



February 16, 2023

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

[submitted via CFTC online portal](#)

RE: Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts

On behalf of millions of members worldwide, many of whom are deeply invested in resolving issues of integrity in the voluntary carbon market, Environmental Defense Fund (EDF) respectfully offers comments in response to the Commission's Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts ([Release No. 8829-23](#)).

EDF strongly supports the proposed guidance and CFTC's oversight of voluntary carbon credit derivative contracts. As articulated in previous comments, the potential for fraud and manipulation in the voluntary carbon market is significant and could compromise related derivatives markets. In setting clear expectations for contract terms and conditions, based on widely accepted standards for carbon credit integrity, CFTC's proposed guidance will boost confidence in the secondary market and provide benchmarks for credit suppliers who wish to participate.

Additionally, we reference with support the remarks given by Commissioner Goldsmith-Romero on March 23, 2023, which outlined five proposed pillars of a responsible regulatory approach to environmental and climate-related products.¹ Unquestionably, this proposed guidance and the deployment of the Division of Enforcement's Environmental Fraud Task force are important and meaningful steps to promote the resilience and vibrancy of markets in environmental/climate-related products. However, CFTC can do more within its existing authority to conduct oversight over environmental/climate related products.

Elements of all five pillars are warranted and could be implemented by the Commission to complement this proposed Guidance.

- Consumer education around verified carbon credits and other categories of environmental products. We welcome CFTC’s efforts to provide the public with greater clarity about the nature, characteristics, and pricing of environmental/climate-related products.
- Assert legal authority over environmental/climate related products, by creating a category for environmental/climate-related products and identifying those products as traded. Identifying and defining a category of environmental/climate-related products that share certain characteristics will be helpful in facilitating other elements of oversight and may provide clarity regarding potential regulatory treatment of various assets. A broad category may also allow the Commission to track and oversee products without specifically defining and deep diving into each one, as has been done for voluntary carbon credits.
- Develop a heightened review framework for any self-certified climate-related products, as the Commission did with derivatives on digital assets. Independent, third-party verification and validation is the hallmark of high-integrity carbon credits, and required by all reputable registries. Climate-related financial products that do not undergo robust certification may represent valid and important conservation objectives, but nevertheless may be inappropriate for sale as a credit representing a specific, quantified unit. Heightened review of these products would be extremely valuable to deter fraudulent activity and build confidence in the market. The reference to these products as “climate-related products” rather than “credits” is appreciated.
- Increase market intelligence to monitor and surveil markets to promote integrity and resilience to climate risk. Additional intelligence and surveillance would be helpful. As tools used to manage transition and physical climate related financial risk, environmental/climate-related products may provide a window into potential sectors or stakeholders subject to consolidating or escalating risk. Also, due to their nature and broad public appeal, these products may attract less sophisticated market participants, and thus warrant closer observation.

We note that these 5 pillars are consistent with the suggestions and “Good Practices” articulated by the International Organization for Securities Commissions (IOSCO) in their Consultation Report to promote the integrity and orderly functioning of the Voluntary Carbon Markets, and specifically point to Key Consideration 4: Market Transparency, and 6: Price Discovery.²

² International Organization of Securities Commissions, Consultation Report to promote the integrity and orderly functioning of the Voluntary Carbon Markets (Dec. 3, 2023); <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf>

Responses to CFTC’s 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.³ Social and environmental safeguards are material terms and conditions and required by most reputable private sector and multinational development initiatives to ensure that financed projects will not be undermined by violations of human, land and labor rights. ICVCM’s Core Carbon Principle 9 (CCP 9) requires mitigation projects “have clear guidance, tools and compliance procedures to ensure mitigation activities conform with or go beyond widely established industry best practices on social and environmental safeguards while delivering positive sustainable development impacts.”⁴ This Principle is consistent with requirements adopted by other international development financing frameworks, including USAID, World Bank, the Green Climate Fund, as well as carbon crediting programs such as CORSIA. Verra, and Gold Standard.⁵

