Mr. Christopher Kirkpatrick
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: In Response to Proposed Guidance on the Listing of Voluntary Carbon Credit Derivative Products on Designated Contract Markets

Dear Secretary Kirkpatrick,

We welcome the opportunity to provide comments on the Commodity Futures Trading Commission's (CFTC or Commission) December 4, 2023, request for comment on proposed guidance for the listing of voluntary carbon credit (VCC) derivative contracts on designated contract markets (DCMs).[1] This request is in keeping with the Commission's long-standing commitment to understanding how climate change intersects and interacts with financial markets.

Section 750 of the Dodd-Frank Wall Street Reform and Consumer Protection Act established an interagency working group, chaired by the CFTC chairman, to "conduct a study on the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market, including oversight of spot markets and derivative markets."[2] In January 2011, the working group released their "Report on the Oversight of Existing and Prospective Carbon Markets,"[3] which provided a thorough overview of carbon markets, including compliance and voluntary markets. More recently, the CFTC made history in 2020, when the Commission's Climate-Related Market Risk Subcommittee published a report which found that climate change threatens the financial stability of the U.S.[4] The report provided 53 detailed policy recommendations, the first of which is the need for an economy wide price on carbon.

While we applaud the CFTC's historical focus on climate-related risks, the proposed guidance falls short of what is needed to address serious problems in the VCC market, problems that implicate the Commission's mission to promote market integrity, prevent price manipulation and other market disruptions, protect customer funds, and avoid systemic risk.[5] Thankfully, the VCC derivatives market is in its infancy, and there is still time for the Commission to enhance

[1] "Guidance Regarding Listing of Voluntary Carbon Credit Derivative Contracts." December 4, 2023, available at: https://www.cftc.gov/sites/default/files/2023/12/2023-28532a.pdf
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, available at C:\Users\skelley\AppData\Roaming\SoftQuad\XMetaL\5.5\gen\c\H4173_~1.XML (cftc.gov)
[3] dfstudy_carbon_011811.pdf (cftc.gov)
[4] Managing Climate Risk in the U.S. Financial System (cftc.gov)
[5] See CEA section 3(b), 7 U.S.C. 5(b).

integrity in the underlying market before additional derivatives products with dubious underlying assets come to market.

The CFTC is not a climate regulator, nor do we expect them to address every climate-related financial risk. Rather, our recommendation is focused on ensuring that an asset class designed to advance a low-carbon future lives up to its stated claims. Doing so will allow VCC derivatives markets to scale alongside growing public and private sector net-zero commitments in a way that facilitates price discovery and effective hedging. Accomplishing this goal means that the CFTC must do more than simply encourage DCMs to drive standardization and integrity in the VCC market through contract design and disclosure. As we detail further below, the Commission should instead mandate that all VCCs serving as the underling in a derivatives contract adhere to the Core Carbon Principles developed by the Integrity Council for the Voluntary Carbon Markets.

Overview of Voluntary Carbon Markets

The 2023 Intergovernmental Panel on Climate Change (IPCC) Synthesis Report painted a dire picture for the future of our planet.[6] From 2011 to 2020, global surface temperature was 1.1°C above pre-industrial levels, which has led to "weather and climate extremes in every region across the globe."[7] The report finds that current emissions trends "make it likely that warming will exceed 1.5°C during the 21st century and make it harder to limit warming below 2°C."

Every feasible pathway forward to meet the Paris Agreement's goal of holding "the increase in the global average temperature to well below 2°C above pre-industrial levels" involves not only the innovation and implementation of green technologies and carbon-free systems, but also scaling strategies and incentives to remove or reduce greenhouse gases (GHGs), particularly in hard-to-abate sectors such as cement, steel, and petrochemicals. The creation and expansion of voluntary and compliance carbon markets will need to accompany developments such as the rapid commercialization of electric vehicles and renewable energy.

Compliance markets are government regulated GHG emissions reduction regimes where firms are allocated annual emissions allowances; like cap-and-trade schemes such as the Regional Greenhouse Gas Initiative. Voluntary markets are entirely self-governed, with buyers typically being private sector companies seeking to meet their sustainability targets and drive down GHG emissions. Moreover, compliance and voluntary markets are not mutually exclusive, with some compliance schemes allowing for a limited use of VCCs.

