February 16, 2024

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
rule-comments@sec.gov

Re: 88 FR 89410, Request for Comment: Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts

Dear Secretary Kirkpatrick:

Thank you to the Commodity Future Trading Commission ("CFTC") for the opportunity to respond to the request for comment on voluntary carbon credit ("VCC") derivative contracts traded on a Designated Contract Market ("DCM".) As members of the Sustainable Finance Initiative at Stanford University, we write in support of the CFTC's efforts to promote development of the Voluntary Carbon Market ("VCM") and VCC that align with effective policy and regulation to address climate change.

Collectively, we have decades of experience advising finance ministers, governors, chief investment officers, and executives in the asset management industry about climate risk and carbon accounting standards. Our book, *Settling Climate Accounts: Navigating the Road to Net Zero* investigates the rough edges of carbon accounting in practice and makes suggestions for the road ahead. Our subsequent work provides guidance toward a universal approach to carbon *accounting*, carbon *accountability* and carbon *markets* with direct applicability to VCM.

The current challenges of VCMs trace back to good intentions but weak foundations. Decades of climate activism and policy advocacy have brought carbon emissions attribution to the forefront. We cannot understate the success of these efforts. The fact that the CFTC is engaged in this comment exercise speaks to that success. However, emissions attribution efforts have diverged from emissions accounting. This is not a problem unique to VCMs but extends to all corners of climate change mitigation activities: from net zero targets and pledges based on complex disclosure estimates, to compliance and voluntary markets developed from ambiguous accounting approaches that too often confuse assets and liabilities. As a result, rather than providing pathways to reduce atmospheric CO_2, VCMs—in their current state—are a surefire road to ineffective financial transactions by which emitters invest in projects that carry a high risk of furthering harm to the atmosphere. The CFTC must ensure that, as futures markets expand product sophistication and variation, oversight and regulation will maximize climate impact and minimize fraud, deception, and manipulation.

1. Each of the signatories to this comment have also signed the comment letter submitted by the E-Liability Institute ("ELI Comment".) We include those comments by reference and expand on some issues here.

2. The ELI Comment describes an approach to GHG emissions accounting that defines liabilities for an emitter ("E-liabilities") based on the 2021 HBR article *Accounting for Climate Change*. This method accumulates embodied supply chain emissions following cost accounting methods. E-liabilities offer an auditable, mutually exclusive, and comprehensively exhaustive allocation of atmospheric emissions to the party creating the emissions. E-liabilities then may pass with products or services to customers. By directly passing E-liabilities from supplier to customer, E-liabilities provide accuracy and simplicity in emissions accounting.

3. In *What's Next After Carbon Accounting?* we propose an *accountability* system for GHG emissions, emissions liability management, that supposes an emitter must defease E-liabilities through ownership of a carbon removal or E-asset. Like financial solvency, emissions liability management requires a firm hold E-assets that meet or exceed E-liabilities, thus netting their liabilities to zero.

4. Under this approach to accountability, avoidance remains essential because E-asset costs likely exceed supply-chain emissions reduction costs in the near term. VCMs might choose to trade avoidance offsets, but they would neither help a buyer reach net zero, nor defease E-liabilities.

5. The ELI Letter then details the five principles for E-asset accounting from the August 2023 HBR article *Accounting for Carbon Offsets*. Each principle is essential to effective markets; however we want to highlight one assumption (bilateral agreements) and one definition (indefinite sequestration) from these principles relevant to futures markets.

6. *Accounting for Carbon Assets* assumes that "[t]he principles are grounded in the core bilateral agreement between an offset producer and a purchaser, because even if markets function through layers of intermediaries, they exist to connect the offset producers with purchasers." The current VCM practice involves layers of intermediaries and service providers, but it is not clear that producers and purchasers exchange dollars for ownership of anything other than certificates that might point to carbon. The certificates do not represent title or rights to carbon. Traditional bilateral transactions might overcome this market failure. We recommend any DCM authorized by the CFTC provide clear guidance to regulators and participants exactly which underlying ownership rights move between buyers and sellers, with a pathway to actual exchange of rights to E-assets.

7. *Accounting for Carbon Assets* Principle 3 requires that an E-asset sequesters carbon *indefinitely*. In *What's Next After Carbon Accounting?* we suggest that given E-liability accounting and emissions liability management, E-assets would serve as both the asset to defease E-liabilities, and a reference asset for carbon removal trading. Few carbon removal assets meet the *indefinite* standard. For example, removals with substantial impairment risk, like forestry, would trade at a discount to the reference E-asset. A futures market participant would call this a form of basis risk.

8. DCMs might choose to relax this "indefinite" criterion. We recommend that the CFTC require any DCM allowing *definite* term removals provide clear guidance to regulators and market participants of: (a) a constraint such that the term may not decrease, and (b) a pathway to extend the term to indefinite. Finally, the notion of "retirement" of removal assets, particularly when

definite term, should not be allowed. Retirement is inconsistent with the notions of persistent E-liabilities or of ongoing solvency obligations.

9. Absent the DCM guidance we suggest, VCM trades will not effectively progress from trading experiments mostly benefiting traders and intermediaries to a viable market to remove carbon from the atmosphere.

In summary, we support CFTC efforts to allow experimentation by DCMs. However, market participants in such DCMs must understand the experimental nature of most transactions. CFTC should ensure that as futures markets expand in product sophistication and variation, oversight and regulation will minimize fraud, deception, and manipulation. We would gladly assist the CFTC as it develops effective oversight of carbon markets.

Sincerely,

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