Wide recognition of the importance of social and environmental safeguards to ensure that financing delivers intended outcomes reflects direct experience with the adverse consequences of their omission. For example, the Kyoto Protocol’s Clean Development Mechanism (CDM) lacked effective social and environmental safeguards. While many good projects were funded under CDM, it has also been criticized for approving offset projects which failed to consult local communities and caused them harm. One such project is the Alto Maipo hydropower scheme near Santiago, Chile. This “run of the river” megaproject diverted water through 70km of tunnels and was credited through the CDM as a source of clean energy. The dam construction led to numerous human rights violations, impacted land used for grazing and local water sources – including degradation of the three principal tributaries of the Rio Maipo which provided drinking water for various Chilean municipalities. The Alto Maipo also created social tensions within

³ In our response to the CFTC’s second convening on voluntary carbon markets, we identified the strong potential for malfeasance around statements related to social and co-benefits. “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.”

⁴ ICVCM Core Carbon Principles; <https://icvcm.org/the-core-carbon-principles/>

⁵ See, e.g. USAID; <https://www.usaid.gov/environmental-procedures/sectoral-environmental-social-best-practices>; World Bank; <https://www.worldbank.org/en/projects-operations/environmental-and-social-framework> Green Climate Fund Environmental and Social Safeguards; <https://www.greenclimate.fund/projects/sustainability-inclusion/ess>; CORSIA Safeguards Systems and Sustainable Development Criteria; https://www.icao.int/environmental-protection/CORSIA/Documents/ICAO_Document_09.pdf; Verra, VCS Standard 3.17, https://verra.org/wp-content/uploads/2022/02/VCS-Standard_v4.2.pdf; Gold Standard, Gold Standard, Safeguarding Principles Procedure, https://www.goldstandard.org/sites/default/files/documents/2017_02_gs4gg_safeguarding_principles_procedure_for_consultation.pdf

local communities by benefiting some parts of the local population but not others, and has destroyed local industries such as livestock and tourism.

Other controversial CDM hydro projects include the Barro Blanco dam in Panama and the Bujagali dam in Uganda. An afforestation project in Kachung forest in Uganda was a CDM certified project despite reports of villagers being deprived of vital resources and experiencing threats and violence. These critiques demonstrate how social and environmental failures not only undermined the specific project, but broader public opinion of the carbon market generally.

Compliance with social and environmental safeguards fundamentally impacts carbon crediting program success, reputational risk, resulting credit characteristics and market value. Accordingly, violations of social and environmental safeguard provisions are treated as material by market participants. For example, Climate Impact X (CIX) suspended deliveries of credits from Verra's Kasigau Corridor REDD Project Phase II – The Community Ranches (VCS 612) project into all vintages of CIX Nature X (CNX) standard contracts after the project proponent was accused of negative community impacts, improper employment practices and sexual offenses linked to the project. CIX also suspended deliveries of Verra's Southern Cardamom REDD+ project to accommodate an investigation into alleged human rights violations.⁶ CIX indicated that credits issued under the suspended projects failed to meet CNX qualifying criteria.⁷

Adherence to social and environmental safeguards impacts other credit characteristics identified by the Commission as material. For example, Verra's Non-Permanence Risk Tool contains specific criteria with which to assess risks to the project that are related to these social issues and assigns specific point values to each risk (or negative values for actions that mitigate risk).⁸ The intended effect is to clarify the extent to which project outcomes become less durable and more vulnerable to disruption without social and environmental safeguards.

