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Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts;
Request for Comment (“Guidance”)¹

RIN 3038–AF40

The Institute for Agriculture and Trade Policy (“IATP”)² appreciates the opportunity to respond to some of the questions in the proposed Guidance. With one exception we note, the Guidance is well anchored in the referenced Core Principles, particularly regarding the obligations of Designated Contract Markets (DCMs).

The proposed Guidance must clearly state the public interest

The Guidance does not include any questions concerning the public interest in Voluntary Carbon Credit (VCC) derivatives and their underlying assets, so we propose a question here: How is the public interest served by provisions proposed in the Guidance? IATP is concerned that under the pressure of the carbon credit “gold rush”³ mindset the Commission may assume the public interest as co-terminus with rules to support the growth of the VCM market. We are signatory to a letter to the Commission regarding a proposed rule on “Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations.”⁴ The letter states, “The CFTC must not embed revenues and profits of exchanges and brokers into the fabric of its definition of the public interest.”⁵

¹ <https://www.cftc.gov/sites/default/files/2023/12/2023-28532a.pdf>

² IATP is a nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minnesota, with offices in Washington, D.C. and Berlin, Germany. IATP participated in the Commodity Markets Oversight Coalition (CMOC) from 2009 to 2015, and the Derivatives Task Force of Americans for Financial Reform since 2010. IATP has participated in the activities of the United Nations Framework Convention on Climate Change since 2007. We have been a member of an international NGO coalition, the Climate Land Action Rights Alliance, since 2010. IATP is an Associate Member of the Commission’s Technology Advisory Council.

³ E.g., Kenza Bryan, “The looming land grab in Africa for carbon credits,” *Financial Times*, December 5, 2023. <https://www.ft.com/content/f9bead69-7401-44fe-8db9-1c4063ae958c>

⁴ “Comment for Proposed Rule 88 FR 81236,” January 17, 2024.

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=73222&SearchText=>

⁵ *Ibid.*, p. 1.

Industry advocates claim that with “the right rules,” VCC trading will increase exponentially, with one econometric study projecting a \$1 trillion annual market already by 2037.⁶ The Guidance statement on the public interest on VCC derivatives listing requirements must make crystal clear that the public interest provisions of the Commodity Exchange Act and the Core Principles, such as the prevention of fraud, market manipulation and market disruption, must take precedence over adapting Integrity Council for the Voluntary Carbon Market (ICVCM) rules and other private sector guidance to enable exponential VCM growth. The CFTC has announced that its long-standing authority to investigate fraud, price manipulation and market disruption in the underlying assets of derivatives contracts will be applied to VCCs).⁷ The Guidance must ensure that the adaptation of the ICVCM standards to the Core Principles structure of regulation does not diminish or impede the Commission’s ability to apply this authority under the lobby pressure to exponentially grow VCMs.

Possible future Guidance regarding VCMs

The proposed Guidance suggests that the Commission may offer future guidance documents pertaining to VCC spot markets and VCC derivatives. (Federal Register (FR), p. 89416) IATP recommends that the Commission develop guidance about VCC-related market participant material risk disclosures, taking as a point of departure Commissioner Kristin Johnson’s statement on this proposed Guidance:

The CEA and CFTC regulations impose material risk disclosure requirements on registered market participants in connection with their communications, solicitations, and negotiations of transactions and material contractual terms. . . The Commission may not need to prescribe the precise language of the disclosures. The material risk disclosure rule is principles-based. Instead, the Commission may identify factors that a market participant must consider in a risk disclosure, including all the factors that could lead to significant losses. Information about a carbon credit, including information about the environmental project and market structure, is material because there is a substantial likelihood that a reasonable counterparty would consider it important in making a trading decision.⁸

Material disclosures, even at a principles-based level, by market participants about their VCC spot market and derivatives activities could reduce information asymmetries in VCMs and in doing so reduce the likelihood of fraud, price manipulation and market disruption. IATP is

⁶ “Carbon Offset Market Could Reach \$1 Trillion With Right Rules,” Bloomberg NEF, January 23, 2023. <https://about.bnef.com/blog/carbon-offset-market-could-reach-1-trillion-with-right-rules/>

⁷ “CFTC Issues Whistle Blower Office Issues Alert Seeking Tips Related To Carbon Market Misconduct,” June 20, 2023. <https://www.cftc.gov/PressRoom/PressReleases/8723-23> and Chris Lang, “Aspiration is reportedly under investigation by the Commodity Futures Trading Commission about the quality of its carbon offsets,” REDD Monitor, January 24, 2024. https://reddmonitor.substack.com/p/aspiration-is-under-investigation?utm_source=post-email-

⁸ Appendix 3: Statement of Commissioner Kristin Johnson,” FR, pp. 89425-89426.

particularly concerned about the material risk to market participants of low-quality VCCs tokenized in cryptocurrencies, which two researchers have characterized as “zombies on the blockchain.”⁹ If VCC spot and derivatives trading scale exponentially as forecast, material disclosures, particularly by highly leveraged market participants, will become even more necessary and urgent.

The Commission proposes to adapt the ICVCM standards and accountability mechanisms to fit CFTC Core Principles

In IATP’s response to the Commission’s Request for Information about climate-related financial risk, we wrote, “The Commission should develop its own [emissions] offset trading definitions, rules and guidance, even if it recognizes that the work of private standards may increase the current level of environmental, social and accounting integrity in emissions offset credits.”¹⁰ The proposed Guidance has adapted the ICVCM’s Core Carbon Principles (CCPs) standards for VCCs and its Assessment Framework (AF) and Assessment Procedure (AP) accountability mechanisms for the crediting programs that issue the VCCs. The adaptation is not in granular detail but broadly fits part of the Commission’s Core Principles. This letter analyzes some provisions of the ICVCM standards and accountability mechanisms to inform the Commission of how the proposed Guidance might be finalized to advise DCMs to design and list VCC derivatives with a granular analysis of ICVCM work, including its shortcomings.

The proposed Guidance poses questions in a framework that would adapt the Core Principles definitions of “commodity characteristics” developed for tangible commodities to the intangible commodities of greenhouse gas emissions reductions and removals. Indeed, as (Carbon)Plan wrote to the Commission, at the June 2022 Convening on Voluntary Carbon Markets, “Some [panelists and moderators] even suggested the ICVCM would offer a framework for the CFTC and other financial regulators around the world to adopt.”¹¹ The International Organization for Securities Commission (IOSCO)’s consultation paper on Good Practices for Voluntary Carbon Markets likewise advises its 131 member government regulators to support the ICVCM framework.¹² The CCP standards and accountability mechanisms have been preliminarily adopted and adjusted to fit the Commission’s Core Principles structure for DCM self-certification or Commission approval or disapproval of new derivatives contracts.

⁹ Graysen Badgley and Danny Cullenward, “Zombies on the blockchain,” (Carbon)Plan, April 7, 2022. <https://carbonplan.org/research/toucan-crypto-offsets>

¹⁰ <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7279>, p. 11.

¹¹ Danny Cullenward, “Request for Information on Climate-Related Financial Risk (Questions 22, 23, and 24),” (Carbon Plan), October 7, 2022, p. 2. <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7279>

¹² Steve Suppan, “IATP Comment to IOSCO Regarding Voluntary Carbon Markets,” Institute for Agriculture and Trade Policy, February 17, 2023. <https://www.iatp.org/iatp-comment-iosco-vcn>

There are several reasons as to why the Guidance takes its point of departure from the ICVCM's work. As was evident at the Commission's two VCM Convenings,¹³ the ICVCM's members have wide representation among the different actors in the carbon credit trading industry. At the close of the United Nations Framework Convention on Climate Change's 28th Conference of the Parties (COP28), ICVCM announced, "Carbon-crediting programs with a 98% share of the market have now applied for assessment against the CCPs. . . Exchanges will play a key role in creating a deep, liquid and transparent market for CCP-labelled credits, and they signaled significant support."¹⁴ The ICVCM review of carbon crediting documentation and the preparation of exchanges to trade CCP labeled VCCs are necessary steps to realize the ICVCM theory of change, represented in the "Build Integrity and Scale Will Follow" motto.

