Sylvera's comments on

# CFTC Request for Comment Regarding the Listing of Voluntary Carbon Credit Derivative Contracts

February 2024

Overview:
*Sylvera is fully supportive of the CFTC's ambitions to introduce guidance to ensure that climate integrity is at the core of any DCM-listed derivative. This is important to protecting well-intentioned purchasers of VCCs, building trust in derivatives and ensuring there is no inadvertent market for low-quality VCCs.*

1. In addition to the VCC commodity characteristics identified in this proposed guidance, are there other characteristics informing the integrity of carbon credits that are relevant to the listing of VCC derivative contracts? Are there VCC commodity characteristics identified in this proposed guidance that are not relevant to the listing of VCC derivative contracts, and if so, why not?

*The quality characteristics included are the core characteristics we would expect to see (and are aligned to the pillars of our ratings), and represent the minimum procedures that we would expect a crediting program to have in place or level of disclosure from a derivative contract.*

*We would also expect DCMs to be thinking about (i) leakage and appropriate baselines (whether within robust quantification or elsewhere), and (ii) FPIC / IPLC processes and status. We have seen accusations regarding improperly obtained consent and rights violations of IPLCs lead to several projects being suspended in recent months, with resultant impacts on pricing of the affected vintages. This is typically more of an issue for nature-based solutions than tech-based solutions.*

2. Are there standards for VCCs recognized by private sector or multilateral initiatives that a DCM should incorporate into the terms and conditions of a VCC derivative contract, to ensure the underlying VCCs meet or exceed certain attributes expected for a high-integrity carbon credit?

*To avoid perpetuating the current fragmentation and inefficiencies of the VCM, we would encourage market participants to stand behind the initiatives that so much thought and collaboration have already gone into.*

*We would suggest that DCMs are encouraged to rely upon standards such as the IC-VCM's CCPs where available and appropriate. That would serve to reduce the diligence burden on the DCMs, increase the trust in derivative contracts, and solidify the position of the emerging industry standards.*

*The ICAO has also done a lot of work to assess the robustness of different methodologies and standards as part of CORSIA Phase 1. Whilst that work is still ongoing and we expect the list of approved registries to grow, CORSIA-approved may become a relevant standard, especially for buyers in the airline industry. However, we would always stress that methodology-level assessments are not proxies for quality; quality can only be assessed at the project-level.*

*Depending on the nature of the derivative contract, ratings can also serve as reference characteristics for incorporating. Using ratings in derivative contracts overcomes a number of problems:*

- *Ratings are a spectrum and not a binary (like standards), meaning they better reflect risk and can better service contracting parties' interests (incl. as to pricing adjustments);*

- *Ratings are dynamic and therefore take into account different information at the delivery date and the contracting date (i.e., they ensure pre-contracting intentions remain achievable); and*

- *Ratings unlock greater liquidity – identifying specific high-quality projects or sets of parameters limits the credits that can be delivered against the contract, whereas if quality is the primary parameter then the liquidity pool increases.*

*Whilst we are supportive of using emerging standards to set the baselines for quality in the VCM, we are seeing increasing demand for ratings to create value above those baselines. ACX, one of the leading environmental markets platforms, recently launched a standardised contract using ratings as a primary attribute for the credits delivered: https://acx.net/media-release/acx-sylvera-contract/.*

3. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider in connection with monitoring the continual appropriateness of the terms and conditions of a VCC derivative contract?

*As above, the benefit to DCMs of cross-referring to standards and ratings is that they are non-static, which serves to reduce the burden around monitoring for continual appropriateness following initial diligence and selection.*

4. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider, which may inform its analysis of whether or not a VCC derivative contract would be readily susceptible to manipulation?

*It may not amount to manipulation, but we are aware that certain derivative contracts have been approached with scepticism by buyers where the delivery criteria has been so broad as to allow for a breadth of quality to be delivered and almost no visibility or control for the buyer. Sellers are able to deliver the cheapest available credit, which often correlates to the lowest quality. Setting stricter criteria for the crediting programs, projects or activities whose credits can be delivered will help. However, rating, assessing and reviewing hundreds of carbon projects has shown us that whilst certain project types or programs trend in a certain direction, for the most part quality is a spectrum and necessitates a project-level view.*

5. Should the VCC commodity characteristics that are identified in this proposed guidance as being relevant to the listing by a DCM of VCC derivative contracts, also be recognized as being relevant to submissions with respect to VCC derivative contracts made by a registered foreign board of trade under CFTC regulation 48.10?

*N/A*

**Transparency**

6. Is there particular information that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether a crediting program is providing sufficient access to information about the projects or activities that it credits? Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a contract's terms and conditions, whether there is sufficient transparency about credited projects or activities?

*We would suggest that the recent AB 1305 legislation in California is a useful starting point for the bare minimum public disclosures that project developer or registry should make about their activities. Specifically, there should be sufficient data and information (including as to calculation methods) to show how the project has met the requirements of the relevant standard, but also for a third party to reproduce and verify the emissions reduction associated with the credit. This is the bare minimum that is required to prevent*

*manipulation, by ensuring third parties can validate the underlying climate claims. Lack of sufficient public disclosure seems to be a particular issue with tech-based removals projects, such as direct air capture and biochar.*

**Additionality**

7. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether the procedures that a crediting program has in place to assess or test for additionality provide a reasonable assurance that GHG emission reductions or removals will be credited only if they are additional?