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[6] IPCC_AR6_SYR_SPM.pdf
[7] Id. at 5

Voluntary markets will play an outsized role in the United States, where there is little political will to implement a compliance market at the national level and where companies are facing increased pressure from shareholders and employees to reduce their carbon footprint, ideally to zero. At COP26 in Glasgow, numerous countries and companies made net-zero pledges that can only be met through significant use of VCCs. McKinsey noted that a net-zero commitment "has become an organizing principle for business" but that these commitments "are running ahead of companies' own plans to meet them."[8] Notably, over 300 companies signed onto the Climate Pledge in March 2022, pledging to "neutralize any remaining emissions" with carbon offsets to reach carbon neutrality by 2040, among other goals.[9]

Public and private net-zero commitments have supercharged growth in VCC markets. Prior to the launch of the UN's Clean Development Mechanism in 2006, the VCC market had roughly $300 million in cumulative sales.[10] At the end of 2022, the market had grown to just under $2 billion. The Boston Consulting Group and Shell Group project VCC purchases could reach $10-$40 billion by 2030[11], while Morgan Stanley expects the market to reach $250 billion by 2050.[12]

Growing demand for VCCs may lead to price volatility, which in turn may increase demand for VCC derivatives as a hedging instrument. Buying compliance allowances or carbon credits and then hedging through forward, future, option, or swap contracts can reduce a firm's financial exposure to risks embedded in changes in carbon prices. Given that many market participants, including the World Bank, expect offset prices to increase in the future, VCC derivatives can also potentially help companies meet their net-zero commitments by securing future VCC delivery at a lower cost. Derivatives can also help foster trust in the carbon market and provide price signals on the quality of underlying assets, thereby facilitating the growth of sustainable investments.[13]

The CME and Nodal Exchange, CFTC-registered derivatives exchanges, listed voluntary carbon offset derivatives contracts in 2021 and 2022 respectively.[14] And as of November 2023, DCMs submitted eighteen futures contracts on voluntary carbon market products to the Commission for

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[8] What COP26 means for business | McKinsey

[9] Leading the Charge on Climate Change. The Climate Pledge. https://www.theclimatepledge.com/us/en/History

[10] Ecosystem Marketplace, "Today's VCM, Explained in Three Figures," August 2022

[11] Anders Porsborg-Smith et al., "The Voluntary Carbon Market Is Thriving," Boston Consulting Group and Shell Group, January 19, 2023, available at https://www.bcg.com/publications/2023/why-the-voluntary-carbon-market-is-thriving

[12] Morgan Stanley. 2023. "Where the Carbon Market is Poised to Surge." https://www.morganstanley.com/ideas/carbon-offset-market-growth

[13] *Derivatives in Sustainable Finance*. Centre for European Policy Studies and the European Capital Markets Institute. www.isda.org/a/ KOmTE/Derivatives-in-Sustainable-Finance.pdf

[14] IOSCO, CR06/2023 Voluntary Carbon Markets, available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf

listing.[15] However, as the Commission's proposed guidance notes, only three of these contracts currently have open interest, which implies that demand for VCC derivatives products remains limited. Thus, now is a perfect time for the CFTC to exercise its regulatory authority to address the well-known problems with VCCs.

Problems with Voluntary Carbon Credits

A quality credit should have the following characteristics:[16]

1. *Additionality*: The GHG removals or reductions from the project would otherwise not have occurred, absent the profit incentives provided by the sale of carbon credits.
2. *Permanence*: The GHG removals and reductions should be permanent and prevent risks of leakage, to the best extent of their ability.[17]
3. *Exclusive Claim*: The GHG removals or reductions should only be counted once and retired afterwards. They should not be double issued, double claimed, or double used.
4. *Measurable*: The GHG removals or reductions should be robustly quantified through conservative, science-based accounting principles.