Furthermore, the ICVCM announced at COP28 that it is "pleased that the [draft guidance published by the Commodity Futures Trading Commission](#) is in accord with the CCPs."¹⁵ The ICVCM has quasi-regulatory momentum. On January 31, the ICVCM announced it "will now begin assessing more than 100 active carbon credit methodologies for adherence to the high integrity [Core Carbon Principles \(CCPs\)](#) with the aim of announcing the first decisions by the end of March."¹⁶ In theory, CCP labeled VCCs could be issued for bilateral purchase and spot market exchange trading by April. If the Guidance for VCC derivatives contract design is finalized to enable CCP labeled credits in spot markets to serve as underlying assets of the DCM carbon derivatives contracts, the ICVCM will have received the de facto imprimatur of the Commission, even if the Commission does not delegate certain of its authorities to ICVCM as a self-regulatory organization. Whether finalization of the Commission's Guidance for the DCM VCC contract design and listing will confer legitimacy and likely boost market participant confidence in both spot and derivatives carbon markets depends not only on market demand for CCP labeled credits, but also on the environmental and social integrity of the ICVCM standards.

Carbon Direct identified five problems with the state of the VCMs in 2022, including a "quality problem with the continued proliferation of risky [offset] project types."¹⁷ The Guidance proposes that the DCMs should design VCC derivatives contracts by documenting their compliance with the Core Principles to ameliorate the VCC quality problem. The DCMs are to include in the VCC derivatives "terms and conditions" requirements that the underlying VCCs be based on ICVCM derived carbon crediting standards. DCM adoption of these standards in "terms and conditions" are intended to preclude the use of risky project types as in the

¹³ <https://www.cftc.gov/PressRoom/PressReleases/8754-23>

¹⁴ "ICVCM Reflections: Widespread Recognition for the Core Carbon Principles and Collaboration Across the Voluntary Carbon Market," December 13, 2023. <https://icvcm.org/icvcm-cop28-reflections/>

¹⁵ Ibid.

¹⁶ "Integrity Council reaches new milestone, assessing 100 carbon crediting methodologies against high integrity benchmark," Integrity Council for the Voluntary Carbon Market, January 31, 2024. <https://icvcm.org/integrity-council-reaches-new-milestone-assessing-100-carbon-credit-methodologies-against-high-integrity-benchmark/>

¹⁷ "Assessing the State of the Voluntary Carbon Market in 2022," Carbon Direct, May 6, 2022. <https://www.carbon-direct.com/insights/assessing-the-state-of-the-voluntary-carbon-market-in-2022>

underlying assets of these contracts. The main contract design benefit of precluding risky project types is to reduce rampant VCC misrepresentation, some of it fraudulent, of climate benefits claimed by VCC project developers and often verified by a third-party hired by the crediting program.¹⁸

How high are the ICVCM's "high integrity" standards?

The ICVCM is faced with a difficult carbon market design problem. Myriad journalistic¹⁹ and academic investigations have shown that the vast majority of VCCs have been derived from emissions reduction or avoidance projects that over credited the quantity of emissions reduced or avoided.²⁰ Some of the project developers violated both land rights and human rights of those living in the project areas.²¹ Customers of companies who bought offset credits and discovered that the climate benefit claims of VCC crediting programs were unfounded or poorly substantiated are suing the companies.²² As of June 2023, at least 2,340 climate-related lawsuits had been filed, three-quarters of them in U.S. courts.²³ "High integrity" standards would attempt to protect from litigation all entities in the VCC supply chain to stimulate demand from prospective buyers concerned about their litigation exposure.²⁴ At the same time, the ICVCM needed to avoid making its requirements so stringent that crediting programs will not agree to comply with them. How did ICVCM solve this carbon market design problem?

The ICVCM rulebook has three major parts: the CCPs (e.g., "robust quantification of emissions reductions and removals,")²⁵ Assessment Framework (AF) and Assessment Procedure (AP). The ICVCM evaluates carbon crediting programs and categories of carbon credits according to AF criteria and requirements to determine if those programs and category level credits comply

¹⁸ Joseph Winters, "Carbon offsets are 'riddled with fraud.': Can new voluntary guidelines fix that?" *Grist*, August 2, 2023. https://grist.org/regulation/carbon-offsets-are-riddled-with-fraud-can-new-voluntary-guidelines-fix-that/?utm_campaign=Hot%20News&utm_medium=email&_hsmi=268894947&_hsenc=p2ANqtz-_OoKE3JPWly7GUzKMBuG3pp8IqkIkvfEflxvyXKQE65vYBupUN6qYZ2MNIhclGrn7sylih-41YdDr6ofM7y9hmk&utm_content=268894947&utm_source=hs_email

¹⁹ E.g., "The Carbon Con," Source Material, January 18, 2023, <https://www.source-material.org/vercompanies-carbon-offsetting-claims-inflated-methodologies-flawed/>

²⁰ Barbara Haya & Emily Clayton. (2022) Repository of Articles on Offset Quality, Berkeley Carbon Trading Project, University of California, Berkeley. <https://gspp.berkeley.edu/research-and-impact/centers/cepp/projects/berkeley-carbon-trading-project/repository-of-articles>

²¹ E.g., Bryan Harris, "Scandal bares the problems of the Amazon carbon credit market," *The Financial Times*, October 10, 2023. <https://www.ft.com/content/4cb93468-d9bd-4dbc-84bc-77e2b3739a7a>

²² "Justine Calma, "Delta faces a class action lawsuit over its climate commitments," *The Verge*, May 31, 2023. <https://www.theverge.com/2023/5/31/23743873/delta-airline-class-action-lawsuit-carbon-neutral-climate>

²³ Karin Rives, "Companies face 'Massive growth' in litigation over climate claims," S&P Global Market Intelligence, July 6, 2023. <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/companies-face-massive-growth-in-litigation-over-climate-claims-76429935>

²⁴ "The Legal Risk of Advertising Carbon Offsets," Client Earth, October 3, 2022.

<https://www.clientearth.org/latest/latest-updates/stories/the-legal-risk-of-advertising-carbon-offsets/>

²⁵ "Core Carbon Principles," July 2023. <https://icvcm.org/the-core-carbon-principles/>

with CCP requirements.²⁶ The interplay of AP evaluation of program level requirements and category related requirements, e.g., for forest sequestration credits, is complex and procedurally weighted towards approval of the programs to list their credits with the high integrity CCP label, e.g.:

In the event that a carbon-crediting program’s documents do not meet the additionality requirements, but the relevant Category is considered by the ICVCM including through the CWG [Category Working Group] and/or MSWG [Multi-Stakeholder Working Groups] to meet additionality requirements based on other information (including but not limited to relevant literature), the relevant Category may still be approved as CCP-Approved in accordance with section 3 of the Assessment Procedure.²⁷

For Categories requiring multi-stakeholder assessment, the Multi-Stakeholder Working Groups will evaluate and advise on Categories that meet the CCP requirements. The MSWG will provide input to the Integrity Council on Categories meeting its requirements and those that are unlikely to do so. As the MSWG meet and conclude their analysis, the ICVCM will prepare draft Evaluation Reports for the Governing Board. The Board will consider the draft Reports, Recommendations and other relevant information and then make decisions on the Categories for which the specific MSWG is tasked.²⁸

We cannot review all the ICVCM program level and credit category requirements, particularly because ICVCM anticipates that the AF program requirements will continue to change under its program of “continuous improvement.”²⁹ Some of these anticipated changes are major. It is important to review at least a few ICVCM requirements, notwithstanding their possible future modification, that may affect the “terms and conditions” of the DMC VCC derivatives contract listings.

One of the most important choices in the AF, and one that is very unlikely to change in the future, is the platform from which to build higher program and credit integrity. The ICVCM explains: “To minimise the burden on carbon-crediting programs operating in the VCM, the ICVCM has determined that programs already eligible under CORSIA [Carbon Offsetting and Reduction Scheme for International Aviation] are also eligible under this version of the Assessment Framework provided that they meet some additional requirements as set out in the Assessment Framework.”³⁰ If program credits are already CORSIA eligible, then they can be fast-tracked for CCP labeling. Reiterated through the AF is the phrase, “in addition to CORSIA requirements,” e.g., “In addition to CORSIA requirements related to governance framework, the

²⁶ Core Carbon Principles, Assessment Framework and Assessment Procedure, Integrity Council for the Voluntary Carbon Market, January 2024, Version 2, p. 23. <https://icvcm.org/wp-content/uploads/2024/02/CCP-Book-V2-FINAL-6Feb24.pdf>

²⁷ Ibid., p. 32.

