



BETTER MARKETS

By Electronic Submission

February 16, 2024

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Request for Comment on Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts (RIN 3038-AF40)

Dear Mr. Kirkpatrick:

Better Markets¹ appreciates the opportunity to comment on the proposed guidance² (“Proposed Guidance”) issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”), regarding the listing for trading of voluntary carbon credit (“VCC”) derivative contracts. The Commission is proposing to issue guidance highlighting key considerations for designated contract markets (“DCMs”) in relation to specific elements of the Commodity Exchange Act (“CEA”) and related CFTC regulations applicable to the listing of VCC derivative contracts for trading.

Better Markets appreciates the Commission’s proposal to issue guidance on the listing of VCC derivative contracts, recognizing this as a crucial step toward enhancing transparency and integrity in the carbon credit markets. In our 2021 letter to then Acting Chairman Behnam, we underscored the significance of the CFTC leveraging its expertise and resources to shape the

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

² Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment; 88 Fed. Reg. 89410 (December 27, 2023).

carbon commodity markets to meet climate-change objectives.³ Better Markets recommended that the CFTC build upon the insights of the 2011 Carbon Markets Report⁴ by developing an updated CFTC-approved report with recommendations for market design and oversight of carbon markets.⁵ We are pleased to see the Commission take proactive measures in line with our recommendation to enhance the integrity and efficiency of the voluntary carbon markets. Initiatives such as calling for whistleblowers to report misconduct,⁶ establishing an environmental fraud task force dedicated to combatting fraud in regulated derivatives markets and relevant spot markets,⁷ and the Proposed Guidance, are all important actions that must be pursued aggressively, quickly, and thoroughly.

However, Better Markets recognizes the challenges within the voluntary carbon markets.⁸ Currently, the market suffers from a lack of order, marked by deep information imbalances among those who develop projects, set standards, certify outcomes, and make purchases.⁹ Such disparities significantly impair the market's efficiency and transparency. Instances of fraud, ranging from the double-counting of credits to the issuance of credits for projects with questionable environmental benefits, exacerbate these challenges, further eroding trust and credibility.¹⁰ Moreover, the reputational concerns that companies face could potentially limit demand for offsets, as businesses become increasingly cautious about the environmental and social integrity of the credits they purchase. This caution is driven by concerns over the genuine impact of these projects and a

³ Better Markets Letter to Acting Chairman Behnam, *Leadership Regarding Climate-Change-Related Risks and the Transition to a Low-Carbon Economy* (June 24, 2021), available at [https://www.bettermarkets.org/sites/default/files/Better Markets Letter to the CFTC Regarding Leadership in Addressing Climate Risks.pdf](https://www.bettermarkets.org/sites/default/files/Better%20Markets%20Letter%20to%20the%20CFTC%20Regarding%20Leadership%20in%20Addressing%20Climate%20Risks.pdf)

⁴ Interagency Working Group for the Study on Oversight of Carbon Markets, Report on the Oversight of Existing and Prospective Carbon Markets (January 18, 2011), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfstudy_carbon_011811.pdf

⁵ See, *supra* n. 3, Better Markets' Letter to Acting Chairman Behnam (June 24, 2021).

⁶ CFTC Whistleblower Office Issues Alert Seeking Tips Relating to Carbon Markets Misconduct (June 20, 2023), available at <https://www.cftc.gov/PressRoom/PressReleases/8723-23>

⁷ CFTC Division of Enforcement Creates Two New Task Forces (June 29, 2023), available at <https://www.cftc.gov/PressRoom/PressReleases/8736-23>

⁸ Dieter Holger, *Rebuilding Trust in Carbon Offsets Faces Uphill Battle*, WSJ Sustainable Business (July 12, 2023), available at <https://www.wsj.com/articles/rebuilding-trust-in-carbon-offsets-faces-uphill-battle-d7811603>

⁹ Allegra Dawes, *What's Plaguing Voluntary Carbon Markets*, Center for Strategic & International Studies (February 2, 2024), available at <https://www.csis.org/analysis/whats-plaguing-voluntary-carbon-markets#:~:text=The%20challenges%20voluntary%20markets%20are,could%20limit%20demand%20for%20offsets>.