Carbon credits often fail to meet these high-quality thresholds. Nearly half of all credits issued are nature-based credits, which are usually created through conservation of land in strategic locations.[18] These include projects for improved forest management (e.g., protecting or restoring lands that have been logged), afforestation, reforestation, and revegetation (e.g., planting trees to remove CO_2), and regenerative agriculture (e.g., using agricultural practices like cover crops and crop rotation to sequester carbon in soil). Nature-based solutions, and their associated credits, have attracted the interest of large financial institutions. In 2023, J.P. Morgan Asset Management purchases $500 million of timberland in the American southeast to use for wood production and carbon capture (i.e., carbon credits).[19] And in 2022, a subsidiary of T. Rowe Price Group led a consortium to pay about $1.8 billion for 1.7 million acres of forest "to maximize how much carbon is stored in the standing trees."[20]

Unfortunately, many forest-based offsets fail to meet the necessary characteristics noted above, and there have been several high-profile scandals involving these credit projects. In one case, corporations bought offsets for the Hawk Mountain Sanctuary near Philadelphia, which

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[15] "Statement of Commissioner Kristin Johnson: Commission Guidance Regarding Listing of Voluntary Carbon Credit Derivative Contracts."
[16] ICVCM. *The Core Carbon Principles*.
[17] Carbon leakage occurs when an offset project may increase emissions elsewhere. For example, conservation projects in one region could incentivize accelerated deforestation in other regions.
[18] Lawrence, Dee. *Forbes*. "High-Quality Nature-Based Carbon Credits: What You Need to Know." September 30, 2022. https://www.forbes.com/sites/forbesnonprofitcouncil/2022/09/30/high-quality-nature-based-carbon-credits-what-you-need-to-know/?sh=3c025abf4e86
[19] J.P. Morgan Asset Management Adds $500 Million of Southern Timberland - WSJ
[20] Wall Street Firm Makes a $1.8 Billion Bet on Forest Carbon Offsets - WSJ

contained 2,380 acres of forested land that sequestered a purported 1.5 million tons of CO_2. The punchline came when Bloomberg reported that this land had remained untouched for 85 years and was never in danger of deforestation.[21] In another example, a 2019 ProPublica study used satellite imagery to find that "protected" forest lands continued to be logged in Cambodia despite the fact that the project developer had sold 48,000 credits on the promise of conservation.[22] Other types of credits, such as pure removal projects, are scarce, expensive, and have a high risk of leakage or permanence issues, given the current state of carbon capture, utilization, and storage (CCUS) technology.

The growing realization that the "large majority" of carbon credits are "not real or are over-credit or both" has led to a systematic rethink of their role in net-zero commitments.[23] In 2021, the Science Based Targets initiative (SBTi), which assists companies in setting emission reduction targets in line with climate science, admitted that "[n]et-zero targets are mostly greenwash" that focus on "offsets instead of reducing emissions."[24] SBTi's Corporate Net-Zero Standard, released in 2023, prohibited the use of carbon credits in meeting companies' near-term or long-term emissions reductions targets.

In addition to the lack of quality assurances, voluntary carbon markets are opaque and disaggregated. There is a real information cost to consumers due to a lack of transparency and standardization. Different standard-setters (and registries) have different criteria, protocols, and categorization for carbon credits and are entirely self-regulated. These standard-setters each assert their model is best in class, without disclosing baseline due diligence requirements. Thus, it is extremely difficult to compare credits across registries.

Not only do different standard-setters have different verification criteria (e.g., the Gold Standard emphasizes alignment with the UN Sustainable Development Goals whereas Verra does not), but they also have different measurement and accounting processes. The lack of transparency and standardization can result in incredible market failures. In one case, a Guardian investigation found that more than 90% of rainforest credits listed on Verra were in fact phantom credits, with threats to forests overstated by 400% on average.[25]

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[21] JPMorgan, Disney, Blackrock Buy Nature Conservancy's Useless Carbon Offsets (bloomberg.com)

[22] Song, Lisa and Moura, Paula. *ProPublica*. "An Even More Inconvenient Truth: What Carbon Credits for Forest Preservation May Be Worse Than Nothing." May 22, 2019. https://features.propublica.org/brazil-carbon-offsets/inconvenient-truth-carbon-credits-dont-work-deforestation-redd-acre-cambodia/

[23] OffsetPaper7.0-6-27-23-FINAL2.pdf (bpb-us-w2.wpmucdn.com)

[24] Tom Dowdall, "Science-Based Net-Zero Targets: 'Less Net, more Zero'," Science Based Targets initiative (SBTi), October 7, 2021.