²⁸ Ibid., p. 23.

²⁹ Ibid., p. 24.

³⁰ Ibid., p. 26.

carbon-crediting program shall.”³¹ Thereafter, follow governance requirements basic to good business conduct. It is surprising that crediting programs don’t already have all these requirements: e.g., “follow practices consistent with robust anti-bribery and anti-corruption guidance and regulation.”³² The AP provides for extensive due process for the crediting programs to demonstrate their compliance with the CCPs and AF requirements.

The choice to make CORSIA the platform for improving VCC standards is not because CORSIA is a well-regarded and robust climate science standard. One analysis of CORSIA states:

While CORSIA is the first international agreement to address emissions for a sector, it has also been heavily criticised for its shortcomings, including the lack of ambition of its goal of “carbon-neutral growth,” the coverage of CO2 emissions only, the limited [airline company] participation in the voluntary phase, the quality of the eligible carbon credits, and its weaknesses in terms of ensuring compliance and enforceability (ICF Consulting et al. 2020; Broekhoff et al. 2020; Siemons et al. 2021).³³

However, CORSIA is diplomatically robust. The CORSIA standard of eligibility for use of carbon offsets in international aviation was adopted in 2016 by the intergovernmental International Civil Aviation Organization (ICAO) of the United Nations.³⁴ As a United Nations organization with a decision-making Assembly composed of representatives from 193 member states,³⁵ ICAO could likely win any lawsuit challenging the integrity of its VCC eligibility standards because of the immunity that governments enjoy in many areas of international law.³⁶ If DCMs design VCC derivatives contracts that have ICVCM CCP labeled credits as their underlying assets, the DCMs, market intermediaries and market participants may all benefit from a tacit ICAO litigation shield. If ICVCM’s CCP, AF and AP improve the CORSIA credit eligibility requirements platform, while also enhancing liability prevention, prospective VCCs and VCC derivatives buyers may sleep more easily believing that no matter how the credits perform economically or environmentally, at least VCC supply chain entities won’t have to worry about litigation risk.

The ICVCM governance emissions impact requirements (AF, pp. 53-60) incrementally improve the CORSIA eligibility standard used by international airlines to buy and sell VCCs. For example, the crediting programs must “have a systematic approach to ensuring the conservativeness of

³¹ Assessment Framework, op. cit., p. 54.

³² Ibid.

³³ Schneider, Lambert; Wissner, Nora (2022): Fit for purpose? Key issues for the review of CORISA[sic]. Oeko-Institut, 5. <https://www.oeko.de/fileadmin/oekodoc/Key-issues-for-first-review-of-CORSIA.pdf>

³⁴ Ibid.

³⁵ <https://www.icao.int/about-icao/Pages/member-states.aspx>

³⁶ Kristina Daugirdas, “What Comes Next After Supreme Court Reduced Obstacles to Suing International Organizations?” Just Security, March 18, 2019. <https://www.justsecurity.org/63216/supreme-court-reduces-obstacles-suing-international-organizations/>

quantification methodologies it approves for use.”³⁷ This requirement is to prevent programs from over crediting project emissions reductions and removals by ensuring that the methodologies to quantify those emissions err on the side of underestimation. However, these requirements apply only to the crediting programs’ process requirements, which are necessary but not sufficient to foster the issuance of high-quality credits. A program level requirement to ensure that emissions quantification methodologies err on the side of underestimation does not ensure that the emissions at the credit level are reduced or removed for long enough to have the climate benefits required to achieve the Paris Agreement’s target of keeping global warming to no more than 1.5°C above the pre-industrial benchmark.

Climate science and the ICVCM VCC crediting standards

The ICVCM did not follow the advice of its Expert Group that ICVCM propose requirements for judging credit quality objectively according to the “best science and expertise available.”³⁸ Instead ICVCM accommodated the crediting programs’ demand to evaluate only their processes and categories of credits and not submit their credits to an independent and objective evaluation.³⁹ Under ICVCM, third parties verify the existence of process requirements and not the substance of the program’s credit quality. As a result, a major problem in VCC contract design is papered over and may cause emissions reduction and removal reporting misrepresentation and even market disruption. For example, consider the apparently neutral requirement (in addition to CORSIA requirements): “clearly define a carbon credit as one metric tonne of CO₂ equivalent of GHG emission reductions or removals.”⁴⁰ This requirement does not make explicit that the relationship between greenhouse gases emitted and those reduced by non-permanent carbon sinks is wholly different than those between emissions and more durable emissions removals. In the plain-spoken language of science-based carbon accounting: “a tonne is not a tonne.”⁴¹ The ICVCM has not proposed carbon credit level requirements on permanence to take into account, per Carbon Market Watch, that “A tonne is not a tonne - and the proposed straightforward equivalency between each tonne emitted and each tonne removed is false?”⁴²

The Commission has allowed at least one DCM to self-certify VCC derivative contracts that appear to incorporate “a tonne is a tonne” carbon accounting and crediting assumptions. For example, the Nodal Exchange’s Global Emissions Reduction (GER) Futures lot specification

³⁷ “Assessment Framework, p. 60. <https://icvcm.org/wp-content/uploads/2024/02/CCP-Book-V2-FINAL-6Feb24.pdf>

³⁸ “Introduction,” ICVCM, p. 3. <https://icvcm.org/wp-content/uploads/2023/03/CCP-Section-1-FINAL-27Mar23.pdf>

³⁹ Cullenward, “Request for Information . . .” p. 3.

⁴⁰ Assessment Framework, July 2023, p. 60.

⁴¹ Freya Chay, Grayson Badgely, Kata Martin, Jeremy Freeman, Joe Hamman and Danny Cullenward, “Unpacking tonne-year accounting,” (Carbon)Plan, January 31, 2022. <https://carbonplan.org/research/ton-year-explainer>

⁴² Wijnand Stoefs, “Respecting the laws of physics: Principles for carbon dioxide removal accounting,” Carbon Market Watch, December 16, 2021, p. 28. <https://carbonmarketwatch.org/publications/respecting-the-laws-of-physics-principles-for-carbon-dioxide-removal-accounting/>

requirement reads: “1,000 Metric Tons (MTs) representing 1,000 Offsets.”⁴³ The GER Futures contract description states: “Physically delivered offsets based on a basket of the following carbon offset subcontracts: Base Carbon Contract (BCC), Forestry Carbon Contract (FCC), Prime Carbon Contract (PCC), and Carbon Capture Contract (CCC), where weightings are calculated and determined by the GER Supervisory Committee (GERSC), in accordance with the GER Governance and Methodology Protocol posted at <http://www.nodalexchange.com>.”⁴⁴ The market participant who reads this contract may assume that the different subcontracts offset emissions equally or that the GER Governance and Methodology Protocol enables a 1:1 ratio between 1,000 Metric Tons of CO₂ emitted and reduced. The market participant might assume and publicize that its purchase of the GER futures contract offset its corporate and/or financed emissions.

If the Guidance continues to allow DCMs to include in VCC derivative “terms and conditions” that incorporate this false carbon accounting and crediting equivalence, there will be hardly any improvement in VCC environmental integrity. If buyers of such VCC credits claim or imply that purchase of credits representing tonnes removed or reduced compensates for equivalent tonnes emitted by their facilities and supply chains, the buyers could be at risk of litigation, even if the crediting programs had complied with the ICVCM process requirements. If DCMs rely on the ICVCM’s tacit assumption of “a tonne is a tonne” of emissions reduced or removed for its VCC derivatives contract “terms and conditions,” the buyers may suffer reputational risk at a minimum even if neither the contract nor its marketing language uses the now undiplomatic term “offset.” The Commission should conduct due diligence on carbon accounting methods and advise DCMs to not use the “one tonne is one tonne” derived definition in VCC derivatives “terms and conditions” nor in marketing literature for the contract. There is academic literature on science-based carbon accounting and crediting that can assist the Commission’s due diligence and advice to the DCMs.⁴⁵

According to Carbon Market Watch, “The ICVCM’s most obvious weakness lies in its treatment of activities that rely on the storage of carbon in non-permanent sinks, such as forests. The requirements for permanence are not in line with scientific evidence that carbon dioxide in biological systems and CO₂ released from the combustion of fossil fuels are not equivalent or interchangeable.”⁴⁶ From the viewpoint of climate science, most, if not all, land-based VCCs misrepresent their emissions impacts, even when they are well designed, well managed, not reversed and not fraudulent. ICVCM intends to develop its standards with “the best science and expertise available.”⁴⁷ According to the “medium consensus” of the 6th Assessment report of

⁴³ <https://www.cftc.gov/sites/default/files/filings/ptc/22/06/ptc061522nodaldcm002.pdf>, p. 1

⁴⁴ Ibid.

