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February 16, 2024

The Honorable Rostin Behnam, Chair
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Via Electronic Filing

Re: Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts RIN 3038-AF40

Dear Chair Behnam,

The Center for American Progress (CAP) is pleased to submit these comments regarding the Commodity Futures Trading Commission's ("CFTC" or "Commission") proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts.[1]

CAP is an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, strong leadership, and concerted action.

When CAP first started examining voluntary carbon credit (VCC) markets over 15 years ago, we were concerned that the claimed benefits might never fully materialize and that the markets could prove to waste both time and money needed to address climate change.[2]

Similarly, nearly 14 years ago when Congress tasked the Commission with leading an interagency working group with studying "the oversight of existing and prospective carbon markets to ensure an efficient, secure, and transparent carbon market,

[1] Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment, CFTC, 88 Fed.Reg. 89410 (Dec 27, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-12-27/pdf/2023-28532.pdf ("Proposal" or "Proposed Guidance").
[2] David J. Hayes, "Getting Credit for Going Green," Center for American Progress, March 2008, available at https://www.americanprogress.org/article/getting-credit-for-going-green/.

including oversight of spot markets and derivatives markets,"[3] members of that working group, representing eight federal agencies, were concerned that perceived benefits of pursuing carbon market approaches were dependent upon their efficacy at actually reducing carbon, and that the appropriate oversight regime depended on "if or when Congress considers Federal market-based options for reducing GHG emissions."[4]

Unfortunately, in the years since, as the voluntary carbon credit markets have grown, concerns have grown. The markets have proven to be rife with speculation, fraud, and misstatements,[5] even as the urgency of reducing global carbon emissions has significantly increased.[6]

While we appreciate the Commission's effort at trying to improve the integrity and efficacy of the markets, including through offering the Proposed Guidance, we believe that the unreliability of voluntary carbon credits constrains what the Commission can do in this proposal, mainly to enforcement efforts to address clear instances of fraud and manipulation. Further, we believe the Commission's proposal, as written, is beyond the agency's legal authority; inconsistent with the agency's obligations under the Commodity Exchange Act; and beyond the agency's substantive and procedural capabilities.

Moreover, as explained in this letter, the Commission's effective promotion of this deeply troubled market is inconsistent with the efforts of policy makers in the U.S. and around the world, advised by scientists, to reduce carbon emissions as quickly as possible in order to prevent the worst economic and human consequences of climate change. The Commission's approach would very likely undermine those efforts, by

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[3] Public Law 111-203, *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Section 750, July 21, 2010, available at https://www.govinfo.gov/content/pkg/STATUTE-124/pdf/STATUTE-124-Pg1376.pdf#page=732.

[4] *Report on the Oversight of Existing and Prospective Carbon Markets,* Interagency Working Group for the Study on Oversight of Carbon Markets, January 18, 2011, available at https://www.govinfo.gov/content/pkg/STATUTE-124/pdf/STATUTE-124-Pg1376.pdf#page=732https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfstudy_carbon_011811.pdf.

[5] See, e.g., Natasha White, "Carbon Offset Gatekeepers Are Failing to Stop Junk Credits," Bloomberg, March 21, 2023, available at https://www.bloomberg.com/news/articles/2023-03-21/top-carbon-offset-registries-are-failing-to-stop-junk-credits?sref=wINQCNXe; Patrick Greenfield, "Revealed: more than 90% of rainforest carbon offsets by biggest certifier are worthless, analysis shows," The Guardian, January 18, 2023, available at https://www.theguardian.com/environment/2023/jan/18/revealed-forest-carbon-offsets-biggest-provider-worthless-verra-aoe; and Debra Kahn, "Offsets' promise and peril," Politico, January 1, 2023, available at https://www.politico.com/newsletters/the-long-game/2023/01/20/offsets-promise-and-peril-00078763.