[25] Greenfield, Patrick. *Guardian*. "Revealed: more than 90% of rainforest carbon offsets by biggest certifier are worthless, analysis shows." January 18, 2023. https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe

Carbon Credits Defy the Definition of Commodity

The problems highlight above point to an essential fact – VCCs are fundamentally different than other physical commodities. As Dr. Joseph Romm noted, VCCs are "a hypothetical reduction of a real a commodity—essentially a negative commodity, a theoretical cut in CO2 emissions."[26] This is different than other commodities, "since buying a positive number of real items is completely different than buying a negative number of hypothetical ones."[27] This distinction creates perverse incentives in the VCC market, where both buyers and sellers have an incentive to ignore fundamental problems in any given VCC project – the buyer wants to offset their own emissions while the seller wants to generate revenue. Contrast this dynamic with real commodities, where the "buyer is motivated to ensure the quantity and quality, even if the seller is not."[28]

VCCs also "challenge the fundamental characteristic of commodities, which is that they are fungible."[29] For instance, "one bushel of No. 2 yellow corn is the same as any other bushel, it does not matter where the corn is grown, and each bushel is worth the same amount, subject to adjustments for factors such as transport distance to the county or terminal elevators, and conformity of the delivered corn with the specifications of the contract with the grain elevator."[30] In theory, each VCC is supposed to represent one ton of CO2e reduced, removed, or avoided. Therefore, VCC prices, regardless of project type, should be the same. However, the market doesn't see it that way. As IOSCO noted in their December 2023 consultation report on voluntary carbon markets, "the pricing of carbon credits varies widely according to the type of project (e.g., renewable energy vs. forestry)."[31]

Ecosystem Marketplace's most recent "State of the Voluntary Carbon Markets" report, released in November 2023, displays VCC prices by project type.[32] Credits generated from Forestry and Land Use projects, the largest project category by credit volume, averaged $10.14 in 2022, whereas credits generated from Renewable Energy projects averaged $4.16 in 2022. Ecosystem Marketplace also notes that "newer credits are attracting higher prices, indicating that buyers are seeking newer vintages with more robust recent methodologies, or are paying more for credits that align with their current emissions years as much as possible."[33] Market data clearly demonstrates that VCC end-users are increasingly discerning between high-quality and low-

[26] OffsetPaper7.0-6-27-23-FINAL2.pdf (bpb-us-w2.wpmucdn.com) at 13
[27] Id.
[28] Id
[29] Comments to the Commodity Futures Trading Commission on the proposed creation of a carbon markets subcommittee of the Energy and Environmental Markets Advisory Committee – The FinReg Blog (duke.edu)
[30] Id.
[31] *CR06/2023 Voluntary Carbon Markets (iosco.org)
[32] 2023 State of the Voluntary Carbon Markets Report - Ecosystem Marketplace
[33] Id.at 6

quality credits, which provides a conundrum for the CFTC when deciding whether, and how, to deploy their anti-fraud and anti-manipulation authority in this market.

Without a spot market regulator, the VCC market will remain fragmented, and credits will continue to lack scientific integrity. A lack of regulation also contributes to price opacity; it is extremely difficult for retail investors to access real-time prices for offsets across all registries. As a result, "it will be difficult to determine whether price discovery in offset futures trading converges with the cash price for offset credits underlying the futures contract as that contract nears its expiration date."[34] As Lee Reiners, John Kostyack, and Dr. Steve Suppan noted, "a futures contract without price convergence benefits only speculators and the exchanges receiving trading and data fees."[35]

Overview of the CFTC's Authority

While the CFTC does not have authority to regulate commodity spot markets, the Commission maintains general anti-fraud and manipulation enforcement authority over VCC cash markets as a commodity in interstate commerce. The question then becomes: What constitutes fraud and manipulation in VCC markets? To its credit, the CFTC partially answered this question in June 2023, when the Whistleblower Office issued an alert notifying the public on how to identify and report potential CEA violations connected to fraud or manipulation in the carbon markets.[36] The alert singled out the following types of misconduct:

- Manipulative and wash trading or other violations of the CEA in CM futures contracts.
- Fraud in the underlying spot markets related to ghost (a/k/a illusory) credits listed on carbon market registries.
- Double counting or other fraud related to carbon credits.
- Fraudulent statements relating to material terms of the carbon credit, including, but not limited to: quality, quantity, additionality, project type, methodology substantiating the emissions claim, environmental benefits, the permanence or duration, or the buffer pool.
- Manipulation of tokenized carbon markets

