TO: Commodity Futures Trading Commission

FROM: Stone Allen Washington; Research Fellow at the Competitive Enterprise Institute

RE: 88 FR 89410

To the Honorable Rostin Behnam, Chairman of the Commodity Futures Trading Commission, and the Honorable Commissioners Kristen N. Johnson, Cristy Goldsmith Romero, Summer K. Mersinger, Caroline D. Pham

Thank you for the opportunity to provide comments regarding the Commission’s proposed guidance for listing voluntary carbon credit (“VCC”) derivative contracts. It would not be within the Commission’s best interest to impose such regulatory parameters on this voluntary market. The Commodity Futures Trading Commission (“CFTC” or “Commission”) is not statutorily authorized to set guidelines for the trade of carbon credits through direct contract markets (“DCMs”). This voluntary carbon market advances a form of environmental currency that does not represent any underlying commodity subject to the CFTC’s jurisdiction. Such a voluntary market simply was not designed to be regulated by any government body.

The unregulated market for VCCs is distinct from mandatory cap-and-trade systems, as only the latter is subject to government control. Market participants must be left to trade carbon credits without concern for triggering compliance standards that are inapplicable to a voluntary system. The CFTC risks overstepping its mission by seeking to legitimize an environmental decarbonization program attached to derivative contracts. The Commission should refrain from passing its proposed guidance by allowing this voluntary market system to remain separate from the regulatory responsibilities of the CFTC.

**The Commission lacks the statutory authority to regulate carbon credits**

Congress has not instructed the CFTC to introduce standards for trading voluntary carbon credits. There has yet to be any proposed legislation that authorizes the Commission to insert itself into a carbon offsetting program. Given this legislative silence, the Commission’s insertion into this voluntary market would be evidence of unwarranted regulatory intervention.[[1]](#footnote-1) This guidance seeks to legitimize the listing of VCC derivatives in the markets. By proposing this guidance, the CFTC is incentivizing investor participation in the purchase and sale of carbon credits. The CFTC exceeds its statutory limitations when issuing a regulatory guidance on the listing and trade of carbon credit derivatives.

The Commission proposes this guidance as a means to ensure that pre-existing carbon credit derivatives are aligned with provisions of the Commodity Exchange Act (“CEA”). The CEA provides no mention for the Commission to regulate environmental-based derivative contracts.[[2]](#footnote-2) Environmental VCC provisions represent decisions by the consenting company to voluntarily decarbonize a segment of its operations to mitigate climate change. It is not for the CFTC to advance standards that facilitate an organization’s listing or procurement of these credits. Establishing such standards tips the scale for investors to display interest in a voluntary system that the Commission is not authorized to regulate in any way.

If Congress felt it appropriate to instruct the CFTC to guide such voluntary transactions, there would be existing legislation to accommodate this. Absent any legislative instruction, the Commission seeks to use its regulatory authority to validate a voluntary market that exists solely between private parties and not the agency itself. This legislative silence regarding carbon credit derivatives may in-part be explained by how such carbon-based mechanisms fail to align with the basic requirements of a derivative contract. Carbon credits derive market value exclusively from environmental protection efforts, such as decarbonization or greenhouse gas (“GHG”) reduction. They do not provide any real market value to the underlying assets that the derivative contract represents. As such, nonfinancial carbon credits do not qualify as actual derivatives when looking to the true definition,[[3]](#footnote-3) since their inherent value is untethered to any form of financial performance. The Commission also violates the CEA by recognizing VCCs as the underlying assets represented by such derivatives. This is because agricultural commodities as recognized under law does not encompass intangible carbon credits or the reduced GHG emissions they represent.[[4]](#footnote-4)

**The CFTC does not exist to “support decarbonization”**

The Commission exceeds its mission statement by promoting investments toward decarbonization. The CFTC exists to “promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation.”[[5]](#footnote-5) This does not enable the Commission to endorse a separate carbon credit system attached to certain derivative contracts. There is nothing in the CFTC’s mission statement or the CEA that deputizes the agency to mitigate climate change.[[6]](#footnote-6) This guidance violates the Commission’s neutrality as a regulator because it openly endorses an extraneous aspect of derivatives that the agency is not authorized to support.

