# Taskforce on Scaling Voluntary Carbon Markets

## Phase II Consultation Report Response

Date: June 21, 2021

*The Futures Industry Association (FIA), the leading global trade organization for the futures, options and centrally cleared derivatives markets, welcomes the opportunity to respond to the Taskforce on Scaling Voluntary Carbon Markets (the Taskforce) Phase II Public Consultation Report, focused on recommendations related to a market governance body and legal principles for the market.*

*At the outset, FIA wishes to thank and commend the Taskforce for bringing together stakeholders from across the globe to provide recommendations and solicit feedback about how best to scale an effective and efficient voluntary carbon market. We would especially like to thank Mark Carney, UN Special Envoy for Climate Action and Finance, for launching the Taskforce, as well as Bill Winters, Group Chief Executive, Standard Chartered; Tim Adams, CEO, the Institute of International Finance; Annette Nazareth, Senior Counsel at Davis Polk; and the McKinsey & Company team for their leadership of this ambitious project over the past several months.*

## FIA Response

The risks posed by global climate change are real and urgent. They include direct financial risks from extreme weather, as well as the transition risks associated with fundamental changes in how the world does business.

The futures, options and centrally cleared derivatives markets are playing, and will continue to play, a critical role in helping the global economy navigate these risks. As the leading global trade organization for these markets, FIA and its members are committed to working with the public and private sectors to help foster robust and transparent voluntary carbon markets. These markets will be essential to meeting the goals of the Paris Climate Agreement.

### *Markets play a proactive and critical role in developing climate change solutions*

Derivatives markets play a critical role in the global economy, providing price discovery on a wide variety of goods and commodities. Our markets also provide important hedging mechanisms for businesses to manage a wide variety of risks attendant to their operations.

**BRUSSELS** Office 621, Square de Meeûs 37, 1000 Brussels, Belgium | **Tel** +32 2.791.7571
**LONDON** Level 28, One Canada Square, Canary Wharf, London E14 5AB | **Tel** +44 (0)20.7929.0081
**SINGAPORE** One Raffles Quay, North Tower, Level 49, Singapore 048583 | **Tel** +65 6662.5782
**WASHINGTON, DC** 2001 K Street, NW, Suite 725, North Tower, Washington, DC 20006 | **Tel** +1 202.466.5460

These core functions are integral for the global response to climate change. By discovering prices for everything from a barrel of crude oil to a megawatt of solar energy to a tonne of CO2, our markets help businesses and policymakers understand the true costs of climate change and, importantly, they provide tools for energy producers and commercial end users to free up capital for innovation that will help the world transition to a low-carbon future.

In September 2020, FIA published a policy paper entitled, ["How derivatives markets are helping the world fight climate change."] The paper highlights existing industry solutions and potential partnerships with the public sector to help build a more sustainable economy.

We are proud that the global regulated derivatives industry has proactively created new products and new venues to manage climate risk over the last several years, showcasing the value of market-based solutions.

***FIA recommendations related to umbrella governance body proposals***

Voluntary carbon markets are a prime example of the kind of innovation financial markets can provide to the global economy to help address climate-related risks. FIA is committed to working with the Taskforce and with the public and private sectors to develop voluntary carbon markets that are of the highest integrity, resilience, and transparency. Equally important, these markets must be designed to allow buy and sell-side market participants, investment firms and funds, including institutional investors, to have the confidence to enter these markets at scale.

Fortunately, FIA members, and listed derivatives markets as a whole, have a strong track record of success in scaling high-integrity markets for a variety of asset classes, with exchanges often acting as regulator and standard-setter to deploy industry-led solutions effectively and transparently. Derivatives exchanges have accomplished this by relying on existing governance and self-regulatory bodies that have proven to be both agile and responsible platforms for innovation.

We are confident that new and existing exchanges, in collaboration with market participants and self-regulatory authorities, will develop the derivatives products necessary to support robust voluntary primary carbon markets and that market participants will be able to trade these listed derivatives products with confidence given the comprehensive set of regulations to which these products are already subject across the world.[1] In scoping its role and focus, we would advise the

[1] For example, the US Commodity Exchange Act requires designated contract markets (exchanges) to monitor and enforce the trading of products for market abuse, to ensure any listed product is not subject to manipulation, to collect information on traders and their trade positions, to set position limits on products to avoid market manipulation, to ensure the segregation and protection of customer funds, and to ensure the financial integrity of these markets. See CEA Section 5, 7 U.S.C. § 7; *see also* Designated Contract Markets, Commodity Futures Trading Commission, https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm.

Taskforce governance body to defer to and rely on this existing regulatory framework and authorities that oversee these well-regulated derivatives markets.

Relying on this existing structure will also leverage prevailing global standards and regulatory coordination that currently exists for these markets. Post-financial crisis reforms have codified the mechanism for jurisdictions abiding by high global standards for derivatives trading and clearing and provided mechanisms for recognition of the high standards of other regulatory regimes. This has allowed investors and market participants to trade with confidence on markets, knowing that the integrity and quality of the marketplace and its regulations are of the highest global standards and that they will not be subject to overlapping and duplicative regulations. It also allows market participants to access exchanges and clearinghouses cross-border to hedge and manage risk in the countries and regions where they operate. This cross-border regulatory framework should be leveraged by the TFSVCM governance body, as carbon markets are necessarily transnational.

FIA also has some general recommendations related to the proposed organizational design of the umbrella governance body, including generally simplifying and clarifying the umbrella governance body structure, mission, and process. FIA commends the Taskforce for its efforts to ensure high credibility and integrity of the carbon credits and offsets. It is critical, however, that any governance body include representation of current market participants. FIA raises a concern about the proposed requirement that only former market participants absent for two years from the industry be eligible to serve. With this requirement, there is a risk that the output of the governing body will not reflect current considerations of market participants and, as a result, these markets may remain nascent with minimal participation by the very commercial and financial firms who will be needed to make them successful.