As with other material terms identified by CFTC in its proposed guidance, social and environmental safeguard systems and requirements can be subject to fraud and manipulation. Reporting covering the Kariba project⁹ included examples of potential fraud and misrepresentation related to social and environmental safeguards.¹⁰ According to community

⁶ Climate Impact X, Market Notice: Southern Cardamom suspended from CIX Nature, placed on Monitoring Period (Dec. 1, 2023); https://assets-global.website-files.com/641b1194b8c5208184a7126e/6569d5fd75a6b071764adcd8_Southern%20Cardamom%20suspended%20from%20CIX%20Nature%20X%2C%20placed%20on%20Monitoring%20Period.pdf

⁷ Climate Impact X, Market Notice: Kasigau Phase 2 suspended from CIX Nature X, placed on Monitoring Period (Nov. 23, 2023); https://assets-global.website-files.com/641b1194b8c5208184a7126e/655c68268e93de9b457b8563_CIX%20Market%20Notice-2023_16_Kasigau%20Phase%202%20suspended%20from%20CNX%20placed%20on%20Monitoring%20Period.pdf

⁸ https://verra.org/wp-content/uploads/AFOLU_Non-Permanence_Risk-Tool_v4.0.pdf

⁹ For background information on Kariba, see, <https://carbongreenafrica.net/kariba-redd-project/> (“The Kariba REDD+ project is a forest conservation project aimed at providing sustainable livelihood opportunities for poor communities in Northern Zimbabwe.”)

¹⁰ Heidi Blake, The Great Cash for Carbon Hustle <https://www.newyorker.com/magazine/2023/10/23/the-great-cash-for-carbon-hustle> (EDF understands that the carbon crediting standard issuing Kariba credits and project developer have responded to allegations raised in this reporting. These citations are used for illustrative purposes only to demonstrate the nature of potential fraud and misrepresentation around social and environmental safeguards.)

sources, local district councils “were like a sleeping partner, with very little knowledge of what the project is all about and with no voice in it’s direction.”¹¹ Promised benefit sharing outcomes and payments were allegedly not verified, and were reportedly funneled through one offshore account linked to the project development partner, with no accountability for whether funds were used in compliance with the contract terms and conditions. Finally, promised environmental attributes of the project were demonstrated to be false. Although the project developer portrayed Kariba as a “haven for wildlife, protecting numerous endangered species such as the African elephant, the lion, the hippopotamus,” the project developer later admitted to using the project area for trophy hunting, among other things, hippopotamus. The qualitative nature of some components of social and environmental safeguards make this characteristic both attractive to buyers, as well as somewhat more susceptible to malfeasance.

Failure to include clarify CFTC’s expectations that listed contracts include terms and conditions reflecting widely established industry best practices on social and environmental safeguards limits the Commission’s ability to protect stakeholders against this prevalent type of fraud and exposes market participants to significant risk.

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?

A variety of credit integrity criteria have been developed for specific types of crediting activities. In general, these represent more granular expressions of the 10 Core Carbon Principles that reflect the unique circumstances and physical realities of mitigation activities in various categories. To the extent that DCMs list voluntary carbon credits in these activity categories, these resources may be relevant and potentially helpful in assuring that credits delivered into listed contracts represent high-integrity credits and yield expected environmental and social outcomes.

Examples of detailed protocols and guides include the Tropical Forest Credit Integrity Guide¹², Carbon Credit Quality Initiative¹³, and Natural Climate Solutions Handbook.¹⁴

DCMs should be aware of and leverage these detailed integrity guides to develop clear and robust contracts in specific credit activity type categories. However, CFTC need not include the level of detail expressed in these resources in its Guidance. The proposal outlines an appropriate level of specificity to both apply to most, if not all, credit activity types, and be widely accepted among voluntary carbon market stakeholders. The benefit of ICVCM, and CFTC’s Guidance, is to simplify and consolidate the vast array of standards and expectations for credit integrity; additional standards and complexity would dilute this benefit.

¹¹ *Id.*

¹² Tropical Forest Credit Integrity Guide, <https://tfciguide.org/>

¹³ Carbon Credit Quality Initiative; <https://carboncreditquality.org/>

¹⁴ Natural Climate Solutions Handbook; <https://www.edf.org/natural-climate-solutions/handbook>

3. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider in connection with monitoring the continual appropriateness of the terms and conditions of a VCC derivative contract?