¹⁰ Emma Newburger, Major registries in the carbon offset market are allowing dubious credits, report says, CNBC (March 21, 2023), available at <https://www.cnn.com/2023/03/21/registries-in-carbon-offset-market-allowing-dubious-credits-report.html>

reluctance to be associated with fraud or predatory conduct. Without the availability of high-quality, verifiable credits, the supply side risks failing to deliver on their promises, thereby undermining the market's potential to contribute effectively to climate change mitigation efforts. The widespread occurrence of fraud highlights the critical and overdue need for stronger regulatory oversight, rigorous verification methods, and the establishment of clear guidelines to safeguard the voluntary carbon markets' integrity and effectiveness.

Nevertheless, the Proposed Guideline is a good step in establishing a fair, transparent, and efficient market for voluntary carbon credits, contributing significantly to the global endeavor to reduce environmental impact. It demonstrates the CFTC's commitment to not only improving market structures and oversight but also to ensuring that the voluntary carbon markets function as effective tools in the fight against climate change. By addressing the root causes of market inefficiencies and fraud, the CFTC is laying the groundwork for a more transparent, reliable, and sustainable market environment. This, in turn, supports the ultimate goal of reducing carbon emissions and mitigating the impacts of climate change. The CFTC's endeavors reflect Better Markets' belief in the transformative power of well-regulated carbon markets to contribute significantly to global climate change mitigation efforts.

Better Markets also acknowledges the critical role of DCMs in ensuring that new and evolving voluntary carbon credit derivatives adhere to the CEA and CFTC regulations. We support the Proposed Guidance emphasizing the importance of compliance with key DCM Core Principles aimed at preventing manipulation and market disruptions, alongside robust market surveillance and enforcement practices. The Proposed Guidance provides a foundation for maintaining market integrity and fostering a stable trading environment for VCC derivatives. Better Markets recommends that the CFTC continue to explore additional avenues for improving the voluntary carbon market such as implementing transaction reporting, setting accountability and business conduct standards for intermediaries, and promoting market integrity with uniform documentation and certification for environmental commodities.¹¹

I. Background on Climate Change.

Concerns that human-generated carbon dioxide emissions and emissions of other greenhouse gases (“GHG”) might cause a warming of the Earth’s climate date back to at least the late 19th century, with Nobel Prize winning chemist Svante Arrhenius positing the idea of a “greenhouse effect” and the notion that human activities might contribute to this phenomenon.¹² At that time, Arrhenius’s hypothesis, like many others in the then-nascent study of how and why

¹¹ See, e.g., Statement of Commissioner Kristin Johnson: Commission Guidance Regarding Listing of Voluntary Carbon Credit Derivative Contracts (December 4, 2023), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/johnsonstatement120423>

¹² Elizabeth Kolbert, FIELD NOTES FROM A CATASTROPHE 39–42 (2006).

the Earth's climate changes over time, was speculative.¹³ However, in the ensuing decades, as climatology evolved and as scientists became better able to measure and model climatic changes and discern the causes behind them, it became increasingly clear that the broad contours of Arrhenius's hypothesis were correct—carbon in the atmosphere was increasing, and the result was higher global temperatures. By the 1980s, scientists were increasingly alarmed about the warming of the climate and the potentially catastrophic consequences, with Dr. James Hansen's congressional testimony in 1988 as a notable example of the increasing visibility of the issue.¹⁴ In 1992, as part of a summit between world leaders to discuss environmental issues, more than 150 countries signed the Framework Convention on Climate Change. They agreed to work to address the issue and to meet periodically, but not much more.¹⁵ In 1997, those countries met in Kyoto, Japan, and the result was the 1998 Kyoto Protocols, which included the first binding commitments to reduce global greenhouse gases.¹⁶