⁴⁵ Some of this academic literature is summarized in Stoefs, “Respecting the laws of physics,” *Op. cit.*

⁴⁶ Gavin Mair, “Integrity Council’s rulebook sets low threshold instead of high bar for carbon markets,” Carbon Market Watch, July 27, 2023. <https://carbonmarketwatch.org/2023/07/27/integrity-councils-rulebook-sets-minimum-threshold-instead-of-high-bar-for-carbon-markets/>

⁴⁷ “Introduction,” ICVCM, p. 3. <https://icvcm.org/wp-content/uploads/2023/03/CCP-Section-1-FINAL-27Mar23.pdf>

Intergovernmental Panel on Climate Change(Chapter 5.6.2.1)⁴⁸ and to IPCC scientists in independent computer modeling studies, biogenic offsets cannot compensate for fossil fuel generated greenhouse gases on a 1:1 ratio: “Results indicate that a CO₂ emission into the atmosphere is more effective at raising atmospheric CO₂ than an equivalent CO₂ removal is at lowering it, with the **asymmetry increasing with the magnitude of the emission/removal.**”⁴⁹ (IATP bolded emphasis.) The greater the quantity of CO₂ released, the greater the disparity between emissions and removals. More simply put, it is physically impossible for short cycle biological carbon to offset long cycle geological carbon emissions.

One reason that the Commission’s Guidance should be informed by science-based carbon accounting and crediting, rather than rely on ICVCM certification program process requirements, is that governments and corporations are planning to increase fossil fuels exploration and production.⁵⁰ As emissions increase, the asymmetry of emissions with removals increases. “A tonne is not a tonne” carbon accounting and crediting must be adapted to compensate for the emissions/removals asymmetry at the credit level, including in the “terms and conditions” of VCC derivatives contract listing.

Nor should the Commission develop Guidance that assumes that Carbon Capture and Storage (CCS) and other engineering-based removal technologies will permanently remove without leakage the increased emissions in the near to medium term.⁵¹ Since the advent of CCS 50 years ago, successive iterations of the technology have never managed to perform at a scale and for a cost promised by its promoters.⁵² In an Information Note for the Paris Agreement Article 6.4 Supervisory Body of negotiators, the United Nations Framework on Climate Change Secretariat wrote, “Land-based activities currently provide most of the removals and are expected to be the main driver of removal in the near-term (i.e., to 2030) and possibly even until 2050.”⁵³ ICVCM

⁴⁸ IPCC, 2021: Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change [Masson-Delmotte, V., P. Zhai, A. Pirani, S.L. Connors, C. Péan, S. Berger, N. Caud, Y. Chen, L. Goldfarb, M.I. Gomis, M. Huang, K. Leitzell, E. Lonnoy, J.B.R. Matthews, T.K. Maycock, T. Waterfield, O. Yelekçi, R. Yu, and B. Zhou (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA, 2391 pp. doi:10.1017/9781009157896.

⁴⁹ Zickfeld, K., Azevedo, D., Mathesius, S. *et al.* Asymmetry in the climate–carbon cycle response to positive and negative CO₂ emissions. *Nat. Clim. Chang.* **11**, 613–617 (2021). <https://doi.org/10.1038/s41558-021-01061-2>

⁵⁰ Justin Jacobs and Miles McCormick, “Oil industry struts Texas staged with its old swagger at energy jamboree,” *Financial Times*, March 11, 2023. <https://www.ft.com/content/f4fb6331-a194-446c-8907-cd817d36d1e4>

⁵¹ Charles Harvey and Kurt House, “Every dollar spent on this climate technology is a waste,” *The New York Times*, August 16, 2022. <https://www.nytimes.com/2022/08/16/opinion/climate-inflation-reduction-act.html>

⁵² Jacobs, “Put up or shut up: Can Big Oil prove the case for carbon capture?” *Financial Times*, October 19, 2022. <https://www.ft.com/content/b8d6848d-1e8a-4c57-b65b-52105b48b178>

⁵³ “Information Note: Removal activities under the Article 6.4 mechanism,” Version 0.30, p. 43 <https://unfccc.int/sites/default/files/resource/a64-sb004-aa-a04.pdf>

estimates that “90% of all nature based solutions,” i.e., land-based emissions offset projects, are in developing countries.⁵⁴

As the Commission aligns in the Guidance the CCPs and AF standards with the DCM Core Principles structure, it should consider the challenges that certification programs face in accounting for VCC non-permanence and the many legal and economic complications of emissions reversals in nature-based offset projects. The developing country context, though seldom explicit the ICVCM rulebook, is indispensable for assessing the likelihood that what the ICVCM requires of the crediting programs can be realized on the ground. We detail some of these challenges below in responding to Guidance questions.

The challenges of aligning ICVCM’s Core Carbon Principles Structure with the CFTC Core Principles Structure

Commissioner Christy Goldsmith Romero wrote in her concurrence to the release of the proposed Guidance, “I am interested in hearing from commenters if the guidance adapts the right parts of the ICVCM standards to encourage integrity and transparency in these markets and if the Commission’s adaptation provides clear, workable expectations. . . I am also interested in hearing more from commenters about whether market integrity can be improved by exchanges relying on a crediting program’s processes and diligence, as assumed in the proposed guidance, or if there is a benefit to exchanges conducting additional due diligence into specific categories, protocols, or projects.”⁵⁵ These are important requests for comment to which we respond generally here before turning to some of the Guidance’s specific questions.

Commissioner Goldsmith Romero is right to question whether the Guidance’s reliance on crediting program due diligence is sufficient to ensure VCC derivative market integrity. The ICVCM requires crediting programs to have in place processes to enable third party validation of emission reduction or removal design and the verification of emissions removed or reduced. ICVCM does not verify independently the integrity of individual offset projects or credits deriving from them.⁵⁶ (There are organizations, such as Calyx Global, which review individual projects to rate in aggregate the integrity of project type credits, e.g., reforestation-based credits, for prospective investors.⁵⁷) However, the Integrity Council “may raise issues or request or perform spot-checks, on a risk-based approach informed by market intelligence, thematic analysis and grievances raised” about emission reversals, non-performance of a project or weak

⁵⁴ “Foreword,” ICVCM, p. 6. <https://icvcm.org/wp-content/uploads/2023/03/CCP-Foreword-FINAL-28Mar23.pdf>

⁵⁵ Appendix 4—Statement of Commissioner Christy Goldsmith Romero, FR p. 89427.

⁵⁶ “Assessment Framework,” p. 69.

⁵⁷ “Calyx Ratings Explained,” Calyx Global, <https://calyxglobal.com/reportviewer.php?q=TlpEdzk2aWJpRIJ2ZTVTaVhmQVZoZz09&t=r>

verification processes.⁵⁸ Despite these due diligence measures, the Commission should consider performing further due diligence to better understand the challenges of implementing even one of the ICVCM program level requirements, illustrated here with double counting issues related to the retirement of credits.

The Guidance proposes to align the CCPs, AF and AP requirements legally with three of the “commodity characteristics” in Appendix C of Core Principle 3 (demonstration that derivatives contracts that are not susceptible to market manipulation⁵⁹) developed for tangible commodities: quality standards; delivery points and facilities; and inspection provisions. (FR, p. 89416) CCPs are clearly quality standards. The AF and AP, respectively evaluate the compliance of crediting programs with the CCPs and explain to the crediting programs how they must apply and how their application will be processed for their VCCs to receive CCP labeling. Together the AF and AP are inspection provisions. “Delivery points and facilities” is the commodity characteristic with the least self-evident alignment with the ICVCM project.