It is not for the CFTC “to help channel capital to support decarbonization”[[7]](#footnote-7) by endorsing investor participation in this voluntary carbon credit market. Nor is it for an independent agency, like the CFTC, to advance “a whole-of-government approach”[[8]](#footnote-8) in league with executive branch departments. Such a politically driven initiative has never been proposed before in the CFTC’s 88-year history, and the agency cannot suddenly advance a climate change reduction agenda by setting these standards. This defeats the entire purpose of the investor class establishing a voluntary market in the first place. And research shows that among financial regulators in the U.S., the CFTC is the least likely to ever encounter climate-related financial risks on its exchanges.[[9]](#footnote-9) This undermines the justification for the Commission’s Climate Risk Unit and its Market Risk Advisory Committee's Climate-Related Market Risk Subcommittee, as climate-related financial risks pose no serious threat to the trade of derivatives.

The CFTC already regulates the listing and exchange of traditional derivative contracts. Extending listing standards to recognize environmental conditions and credits attached to such contracts is unnecessary and unwarranted. As covered in the guidance, only mandatory emissions programs have been actively traded on CFTC exchanges for two decades. By contrast, there are 18 futures contracts with voluntary carbon products. But only three of these (16%) contracts actually possessed an open interest and trading volume at the time of the proposed guidance.[[10]](#footnote-10) Even more problematic is the fact that none of these futures contracts encompassed carbon credits. Rather, each of the three products with an open interest pertained to carbon offset programs. This suggests that businesses are only slightly interested in futures that provide compensation for investing in environmentally friendly initiatives, while permitting their GHG emitting activities. By contrast, there doesn’t appear to be any notable investor demand for carbon credit derivatives that eliminate or reduce a business’s emissions. Why does the Commission suddenly feel compelled to begin regulating this market now absent any market incentive or clear policy justification?

It seems more likely that the Commission has taken issue with such a lack of investor interest to participate in the VCC market. This guidance is merely a stamp of approval to kickstart investor participation with VCCs, imposing regulatory standards that validate the market as a worthwhile venture. This is evident in the guidance itself which admits that “recently, supplies of VCCs are generally considered to be high relative to demand.”[[11]](#footnote-11) Additionally, there has only been one U.S.-based commodities exchange that has actually shown interest in listing VCCs.[[12]](#footnote-12) The abovementioned futures contracts with VCCs are confined only to this New York exchange. Given how only 16% of these contracts carry any investor interest, the Commission cannot use this proposal as a means to inspire market participation in this space. As the corporate participation rate in VCC trading is virtually non-existent compared to the available supply of carbon credits, the CFTC cannot artificially insert guidance standards in a struggling market as a means to boost investor demand and trust.[[13]](#footnote-13) The CFTC is tasked by Congress to create standards for an already viable market for futures trading, not to advance standards that elevate a fleeting sub-market it has no authority over.

**Government intervention in a voluntary market is unwarranted**

This guidance clearly distinguishes between voluntary markets like VCCs and mandatory cap-and-trade markets. Where the former is self-regulated by investor willingness or unwillingness to participate, the latter is influenced by government mandate to induce participation in the market or refrain from emitting GHG. What the Commission seeks to achieve here is something completely unorthodox: adapting mandatory compliance standards to a voluntary carbon credit market.[[14]](#footnote-14) This introduces an unofficial hybrid of government coercing investors to properly exchange VCCs or suffer the penalties for violating CFTC compliance standards. Voluntary markets such as these are meant to be self-regulated by the participants with no government oversight, given that the CFTC did not create the parameters for trading carbon derivatives in the first place. Rather, VCCs are issued by a carbon crediting program with standards set by the Integrity Council for Voluntary Carbon Markets, an independent governance body.[[15]](#footnote-15)

The Commission only possesses authority to ensure compliance with standard derivatives, not contracts with voluntary carbon credit provisions attached. The CFTC cannot overextend its existing anti-fraud and anti-manipulation mechanisms to cover private environmental agreements and punish perceived violations in VCC trading.[[16]](#footnote-16) Such agreements over carbon credits are merely provisional attachments and does not represent the actual derivatives being regulated by the agency. The CFTC’s Environmental Fraud Task Force is not authorized to punish conduct over trading carbon credits simply because the agency cannot control voluntary GHG mitigation efforts. The Commission needs to keep its regulatory focus[[17]](#footnote-17) on the actual underlying assets being represented by derivatives[[18]](#footnote-18), not intangible carbon reduction agreements with no stated basis in statue or the agency’s core principles. VCCs themselves are no substitutes for the actual commodities being exchanged on the markets. The Commission must not misinterpret the meaning of carbon credits as a means of validating this market or to satisfy a political decarbonization agenda.