At the same time, as climate change became more visible and more people, including scientists, began advocating for aggressive policy interventions to address it, the issue also became more politicized. This was in no small part because addressing climate change would necessarily mean imposing costs on certain industries. When he was President, George W. Bush rejected the Kyoto Protocols, contending that adhering to the Kyoto Protocols would harm the U.S. economy. And, as did many climate change deniers at the time, he pointed to supposed uncertainty surrounding (1) whether the climate was warming, (2) whether, if it was, human activity was to blame, and (3) whether, assuming climate change were real and caused by humans, its adverse impact would be serious enough to justify the costs of addressing it.¹⁷

In the ensuing years, the scientific consensus that climate change was real, caused by humans, and threatened a significant adverse impact, only increased. In 2001, the same year that President Bush withdrew the U.S. from the Kyoto Protocols, the Intergovernmental Panel on Climate Change ("IPCC") released an assessment stating, among other things, that an "increasing body of observations gives a collective picture of a warming world," that the 1990s were "very likely" the warmest decade on record, that there was "new and stronger evidence that most of the

¹³ See *id.* at 41 ("By today's standards, Arrhenius's work seems primitive. . . . He was missing crucial pieces of information about spectral absorption, and he ignored several potentially important feedbacks."). Arrhenius, working far before the widespread adoption of the automobile, also did not fully grasp how quickly the phenomenon he had identified would change the Earth's climate, predicting that doubling the atmospheric concentration of carbon would take 3,000 years, but he "was off by 2800 years." Timothy E. Wirth, *A Way Forward on Climate Change*, 2 HARV. L. & POL'Y REV. 313, 313 (2008).

¹⁴ Joseph Allan MacDougald, *Paris, Policy, and the Grid: History and Context*, 33 CONN. J. INT'L L. 409, 414 (2018).

¹⁵ See Daniel Bodansky, *The United Nations Framework Convention on Climate Change: A Commentary*, 18 YALE J. INT'L L. 451, 454 (1993).

¹⁶ Joseph Allan MacDougald, *Paris, Policy, and the Grid: History and Context*, 33 CONN. J. INT'L L. 409, 415 (2018).

¹⁷ Riley Beggin, *The Last Time a U.S. President Dumped a Climate Deal*, ABCNEWS (Jun. 1, 2017), <https://abcnews.go.com/Politics/time-us-president-dumped-global-climate-deal/story?id=47771005>.

warming observed over the last 50 years is attributable to human activities,” and that there would likely be significant adverse impacts as a result of climate change.¹⁸ In other words, despite claims that continue to persist from some about significant uncertainty surrounding the reality and impact of climate change, the scientific consensus has for decades been coalescing around the reality of the phenomenon and the need for urgent action. The IPCC’s 2014 report was even more explicit: It cited to unmistakable warming and “confirm[ed] that human influence on the climate is clear and growing, with impacts observed across all continents and oceans.”¹⁹

Reflecting the widespread, global consensus regarding the need to combat climate change, in 2015, nearly every country on Earth joined the Paris Climate Agreement, pledging to reduce greenhouse gas emissions so as to limit warming to less than 2 degrees Celsius from pre-industrial levels.²⁰ More recently, the U.S. and other nations have redoubled their commitment to combating climate change, pledging to cut emissions by even more than originally agreed; these new commitments have been described as both aggressive yet potentially insufficient, which underscores the inevitability of dramatic societal and economic transformation in the face of climate change.²¹

Ultimately, nearly 100% of climate scientists agree that the climate is warming, that humans are a significant driving factor in causing that warming, and that the adverse consequences, both financial and otherwise, from this warming will be significant.²² Scientists broadly agree that there needs to be a drastic reduction in greenhouse gas emissions in a short period of time, with the U.N. estimating in 2019 that emissions will need to drop by 7.6% each year from 2020–2030

¹⁸ IPCC, CLIMATE CHANGE 2001 SYNTHESIS REPORT 4–6 (https://gridarendal-website-live.s3.amazonaws.com/production/documents/s_document/285/original/spm.pdf?1488203630).

¹⁹ IPCC, CLIMATE CHANGE 2014 SYNTHESIS REPORT v, https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf.