[6] See, e.g., *An IPCC Special Report: Global Warming of 1.5 degrees Centigrade,*ˆ UN IPCC, 2018, available at https://www.ipcc.ch/sr15/; and Press Release, "Climate Plans Remain Insufficient: More Ambitious Action Needed Now," United Nations Climate Change, October 26, 2022, available at https://unfccc.int/news/climate-plans-remain-insufficient-more-ambitious-action-needed-now.

facilitating and lending legitimacy to unreliable VCCs and derivatives based on them, rather than awaiting global consensus around whether and how VCCs can be appropriately deployed in the world's urgent climate emissions reduction challenge.

I. The extensive uncertainties surrounding voluntary carbon credits and their underlying projects limit what the Commission can do

A voluntary carbon credit is a financial product arising from the claimed output of a project that is neither easily, consistently, nor comparably "verified". As the Proposed Guidance notes:

> The process by which VCCs are issued deserves careful consideration, as that process informs VCC quality and, by extension, the overall integrity and effective functioning of voluntary carbon markets.[7]

Unlike other commodity derivatives traded under the Commission's jurisdiction, the very nature of the underlying VCC product being traded – indeed, its very existence -- is not certain at the time of trading.

For example, for corn futures contracts, the Designated Contract Market (DCM or exchange) provides the terms for the contract, including the terms of the product that is covered, the terms of the financial product (e.g., a futures contract), and the terms for how the financial product is traded. The CME Group Rulebook establishes that the corn subject to its "Corn Futures" contracts

> shall be for 5,000 bushels of No. 2 yellow corn at par, No. 1 yellow corn at 1½ cents per bushel over contract price, or No. 3 yellow corn at between 2 and 4 cents per bushel under contract price depending on broken corn and foreign material and damage grade factors. Every delivery of corn may be made up of the authorized grades for shipment from eligible regular facilities provided that no lot delivered shall contain less than 5,000 bushels of any one grade from any one shipping station.[8]

At any point in time, a holder of the title or warrant that forms the basis of a derivatives contract for a physical commodity may verify that the product subject to

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[7] Proposal at FR 89413.

[8] CME Group, Rulebook, Chapter 10: Corn Futures, available at https://www.cmegroup.com/content/dam/cmegroup/rulebook/CBOT/I/10.pdf (last viewed Jan. 16, 2023).

the derivatives contract objectively exists and meets the required specifications. While commodities subject to derivatives contract trading are typically rarely "used" by those who acquire their rights, the mere possibility of that use provides an important check on the integrity of the underlying markets and thus the derivatives contracts referencing them.

In other words, if one trades a corn futures contract, one knows that there will be a specific, objectively verifiable quantity and quality of corn. Moreover, separate "independent" verifiers would be unlikely to have a reasonable dispute, for example, that the quantity of corn provided meets the specifications. [9]

With voluntary carbon credits, by contrast, a project developer engages with a third-party "crediting program that, among other things, issues VCCs for mitigation projects or activities that satisfy the crediting program's standards; and… an independent third party [that] verifies and validates the mitigation project or activity."[10]

Crediting programs and verification methods vary materially, which leads to very different understandings of the underlying products that form the basis for the derivatives contract being traded. Due to differing scientific, policy, and business considerations, one verifier may certify that a project has savings of "X" tons of carbon dioxide equivalent, while another may certify that the savings from the same project are twice that amount, zero, or some other number.

While there are international efforts to attempt to "standardize" these different processes, the reality is that there is no consensus on how to achieve reliability. The result is that the purchaser of a VCC or a derivative thereof does not have any certainty as to the quantity or quality of the underlying asset today.

As explained in more detail below, these uncertainties surrounding the credits and their underlying projects cannot be resolved by the CFTC.

