

**Commodity Futures Trading Commission's
Request for Comment:
Commission Guidelines Regarding the Listing of Voluntary
Carbon Credit Derivative Contracts**

**Consultation response from
Carbonplace UK Ltd**

Date: 15th February 2024

Carbonplace UK Ltd

Carbonplace's response is grounded in our view that the derivatives market is key in the development of any market and can drive improvement in the underlying spot market, but that a fully functioning spot market is a necessity and a precursor to the formation of a derivative market.

The spot market requires a focus on standardised disclosure (with key elements of such disclosure governed by a regulator). Such disclosure could include financial information on the underlying developer and their ability to deliver the result described and associated risk factors. The treatment of voluntary carbon credits in the form of standardised credits on exchanges with physical delivery tends to lead to issues around "cheapest to deliver" and will likely result in continual downward price pressure.

There has been development and alignment through international standards bodies that are supporting the increased function of the voluntary carbon market. Any recommendations from the CFTC should aim to align with these bodies.

Carbonplace was formed by nine global banks in 2022 to support growth and financialisation of the Voluntary Carbon Market. Growth requires increased confidence and trust that will lead to increased participation. Standardisation through existing market infrastructure and oversight is key. Carbonplace is providing key market infrastructure to support the growth in spot voluntary carbon markets.

We thank the CFTC for their thoughtful and well researched approach to this consultation. Guidance from organisations such as CFTC, IOSCO, ISDA and IETA will drive this market forward in achieving the global ambitions of meeting net zero.

General

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? Are there VCC commodity characteristics identified in this proposed guidance that are not relevant to the listing of VCC derivative contracts, and if so, why not?

The commodity characteristics identified address some of the key issues of the spot voluntary carbon market. These characteristics form the basis of valuation and credibility of the underlying asset.

Other characteristics which could be considered are, vintage, methodology, and the usability or deliverability of the spot credits into other regimes. For example, criteria that meet the Integrity Council for the Voluntary Carbon Market's (ICVCM) Core Carbon Principles (CCP) or whether a credit is an Eligible Emissions Unit (EEU) under the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA) are also elements of integrity of the underlying credit.

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?

Yes. The CORSA Eligible Emissions Unit provides a baseline standard. The Core Carbon Principles validated credits are another example of a standard that the private sector should incorporate into the terms and conditions of a derivative contract. Such derivatives that reference a third-party approved list of credits would be able to adjust in line with other initiatives as the market evolves and matures further.

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?

As noted in questions 2 and 3, to monitor the appropriateness of the terms and conditions of the derivative contract, reference to other schemes can provide increased integrity. Rather than referencing the underlying principles driving the eligibility under a scheme. Vintage, methodology, and issuing registry are key criteria worthy of consideration through such approved schemes. I.e. regarding CORSA the derivative terms would recognise EEUs rather than the criteria of determining an EEU.

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?

Supply of the deliverable asset is the key measure. It may also be necessary to monitor and review turnover as a measure of availability of issued supply. There will be a point in the lifecycle of a project where a significant percentage of the available issuance is retired. This would increase the possibility of a squeeze on supply and



would imply removal from reference in derivative contracts. The CFTC could set a percentage limit regarding the ratio of post-retirement available issuance vs total issuance to ensure consistency.

5. Should the VCC commodity characteristics that are identified in this proposed guidance as being relevant to the listing by a DCM of VCC derivative contracts, also be recognized as being relevant to submissions with respect to VCC derivative contracts made by a registered foreign board of trade under CFTC regulation 48.10?

There is great value in the alignment of characteristics in derivatives across jurisdictions. The VCM can create aligned global standards. The contracts themselves could reference international standards thus ensuring alignment for the purpose of delivery. We note the work of IOSCO and CFTC together with ISDA in aligning jurisdictions.

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?

DCMs should list derivatives that reference third party assessments of crediting programmes such as the ICVCM's CCPs or Carbon Credit ratings providers.

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?

These factors are best addressed through the crediting program and standards reflecting usability of the VCC such as CORSIA, required accounting disclosures or third-party assessments mentioned in our previous answer.

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 CFTC should align with industry definitions to support standardisation, for example they should look to the definition of 'additionality' provided by the ICVCM.

Risk of Reversal

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?

Risk of reversal is best dealt with at the level of the crediting programme as they have the potential to address this via any buffer allocation. The consideration for a DCM should only be in regard of the remaining supply in existence being sufficient to avoid any short squeeze or other market manipulation.

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?

We believe that while the risk of reversal is an important issue, it is not one that should be dealt with by the DCM. Rather, it should be a component of price in both the underlying asset and/or the price of the derivative contract itself. For this to be the case, the DCM should aim to promote sufficient disclosure in both the underlying spot credits as well as the traded derivative.

Robust Quantification

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?

DCMs should focus on the standards under which a crediting program is performing. For example, the International Organization for Standardisation (ISO) 14060 standards for quantifying, monitoring, reporting, and validating greenhouse gas emissions to support a low-carbon economy. ISO 14064-2 details principles and requirements for determining baselines, and monitoring, quantifying, and reporting of project emissions. These ISO standards focuses on GHG projects or project-based activities specifically designed to reduce GHG emissions and/or enhance GHG removals and provides the basis for GHG projects to be verified and validated. We would suggest that, at a minimum, DCMs focus on standards which are supported by ISO certification.



Governance

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?

DCMs should develop a set of eligible criteria for inclusion of a reference asset in a derivative contract. These criteria could reference international standards such as ICROA or the ICVCM.

Tracking and No Double Counting

13. In addition to the factors identified in this proposed guidance, are there other factors that should be taken into account by a DCM when considering, and/or addressing in a VCC derivative contract’s terms and conditions, whether the registry operated or utilized by a crediting program has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer, and retirement of VCCs?

DCMs must focus on the aspect of deliverability of the underlying asset. A functioning derivative market relies on the ability of a seller to deliver. A crediting program would need to have a functioning issuance, transfer, and retirement mechanism to ensure delivery. Platforms such as Carbonplace simplify the process of transferring, retiring, and maintaining an audit trail, support a functioning spot market, thereby facilitating delivery in the close-out of a derivative contract.

14. Are there particular 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 it can be demonstrated that the registry operated or utilized by a crediting program has in place measures that provide reasonable assurance that credited emission reductions or removals are not double-counted?

Preventing double counting requires a complete view of the market across registries. DCMs would benefit from a global meta-registry such as the World Bank’s Climate Action Data Trust or platforms that can aggregate issuance across registries.

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?

Delivery procedures should be clear and easily achievable to ensure the smooth functioning of the derivative market. Clear mechanisms for spot delivery should be identified within the specifications of the contract.



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?

A DCM should consider these factors only in the specification of the deliverable assets. Where a project is meeting additional UN Sustainable Development Goals these can be included as a price factor but should not impede the standardisation of a set off deliverable assets to a contract.

17. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities would avoid locking in levels of GHG emissions, technologies or carbon intensive practices that are incompatible with the objective of achieving net zero GHG emissions by 2050, 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?

A DCM could consider this across different contract specifications. It is important that both, standardisation occurs and that buyers have choice in the standard which they choose to trade or use as their reference. Vintage may be a good measure of standards improving over time to ensure progress towards net zero by 2050.