The VCM is broadly engaged in a process of continual improvement. Integrity guidance and criteria such as ICVCM’s Core Carbon Principles are similarly governed by an expectation of positive evolution over time. ICVCM expects to publish the next iteration of the CCPs in 2025, aimed at implementation starting in 2026. Subsequent iterations will be informed by a series of thematic multi-stakeholder work programs as set out in Section C of the Summary for Decision Makers.

DCMs may be interested in identifying carbon crediting programs and categories of carbon credits that have been assessed against the ICVCM Assessment Framework and deemed CCP-Eligible. The Integrity Council has already begun assessing carbon crediting programs. As part of the assessment process for categories of credits, the Integrity Council has established a Categories Working Group made up of internal and external stakeholders. This group is conducting an initial assessment of carbon credits produced by different categories and will evaluate whether credits from these categories can undergo an internal process, need deeper analysis by a Multi-Stakeholder Working Groups (MSWG) or should not be approved. DCMs should continue to monitor the outcomes of the working groups, and application of the CCPs to specific categories to assess whether the category is eligible, and for more detailed information about activity-specific terms & conditions.

As discussed above (*supra*, Question 2), DCMs should also be aware of other resources and initiatives detailing the characteristics and qualities of various credit types. To the extent that contracts include specific credit activity types, DCMs should monitor these initiatives.

4. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider, which may inform its analysis of whether or not a VCC derivative contract would be readily susceptible to manipulation?

Yes. See EDF responses to CFTC Questions 1, 16.

Transparency

6. Is there particular information that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether a crediting program is providing sufficient access to information about the projects or activities that it credits? 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 there is sufficient transparency about credited projects or activities?

Yes. We underscore the importance of transparency, and refer the Commission to IOSCO’s Discussion Paper Key Consideration 4, which provides that “[a] Key Consideration for [Voluntary Carbon Markets] is how to promote transparency by ensuring that market participants

have sufficient data publicly available.”¹⁵ Appropriate transparency can increase market liquidity by reducing information asymmetry and providing disclosure of trading interest, as well as improving price discovery and promoting competition among market participants. DCMs should be aware of efforts to standardize information collection, disclosure, and distribution.

Additionality

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?

8. In this proposed guidance, the Commission recognizes VCCs as additional where they are credited for projects or activities that would not have been developed and implemented in the absence of the added monetary incentive created by the revenue from carbon credits. Is this the appropriate way to characterize additionality for purposes of this guidance, or would another characterization be more appropriate? For example, should additionality be recognized as the reduction or removal of GHG emissions resulting from projects or activities that are not already required by law, regulation, or any other legally binding mandate applicable in the project's or activity's jurisdiction?

The ICVCM recognizes that there are multiple approaches that, depending on the type of mitigation activity, can provide strong assurances of additionality. Along with the CFTC’s proposed requirements pertaining to the added monetary incentive created by the revenue from carbon credits, the concept of additionality commonly includes legal additionality which excludes projects or activities that are already required by applicable law, regulation or other legally binding mandates. For example, in addition to meeting the other requirements in the ICVCM Assessment Framework, carbon-crediting programs must meet the CORSIA additionality requirements. Carbon-crediting programs must have program documents which demonstrate that mitigation activities meet existing host country legal requirements, such that the emissions reductions or removals exceed those required due to relevant and enforced legal requirements.¹⁶

Monetary and legal additionality may be understood in connection with broader analysis types used to assess crediting types and specific projects within the context of their development. ICVCM recognizes that there are several recognized types of analysis that may be combined in different ways to demonstrate additionality.

- Investment analysis and market penetration/common practice (optionally combined with further approaches); or

¹⁵ International Organization of Securities Commissions, Consultation Report to promote the integrity and orderly functioning of the Voluntary Carbon Markets (Dec. 3, 2023); <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf>

¹⁶ ICVCM, Core Carbon Principles pg. 32

- Barrier analysis and market penetration/common practice, (optionally combined with further approaches); or
- Standardized approaches (no combination required). Carbon-crediting programs using alternative approaches that are equivalent in terms of stringency may present these to the ICVCM for consideration in the assessment process.