**Conclusion**

The Commission should not pass this proposed guidance. I urge the Commissioners to leave the voluntary market for carbon credits as it has been for nearly 20 years: untouched. Such markets were designed to be self-regulated by the investors and companies that opt to participate. The provisional agreements within VCCs are separate from the actual derivatives being regulated. Intangible VCCs are not actual commodities and shouldn’t be confused as an official asset class that is covered under the Commission’s core principles or the CEA. Attempting to do so would be a misinterpretation by the Commission regarding the laws that govern commodities trading. The CFTC is not statutorily permitted to issue guidance on the trade of VCCs. It cannot misapply its core principles or CEA provisions affecting DCMs in an effort to artificially validate VCC trading.

Investors are free to trade with carbon credits at their own risk, which is separate from the established regulatory standards governing the trade of actual derivatives on DCMs. The Commission must not abandon its statutorily-backed core mission in pursuit of a new mission by helping to “channel capital to support decarbonization.” Doing so would in fact establish the CFTC as an unsanctioned climate regulator, which is something that Chair Benham has promised would never happen under his watch. The Commission must honor this promise, its core mission, and the will of Congress by not adopting this proposed guidance.

Thank you for the opportunity to comment on this matter.

Sincerely, Stone Allen Washington

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1. Halley I. Townsend and Alexander S. Holtan, “CFTC Moves to Set Voluntary Carbon Market Standards”, Holland & Knight, December 13, 2023, <https://www.hklaw.com/en/insights/publications/2023/12/cftc-moves-to-set-voluntary-carbon-market-standards>. See the following, “The CFTC does not have the statutory authority to directly impose standards on the VCC market.” [↑](#footnote-ref-1)
2. Commodity Exchange Act of 1936, 7 U.S. Code Chapter 1, <https://www.law.cornell.edu/uscode/text/7/chapter-1>. Given that, by themselves, carbon credit derivatives do not generate any actual financial value for the underlying assets they represent, the CFTC cannot treat these like traditional derivative contracts. [↑](#footnote-ref-2)
3. See the legal definition for “derivatives”, “means a financial contract that derives its value from the value and performance of some other underlying financial instrument or variable, such as an index or interest rate.” 12 CFR § 703.102 – Definitions. <https://www.law.cornell.edu/cfr/text/12/703.102#:~:text=Derivative%20means%20a%20financial%20contract,CFTC)%20in%2017%20CFR%201.3>. [↑](#footnote-ref-3)
4. Section 1a(9) of the Commodity Exchange Act, 7 USC 1a(9). The term “commodity” does not encompass carbon credits or the emissions from actual commodities. Rather, it pertains to, “wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by section 13–1 of this title).”  [↑](#footnote-ref-4)
5. Commodity Futures Trading Commission, “CFTC Mission Statement”, <https://www.cftc.gov/About/AboutTheCommission> [↑](#footnote-ref-5)
6. David R. Burton, public comment in “Request for Information on Climate-Related Financial Risk”, Commodity Futures Trading Commission, August 8, 2022, <https://thf_media.s3.amazonaws.com/2022/Regulatory_Comments/Comment%20Letter%20of%20David%20R%20Burton%20re%20CFTC%20Request%20for%20Information%20on%20Climate-Related%20Financial%20Risk%20080822.pdf>. See the following, “the CFTC does not have the authority to impose regulations that have as their objective environmental regulation and the mitigation of climate change. The generalized instruction in the Commission’s statutory charge to act in the ‘public interest’ does not given it authority to whatever it wants.” [↑](#footnote-ref-6)
7. Commodity Futures Trading Commission, “Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment”, notice of proposed guidance, *Federal Register,* (December 27, 2023), pp. 89411-89428. See pg. 89422. [↑](#footnote-ref-7)
8. Commodity Futures Trading Commission, “Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts, see pg. 89422. [↑](#footnote-ref-8)