Also in June 2023, the CFTC's Division of Enforcement announced the creation of an Environmental Fraud Task Force to combat environmental fraud and misconduct in VCC spot and derivatives markets.[37]

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[34] Comments to the Commodity Futures Trading Commission on the proposed creation of a carbon markets subcommittee of the Energy and Environmental Markets Advisory Committee – The FinReg Blog (duke.edu)
[35] Id.
[36] See CFTC Whistleblower Alert, available at: https://www.whistleblower.gov/sites/whistleblower/files/2023-06/06.20.23%20Carbon%20Markets%20WBO%20Alert.pdf
[37] See CFTC Release Number 8736–23 (''CFTC Division of Enforcement Creates Two New Task Forces'') available at: https://www.cftc.gov/ PressRoom/PressReleases/8736-23

While these are important initiatives, the CFTC must do more to clarify the types of actions and outcomes that constitute fraud and manipulation in VCC markets. Given the widespread and well-known problems with VCCs, you could argue that the entire market is fraudulent. For instance, a 2022 New Scientist article explained that "California's carbon offsetting may actually be increasing emissions"[38] and a 2019 study by Dr. Barbara Haya found most credits offered by California for forest preservation "likely do not represent true emissions reductions due to the protocol's use of lenient leakage accounting methods."[39] Similar studies and stories have become all too common, eroding the VCC market's credibility, as well as the credibility of companies that rely on VCCs to meet net-zero commitments. In 2022, Yale professor Robert Mendelsohn, told Bloomberg that "there's a distinct possibility that a great deal of existing carbon offsets are effectively fake."[40]

The Proposed Guidance Comes Up Short

If the Commission is unwilling to say that the entire VCC market rests on a foundation of fraud – and therefore VCCs cannot be the underlying in ANY derivatives contract – it needs to specify which VCCs will be permitted as the underlying asset in derivatives contracts. Unfortunately, the proposed guidance falls short in this regard, and amounts to nothing more than a handful of recommendations for DCMs to consider when listing VCC derivatives contracts. The guidance rightly focuses on the need to ensure that DCMs seeking to list VCC derivatives contracts adhere to DCM Core Principle 3, which requires DCMs to list for trading derivative contracts that are not readily susceptible to manipulation.[41] But rather than clarify how a commodity rife with fraud can somehow serve as the underlying in a derivatives contract that can't be manipulated, the Commission simply points to Appendix C to Part 38 of the Commission's regulations, which "outlines certain relevant considerations for a DCM when developing derivative contract terms and conditions, and providing supporting documentation and data in connection with the submission of the derivative contract to the Commission."[42] Accordingly, the guidance encourages DCMs to list and describe the unique "characteristics" of VCCs in contract terms and conditions. These characteristics include: the crediting program; the type of project; the crediting program's procedures for assessing additionality, the risk of reversal, and measures to prevent

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[38] Lois Parshley, "California's carbon offsetting may actually be increasing emissions," New Scientist, December 22, 2022, https://www.newscientist.com/article/2352926-californias-carbon-offsetting-may-actually-be-increasing-emissions/

[39] Barbara Haya, "The California Air Resources Board's US Forest offset protocol underestimates leakage," UC Berkeley Technical Report, May 2019, https://www.researchgate.net/publication/342509462_The_California_Air_Resources_Board%27s_US_Forest_offset_protocol_underestimates_leakage

[40] Ben Elgin, "This Timber Company Sold Millions of Dollars of Useless Carbon Offsets," Bloomberg, March 17, 2022.

[41] CEA section 5(d)(3), 7 U.S.C. 7(d)(3).

[42] See Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 at 36632 (June 19, 2012).

doubly counting; and information on the registry used to track ownership and retirement of the underlying VCC.

Asking DCMs to disclose more information about the VCCs underlying listed derivatives contracts will have no impact on VCC quality and standardization and will do little to prevent fraud and manipulation in VCC derivatives. Thankfully, there is a cost-effective, market driven solution that the CFTC can leverage.

Our Recommendation

The Integrity Council for the Voluntary Carbon Markets (ICVCM) is an independent governance body for the voluntary carbon market made up of representatives from sustainable finance, NGOs, science and academia, the corporate sector, local communities, and indigenous peoples. In March of 2023, the ICVCM released the Core Carbon Principles (CCP) to serve as a global benchmark for high-integrity carbon credits. In July 2023, ICVCM published full criteria for assessing categories of carbon credits and crediting methodologies.[43] We recommend that the CFTC require DCMs to use CCP-eligible credits in VCC derivatives.

