whether the crediting program can demonstrate that it has a governance framework that effectively supports the program’s transparency and accountability?

Yes. In my view, the outcome of the recent ‘Section 6’ review by Verra of the Northern Kenya Grassland Carbon Project’, instigated by Verra following Survival International’s investigations into the project, raises multiple serious questions about the quality of governance of the Verra system¹⁰. Specifically:

⁷ See ‘Spreading like Wildfire: The Rising Threat of Extraordinary Landscape Fires’, [here](#)

⁸ See reference in Footnote 5.

⁹ See for example, the study ‘Pervasive over-crediting from cookstoves offset methodologies’, Berkeley University, [here](#).

¹⁰ See [here](#) for our full response to the Section 6’ review by Verra of the Northern Kenya Grassland Carbon Project.

- ***That Verra has no effective, reliable or credible ‘measure of last resort’ which would be used to cancel or reverse an offsetting project or specific credits’ issuance***, even where there is compelling evidence that the project/issuance is not compliant with the relevant Verra methodology, is failing against all key criteria applicable to offset projects, and is therefore not generating credible credits; in other words, ***Verra allows continued issuance of carbon credits which do not represent genuine reductions of emissions or additional carbon storage***;
- There are ***inherent conflicts of interest*** in Verra setting standards and overseeing validation and verification of a project and credit issuance when it has a vested commercial interest in *not* finding fault with said project or credit issuance because it is also profiting (through *per credit* commissions and other fees) from the issuance of credits¹¹;
- Verra’s system includes ***no external/independent appellate or grievance body***;
- Verra’s system provides for ***no appeal*** against its ultimate ‘Section 6 Review’ decision.

Even Verra-verified offset project developers now complain about the state of Verra’s review process¹².

I therefore believe that, until such time as the evident structural shortcomings are addressed (along with the other problems noted in this submission) ***no VCC reliant on Verra verification could be considered as a high-integrity underlying asset, and therefore should not be permitted in derivative contracts.***

The qualities of ‘**cancellability**’ of credits, lack of **conflicts of interest**, **independence of review processes**, and an **appeal process**, should all be governance requirements of permitted crediting programmes in addition to those outlined in the draft guidance.

16. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities meet or exceed best practices on social and environmental safeguards, as a characteristic that helps to inform the integrity of VCCs issued by the crediting program. When designing a VCC derivative contract, should a DCM consider whether a crediting program has implemented such measures?

Yes. As yet, no crediting programme requires or applies even internationally agreed standards, norms and processes for safeguarding of social interests, such as indigenous peoples’ rights, or environmental agreements¹³. Crediting programmes should explicitly state how their systems require strict project adherence to, *inter alia*:

- The United Nations Declaration on the Rights of Indigenous Peoples (2007)
- International Labour Organisation Convention 169 concerning Indigenous and Tribal Peoples (1989)

¹¹ Similar concerns could be raised in relation to the Gold Standard issuance system and others.

¹² Suspended developers rally to call for swifter resolution from Verra, Quantum Commodity Intelligence, 25th January 2024. <https://bit.ly/3Hxpx4>

- The United Nations Declaration on the Rights of Peasants and Other People Working in Rural Areas (2018)
- The UN Food and Agriculture Organisation Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security (2012)
- The UN Convention on Biological Diversity (1992)

B. General comments/observations; detailed guidance on issuance systems is essential

The draft guidance states that “*VCC derivatives are a comparatively new and evolving class of products, and...standardization and accountability mechanisms for VCCs are still being developed*”.

This does not appear to align with current developments.

Without systems of registration, validation, verification, audit, etc, the underlying asset, the VCC, is essentially worthless. It is merely a ‘story’ of what might have happened in the absence of an offset project, and what is then claimed *with* the project. The ‘story’ only assumes an asset value through the process of validation and verification etc. The quality of the underlying asset is only as good as these processes.

Section A of the Guidance refers to an “*individual characteristic of the commodity*”: a key individual characteristic of the underlying commodity in this case is the name the certification/verification system which has generated the credit, and indeed the guidance states that “*The contract terms and conditions should include information that readily specifies the crediting program or programs*”. However, simple *naming* of the crediting program does not in itself “*ensure that the pricing of the contract accurately reflects the intended quality of the underlying*” credits. Not only must the issuing system be *named*, but also its **reliability** guaranteed.