²⁰ United Nations, PARIS AGREEMENT (last visited Jun. 7, 2021), <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>. Reflecting the ongoing politicization of climate issues in the U.S., in 2017 former President Donald Trump withdrew America from the Paris Agreement. Michael D. Shear, *Trump Will Withdraw U.S. From Paris Climate Agreement*, N.Y. TIMES (Jun. 1, 2017), <https://www.nytimes.com/2017/06/01/climate/trump-paris-climate-agreement.html>. Reflecting the fact that the arguments against acknowledging the reality of climate change and the necessity of combating it are not based in anything approaching fact or reality, Trump’s speech announcing the withdrawal was littered with falsehoods. Vanessa Schipani, et al., *FactChecking Trump’s Climate Speech*, FACTCHECK.ORG (Jun. 1, 2017), <https://www.factcheck.org/2017/06/factchecking-trumps-climate-speech/>. As one of his first acts in office, President Biden rejoined the Paris Agreement. Nathan Rott, *Biden Moves to Have U.S. Rejoin Climate Accord*, NPR (Jan. 20, 2021), <https://www.npr.org/sections/inauguration-day-live-updates/2021/01/20/958923821/biden-moves-to-have-u-s-rejoin-climate-accord>.

²¹ Brad Plumer & Nadja Popovich, *The U.S. Has a New Climate Goal. How Does it Stack Up Globally?*, N.Y. TIMES (Apr. 22, 2021), <https://www.nytimes.com/interactive/2021/04/22/climate/new-climate-pledge.html>.

²² David Herring, *Isn’t There a Lot of Disagreement Among Climate Scientists About Global Warming*, CLIMATE.GOV (Feb. 3, 2020), <https://www.climate.gov/news-features/climate-qa/isnt-there-lot-disagreement-among-climate-scientists-about-global-warming>.

to prevent the Earth from warming more than 1.5 to 2 degrees Celsius above pre-industrial levels. The scientific consensus identifies this path as the essential target we must reach to avoid the worst effects of climate change.²³

The impact from both the effects of climate change itself and the significant policy changes required to forestall the worst of those effects will be broad, touching nearly every aspect of society. This, of course, includes the economic impacts, which one study confirmed will be negative and will apply broadly “to poor or rich, and hot and cold countries alike, as economic growth is affected not only by higher temperatures but also by the degree of climate variability.”²⁴ By one estimate, the impact of climate change could result in a loss to the American economy of 2% of GDP per year.²⁵ Another study determined that climate change could wipe off \$23 trillion in global wealth by 2050.²⁶

Indeed, the tangible repercussions of climate change are becoming increasingly evident across economic sectors, signaling a transformative impact on global economic structures and individual livelihoods. For example, the U.S. property and casualty industry suffered losses of \$5 billion in 2021, which ballooned to losses of \$26.5 billion in 2022.²⁷ In 2023, the U.S. witnessed 28 weather/climate disasters, each causing over \$1 billion in damages, a stark increase from an annual average of 8.5 events to an annual average of 20.4 events for 2019–2023.²⁸

Given the clear and increasing impact of climate change across various sectors, evidenced by escalating financial losses and the growing frequency of billion-dollar climate disasters, the

²³ Brady Dennis, *In Bleak Report, U.N. Says Drastic Action Is Only Way to Avoid Worst Effects of Climate Change*, WASH. POST (Nov. 26, 2019), <https://www.washingtonpost.com/climate-environment/2019/11/26/bleak-report-un-says-drastic-action-is-only-way-avoid-worst-impacts-climate-change/>.

²⁴ See Matthew E. Kahn, et al., LONG-TERM MACROECONOMIC EFFECTS OF CLIMATE CHANGE: A CROSS-COUNTRY ANALYSIS 4, (NBER Working Paper No. 26167) (Aug. 2019) (finding that climate change has a negative impact on long-term growth and that “our empirical findings apply equally to poor or rich, and hot or cold countries”), https://www.nber.org/system/files/working_papers/w26167/w26167.pdf.

²⁵ The Hamilton Project and the Stanford Institute for Economic Policy Research, TEN FACTS ABOUT THE ECONOMICS OF CLIMATE CHANGE AND CLIMATE POLICY 7 (2019), https://www.brookings.edu/wp-content/uploads/2019/10/Environmental-Facts_WEB.pdf.

