ISDA Safe, Efficient Markets

February 16, 2024 ***Submitted Electronically***

Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St., N.W.
Washington, DC 20581

Re: Listing of Voluntary Carbon Credit Derivatives Contracts (RIN 3038-AF40)

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. (**"ISDA"**)[1] appreciates the opportunity to submit these comments on the Commodity Futures Trading Commission's (**"CFTC or Commission"**) proposed guidance regarding the listing of voluntary carbon credit derivatives contracts ("**Proposed Guidance"**) published in the Federal Register on December 27, 2023.[2]

We support the Commission's ongoing efforts to enhance the quality of voluntary carbon credits (**"VCCs"**) and the integrity of the voluntary carbon market (**"VCM"**). We agree with the Commission that the process by which VCCs are issued deserves careful consideration, given that such process informs the quality of VCCs and effective functioning of the VCM, and, by extension, the integrity of VCC futures and derivatives. In this regard, we strongly support the Commission's proposed guidance as a as a first step to bringing greater transparency and integrity of the VCM.

We are also mindful of the existing friction between Commission's desire to build confidence in the VCM and its limited authority to oversee the VCM and appreciate its intent to provide regulatory clarity within its existing regulatory regime. Additionally, we support the Commission's intent to align its proposed approach with existing and future frameworks to

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.
[2] 88 Fed. Reg. 89414 (Dec. 27, 2023), *available at* https://www.cftc.gov/PressRoom/PressReleases/8829-23.

provide further consistency with other integrity efforts, such as the Integrity Council for the Voluntary Carbon Market's ("**ICVCM**") Core Carbon Principles and Carbon Offsetting and Reduction Scheme for International Aviation (**"CORSIA"**) administered by the International Civil Aviation Organization ("**ICAO**") to provide further consistency with other integrity efforts.

Given the integral role that VCC derivatives contracts play in growing the VCM, we believe the guidance could be strengthened by: (1) reinforcing the CFTC's oversight in ensuring that listed VCC derivatives contracts meet the factors outlined in the Commission's guidance; (2) clarifying that the CFTC should have a heightened regulatory interest in the rules that govern VCC registries given their role as delivery points for VCC futures contracts; (3) encouraging standardization in the VCM to promote trading and liquidity; and (4) encouraging the Commission's regulatory counterparts across jurisdictions to clarify the legal nature of VCCs under their respective laws. We explain our comments in more detail below.

1. ***Strengthening CFTC Oversight of Listed VCC Derivatives Contracts***

Under the Proposed Guidance, DCMs "should (rather than "must") consider" whether VCCs meet quality standards and have appropriate governance frameworks. The lack of a requirement to ensure appropriate standards and governance, coupled with the constraints on the part of DCMs to independently verify the accuracy of the information provided by VCC registries or carbon crediting programs, would make it challenging to ensure that listed contracts meet the Proposed Guidance's standards.

We believe that the CFTC should allow DCMs to rely on third-party expert certifications to bolster the integrity of the contracts and ensure there are no liquidity drops due to DCM's uncertainty regarding compliance with the principles in the Proposed Guidance. For example, the ICVCM, who is the most reputable standard setter in the VCC space, has established Core Carbon Principles that are closely tracked by the guidance along with a robust assessment procedure to ensure only high-quality carbon-crediting programs receive their certification. ICAO (to which the United States is a Member State) has also created a framework for carbon credits for use by CORSIA, and in so doing, it has also become a benchmark for market participants in the VCM. [3]

In addition, the CFTC should play a larger role in evaluating whether listed VCC contracts meet the standards outlined in the Proposed Guidance. As the primary regulator for commodity futures contracts, and thus, listed VCC contracts, the CFTC is well-positioned to independently evaluate the information provided by DCMs, VCC registries and carbon-crediting programs to further verify the integrity of VCC listed futures contracts. In our view, increasing the CFTC's oversight in relation to the quality assessment of the VCCs' information submitted by DCMs would further ensure that listed VCC contracts meet the appropriate standards outlined in the guidance.

[3] Notably, there are several frameworks now combining forces as of COP28 to create an end-to-end framework for trading VCC.