II. Voluntary carbon credits derivatives are fraught with misguided incentives and conflicts of interest

Contributing to these problems with the certainty of the VCCs themselves are the skewed incentives of the participants in these markets, which at times are likely

[9] Unfortunately, in part because the commodities are so rarely used, there are instances where the derivatives markets have been manipulated because the underlying commodities do not meet the specifications. For example, it was reported that the nickel held in a warehouse that was subject to derivatives contracts owned by JPMorgan Chase was, in fact, simply bags of rocks. Jack Farchy, Archie Hunter, and Mark Burton, JPMorgan Owned the LME 'Nickel' That Was Actually Bags of Stones, Bloomberg, March 20, 2023, available at https://www.bloomberg.com/news/articles/2023-03-20/jpmorgan-owned-the-lme-nickel-that-was-actually-bags-of-stones.

[10] Proposed Guidance, at 89413.

directed toward the creation and trading of low-quality credits and are materially different from those of the agency's traditional markets.

Managers of Designated Contract Markets have incentives to offer as many products for trading as reasonably possible, in order to increase their exchange's transaction and market data revenues. Thus, they will likely seek to have more credits available for trading.

Similarly, sellers of carbon credits are looking to obtain funds through the sale of the credits. In general, the more credits that they can generate for sale, the better for them. But VCCs are not subject to the physical constraints that impose limitations on corn, oil, or other physical commodities. There is no exchange-regulated "storage," for example. There is also not really "usage" of the credits, such as the use of metal for manufacturing. Sellers are highly incentivized to shop around for the most generous credit standard and verifier they can reasonably use. Some unscrupulous sellers may also succumb to the incentives and opportunities to double count their projects to generate additional VCCs.

Verifiers are also acutely sensitive to this race to the bottom for VCCs. Not surprisingly, there have been numerous instances of supposedly verified projects that were found either not to exist, or not to have generated the number of credits claimed.[11]

Of particular concern are the skewed incentives of the purchasers of VCCs. Again, unlike purchasers of physical commodities, for which there is the opportunity (or risk) of physical delivery and usage, purchasers of VCCs face no such risks.

Corporate purchasers seeking to offset their carbon usage are generally incentivized to care far more about the price of the VCCs or derivatives than about actual quantity and quality of the VCCs at the heart of the contracts, because, unlike metal or other physical commodities, there is zero actual usage of the underlying product. The buyer is not making cars with metal, for example. In fact, the VCC buyer might prefer proliferation of lower quality credits because it would increase supply and drive down the cost of claiming offsets for their actual emissions.

These unique market dynamics, which are qualitatively and quantitatively different from the other markets the Commission oversees, are almost entirely unaddressed in the Proposed Guidance.

[11] See, e.g., Natasha White, "Bogus Carbon Credits are a 'Pervasive' Problem, Scientists Warn," TIME, March 21, 2023, available at https://time.com/6264772/study-most-carbon-credits-are-bogus/.

III. The Proposed Guidance is beyond the Commission's legal authority.

While the Commodity Exchange Act grants the agency authority over commodity derivatives markets, the agency's authority over the commodity spot markets is extremely limited. Generally, the agency is limited to seeking to prevent fraud and manipulation that directly affect the derivatives markets.[12]

The Proposed Guidance appears to recognize some of the challenges to the integrity of the underlying market and attempts to reconcile them by proposing guidance related to the standards that DCMs could follow to list and trade derivatives contracts. While purporting to not approve a standard setter, it cites to a single standard setter several times in the proposal.[13]

However, the Commission offers little legal basis for directing DCMs to adopt such standards. Indeed, the Commission's authority is more directly tied to its disapproving products that would be inconsistent with the Core Principles (whether or not preceded by a DCM self-certifying otherwise).

By analogy, it is as if the Commission were requiring DCMs to only list contracts for trading oil futures if the contracts entitle the holder to oil at specific, CFTC-blessed facilities, or facilities that meet CFTC-outlined specifications. But the CFTC does not set facilities standards. The CFTC's power is limited to ensuring that the financial products it regulates are not subject to manipulation or fraud or otherwise inconsistent with the Core Principles.