The programmes generating VCCs are in fact rapidly **diversifying and fragmenting** further, with at least three entirely new systems having been announced even within the last few months. There is arguably growing divergence between these schemes, including important aspects such as baseline determination and quantification. The governance characteristics are probably becoming even more inconsistent, with some, for example, proposing much less third party participation, and thus potentially institutionalising higher risks of, for example, conflicts of interest.

Important consequences flow from this. Most significant is that for the Commission to determine whether a VCC derivative contract submitted for approval by a DCM is compliant with the requirements of the Commodity Exchange Act, including the Core Principles, will require **a qualitative assessment of the reliability of each issuing program** supplying credits for the contract.

The new general Guidance recognises certain underlying qualities which crediting systems should possess. But it does *not* address the issue that there can be very large (and systemic) differences between what each crediting programme sets out on paper, and **what happens in reality**. For example, the Guidance rightly prescribes that “*a DCM should consider whether a crediting program can demonstrate that it has procedures in place to assess or test for additionality. A DCM should consider whether those procedures are sufficiently rigorous and reliable to provide a reasonable assurance that GHG emission reductions or removals are credited only if they are additional.*”

In my view, the NRT case as referred to above under Q7, and multiple other studies and assessments¹⁴, demonstrate that Verra's mechanisms for testing additionality are clearly faulty. Whilst the Verra programme *on paper* has certain procedures in place in relation to additionality, these are not only too vague and flexible to ensure genuine additionality, but the audit systems which are then used to scrutinise additionality are also demonstrably unreliable.

Similar concerns can be raised about the reliability of permanence and accounting for the risk of reversal, robust quantification, and third-party validation and verification – all referred to in the draft Guidance, all in theory covered by procedures within the Verra issuance system, but all with many examples of chronic system failures.

Many of the above failures relate to structural problems in the issuing system's governance. We note the Guidance states that a *“DCM should consider whether the crediting program for the underlying VCCs can demonstrate that it has a governance framework that effectively supports the crediting program's independence, transparency and accountability”*.

What exactly would constitute such governance? In my view, for example, whilst the Verra system displays what on the surface appears to be a credible governance framework, in practice it has serious deficiencies, which have emerged as the scale of mis- or over-crediting stretching back more than a decade have begun to emerge, including those noted above in our answer to question 12. The system can be said to be neither independent, as it is closely linked to the economic interests of the issuing projects, nor accountable, as essential accountability mechanisms are lacking. Whilst it could be described as transparent in the sense that much documentation at the systems and project level is available, it also fails in that respect as the documentation is often extremely opaque, highly technical, often not in the languages of those who would need to assess it (such as regulatory or 'watchdog' bodies in the countries in which projects are located), as well as being badly organised, and sometimes contradictory.

Verra itself has recently acknowledged that it needs to prioritise improvements in operations, accountability, programme impact and scientific integrity¹⁵. That the world's largest carbon crediting system of sixteen years' existence should suffer such multiple serious deficiencies speaks of long-term and systemic governance failures.

As a result of the above, I believe that any and all credits issued through the Verra system fail to comply with a requirement to have been issued through an appropriately governed issuance system. Critically, ***this can feed directly through to the credibility and validity of the underlying VCC asset in a derivative contract.***

The CFTC must therefore, I believe, ***take a more proactive view on the integrity of the crediting programme through which the underlying VCC is issued.*** The Commission needs to play a more proactive role in establishing detailed guidance and norms through which DCMs can address the many valid issues which are raised in the new general guidance, specifically related to the integrity of the various crediting programmes. Until such time as the CFTC has been able to properly assess the quality of VCC issuing systems, and has been able to offer detailed guidance on it, ***VCC-based derivatives should not be permitted for trading on the DCM's under the CFTC's purview.***

¹⁴ See for example references cited in Footnotes 3, 4 and 5.

¹⁵ 'Verra provides updated timeline on reform efforts', Carbon Pulse, 25th January 2024. <https://bit.ly/3vPILeH>