²⁶ Christopher Flavelle, *Climate Change Could Cut World Economy by \$23 Trillion in 2050, Insurance Giant Warns*, N.Y. TIMES (Apr. 22, 2021), <https://www.nytimes.com/2021/04/22/climate/climate-change-economy.html>.

²⁷ Better Markets Special Report, *The Unseen Banking Crisis Concealed Behind the Climate Crisis* (August 23, 2023), available at https://bettermarkets.org/wp-content/uploads/2023/08/BetterMarkets_Report_Unseen_Banking_Crisis_Behind_Climate_Crisis_08-23-2023.pdf

²⁸ NOAA National Centers for Environmental Information (NCEI) U.S. Billion-Dollar Weather and Climate Disasters (2024), available at [https://www.ncei.noaa.gov/access/billions/#:~:text=In%202023%20\(as%20of%20August,and%201%20winter%20storm%20event](https://www.ncei.noaa.gov/access/billions/#:~:text=In%202023%20(as%20of%20August,and%201%20winter%20storm%20event).

urgency for regulatory bodies to adapt and respond has never been more apparent. Within this context, the CFTC proposed guidance to bring transparency and integrity to the voluntary carbon markets is very important. This initiative to regulate the listing of voluntary carbon credit derivative contracts is a good step toward safeguarding the financial system against climate change risks and underscores the essential role of regulatory oversight in fostering a sustainable future. This critical measure for regulating voluntary carbon credit derivative contracts marks a significant stride in protecting our financial ecosystem from climate-induced risks. Furthermore, integrating derivatives markets into climate strategies offers a powerful tool to mitigate the effects of climate change. Such efforts not only aim to shield the economy but also promise a sustainable environment, safeguarding a healthier planet for future generations.

II. Better Markets supports the proposed guidance advising DCMs on designing VCC futures contracts, emphasizing quality, delivery, and inspection to ensure pricing accuracy, prevent manipulation, and enhance market confidence.

The proposed guidance provides guidelines for DCMs when designing futures contracts for voluntary carbon credit commodities. The guidelines highlight specific characteristics of VCCs that should be taken into consideration, such as quality standards, delivery points and facilities, and inspection provisions. Quality standards include transparency, additionality, permanence, and accounting for the risk of reversal, as well as robust quantification of emissions reductions or removals.²⁹ Delivery points and facilities include effective governance at the carbon crediting program, tracking the issuance, transfer, and retirement of VCCs, and avoiding double counting.³⁰ Inspection provisions include independent third-party validation and verification.³¹ By considering these factors, DCMs can ensure accurate pricing, reduce the susceptibility of the contract to manipulation, help prevent price distortions, and promote confidence in VCC contracts.

A. Quality Standards

DCM Core Principle 3 requires DCMs to list only those derivative contracts that are not readily susceptible to manipulation.³² In alignment with this principle, Appendix C Guidance provides essential considerations for DCMs in crafting contract terms and conditions and furnishing requisite documentation and data for contract submissions to the Commission.³³

²⁹ See Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment; 88 Fed. Reg. 89410 (December 27, 2023).

³⁰ *Id.*

³¹ *Id.*

³² 7 U.S.C. 7(d)(3).

³³ 17 CFR part 38, Appendix C.

The Proposed Guidance emphasizes the need for contract terms to reflect the unique attributes of the underlying commodity, recognizing that the characteristics dictating these specifications vary by commodity.³⁴ Specifically, for voluntary carbon credits, the Proposed Guidance notes the evolving nature of standardization and accountability mechanisms as a distinct characteristic that must be considered.³⁵ Better Markets supports this approach, acknowledging that the ongoing development of VCC standardization and accountability is a critical factor that DCMs should incorporate when designing VCC derivative contracts. This ensures that the contracts are structured with a deep understanding of the VCC market's current landscape, fostering integrity and resilience in the trading of these derivatives.

1. Transparency

Better Markets advocates for transparency and the public availability of data to enhance market clarity, credibility, integrity, oversight, and accountability. In this spirit, we fully support the notion that DCMs should outline, within the terms and conditions of voluntary carbon credit derivative contracts, comprehensive information about the eligible VCCs for delivery.³⁶ Such details must encompass the crediting programs and, if relevant, the specific project types or activities eligible for issuing VCCs.³⁷ This transparency is crucial for providing market participants with clear expectations about the VCCs deliverable under the contract, thus ensuring that contract pricing represents the quality of the underlying VCCs.