There is also a significant question about whether many of these initial sales of VCCs are, in fact, unregistered offerings of securities. While a carbon credit, once created, may ostensibly be fungible, the manner in which many carbon credits are created calls into question the veracity and integrity of the entire market.

VCCs are often derived from investors offering funds to a business enterprise that promises to engage in work that is intended to generate some measurable carbon savings that have monetary value in a market. In other words, sellers of carbon credits are representing that the buyer will profit from the purchase based on the effort of someone else—the definition of a security.[14] Given those elements, many of these credits may be appropriately and legally classified as securities.

This issue also is not addressed in the Proposed Guidance.

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[12] 7 U.S. Code Section 2(a)(1)(A), available at https://www.law.cornell.edu/uscode/text/7/2.
[13] See, e.g., 88 FR 89412, footnotes 35 and 36; 89414, footnote 46; 89427-89428, Appendix 4.
[14] *SEC v. W.J. Howey Co.,* 328 U.S. 293 (1946), available at https://supreme.justia.com/cases/federal/us/328/293/#:~:text=SEC%20v.-,W.J.,%2C%20328%20U.S.%20293%20(1946).

IV. The proposal is inconsistent with the agency's obligations under the Commodity Exchange Act

Consistent with its general regulatory approach with respect to other commodities, the CFTC's Proposed Guidance would effectively allow DCMs to self-certify the contracts for listing of voluntary carbon credit derivatives contracts, and then offers guidance for very general parameters that are specific to voluntary carbon credit derivative contracts and the underlying projects from which the credits are derived.

At a basic level, the characteristics of the assets underlying any derivative contract must be certain and verifiable in order to be fungible enough to ensure that the trading of those contracts will be consistent with the Core Principles.

That may exist in the physical commodities markets. That simply cannot currently occur in VCC markets.

The proposed guidance would effectively ignore the distinctions from its other regulated markets, and permit DCMs to self-certify that their contracts comply with the Commodities Exchange Act (CEA), even though the DCMs lack any climate expertise or knowledge of the underlying projects, which determine whether the credits are fraudulent or not. Worse, as mentioned above, DCMs are highly incentivized to have generally low-quality verification procedures and practices because that may promote more credit availability and trading on their markets. And, while that incentive is counteracted in the physical commodities markets by the risk of physical delivery, there simply is not an equivalent countervailing force in the VCC derivatives markets. Compounding this problem, the Proposed Guidance would allow DCMs to rely on accrediting organizations that are self-regulatory, as well. This is both a recipe for disaster and facially inconsistent with the CEA itself.

While the CFTC cannot delegate a standard setter for voluntary carbon offsets, it cannot regulate derivatives based on those offsets without the ability to verify the credits. And while DCMs may be capable of establishing protocols for the verification of the quantity and quality of metal underpinning a futures contract, the variability of the "offset" calculation and integrity of carbon credits precludes them from being able to reasonably and reliably perform that function here.

Again, the commodities markets depend upon being able to reasonably measure quantity and quality of the products being referenced. The CFTC's role is limited to overseeing the trading of derivatives contracts, and the characteristics of the assets underlying any derivative must be certain and verifiable in order to be fungible enough to ensure that the trading of those contracts will be consistent with the Core Principles. Investors or companies need to know what they are buying with limited due diligence and verification. They depend upon others to fulfill those tasks. For corn, this happens on physical inspection at the time of delivery.

The CFTC has taken this principle—that derivatives must be based on certain and verifiable factors—as a reason to significantly expand its oversight to guidance on how carbon credits should be verified, and it does so by essentially deferring to exchanges' judgment about how underlying VCCs must be verified and about other aspects of VCC derivative product design and listing. It also rationalizes that it must do this in order to carry out its mission to monitor fraud and manipulation in the spot markets.

And yet, the DCMs are incapable of and lack sufficient incentives to perform this task sufficiently to permit the products to be appropriately standardized, reliable, and fungible to comply with the Core Principles.