In theory, the retirement of a VCC should correspond to the physical delivery of a tangible commodity. Crediting programs deliver VCCs mostly to intermediaries who resell the credits bilaterally. However, according to Ecosystem Marketplace, currently “Transactions between parties not resulting in a retirement are not reflected in [crediting program] registries” and “Retirements are often made on behalf of the end user without transferring registry accounts.”⁶⁰ As a result of these industry practices, it is difficult to know when and where the VCCs have been delivered and whether double counting or double use of the VCCs by the buyer and seller has occurred prior to or after the delivery. The ICVCM has proposed crediting program requirements to improve the tracking of credits and retirements in crediting program registries.⁶¹

Under its no double counting criteria, AF also requires crediting programs to establish and maintain “registry provisions that prevent the further transfer, retirement or cancellation of a carbon credit once it has been cancelled or retired.”⁶² However, it is not clear how a crediting program can prevent the host country government of the mitigation projects from both selling a VCC to a private party and claiming a VCC in its Nationally Determined Contribution to

⁵⁸ “Assessment Procedure,” July 2023, p. 126. <https://icvcm.org/wp-content/uploads/2023/07/CCP-Section-6-R2-FINAL-26Jul23.pdf>

⁵⁹ Appendix C to Part 38—Demonstration of Compliance That a Contract Is Not Readily Susceptible to Manipulation, <https://www.ecfr.gov/current/title-17/chapter-I/part-38/appendix-Appendix%20C%20to%20Part%2038>

⁶⁰ “Paying for Quality: State of the Voluntary Carbon Market 2023,” November 28, 2023, Box 1: What you need to know about registry data,” p. 9. https://3298623.fs1.hubspotusercontent-na1.net/hubfs/3298623/SOVCM%202023/2023-EcoMarketplace_SOVCM-Nov28_FINALrev-1.pdf

⁶¹ “Criterion 2.1 Effective registries,” Assessment Framework, July 26, 2023, p. 55. <https://icvcm.org/wp-content/uploads/2023/07/CCP-Section-4-R2-FINAL-26Jul23.pdf>

⁶² “Criterion 6.2: No double use,” p. 62.

mitigation reporting under the Paris Agreement. Both the ICVCM and Verra, the largest crediting program, take the position that crediting programs are not obliged under Article 6.2 of the Paris Agreement to make corresponding adjustments to their registries to prevent double counting following the sale of carbon credits authorized by the mostly developing country host governments to mostly corporate buyers in North America and Europe.⁶³

As a compromise, the ICVCM provides as an optional attribute to the CCPs label “Host country authorization pursuant to Article 6 of the Paris Agreement.” Among the requirements that the crediting program must fulfill to label its CCP credits with this attribute: “The carbon-crediting program shall regularly seek evidence of the appropriate application of corresponding adjustments pursuant to Article 6 authorization by the host country.”⁶⁴ If a crediting program wishes to buy credits authorized by the host government and be assured that the government will apply corresponding adjustments to prevent double counting, either it obtains that evidence within two years or the crediting organization withdraws the Paris Agreement Article 6 attribute from its CCP. (An unresolved Article 6.4 negotiation is whether host countries can issue credits derived from unauthorized emissions reduction projects and apply corresponding adjustments to prevent double counting.)

Since most CCP labeled VCC credits will come from emissions reductions projects hosted in developing countries, the Article 6 host country attribute depends on Article 6 implementation measures that are far from agreed, particularly regarding double counting. To the extent that DCMs adapt the Commission’s Guidance derived from the ICVCM rulebook to specify the underlying VCCs in their VCC derivatives contracts, DCMs should make explicit in their contract and marketing language that the deliverable supply of “high integrity” VCCs depends not only on effective implementation of crediting program standards, but effective implementation of Article 6 in the developing country hosts of the emissions reduction projects.

Responses to specific questions in the guidance

- 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? (FR, p. 89421)*

⁶³ Ivy Yin, “Corresponding adjustments should not be enforced in voluntary market: ICVCM, Verra,” S&P Global Commodity Insights, June 8, 2023.

⁶⁴ “Table 1,” Assessment Framework, p. 101.

The Guidance lists the following VCC commodity characteristics from Appendix C⁶⁵ as relevant to carbon credit integrity in the DCM contract design and listing of VCC derivatives contracts: quality standards; delivery points and facilities; and inspection provisions. (FR, p. 89416)

Quality encompasses: “transparency (publicly available data to promote transparency);” “additionality” of emissions reduced or removed that would have not otherwise been reduced or removed absent investment in emissions removal or reduction projects or activities; relative “permanence” of emissions removed or reduced from the free atmosphere and provisions to compensate for emissions reversals in projects and activities from which VCCs are derived; “robust quantification” by the VCC crediting program of emissions removed or reduced, which would enable the DCM to estimate the deliverable supply of VCCs in the VCC contract “terms and conditions” and the speculative position limits for the contract. (FR, pp. 89417-89418)

Additionally, the proposed Guidance states, “The Commission believes that the fact that standardization and accountability mechanisms for VCCs are currently still developing is, itself, an “individual characteristic of the commodity” that should be taken into account by a DCM when designing a VCC derivative contract and addressing the underlying commodity in the contract’s terms and conditions.” (FR, p. 89416) Recall that under the ICVCM’s program of “continuous improvement,” standards are a moving benchmark. For example, the ICVCM plans to issue revised CCPs in 2025 for implementation in 2026.⁶⁶ There is no comparable “individual characteristic” for a tangible commodity.

IATP agrees that transparency, additionality, permanence and robust quantification are relevant carbon credit criteria for the DCM to stipulate in the contract design of VCCs derivatives. IATP is not persuaded by the Commission’s interpretation of Core Principle 3’s Appendix C commodity characteristics that the ongoing development of “standardization and accountability mechanisms” is consistent with Appendix C characteristics relevant to achieving the Core Principle 3 objective.

IATP believes that the Guidance’s interpretation of “specific commodity characteristic” diverges from Appendix C requirements to Core Principle 3 in a way that would allow DCMs to design VCC based contracts with too much leeway to be susceptible to market manipulation. The Guidance’s citation of “individual characteristic of the commodity” leaves out crucial context from the Appendix C illustrations of “individual characteristic of the commodity” per the following: “For any particular commodity contract, the specific attributes that should be enumerated depend upon the individual characteristics of the underlying commodity. These may include, for example, the following items: grade, quality, purity, weight, class, origin, growth, issuer, originator, maturity window, coupon rate, source, hours of trading, etc.”⁶⁷ The examples of “individual characteristics” in Appendix C were developed for tangible commodities

⁶⁵ Appendix C to Part 38—Demonstration of Compliance That a Contract Is Not Readily Susceptible to Manipulation, https://www.law.cornell.edu/cfr/text/17/appendix-C_to_part_38

⁶⁶ “What next for the Integrity Council?” <https://icvcm.org/assessment-framework/>

⁶⁷ Appendix C Guidance, paragraph (b)(2)(i)(A)

rather than to intangible emissions reductions or removals. However, many of these examples also apply to VCCs: e.g., “quality” (VCCs approved by the ICVCM to qualify for its CCP) label); “weight” (1 metric ton CO₂ equivalents); “class” (emissions reduction or removal project type); “origin” (site of the validated and verified emissions reduction or removal projects) “issuer” (the crediting program issuing VCCs for purchase), etc.

However, none of these “individual characteristics” are similar in meaning to the revisions of “standardization and accountability mechanisms” that the Guidance proposes to characterize as a novel “individual characteristic of the commodity.” The Guidance recognizes the ICVCM as an authoritative source of definitions that DCMs could adopt in the design of their VCC derivatives listed contracts.⁶⁸ The ICVCM promises a “program of continuous improvement” on its CCP standards, Assessment Framework and Assessment Procedure. Will the DCM inform market participants of each and every revision to the ICVCM standards and accountability mechanisms or only the revisions that the DCM deems to be “economically significant?” If the revisions result in devaluation of VCC derivatives positions held by market participants despite being not considered “economically significant” in the DCM VCC derivative contract, do market participants have any customer protections or legal recourse if the changes are proven to be economically significant?

IATP urges the Commission to strike the ongoing development and revision of “standardization and accountability mechanisms” from inclusion as an “individual characteristic” of the VCC commodity. Chairman Rostin Behnam stated, “The proposed guidance is not intended to modify or supersede existing statutory or regulatory requirements, or existing Commission guidance that addresses the DCMs’ listing of derivative contracts, such as Appendix C to Part 38 of the Commission’s regulations.”⁶⁹ Notwithstanding the Commission’s intention, retaining the ongoing development of “standardization and accountability mechanisms” as an “individual characteristic of the [VCC] commodity” would amend Appendix C in a way that would make it difficult for the Commission to determine whether the design of a VCC derivatives contract complied with Appendix C requirements. Such an amendment would require rulemaking.