Ambiguities or uncertainties regarding the VCC quality could expose contracts to potential manipulation or price distortions. We support the initial view that in developing terms for VCC derivative contracts, DCMs should carefully consider the transparency of the crediting program's policies, procedures, and the projects or activities it credits.³⁸ The availability of detailed, searchable, and comparable program information will enable market participants to grasp how greenhouse gas emission reductions or removals are calculated, including the assessment of additionality and the quantification of emission reductions or removals.³⁹ This transparency is pivotal in aiding market participants to make informed judgments and comparisons regarding the quality of VCCs underpinning derivative contracts, thereby facilitating accurate pricing.

Therefore, the disclosure of information on the crediting program's policies and procedures for public access should be considered a critical attribute of the VCC that must be explicitly outlined in the terms and conditions of the VCC derivative contract. This approach not only fosters

³⁴ *Id.*

³⁵ Proposed Guidance at 89416.

³⁶ Proposed Rule at 8417.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

market transparency but also strengthens the market's integrity and the reliability of VCC derivative contracts.

2. Additionality

Better Markets supports the view that in crafting the terms and conditions of a VCC derivative contract, DCMs must prioritize the principle of "additionality" for the underlying VCCs.⁴⁰ Additionality refers to the concept that VCCs should represent greenhouse gas emission reductions or removals that would not have occurred without the financial incentives provided by the sale of carbon credits.⁴¹ This criterion is crucial for ensuring that VCCs contribute effectively to emissions mitigation, represent genuine environmental value, and elimination of fraud in connection with VCCs.

Additionality is a cornerstone of high-quality VCCs. A VCC lacking this characteristic fails to meet the ultimate goal of contributing to meaningful emissions reduction. As such, DCMs must rigorously evaluate whether the crediting programs for VCCs have robust and reliable procedures in place to verify that emission reductions or removals are indeed additional—ensuring that these reductions or removals would not have happened without the economic motivation of carbon credit sales.⁴²

Market participants' confidence in the additionality of VCCs eligible for delivery under a contract is essential for the contract's pricing to accurately reflect the quality of the delivered VCCs. Without verified additionality, the market risks valuing VCCs that do not meet the high-quality standards expected by participants, potentially undermining the contract's integrity and the broader goal of emissions mitigation.

Therefore, the examination of crediting programs' methodologies for assessing additionality must be considered an economically significant aspect of the VCCs and should be clearly defined in the terms and conditions of VCC derivative contracts.⁴³ This commitment to additionality not only bolsters the credibility and environmental impact of VCCs but also reinforces market confidence and the pursuit of genuine emissions reduction efforts.

3. Permanence and Accounting for the Risk of Reversal

It is essential for DCMs to rigorously assess the measures implemented by crediting programs to manage the risk of reversal.⁴⁴ This risk pertains to instances where carbon credits might need to be recalled or canceled due to the carbon sequestered by a project being inadvertently

⁴⁰ Proposed Rule at 8417.

⁴¹ Proposed Rule at 8417.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Proposed Rule at 8417.

released back into the atmosphere or because of a reassessment of the project's carbon reduction or removal impact.⁴⁵

Understanding and addressing reversal risks is particularly crucial for projects with a higher likelihood of such risks. These risks directly affect the risk management strategies of market participants engaged in physically-settled VCC derivative contracts, who rely on these instruments to achieve their carbon mitigation objectives. They need assurance that the VCCs, upon physical settlement, will effectively deliver the promised emissions reduction or removal.

Hence, the approach a crediting program takes to estimate, monitor, and manage the risk of reversal is intrinsically linked to the perceived quality of the VCCs and, consequently, to the valuation of the derivative contracts.⁴⁶ Information detailing how crediting programs confront reversal risks—including measures for estimating, monitoring, and rectifying reversals—should be recognized as a significant attribute of the underlying VCCs and detailed within the terms and conditions of VCC derivative contracts.