The CFTC could not reasonably permit trading in a corn futures contract that claimed that it was for 5 bushels of corn but in reality *might* not include any corn, because that contract would be facially materially misleading, subject to manipulation, and inconsistent with the CEA. Similarly, the agency cannot reasonably permit trading in VCC derivatives.

V. The proposal is beyond the agency's substantive and procedural capabilities.

The CFTC has long had oversight for energy, metals, or other physical commodity trading markets. However, its oversight has proven ineffective. For example, there have been instances where brazen market manipulation lasted for years, even decades, in both the spot and derivatives markets without CFTC intervention.[15]

With carbon credits, it is not just a question of determining whether the trading of the VCC derivatives can be manipulated but whether the asset that is the subject of the derivative contract is real in the first place.

As discussed above, virtually any commodity currently used in derivatives markets can be verified at the end of the derivative contract on which it is based either through physical inspection or a clearly identified fact, such as the physical quality of a bushel of corn or a published government interest rate. It is easy to determine the value. Moreover, at the end, some party has a strong incentive to ensure that what was promised is delivered.

But VCCs cannot be verified. Unlike with assets and indicators underlying those other derivatives, carbon projects underlying VCC derivatives cannot be linked to verifiable facts.

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[15] See, e.g., Abhishek Manikandan and Michelle Price, JPMorgan to pay $920 million for manipulating precious metals, treasury market, Reuters, September 29, 2020, available at https://www.reuters.com/article/idUSKBN26K321/.

To date, there is no consensus approach or methodology for creating credits that can be verified and no central registry for carbon credits to prevent double counting and improper use of credits beyond their expiration. Members of a UN-sponsored effort last year at the 28th Conference of the Parties (COP28) hoped to arrive at consensus on carbon credits for purposes of funding projects in developing countries, but the parties could not agree on the basics of how to create, verify, and monitor credits for this purpose.[16] The U.S. Treasury Department has said in its "Principles for Net Zero Financing and Investment" that it, along with other federal agencies, is actively engaging with relevant stakeholders, including international partners, on ways to assess and improve the quality of [VCC markets] and carbon credits…." But there is no national or global consensus on this.

Before carbon credits can form the basis for derivative contracts, there must be an independent, reliable, fact-based entity that verifies carbon emission reductions on a global basis.

VI. The approach in the Commission's proposal is inconsistent with the approach that Congress has chosen for reducing U.S. carbon emissions.

As the climate crisis worsens, it has become increasingly clear that voluntary carbon credits are not the answer to reducing carbon emissions. There is no consensus on whether carbon credits will truly result in verifiable, unique, additional, and permanent emissions reductions. More direct and reliable approaches are needed and are already being adopted by the U.S. and other nations.

The 2015 Paris Agreement set a goal of limiting global temperatures to well below 2 degrees Celsius above preindustrial levels to avoid dangerous climate impacts.[17] Recent scientific reports of accelerating climate change have added more urgency to the goal of reducing carbon emissions.[18] In 2018, the Intergovernmental Panel on Climate Change determined that climate impacts at temperatures above 1.5 degrees

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[16] Eklavya Gupte and Agamoni Ghosh, "COP28: Lack of progress on Article 6 likely to further limit carbon market growth," S&P Global, December 13, 2023, available at https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/oil/121323-cop28-lack-of-progress-on-article-6-likely-to-further-limit-carbon-market-growth#:~:text=The%20International%20Emissions%20Trading%20Association,%2C%20safeguards%2C%20and%20human%20rights.

[17] "The Paris Agreement," United Nations Climate Action website, available at https://www.un.org/en/climatechange/paris-agreement#:~:text=substantially%20reduce%20global%20greenhouse%20gas,and%20impacts%20of%20climate%20change (last accessed February 2024).

