FIA.org

February 16, 2024

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st St. NW
Washington, DC 20581

Re: Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment; RIN 3038–AF40

Dear Mr. Kirkpatrick,

The Futures Industry Association ("FIA")[1] welcomes the opportunity to respond to the Commodity Futures Trading Commission ("CFTC" or "Commission") proposed guidance ("Proposed Guidance")[2] regarding the listing for trading of voluntary carbon credit ("VCC") derivative contracts, which outlines certain factors the Commission believes a CFTC-regulated exchange, or designated contract market ("DCM"), should consider when addressing requirements of the Commodity Exchange Act ("CEA") and CFTC regulations in connection with designing and listing VCC contracts.

FIA welcomes the CFTC's focus on carbon markets over the last several years and in particular its efforts to promote the integrity and strengthen the transparency, liquidity and price discovery of these rapidly-growing markets. We also appreciate that the CFTC has remained strictly focused on its jurisdictional remit and coordinated closely with other financial regulators and standard setting bodies, both in the US and internationally, to foster global clarity for these important markets. Regulatory certainty can support robust participation and liquidity in markets, and carbon markets are no exception.

Voluntary carbon markets ("VCMs") and related VCC derivative contracts are playing a critical role in helping the global economy navigate and manage risks associated with the energy transition and reduction of greenhouse gas ("GHG") emissions. In just the last few years, we have witnessed rapid growth in carbon, climate and sustainability-linked markets. We expect this growth to continue, and indeed accelerate, in the years to come as new technologies emerge and markets evolve. There are many public and private-sector initiatives that are aiming to bring increased standardization to VCCs and related derivatives, and as noted in the Proposed Guidance, several CFTC-regulated exchanges have listed standardized VCC contracts to help commercial firms and market participants that are striving to meet ambitious carbon-reduction targets in both the near- and long-term and with respect to compliance markets and VCCs.

---

[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.

[2] Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment, 88 Fed. Reg. 89410 (Dec. 27, 2023).

Although progress has been made to develop and apply objective, reliable standards to VCMs and VCCs, opportunities for improvement remain, aided by emerging technologies, further scientific dialogue, international cooperation[3] and more uniform adoption of standards. This is to be expected from any new commodity market. We are aware of press reports and academic publications that have raised questions about the methodologies employed by certain third-party validators to calculate the emissions reduced and/or avoided by carbon offset projects. These findings have been disputed by the subjects of the reports. This uncertainty creates challenges – regulatory, commercial and reputational – both for exchanges that are developing innovative products to meet growing demand and for market participants seeking access to these markets to fulfil climate commitments.

In contrast with carbon compliance (or mandatory) markets, however, such as the California Cap and Trade or the Regional Greenhouse Gas Initiative carbon emission reduction regimes, non-derivative VCMs are currently outside of comprehensive state or federal oversight. We view the Proposed Guidance as a good-faith effort in facilitating a more structured and tailored approach to the development of nascent derivative VCMs.

Fundamentally, FIA believes in the power of markets and innovation to solve these challenges over time. The listed derivatives markets have a strong track record of success in scaling markets for a variety of asset classes and product types. Futures markets, in particular, provide an efficient way for companies and financial firms to manage risk associated with an asset class, and serve as efficient price discovery tools. The existing regulatory framework and track record of the US futures markets have provided market participants added confidence when they seek to manage risk in these markets. We are confident that new and existing exchanges, in collaboration with market participants, self-regulatory authorities, and industry-led efforts and multinational projects[4] that seek to bring greater integrity to carbon markets, will develop the derivatives products necessary to support robust VCMs.

We have no reason to doubt that the exchanges developing and listing VCCs today are already complying with their obligations under the CEA and CFTC regulations. That said, we view the Proposed Guidance as an attempt to provide more clarity into how exchanges, moving forward, may carry out their regulatory obligations in developing and listing new VCC-linked contracts and to give market participants added assurance that the contracts meet the requirements of the CEA and CFTC regulations.

We also believe that the Proposed Guidance may serve to encourage further adoption of scientifically-rooted standards in the underlying VCC markets. We understand from members that the primary challenges with VCMs is not with the derivatives markets, but rather with the underlying VCCs themselves, specifically involving a lack of consistency in methodologies employed by third-party validators and questions relating to the quality of the credits. These are key issues for market strength and growth. Private sector-led initiatives, such as the Integrity Council for the Voluntary Carbon Market ("ICVCM"),[5] are presently working to address these challenges, and we welcome and support their efforts.

[3] *See, e.g.*, https://www.whitehouse.gov/briefing-room/statements-releases/2023/12/13/statement-from-president-joe-biden-on-agreement-reached-at-cop28/.
[4] *See, e.g.*, the Sustainable Stock Exchanges Initiative (https://sseinitiative.org/)
[5] Information on the ICVCM is available here: https://icvcm.org/.

Market participants generally welcome these types of private sector led efforts to improve the integrity of carbon markets. At the same time, market participants have welcomed the engagement and coordination of policymakers and regulators, like the CFTC. That is because market participants seeking the ability to manage risk associated with the carbon asset class – in the spot market, through forward contracts, and in listed derivatives markets – are seeking access to high-quality carbon credits that have been reliably verified by third-party firms in line with international best practices and standards.