Carbon crediting programs may use these alternative approaches to demonstrate additionality for ICVCM consideration.

Inspection Provisions

15. Should the delivery procedures for a physically-settled VCC derivative contract describe the responsibilities of registries, crediting programs, or any other third-parties required to carry out the delivery process?

Responsibilities of registries, crediting programs and other third-parties required to carry out the delivery process are generally articulated in Terms of Use contracts available on registry websites and mandatory for registry account activation. DCMs should specify which registry or registries will be used, and how the respective Terms of Use satisfy governance, tracking mechanisms and double-counting prevention measures.

Additionally, while this question focuses on physically-settled VCC derivative contracts, CFTC may wish to clarify the role and relationships between registries, crediting programs and VCM stakeholders, and implications on the regulatory classification of VCCs more broadly.

The definitions of “swap” and “security based swap” exclude “any sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled. The CFTC’s historical interpretation has been that forward contracts with respect to nonfinancial commodities are “commercial merchandising transactions,” the primary purpose of which is to transfer ownership in a commodity and not transfer solely its price risk. CFTC extends this logic, and associated exclusion, to environmental commodities, so long as ownership of the commodity can be conveyed, the commodity can be consumed, and there is an intent to physically settle the transaction.¹⁷

In the Joint Final Rule: Further Definition of “Swap,” “Security-Based Swap” and “Security-Based Swap Agreement” Mixed Swaps; Security-Based Swap Agreement Recordkeeping¹⁸, CFTC and SEC noted a range of perspectives regarding consumption and settlement. (*e.g.* “Consumption occurs through retirement of the environmental commodity;” “Settlement of a transaction in an environmental commodity through an electronic registry system.”). The joint rule discussion does not distinguish between compliance credits that are consumed through regulatory requirements and voluntary credits that may be procured with the sole intent to trade

¹⁷ CFTC, Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping 17 CFR Part 1, RIN 3038-AD46, pp 98-99 (“Therefore, an agreement, contract or transaction in an environmental commodity may qualify for the forward exclusion from the swap definition if the transaction is intended to be physically settled.”)

¹⁸ *Id.*

and held in registries without retirement, or specifically endorse an interpretation of physical settlement and consumption in the context of voluntary carbon markets.

Due to the significant regulatory ramifications of these interpretations, and in recognition of the variety of potential interpretations, we encourage CFTC to articulate its current understanding of physical settlement and consumption in the context of VCMs.

Sustainable Development Benefits and Safeguards

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. See EDF responses to CFTC Question 1. In the preamble to the Draft Guidance, CFTC cites Core Principle 12, which requires DCMs to establish and enforce rules to protect markets and market participants from abusive practices, and to promote fair and equitable trading on the DCM. This statutory obligation closely aligns with ICVCM Core Carbon Principle 9, which pertains to sustainable development benefits and safeguards. However, the body of the draft Guidance, and specific expectations for DCMs, did not articulate CFTC's expectation that carbon crediting programs eligible to generate and deliver voluntary carbon credits into listed derivatives contracts have clear guidance, tools and compliance procedures to ensure mitigation activities conform or exceed best practices on social and environmental safeguards.

This is a significant omission. For the reasons articulated in response to Question 1, social safeguards and transparency around benefit sharing provisions and broker/intermediary fee structures are economically significant attributes of the carbon credits. Sustainable development benefits and safeguards materially influence contract pricing, directly impact the extent to which the credit will be delivered and influence the political durability of those credits. In omitting guidance around sustainable development benefits and safeguards as an expression of Core Principle 12, CFTC is missing a critical opportunity to ensure that stakeholders across the VCC market are protected from abusive practices including conflicts of interest and misrepresentation.

Sincerely,

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