Instead, the Commission should advise DCMs that rely implicitly or explicitly on the ICVCM for crediting program VCC integrity in the underlying asset to include in the VCC derivatives contract “terms and conditions” a clear reference to the ICVCM disclaimer prefacing its Core Carbon Principles: *inter alia* “This document is provided for information only. Nothing herein should be construed as financial, legal, tax, accounting, actuarial or other specialist advice.”⁷⁰ The inclusion of this disclaimer may seem superfluous since VCC derivatives self-certifications already hold the DCM harmless. For example, the CME seeks to exempt itself from fraud and

⁶⁸ Footnote 36, FR, p. 89412 and FR, p. 89414, footnote 46 *et passim*.

⁶⁹ Appendix 2—Statement of Support of Chairman Rostin Behnam, FR, p. 89422.

⁷⁰ <https://icvcm.org/wp-content/uploads/2023/03/CCP-Foreword-FINAL-28Mar23.pdf>, p. 3.

other integrity concerns associated with its Nature Based Emissions offset futures contract: “The Exchange makes no representation respecting the authenticity, validity or accuracy of any Notice of Intention to Accept, Notice of Intention to Deliver, check or of any document or instrument delivered pursuant to these rules.”⁷¹ However, because the Guidance adopts the quality terminology of the ICVCM, market participants might infer that VCC credits with the CCP label are of such quality that the CME disclaimer is merely pro forma.

Rather than invent an Appendix C commodity characteristic, the Commission should urge DCMs to present VCC derivatives contracts for Commission approval or disapproval whenever the Commission’s or the DCM’s analysis of revisions to the CCPs, AF and/or AP shows the revision(s) to be likely economically significant for the contract. To facilitate that DCM determination, the Guidance should include the provision for an “information sharing agreement” between the DCMs and ICVCM, as recommended by Commissioner Goldsmith Romero.⁷²

For example, it is very likely that ICVCM will change its rules on emissions reversal and reversal risk management. These changes should be reported to the DCMs and the Commission under the terms of the information sharing agreement. Emissions reversals will almost certainly increase in scope and frequency, at least for nature-based emissions reduction activities, with the imminent arrival of extreme weather events driven by climate tipping points.⁷³ The economic and legal consequences for the crediting programs’ buffer accounts of credits to attempt to compensate for reversals cannot not be forecast with accuracy. However, we know that current reversals, e.g., recent California wildfires, have eliminated any temporary climate benefits from offset projects and are showing the buffer accounts to be vastly underfunded.⁷⁴

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?*

If the Guidance recommends that DCMs incorporate private and/or multilateral standards into the terms of a VCC derivatives contract, it should only do so provisionally. In both the ICVCM standards and the Article 6.4 negotiations,⁷⁵ there are major features of the standards that

⁷¹ Op. cit., p. 7.

⁷² Op. cit., p. 89428.

⁷³ Courtney Lindvall, “Climate Tipping Points Are Closer Than We Once Thought,” Natural Resources Defense Council, November 15, 2022. <https://www.nrdc.org/stories/climate-tipping-points-are-closer-once-thought>

⁷⁴ Badgley G, Chay F, Chegwiddden OS, Hamman JJ, Freeman J and Cullenward D, (2022) California’s forest carbon offsets buffer pool is severely undercapitalized. *Front. For. Glob. Change* 5:930426. doi: 10.3389/ffgc.2022.930426 and Gilles Dufrasne, “Up in smoke: California fires highlight once again dangers of forest offsets,” Carbon Market Watch, October 22, 2020. <https://carbonmarketwatch.org/2020/10/22/up-in-smoke-california-fires-once-again-highlight-dangers-of-forest-offsets-2/>

⁷⁵ Suppan, “Carbon market design problems await COP28 delegates, institute for Agriculture and Trade Policy, November 21, 2023. <https://www.iatp.org/carbon-market-design-problems-await-cop28-delegates>

would have to be agreed for the standards to align with climate science and best carbon crediting practices. For example, consider the next iteration of the Assessment Framework, regarding permanence: “The ICVCM will consider longer monitoring and compensation periods (e.g., one hundred years) and shifting the monitoring and compensation oversight to the carbon-crediting program or the jurisdiction aligned with existing and emerging best practice among carbon crediting programs.”⁷⁶ The duration of permanence of CO₂ removals in the current ICVCM standard is “at least 40 years.”⁷⁷ A climate science robust duration is much longer: e.g., According to a recent Carbon Market Watch analysis of academic literature, “CO₂ can be considered permanently stored only when it is put away as long as the significant percentages of CO₂ emissions last in the atmosphere (up to 25%), that is up to 1,000 years. At the very minimum, the bar for storage with significant climate benefits is several centuries.”⁷⁸ The legal and economic consequences of adopting this science-based duration for the monitoring of offset removals and compensation for emissions reversal are staggering.

Even an ICVCM member agreement to raise the duration of permanence from 40 years to 100 years would be very challenging for ICVCM and crediting programs to oversee, because of the increased costs of monitoring and maintaining a buffer account of credits to be used to compensate for the increasing severity and frequency of emissions reversals. In the event of a ICVCM standard of a 100-year carbon storage permanence it is likely that VCC jurisdictions backstopped by host developing countries would have to assume the costs of monitoring and maintaining an adequately financed buffer account of high-quality credits to compensate for the reversals. In the event of “several centuries” standards, it is all but certain that developing country governments would have to assume the monitoring and compensation costs. When United Nations agencies promote high integrity carbon markets as a reliable source of climate finance and a means to realize Nationally Determined Contributions to mitigation and Sustainable Development Goals,⁷⁹ the costs of carbon market implementation are seldom mentioned. The possible assumption of buffer account finance by their governments is never mentioned.

⁷⁶ Assessment Framework, Table 4, p. 85.

⁷⁷ a) “The carbon-crediting program shall in relation to Categories listed in criterion 9.1 b) 1) above: 1) require a monitoring and compensation period for such mitigation activities of at least forty years from the start of the first crediting period or to at least the end of the crediting period, whichever is the later,” Assessment Framework, Table 9.3, “Monitoring and compensation period,” p. 83.

⁷⁸ Fabiola De Simone and Wijnand Stoefs, “The bare necessities: Essential principles to design sensible carbon removal policies,” Carbon Market Watch, November 2023, p. 7.
<https://docs.google.com/viewerng/viewer?url=https://carbonmarketwatch.org/wp-content/uploads/2023/12/The-bare-necessities-essential-principles-to-design-sensible-carbon-removal-policies-1.pdf>

⁷⁹ E.g., “UNDP’s High Integrity Carbon Markets Initiative,” United Nations Development Program, December 2023.
https://climatepromise.undp.org/sites/default/files/research_report_document/High-Integrity%20Carbon%20Markets%20Initiative%20-%20Final.pdf

If DCMs adopt ICVCM standards in VCC “terms and conditions,” they should do so only with an explicit proviso along these lines: “Any modification to ICVCM standards and accountability mechanisms that would affect the economic and legal viability of the crediting program and the integrity of the VCC underlying could result in major changes to ‘terms and conditions.’” These major changes could even include a decision by the DCM governing body to withdraw its incorporation of private standards in the VCC derivatives “terms and conditions.”

3. *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?*

The criteria and factors discussed in the proposed Guidance assume that contract design incorporating high integrity standards can reorient traders’ strategic behavior away from the purchase of low integrity credits in bilateral transactions at prices that are opaque compared to exchange reported spot market prices. There is no empirical way to test this assumption a priori, particularly when the CCPs, the AF and AP are subject to “continuous improvement.” Any setback in the scaling up of VCMs can be remedied with the promise of future improved standards and accountability mechanisms.

After the finalization of the proposed Guidance, there will likely be an increase in spot market VCC trading, but that increase could diminish, particularly if a major change in the ICVCM standards exposes carbon market structural vulnerabilities. For example, how is VCC liquidity affected, if emissions reversals outpace the ability of crediting program buffer accounts to compensate for the reversals, resulting in legally and economically impaired crediting programs?