FIA welcomes the acknowledgement of the CFTC that the "proposed guidance is not intended to modify or supersede existing statutory or regulatory requirements, or existing Commission guidance that addresses the listing of derivative products by CFTC- regulated exchanges."[6] As we stated in the October 2022 FIA response to CFTC climate Request for Financial Information ("RFI"),[7] we believe the CFTC and National Futures Association's ("NFA") existing principles-based regulatory framework is sufficient to accommodate VCCs as a new asset class.[8] Accordingly, we request that the CFTC clarify the following:

- *Whether the factors articulated in the Proposed Guidance be used as evidence of a DCM's compliance with requirements of Core Principle 3 (and other CEA and CFTC requirements).* As a general matter, overlaying too many regulatory requirements onto a nascent and emerging market could inhibit its growth. DCMs already must demonstrate that any contract they list is not readily susceptible to manipulation.[9] Should the CFTC view the Proposed Guidance as establishing additional requirements for DCMs to implement, FIA asks that the CFTC engage in a formal Notice of Proposed Rulemaking (NPRM) which would provide even further transparency and clarity to market participants, both DCMs and commercial firms.

- *Whether the Proposed Guidance applies to other third parties involved in the trading of VCCs*. We believe it should apply. Specifically, CFTC and NFA-registered FCMs, introducing brokers, commodity trading advisers, commodity pool operators, swap dealers, floor brokers and their associated persons are not charged with the duty to police and monitor these markets to the extent this may be implied in the Proposed Guidance above and beyond of what is already required from these entities under the CEA, CFTC Regulations, NFA rules and interpretations, as well as DCM rules as their SRO. The Proposed Guidance reminds that § 38.254 of CFTC Regulations already requires that trading market participants not only keep the records of their trading on a DCM, but also the records of their trading in underlying commodities.[10]

[6] *See* 88 Fed. Reg. at 89415; *see also id.* at 89411 n. 20.
[7] Letter from Walt L. Lukken, President and CEO, FIA, to Christopher Kirkpatrick, Secretary, CFTC (Oct. 7, 2022), available at https://www.fia.org/sites/default/files/2022-10/FIA%20Climate%20RFI%2010.07.22.pdf
[8] For example, there is plenty of guidance as well as CFTC enforcement experience with implementing DCM Core Principle 3 that mandates that the DCM only list contracts that are not readily susceptible to manipulation.
[9] *See* Appendix C to Part 38.
[10] *See* 88 Fed. Reg. at 89420 & n. 87.

We further agree with the Commission that the VCCs and VCMs are evolving and that it may be appropriate for the Commission to revisit this guidance as VCCs and VCMs continue to develop and mature.

Relatedly, as noted above, we ask that the CFTC exercise its enforcement authority in VCMs and VCC derivatives with caution. Let us be clear: markets should be safe and free from manipulative and deceptive conduct, and bad actors should be prosecuted to the fullest extent of the law to stop and deter such conduct. As noted earlier, however, the primary challenge with VCMs today is not in the derivatives markets, but rather in the underlying VCCs, specifically the lack of consistency in methodologies employed by third-party validators and quality of the credits. Enhancing the integrity of the underlying credits would be the most effective way to drive value for market participants in VCMs – both the underlying and derivatives markets. The CFTCs formation in June 2023 of its Environmental Fraud Task Force[11] and accompanying notice from its Whistleblower Office[12] on how to identify and report potential CEA violations connected to fraud or manipulation in the carbon markets may help serve these fundamental goals. However, we urge the CFTC to focus its enforcement on clear instances of misconduct. Prosecution of market participants – whether platforms, intermediaries or end users – that rely in good faith on the representations of purported third-party experts and validators as to the quality of VCCs may chill the growth and development of VCMs. It would be troubling for companies to be subject to increased enforcement risk for taking steps in good faith to reduce their emissions and, over time, transition to a more sustainable economy. Therefore, we encourage the CFTC to clarify that it will not bring enforcement action against trading venues, intermediaries, and market participants acting in good faith to comply with the CEA and CFTC rules and regulations. Moving forward, FIA encourages the CFTC to continue coordinating with regulators and standard setting bodies, such as IOSCO, to examine their treatment of VCCs to better align these programs across jurisdictions. FIA also encourages the CFTC to closely monitor developments at a state level and serve as a resource to policymakers and regulators as they contemplate actions that may impact VCMs, and market participants, regulated by the CFTC.

Further, FIA urges the CFTC to support industry-led efforts that seek to address uncertainty and confusion, and raise the integrity and transparency, in these emerging markets. For example, the CFTC and the NFA can be instrumental in sponsoring the development of a VCC / VCM industry code, similar to the FX Global Code (sponsored by the Global Foreign Exchange Committee)[13] and the Global Precious Metals Code (sponsored by the LBMA).[14] Looking to other jurisdictions, in December 2023 Singapore's National Climate Change Secretariat (NCCS) and Gold Standard and Verra's Verified Carbon Standard (VCS) Program announced a collaboration to support countries to better leverage and utilize carbon crediting programs to achieve their Nationally Determined Contributions (NDCs) under the Paris Agreement.[15] Such voluntary document should be designed to foster development of a more reliable and orderly physical cash commodity market in VCCs.

[11] https://www.cftc.gov/PressRoom/PressReleases/8736-23
[12] https://www.cftc.gov/PressRoom/PressReleases/8723-23
[13] https://www.globalfxc.org/fx_global_code.htm
[14] https://www.lbma.org.uk/publications/the-code
[15] https://www.goldstandard.org/blog-item/singapore-verra-and-gold-standard-partner-develop-playbook-carbon-crediting-under-paris

Closing

In sum, FIA supports the underlying goal of the CFTC in the Proposed Guidance of fostering the integrity of carbon markets by providing clarity to market participants. FIA members remain committed to working with the public and private sectors to promote and maintain safe, reliable VCMs. We appreciate the Commission's efforts in this regard with its various climate-related publications and forums, culminating in the proposed guidance, and believe the future of carbon markets is brighter for the thoughtful engagement with industry stakeholders and the public.

Most respectfully,

Walt L. Lukken

Walt L. Lukken
President and CEO