[18] Chris Mooney and Shannon Osaka, "Is climate change speeding up? Here's what the science says" The Washington Post, December 26, 2023, available at https://www.washingtonpost.com/climate-environment/2023/12/26/global-warming-accelerating-climate-change/.

were more serious than previously estimated,[19] making it imperative that the world strive to avoid exceeding that level. Meanwhile, the number of weather and climate disasters costing $1 billion or more continues to increase, with an average of 22 such events per year in the last three years, at a cost of $143 billion per year.[20] Accordingly, President Biden's Executive Order 14057 set a goal for the federal government to achieve net zero emissions economy-wide by 2050,[21] and Congress passed sweeping legislation to begin the development of essential clean-energy infrastructure and to incentivize businesses and individuals to make the transition to cleaner forms of energy.[22]

To meet the imperative of net zero emissions by 2050, every entity across the U.S. economy responsible for emissions must reduce their absolute carbon emissions as close as possible to zero as quickly as possible. This will require direct capital investments in U.S. carbon reduction and alternative forms of energy. Purchasing VCCs instead will only delay these essential investments and undermine the net zero emissions goal.[23] In addition to capital lost to the purchase of unreliable credits, fees flowing to voluntary carbon market intermediaries will make the energy transition even less efficient.

The need to reduce absolute emissions first and as much as possible has been recognized by leading experts. For example, the Science Based Targets initiative (SBTi), an organization that assists thousands of companies with carbon emission plans, only considers carbon credits to be an option for neutralizing residual emissions or to finance additional climate mitigation beyond their science-based emission reduction targets.[24] Avoided emissions do not count toward science-based targets.[25]

Historically, carbon credits arose out of decades-old cap and trade regimes. In those cap-and-trade regimes, a government places a cap on the overall and firm-specific emissions allowed. Firms that are unable to reduce their emissions enough to stay

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[19] *An IPCC Special Report: Global Warming of 1.5 degrees Centigrade,* ˆ UN IPCC, 2018, available at https://www.ipcc.ch/sr15/.

[20] Billion-Dollar Weather and Climate Disasters, National Centers for Environmental Information website, available at https://www.ncei.noaa.gov/access/billions/ (last accessed February 2024).

[21] Executive Order 14057: Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability, FedCenter.gov, available at https://www.fedcenter.gov/programs/eo14057/.

[22] Emma Newburger, "Biden's infrastructure bill includes $50 billion to fight climate change disasters," CNBC, November 15, 2021, available at https://www.cnbc.com/2021/11/15/biden-signs-infrastructure-bill-how-it-fights-climate-change.html; and H.R.5376 – Inflation Reduction Act of 2022, 117th Congress, available at https://www.congress.gov/bill/117th-congress/house-bill/5376.

[23] Joseph Romm, Ph.D., "Are carbon offsets unscalable, unjust, and unfixable—and a threat to the Paris Climate Agreement?" Penn Center for Science, Sustainability, and the Media, July 2023, available at https://bpb-us-w2.wpmucdn.com/web.sas.upenn.edu/dist/0/896/files/2023/06/OffsetPaper7.0-6-27-23-FINAL2.pdf.

[24] SBTi Criteria and Recommendations for Near-Term Targets, April 2023, p.10, available at https://sciencebasedtargets.org/resources/files/SBTi-criteria.pdf.

[25] Ibid.

below the cap can purchase credits (permits) from firms that are able to do so and have excess permissible emissions. A key factor is that the government involved oversees the creation and tracking of the credits and the underlying activities of firms that give rise to them.

VCCs are likely to continue inviting waste and fraud, because by definition they do not involve governments, do not have corresponding government emissions caps, and can be created anywhere in the world, making them nearly impossible to verify and monitor. One recent study found that the vast majority of voluntary carbon credits are not valid.[26]

Most importantly, because of decades-long and still-unresolved problems with voluntary carbon credits and the projects on which they are based, the voluntary carbon credit derivative products for which the CFTC proposes to provide guidance are highly unlikely to result directly or indirectly in the environmental benefits claimed by those who are selling them.