Leveraging the CCPs for regulatory purposes has several advantages. First, as Commissioner Goldsmith Romero noted in her statement of support for the proposed guidance, the guidance "adapts terminology, concepts and standards from the ICVCM's Core Carbon Principles and its recently issued Assessment Framework."[44] Thus, the Commission is already familiar with the CCPs and receptive to mandating their use by DCMs.

Second, the CCPs are compatible with existing market structure. To be CCP-eligible, a crediting program "would need to voluntarily submit to an assessment by ICVCM, and meet the requirements established by the ICVCM."[45] These requirements apply to both the crediting program and project categories. At the program level, "the CCPs identify principles around effective governance, tracking, transparency and robust independent third-party MRV [measurement, reporting, and third-party verification]."[46] At the category level, "CCPs require that the GHG emission reductions or removals from the mitigation activity are additional and permanent."[47] Crediting programs and registries would still be able to create and list non-CCP-compliant credits, and companies would still be able to purchase them. However, these non-compliant credits could not serve as the underlying asset in a derivatives contract.

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[43] Global benchmark for high-integrity carbon credits aims to mobilize climate finance at speed and scale - ICVCM (July 27, 2023), https://icvcm.org/global-benchmark-for-high-integrity-carbon-credits-aims-tomobilize-climate-finance-at-speed-and-scale

[44] Statement of Commissioner Christy Goldsmith Romero on Exchange Listing Standards for Voluntary Carbon Credit Derivative Contracts | CFTC

[45] IOSCO at 56

[46] Id

[47] Id

Potential Costs

As with any type of regulation, there will necessarily be compliance costs associated with developing a high-quality voluntary carbon market. In adopting the Core Carbon Principles, and adhering to its assessment framework and platform, originators of carbon credits will incur an additional cost of compliance as well as third-party verification. These costs will likely be passed onto end-users of VCCs, raising average prices for carbon credits.

Additionally, relying on a standard developed by a third-party comes with legal risks. U*nited States Telecom Association v. Federal Communications Commission "*invalidated the Federal Communications Commission's (FCC) practice of delegating "impairment determinations"[48] to state communications commissions, which the agency deemed better positioned, as local regulators, to make more nuanced and granular assessments and decisions. In striking down this delegation, the U.S. Court of Appeals for the D.C. Circuit "distinguished between delegating decision-making authority to subordinate agencies and delegating decision-making authority to outside parties."[49] Thus, it is possible that a court could find that the use of the CCPs amounts to the CFTC delegating decision-making to the ICVCM, and the rule gets struck down.

Finally, mandating the use of the CCPs may restrict the number of VCCs that can be used as underlying assets for derivative contracts, which in turn could decrease the overall supply of VCCs. In the short term, this may mean that companies cannot meet their net-zero commitments. This may also create more opportunity for manipulation of VCC prices, and by association, any related derivative contracts.

These compliance costs are lower than reputational costs to firms that had intended to use carbon credits to reduce their carbon footprint but instead purchased faulty credits and was accused of greenwashing. For example, Shell came under intense media scrutiny for greenwashing after an investigation revealed questionable accounting practices for their VCC projects.[50] In another case, a Bloomberg report accused Credit Suisse, Delta, Volkswagen, and a number of other large

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[48] See *United States Telecom Association v. Federal Communications Commission*, 359 F.3d 554, 566 (D.C. Cir. 2004), available at https://casetext.com/case/united-states-telecom-assn-v-fcc.

[49] Bruce, Dylan, Gellasch, Tyler, and Phillips, Todd. "The SEC Should Write Its Own Environmental, Social, and Governance Rules." The Center for American Progress. December 13, 2021. https://www.americanprogress.org/article/the-sec-should-write-its-own-environmental-social-and-governance-rules/#:~:text=The%20SEC%20is%20not%20legally,in%20how%20it%20does%20so.