9. Burton, “Request for Information on Climate-Related Financial Risk”. See the following passage, “According to the Bank of International Settlements, only 8 percent of credit default swaps have a maturity of over five years. According to OCC data, only 12 percent of interest rate, FX, and gold derivatives held by banks were over five years in maturity. Thus, the CFTC regulated entities appear to face vastly less climate-related risk than securities issuers or banks extending loans.” [↑](#footnote-ref-9)
10. See footnote 51, Commodity Futures Trading Commission, “Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment”. [↑](#footnote-ref-10)
11. Commodity Futures Trading Commission, “Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment”, pg. 89413. See also, Transcript of Commission's Second Voluntary Carbon Markets Convening (July 19, 2023), Kyle Harrison, stating, “Because you have an oversupply, you have a surplus of cheaper credits and companies can go ahead and use those in many cases as a band-aid solution, as opposed to de-carbonizing and reducing their gross emissions,” available at: [*https://www.cftc.gov/​sites/​default/​files/​2023/​11/​1700165549/​SVCMC\_​transcript071923.pdf*](https://www.cftc.gov/sites/default/files/2023/11/1700165549/SVCMC_transcript071923.pdf). [↑](#footnote-ref-11)
12. Levi McAlister, Pamela T. Wu, Sarah V. Riddell, “CFTC To Exercise Its Jurisdictional Hook: Regulating Voluntary Carbon Markets Via Futures Exchanges Oversight”, Morgan Lewis, December 8, 2023, <https://www.morganlewis.com/pubs/2023/12/cftc-to-exercise-its-jurisdictional-hook-regulating-voluntary-carbon-markets-via-futures-exchanges-oversight>. See the following statement, “Currently, NYMEX is the only US exchange that offers futures contracts on voluntary carbon credits with open interest,”. [↑](#footnote-ref-12)
13. Allegra Dawes, Cy McGeady, and Joseph Majkut, *Voluntary Carbon Markets: A Review of Global Initiatives and Evolving Models* (Washington D.C.: Center for Strategic and International Studies, May 31, 2023), pg. 8, “Though governments are not the only actors that can serve this function, they have unique legitimacy and regulatory authority, which can drive credit supply and trade infrastructure toward centralization in voluntary markets.” <https://csis-website-prod.s3.amazonaws.com/s3fs-public/2023-05/230531_Dawes_Voluntary_CarbonMarkets.pdf?VersionId=Ji7fxv9DiPwRUJekj.0SJ14GCdstvZh8>. [↑](#footnote-ref-13)
14. International Swaps and Derivatives Association, “Legal Implications of Voluntary Carbon Credits”, (New York City: ISDA, December 2021). See the following, “In contrast to the highly regulated mandatory carbon market, voluntary carbon markets currently do not involve any specific government authority oversight.” [↑](#footnote-ref-14)
15. Integrity Council for the Voluntary Carbon Market, “About Us”, <https://icvcm.org/about-the-integrity-council/>. [↑](#footnote-ref-15)
16. Townsend and Holtan, “CFTC Moves to Set Voluntary Carbon Market Standards.” See the following, “the Proposed Guidance is an attempt by the CFTC to indirectly impose standards on the VCC market via the exchanges it regulates.” [↑](#footnote-ref-16)
17. Stone Washington, “Are we ready for a ‘Carbon’ Futures Trading Commission?”, Open Market (blog), Competitive Enterprise Institute, July 28, 2023, <https://cei.org/blog/are-we-ready-for-a-carbon-futures-trading-commission/>. See the following quoted passage from my blog on Chair Behnam’s remarks at the CFTC’s second voluntary carbon market convening in July 2023, “‘the CFTC is not a climate regulator.’ Behnam continues by stating that, ‘indeed it is not within our authority to require that market participants comply with a specific climate policy or foreclose access to our regulated markets based on any such policy.’” Despite what is claimed, this proposed guidance serves as a climate policy to direct investor conduct in the voluntary carbon market. It requires VCCs to conform to existing compliance standards that have not applied to the trade of carbon credits until now. [↑](#footnote-ref-17)
18. Peter Y. Malyshev, Jason M. Halper, Jeffrey Nagle, “CFTCs Increased Reach over Environmental Commodities”, Cadwalader, December 15, 2023, <https://www.natlawreview.com/article/cftcs-increased-reach-over-environmental-commodities#:~:text=During%202023%20the%20Commodity%20Futures,(VCC)%20markets%20in%20particular>. [↑](#footnote-ref-18)