The Commission should not confine its analysis of susceptibility to market manipulation to a legal analysis of “terms and conditions,” in the framework of Commission regulations and authorities. The Commission should also use the academic literature on market manipulation to analyze how market manipulation could occur, notwithstanding a DCM’s VCC derivatives contract “terms and conditions.” For example, Anthony Zhang writes,

Contract position limits imposed on spot traders can lower manipulation risk, by lowering spot traders’ incentives to manipulate. Manipulation-induced distortions will tend to be smaller in spot markets which are more competitive, and in markets with larger aggregate storage capacity for spot goods. In the model of the [his] paper, regulators can quantitatively estimate manipulation induced basis risk using data which is observed in many markets. These measures could be used by regulators to determine

how large contract position limits should be, and whether to approve newly proposed derivative contracts.⁸⁰

Zhang's paper is an example of an emerging economic literature that the Commission should use to study market manipulation in spot markets, including in VCCs contracts. Economically well-justified spot market position limits could reduce the likelihood of a boom and bust in VCC contract prices that may occur if the Commission adapts and legitimizes the ICVCM self-regulatory framework, and the global VCM scales to \$1 trillion annual in notional value by 2037, as projected in a study cited above. Current VCC derivatives contracts have been developed in anticipation of the Commission's adaptation of the ICVCM rulebook, e.g., the CBL Core Global Emissions Offset™ launched on March 7, 2022, is "intended to align with the Core Carbon Principles."⁸¹ The Commission should ascertain how ICVCM changes to its rulebook affect this intended alignment and inform the DCMs of its analysis.

European authorities are considering applying position limits to spot market trading of allowances in the Emissions Trading Scheme to prevent and diminish excessive speculation in those assets by financial speculators with no bona fide commercial interest in the allowances.⁸² Excessive speculation is an economic indicator of possible market manipulation, which like fraud, faces the evidentiary burden of proof of intentionality. The Commodity Exchange Act authorizes the Commission to set speculative position limits on any commodity "for the purpose of diminishing, eliminating or preventing" excessive speculation that results in "sudden of unreasonable fluctuations or unwarranted changes in the price of such commodity" resulting from trading without limits in the derivative contract for that commodity.⁸³ Current VCCC derivatives contracts have DCM set reporting and accountability levels and position limits, e.g., the Nodal Exchange levels and limits in its self-certified GER contract.⁸⁴ The Commission should review the DCM documentation to justify VCC derivatives spot month levels and limits and analyze how the ICVCM rulebook may affect the DCM's estimated deliverable supply of VCCs from which the levels and limits are set.

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

⁸⁰ Anthony Lee Zhang, "Competition and Market Manipulation in Derivatives Contract Markets," September 2021, p. 5. <https://anthonyleezhang.github.io/pdfs/cmdcm.pdf>

⁸¹ Julia Scheiffer, "CME Group to Launch CBL Core Carbon Global Offset Futures," DerivSource, February 8, 2022.

⁸² Thomas Helm, "Carbon markets could have position limits regime," IFLR, May 17, 2022.

<https://derivsource.com/2022/02/08/cme-group-to-launch-cbl-core-global-emissions-offset-futures/><https://www.iflr.com/article/2a7cuhvpor15vq4ki1kht/carbon-markets-could-have-position-limits-regime>

⁸³ 7 U.S. Code § 6a – Excessive Speculation.

<https://www.law.cornell.edu/uscode/text/7/6a#:~:text=Excessive%20speculation%20in%20any%20commodity,respect%20to%20registered%20entities%20causing>

⁸⁴ "Nodal Exchange, LLC Rulebook Appendix C: Reporting Levels, Accountability Levels and Position Limits", June 17, 2022. <https://www.cftc.gov/sites/default/files/filings/ptc/22/06/ptc061522nodaldcm003.pdf>

as being relevant to submissions with respect to VCC derivative contracts made by a registered foreign board of trade under CFTC regulation 48.10?

Yes. However, it is not clear if the registered Foreign Board of Trade (FBOT) derivative contract “terms and conditions” requirements of Regulation 48.10 are sufficient to give the Commission insight into the underlying spot market VCCs in a FBOT submission. One component of a Commission recognition of the commodity characteristics in a FBOT submission should be that it had adopted and implemented the International Organization of Securities Commissions finalized Good Practices for Voluntary Carbon Market recommendations.⁸⁵ If the Commission has concerns about the regulatory oversight of FBOTs in the jurisdiction from which the FBOT submission originates, the Commission may consider amending its comparability determination for that jurisdiction to take into account any divergence from the Commission’s guidance on commodity characteristics in the VCC derivatives listing, as well as the foreign regulator’s capacity to monitor and enforce VCC requirements in its jurisdiction.

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?

As many critics of land-based VCCs have noted, particularly those derived from emissions avoidance activities, additionality is based on counterfactual scenarios about emissions that would have occurred in the absence of the emissions avoidance or reduction project. The counterfactual scenarios can be used to over credit project performance by overestimating emissions reductions or avoidance relative to a baseline scenario validated by a third party.⁸⁶ The ICVCM does not formally define “additionality.” However, it does define “baseline scenario,” which is the zero point of emissions avoidance and reduction project design and of additionality claims: “A description of the situation and the outcome that is predicted or assumed to occur in the absence of the incentives created by the carbon credits and their associated mitigation activities, while holding all other factors constant.”⁸⁷ Although all factors can be held constant as

⁸⁵ <https://www.iosco.org/news/pdf/IOSCONEWS714.pdf>

⁸⁶ E.g., West, Thales A. P., Jan Börner, Erin O. Sills, and Andreas Kontoleon. 2020. “Overstated Carbon Emissions Reductions from Voluntary REDD+ Projects in the Brazilian Amazon. Proceedings of the National Academy of Sciences 117, no. 39 (September): 24188–194. <https://www.pnas.org/doi/full/10.1073/pnas.2004334117>; Bailis, Rob, Yiting Wang, Rudi Drigo, Adrian Ghilardi, and Omar Masera. 2017. “Getting the Numbers Right: Revisiting Woodfuel Sustainability in the Developing World.” Environmental Research Letters 12, no. 11 (October): 115002. <https://doi.org/10.1088/1748-9326/aa83ed>;

⁸⁷ “Definitions,” ICVCM, July 2023, p. 104.

an econometric variable in emissions offset project design and validation, all factors cannot be held constant in the real world.

The ICVCM additionality requirements are not limited to the demonstration of financial incentive in the emissions reduction or avoidance of projects. If the final Guidance expands the definition of additionality beyond an investment analysis of the financial incentive to create and maintain projects that issue VCCs, the Commission should consider whether the ICVCM requirement of additionality for crediting programs in terms of “projects or activities that are not already required by law” is compatible with CFTC enforcement standards. Under the criterion of “Existing host legal requirements” for additionality, the Assessment Framework states,

the carbon-crediting program shall: 1) ensure that the mitigation activity is registered only if the resulting carbon credits represent emission reductions or removals that exceed those required due to relevant legal requirements that are enforced. For high-income countries [footnote 13 points to the World Bank definition of high-income countries], all legal requirements shall be deemed to be enforced. For countries other than high-income countries, legal requirements shall only be deemed to be unenforced based on authoritative and up-to-date information of nonenforcement that is relevant and applicable to the mitigation activity.⁸⁸

IATP would oppose the Commission’s adoption in the Guidance’s additionality quality standard of this peculiar dual standard of enforcement. The fact that a country is defined as high income should not allow the ICVCM or the Commission to assume that all legal requirements for additionality are enforced. The demonstration that a non-high-income host country does not enforce legal requirements pertaining to eligibility requires the presentation of evidence to the ICVCM Governing Board that it might dismiss as not “authoritative and up-to-date.” For example, journalistic and academic investigations of over-crediting of projects related to additionality claims could be “deemed” by the Governing Body as not “authoritative and up to date.” Why would the Commission adopt such requirements concerning enforcement and non-enforcement in its Guidance on additionality? Could the Commission effectively investigate cases of possible carbon market fraud while adapting the ICVCM requirements for additionality and host country legal requirements to Appendix C documentation of quality standards?

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?

⁸⁸ Assessment Framework, “Table 8.2: Existing host country legal requirements,” p. 74.

The ICVCM does not always provide the crediting programs with clear requirements to advise the DCMs that intend to align with those requirements. Consider this crediting program requirement for nature-based credits: “require mitigation activity proponents [Footnote 20, “Or the carbon-crediting program or host country, if applicable”] to monitor and report any reversals for the full monitoring and compensation period and compensate for avoidable reversals;”⁸⁹ This requirement raises questions of who monitors reversals, who reports them, who compensates for the reversal and who decides which reversals are avoidable? If the reversals are unavoidable, e.g., a wildfire to which nobody can assign effective liability, and uncompensated, how can the DCM design a VCC derivatives contract in such a way as to inform prospective buyers of a VCC derivative that reversals might not be compensated for a category of credits that are in the VCC derivatives “basket”?