*We see additionality risks varying by project type. As noted above, industry initiatives such as IC-VCM have already developed quality frameworks that consider factors such as additionality. We would encourage the CFTC to encourage alignment with these frameworks to avoid market fragmentation.*

*You can read more about our perspective on additionality and the project-specific consideration here.*

8. In this proposed guidance, the Commission recognizes VCCs as additional where they are credited for projects or activities that would not have been developed and implemented in the absence of the added monetary incentive created by the revenue from carbon credits. Is this the appropriate way to characterize additionality for purposes of this guidance, or would another characterization be more appropriate? For example, should additionality be recognized as the reduction or removal of GHG emissions resulting from projects or activities that are not already required by law, regulation, or any other legally binding mandate applicable in the project's or activity's jurisdiction?

*Sylvera considers a carbon project to be additional if the emissions reductions or removals would not have occurred without revenue from the sale of carbon credits. This is a very similar but slightly stricter definition than that proposed here on the face of it, as it refers to the necessity of the revenue as opposed to the incentive of the revenue. However, in practice, we evaluate a carbon credit project on a spectrum of 'very unlikely' to 'very likely' to be additional by analyzing a number of variables. We also consider additionality from three perspectives: (i) financial additionality, (ii) policy & regulatory, and (iii) common practice, with each attracting a score that drives the overall additionality score for the project.*

**Risk of Reversal**

9. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, a crediting program's measures to avoid or mitigate the risk of reversal, particularly where the underlying VCC is sourced from nature-based projects or activities such as agriculture, forestry or other land use initiatives?

*As noted above, industry initiatives such as IC-VCM have already developed quality frameworks that consider factors such as reversal risk. We would encourage the CFTC to encourage alignment with these frameworks to avoid market fragmentation.*

*You can read more about our perspective on additionality and the project-specific consideration here.*

10. How should DCMs treat contracts where the underlying VCC relates to a project or activity whose underlying GHG emission reductions or removals are subject to reversal? Are there terms, conditions or other rules that a DCM should consider including in a VCC derivative contract in order to account for the risk of reversal?

*Initiatives such as IC-VCM require standards to have appropriate safeguards in place to minimise removals and compensate if removals occur. As above, we would encourage the CFTC to further alignment with these existing initiatives.*

**Robust Quantification**

11. Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a contract's terms and conditions, whether a crediting program applies a quantification methodology or protocol for calculating the level of GHG reductions or removals associated with credited projects or activities that is robust, conservative and transparent?

*As above, robust quantification is only verifiable by third parties if there are sufficient disclosures by the project developers to allow third parties to check the accounting. We would therefore strongly encourage the CFTC to stand behind initiatives such as AB-1305 (and support further initiatives) that require such levels of disclosure for any trading projects.*

*Otherwise, we would encourage the CFTC to further alignment with existing initiatives such as IC-VCM on topics such as quantification.*

**Governance**

12. In addition to a crediting program's decision-making, reporting, disclosure, public and stakeholder engagement, and risk management policies, are there other criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether the crediting program can demonstrate that it has a governance framework that effectively supports the program's transparency and accountability?

*IC-VCM has spent a lot of time considering governance best practice for crediting programs, so would encourage DCMs to leverage the thinking and work done there.*

**Tracking and No Double Counting**

13. In addition to the factors identified in this proposed guidance, are there other factors that should be taken into account by a DCM when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether the registry operated or utilized by a crediting program has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer, and retirement of VCCs?

*Initiatives such as IC-VCM already provide guidance on tracking and double counting. Some buyers may seek a Corresponding Adjustment under Article 6 of the Paris Agreement to guard against double counting. We do not believe this should be a requirement for voluntary transactions of carbon credits, but whether or not one is applied should be clearly disclosed. As above, we would encourage the CFTC to further align with existing initiatives.*

14. Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether it can be demonstrated that the registry operated or utilized by a crediting program has in place measures that provide reasonable assurance that credited emission reductions or removals are not double-counted?

*N/A*

**Inspection Provisions**

15. Should the delivery procedures for a physically-settled VCC derivative contract describe the responsibilities of registries, crediting programs, or any other third-parties required to carry out the delivery process?

*To the extent that ratings are referenced within a derivative contract, ratings agencies could quite easily provide attestation of the rating as at the date of delivery (including whether or not the project is "on watch").*

**Sustainable Development Benefits and Safeguards**

16. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities meet or exceed best practices on social and environmental safeguards, as a characteristic that helps to inform the integrity of VCCs issued by the crediting program. When designing a VCC derivative contract, should a DCM consider whether a crediting program has implemented such measures?

*We would encourage the differentiation between safeguards and additional benefits. Safeguards should be included, and this is the position taken by the IC-VCM.*

*Additional co-benefits can often lead to higher prices. If DCMs include credits where a characteristic is their additional co-benefits, these should be accredited in some way, e.g. through Verra's CCB or IC-VCM's "Quantified SDG Impacts" tag.*

17. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities would avoid locking in levels of GHG emissions, technologies or carbon intensive practices that are incompatible with the objective of achieving net zero GHG emissions by 2050, as a characteristic that helps to inform the integrity of VCCs issued by the crediting program. When designing a VCC derivative contract, should a DCM consider whether a crediting program has implemented such measures?

*We would point the CFTC to the IC-VCM's thinking on technological lock-in.*