If the Commission's proposed guidance is finalized as written, it could provide a patina of legitimacy to these poorly-regulated, inconsistent, and fraud-laden products, which in turn could greatly expand the market.

At root, if the Commission were to take the steps proposed, a company or person could potentially reasonably claim -- based upon the plain language of the contracts themselves, and the Commission's guidance -- that their purchase of the derivative contracts was a credible offset to their actual carbon emissions.

However, given that we already know that a material percentage of the underlying projects do not generate the claimed carbon savings and those that do actually generate savings are often subject to double counting – such claims would be materially misleading. Put another way, the Commission's guidance related to the voluntary carbon credit derivatives could not just lead to even more inefficient use of capital, but also fraud.

Critically, the consequences of failure of the underlying assets to meet expectations extend far beyond the parties to the transaction—indeed, they could have global consequences. Those consequences extend far beyond any consequences contemplated by the failure of traditional commodities, and the CFTC is in no position to oversee or address those consequences. The CFTC—a very small government agency that lacks the capacity, expertise, authority, and funding for this purpose—

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

should not effectively provide a stamp of approval for these credits, either directly or especially indirectly by allowing exchanges to self-regulate around management of voluntary carbon credit derivative trading. This would only mislead the market, create confusion, and open the floodgates to greenwashing by companies and profit-taking by market intermediaries. The world cannot afford to experiment with this approach only to find that only a small percentage of the supposed carbon reductions were real and permanent, even as firms failed to take steps to reduce their absolute emissions or profited from trading these derivative instruments.

The fact that the CFTC has signaled by this proposal that it will police fraud and manipulation in the markets for voluntary carbon credit derivatives is appropriate. However, the way it proposes to proceed, as explained above, is not appropriate. The proposed guidance would likely lead to significant greenwashing and open the door to carbon credit projects run by parties that have little if any incentive to ensure that the carbon reductions are real, much less that the projects respect the rights and wellbeing of local communities. The resulting markets could diverge significantly from the processes and methodologies of internationally agreed upon carbon credit markets, should consensus on those be reached in the future.

VI. Recommendations:

In light of the above concerns, we strongly recommend that the CFTC revise its proposal as described below to avoid providing legitimacy to a market based on an asset that is fraught with problems.

- The CFTC should clearly outline the basis and extent of its legal authority to adopt this Proposed Guidance.
- Consistent with its obligations under the CEA to uphold the Core Principles, the CFTC should declare that VCC derivatives cannot be listed for trading because there is not a consistent, reliable, comprehensive and accurate way to ensure all like credits are, in fact, alike (or even real). Put simply, due to the issues surrounding the integrity of the spot markets, it is simply impossible for the spot markets to support derivatives markets that work as intended.
- If the CFTC chooses to continue permitting the listing and trading of VCC derivatives, it should ensure that the underlying VCCs are created, monitored, and maintained via a global consensus on the appropriate methodologies for creating voluntary carbon credits and establishing their permanence, as well as how to verify, register, and retire credits in a unified global system, such that there is no double counting. Otherwise, the most essential terms of the contract, the amount of carbon actually being removed, will not be sufficiently known to be a reliable market that is consistent with the Core Principles.
- The CFTC should aggressively pursue cases of obvious fraud and manipulation in VCC markets that have impacts on its derivatives markets, including for

contracts that have already been identified as being tied to credits that were awarded for fraudulent or erroneous reasons.

In sum, while we appreciate the CFTC's efforts to enhance the VCC markets, the Proposed Guidance is largely outside of its authority and expertise. The VCC derivatives products themselves are facially inconsistent with the Core Principles, and should be disapproved for listing and trading, as constructed.

For any questions regarding this comment letter, please contact Alexandra Thornton, Senior Director, Financial Regulation, at the Center for American Progress, athornton@americanprogress.org.

Sincerely,

Center for American Progress