In line with ensuring market integrity and participant confidence, Better Markets supports the preliminary view that DCMs must evaluate whether crediting programs have instituted effective mechanisms, such as buffer reserves, to guarantee that, in the event of a reversal, the affected VCC will be substituted with another of equivalent high quality that fulfills the contract's specifications.⁴⁷ These buffer reserves, or "pools," are essential for compensating for reversals, ensuring that credits from these reserves can be allocated to offset the impact of any reversed credits, maintaining the integrity of the VCCs and the contracts they underpin.⁴⁸

Furthermore, DCMs should assess whether crediting programs regularly reevaluate their buffer reserve methodologies to address evolving climate risks that may increase the likelihood of reversals, and whether they have established audit mechanisms to ensure the ongoing adequacy of these reserves.⁴⁹ Such diligence is paramount in maintaining the credibility of VCC markets and ensuring that derivative contracts remain a reliable tool for participants aiming to achieve their carbon reduction commitments.

4. Robust quantification

Better Markets also supports the Commission's preliminary view that DCMs must evaluate the methodologies or protocols employed by crediting programs to calculate GHG emission reductions or removals for projects or activities.⁵⁰ The lack of standardized methodologies across, and even within, crediting programs for different project types underscores the necessity for DCMs

⁴⁵ *Id.*

⁴⁶ Proposed Rule at 89418.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

to ensure that the crediting programs for underlying VCCs utilize quantification methods that are robust, conservative, and transparent.

A quantification methodology that embodies these qualities is crucial for the integrity of the carbon market. It guarantees that the number of issued VCCs genuinely represents the actual GHG emission reductions or removals achieved by the projects or activities. Therefore, details regarding the methodologies or protocols used to calculate these reductions or removals should be considered significant attributes of the underlying VCCs and must be explicitly defined in the terms and conditions of VCC derivative contracts.

Better Markets believes that ensuring the credibility of quantification methodologies is not just a matter of market efficiency but also of environmental integrity. It's about ensuring that the carbon markets contribute meaningfully to the fight against climate change by supporting projects that offer verifiable and substantial GHG emission reductions or removals. Thus, we advocate for stringent scrutiny and transparency of quantification methodologies as part of the contract design process to strengthen market confidence and environmental outcomes.

B. Delivery Points and Facilities

Better Markets agrees with the Commission's preliminary view that DCMs should rigorously evaluate the governance frameworks and tracking mechanisms employed by the crediting programs of the underlying VCCs.⁵¹ Such an assessment is crucial to ensuring that these frameworks and mechanisms are robust enough to facilitate seamless delivery by both parties involved in the contract. Furthermore, the prevention of double-counting of VCCs is of paramount importance to maintain the credibility of the carbon market. Double-counting undermines the environmental integrity of carbon trading by overstating emission reductions, which in turn can dilute the effectiveness of carbon markets in contributing to global climate mitigation efforts.

The governance framework of a crediting program plays a critical role in establishing the rules and procedures that guide the issuance, transfer, and retirement of VCCs, thereby ensuring that these credits are managed in a transparent and accountable manner.⁵² Similarly, effective tracking mechanisms are essential for maintaining a reliable record of the lifecycle of each VCC, from issuance through to retirement, ensuring that each credit is only counted once towards a specific emission reduction or removal objective.⁵³

In addressing delivery procedures for physically-settled VCC derivative contracts, DCMs should consider these aspects as integral to the contract's design. By doing so, they can help ensure the alignment of derivative and cash prices, reflecting the true value and quality of the underlying VCCs. This alignment is essential for the market's functioning, as it supports price discovery, risk management, and the accurate valuation of carbon credits, thereby contributing to the broader goal of reducing greenhouse gas emissions.

⁵¹ Proposed Rule at 89418.

⁵² *Id.*

⁵³ Proposed Rule at 89419.

Better Markets believes that by prioritizing the evaluation of governance frameworks, tracking mechanisms, and measures to prevent double-counting, DCMs can significantly contribute to the resilience and integrity of the carbon market. Such actions not only foster trust among market participants but also enhance the market's ability to support effective climate action.