2. Heightened Regulatory Interest over VCC Registries as Delivery Points

The CFTC has a long-established authority over delivery points for physically settled commodity futures contracts.[4] As with any other physically settled commodity futures contracts, we believe that the Commission has a strong regulatory interest in ensuring that VCC futures are physically settled in an orderly manner. Carbon registries currently serve as delivery points for carbon futures contracts. Carbon credit registries (i) track projects and issue carbon credits for each unit of emission reduction or removal that is verified and certified, and (ii) oversee the transfer of carbon credits from one party to another through tracking ownership. Currently, these registries have their own set of requirements that project designers must meet and are validated and monitored by verification entities.[5]

It is important to ensure registries have consistent and transparent rules on how VCCs are verified, counted and transferred. Failure to correctly track and safeguard carbon credits, or a gap in standards in the creation of a carbon credit itself, could lead to fraudulent practices, such as greenwashing and double counting. As with rules for delivery points of other commodity futures contracts, consistent and transparent requirements for carbon registries can help guarantee the validity of VCC transactions, thereby bolstering the integrity of trading VCCs in secondary markets.

Given the CFTC's authority over delivery points, we believe the CFTC has a regulatory interest in ensuring that VCC registries (that act as delivery points for carbon futures contracts) adopt appropriate procedures for tracking the buying and selling of credits in the context of VCC futures and other bilateral markets (such as spot and physically settled forwards), especially considering the CFTCs' anti-fraud and manipulation authority.

3. Encouraging Standardization in the VCM to Promote Trading and Liquidity

Since the VCC market is global in nature, it is important to develop a robust VCM across jurisdictions that will strengthen the functioning of the carbon credit derivatives markets, thus enabling the continued development of liquidity in derivatives products so that market participants can appropriately manage their business risks. Facilitating trading in carbon credit derivatives that serve as hedge for climate mitigation projects will contribute to the development of deep and liquid voluntary carbon credit markets. Toward this end, ISDA developed standardized trading templates for spot, forward, option transactions in VCCs.[6] Such

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[4] In this regard, CFTC officials have noted that "[t]he specification of delivery points, deliverable grades and their corresponding price differentials has a direct bearing on the susceptibility of the futures contract to price manipulation and market congestion." Policy Statement on Price Differentials, CFTC, www.cftc.gov/IndustryOversight/ContractsProducts/EconomicRequirements/differential.html.

[5] ISDA Paper: Voluntary Carbon Markets Analysis of Regulatory Oversight in the US, https://www.isda.org/2022/06/02/voluntary-carbon-markets-analysis-of-regulatory-oversight-in-the-us/ (discussing the CFTC's authority in more detail).

[6] The 2022 ISDA Verified Carbon Credit Transactions Definitions, https://www.isda.org/book/2022-isda-verified-carbon-credit-transaction-definitions/.

documentation is intended to assist in standardizing terms and conditions for transactions in VCCs globally, which in turn, may facilitate more trading in VCCs.

4. Clarifying the Legal and Regulatory Treatment of Voluntary Carbon Credits

One of the obstacles to advancing voluntary carbon trading is the lack of clarity regarding the legal nature of VCCs across jurisdictions. Other than the US and the UK, very few jurisdictions provide legal certainty about how credits can be created, bought, sold, and retired, thus making it unclear what type of security may be taken and enforced against VCCs and how that can be achieved, as well as how VCCs would be treated following an insolvency (including with regards to netting). Such determination may also have an impact on broader considerations, such as the regulatory, tax and accounting treatment of VCCs.

We believe the Commission could play a critical role in advocating that legal authorities and market regulators from other jurisdictions clarify the legal nature of VCCs under their respective laws and regulations. Understanding the legal treatment of VCCs in each jurisdiction is necessary to create robust *global* VCM, which, in turn, will enable the development of a clear price signal for carbon and allow funds to be efficiently channeled towards emissions-reducing projects.[7]

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Our members are strongly committed to maintaining the safety and efficiency of the U.S. derivatives market and recognize that they have a significant role to play in the transition towards a more sustainable global economy. We look forward to further engagement with the Commission on these important issues.

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[7] ISDA Paper: Legal Implications of Voluntary Carbon Credits, https://www.isda.org/2021/12/01/legal-implications-of-voluntary-carbon-credits/.