[50] Cvililini, Matteo. "Revealed: How Shell cashed in on dubious carbon offsets from Chinese rice paddies." *Climate Home News*. March 28, 2023. https://www.climatechangenews.com/2023/03/28/revealed-how-shell-cashed-in-on-dubious-carbon-offsets-from-chinese-rice-paddies/

companies of buying "junk credits to cheaply attain carbon neutrality status."[51] Most companies purchasing carbon credits have a genuine desire to reduce their carbon footprint. A report last year from Ecosystem Marketplace found that the median VCC buyer "is investing 3X more in emission reduction efforts within their value chain" and that VCC buyers are "3.4X more likely to have an approved science based climate target" compared to non-buyers.[52] Requiring the use of the CCPs in VCC derivatives contracts will send a powerful signal to the market and assist companies that want to buy high-quality credits but don't have the resources or expertise to examine every credit project. Companies will think: "If it's good enough for the CFTC, it's good enough for me."

The performance of voluntary markets is critical to mitigating climate-related financial risk. While planting trees or removing carbon may seem like low-impact activities from a systemic risk standpoint, they are instrumental in delaying the worst effects of climate change. If registries continue to over-credit projects and credit quality fails to improve, GHG emissions could actually EXCEED what they would have been absent a VCC market. Higher emissions mean greater physical and transition risks, which could threaten global financial stability. Part of the CFTC's statutory mission is to avoid systemic risks, and mandating the use of high-quality credits in VCC derivatives contracts serves this mission.

Conclusion

The VCC derivatives contracts listed by DCMs have all come to market through the self-certification regime. Lee Reiners, John Kostyack, and Dr. Steve Suppan detailed the use of self-certification to list the first two VCC derivatives contracts in a previous comment letter to the CFTC:

> "Self-certification allows designated contract markets ("DCMs") to list any new contract for trading, and approve any new rule or amendment, by providing a written certification to the CFTC that the new contract, rule, or rule amendment, complies with the CEA and CFTC regulations. Unless the CFTC finds the new product or rule change violates the CEA or CFTC regulations, the DCM may list the new product no sooner than one full business day following the self-certification. In a major development in the carbon markets, CME Group took advantage of this tight turnaround and limited regulatory oversight by making their certification for Global Emission Offset ("GEO") futures effective Sunday, February 28, 2021 for trading on Monday March 1, 2021. On July 16,

[51] Rathi, Akshat, White, Natasha, and Pogkas, Demetrios. "Junk Carbon Offsets Are What Make These Big Companies Carbon Neutral." Bloomberg Green. November 21, 2022. https://www.bloomberg.com/graphics/2022-carbon-offsets-renewable-energy/

[52] Ecosystem Marketplace. "New research: Carbon credits are associated with businesses decarbonizing faster." October 10, 2023. https://www.ecosystemmarketplace.com/articles/new-research-carbon-credits-are-associated-with-businesses-decarbonizing-faster/

2021, CME self-certified N-GEO futures, which allow companies to buy and sell "nature-based" carbon offset derivatives."[53]

Lee Reiners has previously documented the troubling use of self-certification to list Bitcoin futures contracts in 2017, and we encourage the Commission to reconsider the use of self-certification to list novel derivatives products, like VCC derivatives contracts.[54] Requiring DCMs to submit proposed VCC derivatives contracts to the Commission for formal approval will give the Commission the opportunity to investigate whether the underlying asset serves its stated purpose of emissions reduced, avoided, or removed.

We also encourage the Commission to periodically revisit the ICVCM standards and ensure that they are continuing to adequately avert as much risk as possible within the market. The ICVCM does state that its guidelines are "living documents [that] will further evolve in the light of experience."[55] However, the CFTC must check their work. If the CCPs prove inadequate, alternative standards can be brought forth for consideration.

We welcome further engagement on these and other topics. Again, we are grateful for the opportunity to submit our ideas and look forward to a continued dialogue.

Respectfully submitted,

Lee Reiners and Susan Lin*

[53] Comments to the Commodity Futures Trading Commission on the proposed creation of a carbon markets subcommittee of the Energy and Environmental Markets Advisory Committee – The FinReg Blog (duke.edu)
[54] Lee Reiners, *Bitcoin Futures: From Self-Certification to Systemic Risk*, 23 N.C. Banking Inst. 61 (2019). Available at: https://scholarship.law.unc.edu/ncbi/vol23/iss1/8
[55] "Part 6: Assessment Procedure." The Integrity Council for the Voluntary Carbon Market. https://icvcm.org/wp-content/uploads/2022/07/ICVCM-Public-Consultation-FINAL-Part-6.pdf

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