There is a risk, given the pace and scale of change in these markets, that a requirement for members of the governing body not to have been active market participants for the last two years may restrict the ability of the governing body to remain current and reflect the commercial concerns of the market as it continues to develop. Commercial and financial firms, which are heavily regulated and are held responsible for the safety and soundness of the markets in which they operate, take into consideration several factors when considering whether to enter a new market or clear new products. This makes their representation in any governance body even more critical to achieving the ambitious goals supported by the Taskforce. Any firm exploring whether to participate in such markets will necessarily undergo a credit, risk, legal and regulatory assessment process, as well as determining that there is sufficient commercial rationale for doing so. It is therefore important to understand, reflect and, so far as possible, address the issues that this review process identifies in order to ensure as wide a participation in these markets as possible.

**BRUSSELS** Office 621, Square de Meeûs 37, 1000 Brussels, Belgium | **Tel** +32 2.791.7571
**LONDON** Level 28, One Canada Square, Canary Wharf, London E14 5AB | **Tel** +44 (0)20.7929.0081
**SINGAPORE** One Raffles Quay, North Tower, Level 49, Singapore 048583 | **Tel** +65 6662.5782
**WASHINGTON, DC** 2001 K Street, NW, Suite 725, North Tower, Washington, DC 20006 | **Tel** +1 202.466.5460

FIA.org

There are numerous examples of self-regulatory organizations that allow and even encourage representation from market participants in their governance structures. Any perceived conflicts of interest can be mitigated by having a diverse set of governance participants – each with a fiduciary duty to the organization as a member of the board of directors. For example, boards often require their members to disclose potential conflicts of interest, and when a board member is faced with a true conflict between the interests of the relevant body and the board member's employer or personal holdings, that board member would be expected in many instances to recuse himself or herself from the board's decision with respect to the relevant issue. Restricting key governance positions to non-market participants, while no doubt well intended, risks the ambitious goals of the Taskforce by not providing a voice for the needs of market participants. FIA encourages the Taskforce to include market participants in key positions within the umbrella governance body and require they have a fiduciary duty that is transparent and public.

Additionally, FIA intends to apply for a role in the member consultation group. However, we recommend that the member consultation group, established under the governance body, be divided into subject matter subcommittees with specific expertise and focus areas, including a subcommittee focused on market and/or secondary market structure. A good model to reference is the Commodity Futures Trading Commission (CFTC) Advisory Committee structure, which was created to "facilitate communication between the Commission and US derivatives markets, trading firms, market participants, and end users."[2]

FIA would be happy to engage with the Taskforce about the need to directly engage with market participants. This will bring efficiencies to the work of the consultation group, allowing numerous workstreams to run concurrently and will create better opportunities for engagement from technical experts engaged in the voluntary carbon market space.

***FIA recommendations related to legal principles and contracts proposals***

Climate change is a global problem that requires a coordinated response across jurisdictions, markets, and industries.

Regulatory certainty[3] is necessary for robust participation in markets, and carbon markets are no exception. FIA supports recommendations included in the Taskforce's Phase II Consultation

[2] https://www.cftc.gov/About/AdvisoryCommittees/index.htm

[3] FIA members have identified several specific legal areas the Taskforce should focus. For example, with clearing members serving as our primary members, we are acutely aware of the importance of closeout netting to firms' management of counterparty credit risk and their regulatory capital obligations. Oftentimes, the availability of closeout

**BRUSSELS** Office 621, Square de Meeûs 37, 1000 Brussels, Belgium | **Tel** +32 2.791.7571
**LONDON** Level 28, One Canada Square, Canary Wharf, London E14 5AB | **Tel** +44 (0)20.7929.0081
**SINGAPORE** One Raffles Quay, North Tower, Level 49, Singapore 048583 | **Tel** +65 6662.5782
**WASHINGTON, DC** 2001 K Street, NW, Suite 725, North Tower, Washington, DC 20006 | **Tel** +1 202.466.5460

FIA.org

Report that encourage global regulators to examine their treatment of voluntary carbon credits with the aim to better align these programs across jurisdictions.

FIA supports efforts of the Taskforce to promote the introduction of core carbon spot and futures contracts and design the contracts to be homogeneous across markets. There is an important role for both the bespoke over-the-counter markets as well as the more standardized exchange-traded spot and futures markets. The development by the Taskforce of standardized contracts will improve primary and secondary market liquidity and price discovery. Deep markets typically have cash settled contracts as well as contracts that allow for physical delivery to encourage diversified participation by users of these products.

FIA believes the definition of *exchange traded contract* on page 42 of the Consultation Report could be clarified to read: "Contract that is listed and traded on a regulated exchange" Also on page 42, under the definition for *spot vs. futures contracts*, it would be helpful to highlight the importance of spot contracts and note that exchanges would be expected to set their trading terms for futures <u>and</u> spot contracts (rather than only futures).

**<u>Closing</u>**

FIA is proud to have participated in the ambitious work of the Taskforce and is committed to working with the public and private sectors to foster robust and transparent voluntary carbon markets to help meet the goals of the Paris Climate Agreement.

Most respectfully,

Walt L. Lukken

Walt L. Lukken
President and CEO

---

netting under governing law is a binding constraint to a firm's ability to serve local derivatives markets. There will need to be legal certainty on market issues such as netting for carbon markets to flourish.

Additionally, FIA urges the Taskforce to consider the legal nature of carbon offsets and credits, including issues related to reversibility and insolvency. A lack of harmonization across jurisdictions in these technical areas is a key risk to consider, which could inhibit the scaling of these markets to meet the goals of the Paris Climate Agreement.