C. Inspection Provisions

Better Markets supports the Commission's perspective that DCMs should critically assess the validation and verification processes utilized by the crediting programs for underlying VCCs.⁵⁴ These processes are vital for confirming that credited mitigation projects or activities adhere to the program's rules and standards, ensuring that the emission reductions or removals claimed are genuine and verifiable.

In line with the Commission's preliminary views, Better Markets believes that the credibility of these processes hinges on their currency, robustness, and transparency. Moreover, the involvement of reputable, independent third parties in the validation and verification of projects or activities is crucial.⁵⁵ Such independent oversight provides assurance that the GHG emission reductions or removals claimed are accurately achieved, thereby enhancing the quality of the underlying VCCs and, by extension, the reliability of the VCC derivative contracts.

Furthermore, we highlight the importance of adopting best practices in third-party validation and verification.⁵⁶ These practices should ensure diverse and impartial review by preventing the exclusive reliance on a single validator for all projects or activities. They should also include mechanisms for addressing performance issues, conducting periodic reviews of validators, and ensuring that ongoing validation and verification are carried out by different parties from those who performed the initial assessments. These measures are critical for maintaining the voluntary carbon market's integrity and fostering trust among participants.

By incorporating detailed inspection or certification procedures into the terms and conditions of VCC derivative contracts, DCMs can significantly contribute to the transparency, accuracy, and trustworthiness of the carbon markets.⁵⁷ Such practices not only support market integrity but also enhance the environmental impact of carbon trading by ensuring that credited emission reductions or removals are both real and significant.

⁵⁴ Proposed Rule at 89419.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

III. DCMs must monitor a voluntary carbon credit derivative contract terms and conditions as they relate to the underlying carbon credit.

DCM Core Principle 4 mandates DCMs to guard against manipulation, price distortion, and disruptions in the delivery processes of physically settled derivative contracts.⁵⁸ This principle underscores the importance of vigilant market surveillance, compliance, and enforcement practices to maintain market integrity.

In the context of physically-settled VCC derivative contracts, the obligation extends to meticulous monitoring of the contract's terms and conditions, especially as they pertain to the underlying commodity market. This includes ensuring the alignment of contract prices with the prices of the underlying commodity and assessing the adequacy of the commodity's supply in meeting delivery requirements.⁵⁹ Such proactive oversight is crucial for identifying potential vulnerabilities to price manipulation or distortions and for evaluating the ongoing relevance of the contract's terms and conditions.

Given the nascent and evolving nature of VCC derivatives, the Commission rightly believes in the need for DCMs to continuously review and update these contracts.⁶⁰ This involves verifying that the underlying VCCs remain in compliance with, or are updated to reflect, the most current certification standards. Changes in crediting programs or in the types of projects and activities associated with the VCCs, prompted by new standards or certifications, necessitate timely adjustments to the contract's terms and conditions to ensure they accurately reflect these updates.⁶¹

Moreover, DCMs are tasked with the critical responsibility of ensuring an adequate supply of the underlying VCCs to meet the contracts' delivery requirements, further emphasizing the need for ongoing monitoring and adaptability.

Additionally, the Commission's regulations implementing DCM Core Principle 4, which obligate DCM market participants to maintain and, upon request, provide records of their trading activities in both the VCC cash markets and related derivatives markets, are a key component of this surveillance framework.⁶² These records are instrumental in enabling DCMs to fulfill their market monitoring duties and are also subject to Commission inspection, ensuring transparency and accountability in trading activities.

Better Markets regards the CFTC's proposed guidance as an essential first step towards the integrity and stability of the VCC derivatives market. Following these guidelines will allow DCMs

⁵⁸ 7 U.S.C. 7(d)(4).

⁵⁹ Proposed Rule at 89420.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

to create a robust trading environment aligned with environmental sustainability and carbon mitigation goals.

CONCLUSION

We hope these comments are helpful as the Commission finalizes its Proposed Guidance.

Sincerely,

A handwritten signature in black ink, appearing to read "Cantrell Dumas". The signature is fluid and cursive, with the first name being more prominent.

Cantrell Dumas
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