The AF monitoring and compensation requirements for reversals instruct the crediting program to “draw upon the pooled buffer reserve if avoidable reversals are not compensated per a) 2) above.”⁹⁰ Assuming the buffer pool has enough credits of equal or better quality to compensate the reversal, the compensation program is solved, but only for avoidable reversals, whatever they are and whoever decides what is avoidable.

Recalling our example above, the Nodal Exchange Global Emissions Reduction (GER) futures contract has at least one subcontract whose offset projects are inherently at risk of reversals, the Forestry Carbon Contract. If forest-related reversals are uncompensated because of a dispute among offset project developer (“mitigation activities proponent”) the host country authorities and the crediting program about whether the reversal is avoidable, what is the VCC price impact of the VCC credit that no longer represents fully the quantity of emissions represented in a credit or lot of credits? There is nothing in the GER[®] Governance and Methodology Protocol⁹¹ that discusses uncompensated reversals, their impact on VCC quality, VCC prices and VCC price volatility. If we assume that reversals will become more frequent and severe as climate tipping points drive more extreme weather events, DCMs should begin to account for the impact of reversals on VCC estimated deliverable supply and on the possibility of market disruption if uncompensated reversals become widespread.

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

⁸⁹ Assessment Framework, Criteria 9.3 Monitoring and Compensation, para a)2, p. 83.

⁹⁰ Ibid. para a)4.

⁹¹ <https://www.cftc.gov/sites/default/files/filings/ptc/22/06/ptc061522nodaldcm004.pdf>

program has in place measures that provide reasonable assurance that credited emission reductions or removals are not double-counted?

An important AF rule under the sub-principle of “no double use” addresses the problem of verifying the retirement of a credit: “The carbon-crediting program shall have registry provisions that prevent the further transfer, retirement or cancellation of a carbon credit once it has been canceled or retired.”⁹² Whether these provisions are adequate to comply with “no double use” will be judged according to the Assessment Procedure.

That AP judgment will be complicated by the chain of credit custody for which the ICVCM makes the certification program responsible. Most credit buyers prefer to do so bilaterally, i.e., a certification program facilitated transaction between an offset project developer or a broker who has purchased offset credits and a credit buyer,⁹³ rather than buying through a multilateral trading platform, such as a DCM. A bilateral transaction and retirement of that credit can be recorded on a program registry. However, to have a registry “provision” that monitors the afterlife of a retired or canceled credit probably requires the post transaction accounting and auditing capacity of a DCM’s clearing organization, which crediting programs may not have. In sum, operationalizing just one ICVCM rule to increase credit integrity could be very challenging for even a well-resourced certification program.

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?

Yes. If the Guidance does not advise entities involved in delivering VCCs to their ultimate destination, i.e., retirement of the VCC, on their responsibilities in the VCC supply delivery chain, the Commission will not have benchmarks for investigating cases in which crediting programs failed to prevent double use or double claiming of a VCC. If there are no stipulated delivery procedures, the proposed commodity characteristic for VCCs of “inspection provisions” exists in name only.

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?

⁹² Assessment Framework, January 2024, Version 2, p. 62. <https://icvcm.org/wp-content/uploads/2024/02/CCP-Section-4-V2-FINAL-6Feb24.pdf>

⁹³ “The Art of Integrity,” Ecosystem Marketplace, August 2022, p. 11, figure 4. <https://app.hubspot.com/documents/3298623/view/433338095?accessId=3abc8b>

An accurate pricing of the underlying VCCs requires inclusion of the costs of establishing and maintaining the safeguard measures, including a grievance mechanism for safeguard violations, as recognized in the work program of the Paris Agreement Article 6.4 Supervisory Body.⁹⁴ The ICVCM proposes as an optional attribute of the CCP “Sustainable Development Indicators and Benefits.”⁹⁵ However, the Assessment Framework criteria for this optional CCP attribute are notably underdeveloped relative to the other criteria. Indeed, they are little more than “Mitigation activities shall meet CORSIA requirements related to Safeguards systems.”⁹⁶ Although ICVCM plans future work on sustainable development indicators and safeguards to substantiate this optional attribute to the CCPs, it is surprising that the attribute is proposed with this paucity of criteria.

IATP believes that what the ICVCM characterizes as optional for CCP labeled VCCs, the DCMs should make mandatory within the VCC derivative contract design. However, the Commission should not base any Guidance on safeguards in VCC derivatives contracts on the ICVCM’s work thus far. Absent a crediting program and host government authority enforcement of these environmental and social safeguard, and absent an effective and readily accessible grievance mechanism for violations of these guardrails,⁹⁷ sustainable development indicators and benefits will likely remain unrealized promises or intentions. The Guidance must not be grounded in promises and intentions.

Conclusion

Here IATP summarizes our major recommendations to the Commission for the Guidance.

- The Guidance should include a clear statement of the public interest in DCM design and listing of VCC derivatives contracts, as well as in the Commission’s monitoring and enforcement activities.
- The Commission should follow Commissioner Kristin Johnson’s recommendations concerning future guidance documents, including the application of material risk disclosure requirements to registered market participants trading VCC derivatives contracts.
- The Commission should avail itself of the best climate science and science-based carbon accounting and crediting literature to advise DCMs in the design and listing of VCC derivatives contracts.
- The Guidance should advise DCMs to inform market participants in the VCC derivatives “terms and conditions” that unresolved issues in Paris Agreement Article 6

⁹⁴ E.g., “Concept note: Development of a Sustainable Development Tool for Article 6.4 of the Paris Agreement,” Version 02.0, August 25, 2023. <https://unfccc.int/documents/630333>

⁹⁵ “Core Carbon Principles,” p.19.

⁹⁶ Table 12. Safeguards, p. 96.

⁹⁷ E.g., https://unfccc.int/sites/default/files/resource/SB008-CIEL_SubmissionAppealGrievanceProcess.pdf

implementation, e.g., regarding corresponding adjustment to prevent double counting of credits, may affect the estimated deliverable supply of high integrity VCCs originating in developing country hosts of emissions reduction projects.

- The Guidance should not advise the DCMs that the ICVCM or other private organization processes for revising VCC standards and accountability mechanisms is an Appendix C “individual commodity characteristic” since that process does not share any of the Appendix C criteria to be included as an “individual commodity characteristic.” Instead, the Guidance should advise the DCMs to present a VCC derivatives contract for approval or disapproval whenever the Commission or DCM determine that changes to the ICVCM standards or accountability mechanisms would have an “economically significant” impact on the contract.
- The Guidance should advise DCMs that include nature-based VCCs in the underlying of their VCC derivatives “terms and conditions” to note that these VCCs are subject to emissions reversals that may not be compensated by crediting programs if the ICVCM Governing Board determines these reversals to be unavoidable. Uncompensated reversals affect the standard of permanence of greenhouse gas dioxide storage and possibly the price of the underlying VCC. Under climate tipping points, the increasing frequency and severity of emissions reversals will be the rule, not the exception.
- The Commission should avail itself of emerging economic modeling of market manipulation and consider applying that modeling to entities in the VCC supply chain as warranted. Because excessive speculation can be an indicator of market manipulation, the Commission should advise the DCMs to provide documentation to substantiate DCM spot month position limits in VCC derivatives contracts.
- The ICVCM plans to offer an optional Sustainable Development Indicators and Benefits attribute to its CCP. The attribute would include requirements concerning crediting program safeguards to ensure the environmental and social integrity of CCPs. In IATP’s view, sustainable development claims cannot be substantiated without enforceable safeguard requirements, e.g., to ensure that VCCs have not been developed from projects that violate human and land rights to cut VCC development costs. We further advocate that DCMs attest in their “terms and conditions” for VCC derivatives contracts that the crediting programs providing VCCs for their derivatives contracts define their safeguards and document their efficacy.

The Institute for Agriculture and Trade Policy hopes that these comments will assist the Commission in finalizing this Guidance to DCMs. We would be pleased to respond to any questions the Commission may have about these comments. Finally, we look forward to assisting the Commission in developing any further Guidance or rulemakings about VCMs and VCC derivatives.

Respectfully,

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