C2ES CENTER FOR CLIMATE AND ENERGY SOLUTIONS

# COMMENTS OF THE CENTER FOR CLIMATE AND ENERGY SOLUTIONS

*Via Public Comment Portal*

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

**Comments of the Center for Climate and Energy Solutions on Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts (88 FR 89410 (December 27, 2023)) Document Number: 2023-28532**

Dear Mr. Kirkpatrick,

This document constitutes the comments of the Center for Climate and Energy Solutions (C2ES) on the proposed guidance regarding the listing for trading of voluntary carbon credit derivative contracts (Proposal) by the Commodity Futures Trading Commission (CFTC) and published in the Federal Register on December 27, 2023.[1]

C2ES is an independent, nonprofit, nonpartisan organization working to secure a safe and stable climate by accelerating the global transition to net-zero greenhouse gas emissions and a thriving, just, and resilient economy. A unique asset of C2ES is our 41-member Business Environmental Leadership Council (BELC).[2] In preparing these comments, C2ES has incorporated input and feedback provided by BELC members. However, the views expressed here are those of C2ES alone and do not necessarily reflect the views of members of the BELC.

In addition to having a long history of thought leadership and engagement on market-based climate policies, C2ES is a co-founding member of the Executive Secretariat of the Integrity Council for the Voluntary Carbon Market (ICVCM) and continues to play a leading role in the ICVCM. This positions the organization well to provide recommendations on the proposed guidance.

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[1] Commodity Futures Trading Commission, RIN 3038–AF40, *Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment* (Federal Register / Vol. 88, No. 247 / Wednesday, December 27, 2023 / Notices), https://www.cftc.gov/sites/default/files/2023/12/2023-28532a.pdf.
[2] "BELC Membership," Center for Climate and Energy Solutions, last accessed February 15, 2024, https://www.c2es.org/belc/belc-membership.

The following acronyms will be frequently used throughout the text: voluntary carbon credits (VCC), designated contract markets (DCMs), terms and conditions (T&C), Core Carbon Principles (CCPs).

## Summary

The Proposal provides guidance for DCMs with regards to the quality/integrity of the carbon credits in the T&C of VCC derivative contracts they wish to list for trading, which they must submit to the CFTC for review and approval prior to listing.

C2ES strongly supports the Proposal. Ensuring high integrity in the voluntary carbon market—including in derivatives markets—is critical. The consideration and disclosure of VCC commodity characteristics, as outlined in the Proposal, would also provide significant value for market participants. By enhancing transparency and promoting integrity, the Proposal would contribute to more accurate VCC derivative pricing and reduce susceptibility to manipulation—ultimately driving market confidence, efficiency, and scale.

As recognized in the Proposal, there is a robust existing ecosystem of private sector standard-setting organizations that work to promote and ensure the integrity of the voluntary carbon market (VCM). The ICVCM, which acts similarly to a voluntary regulatory body for the voluntary carbon market, has developed a threshold quality standard for carbon credits in the VCM, known as the Core Carbon Principles.[3] Other organizations, such as the Voluntary Carbon Markets Integrity initiative (VCMI) and the International Sustainability Standards Board (ISSB), have developed disclosure standards for the use of credits.

**Direct government intervention in regulating the quality of carbon credits in the VCM should refer to and draw on these existing integrity assessment, certification, and methodological efforts as much as possible.**[4] In most cases, **a reference to relevant existing voluntary standards around the trading of carbon credits should suffice**, along with the application of relevant existing regulatory frameworks for derivatives markets more broadly. Independent assessment of the quality of carbon credits requires substantial time and effort as well as detailed subject matter expertise that the CFTC, other government agencies, and DCMs do not currently possess. However, the voluntary standard-setting organizations mentioned above have already developed the requisite expertise. For example, the ICVCM has deep subject matter expertise in its Executive Secretariat and on its Board of Directors; it also maintains an expert panel with 26 leading carbon market experts from academic and non-profit organizations around the world, who have contributed to drafting the ICVCM's CCPs and are involved in assessing carbon credit programs and categories against them. The ICVCM thus provides a level of assurance that is additional to that of validation and/or verification bodies, which operate at a project level. Moreover, ICVCM has taken pains to align its CCPs with similar efforts undertaken by other expert bodies, such as the Technical Advisory Body (TAB) for the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) of the International Civil Aviation Organization

[3] "The Core Carbon Principles, Plus the Program-Level Assessment Framework and Assessment Procedures," February 14, 2024, https://icvcm.org/the-core-carbon-principles and The Integrity Council for the Voluntary Carbon Market (2023), Section 4. Assessment Framework – Core Carbon Principles, January 2024, Version 2, https://icvcm.org/wp-content/uploads/2024/02/CCP-Section-4-V2-FINAL-6Feb24.pdf.

[4] This view was shared by Nat Keohane, President of C2ES, and the Honorable Annette Nazareth, Chair of ICVCM, at CFTC's Second Carbon Markets Convening on 18th July 2023, https://www.cftc.gov/PressRoom/PressReleases/8754-23.

(ICAO). New efforts to assess carbon credit quality in the VCM by the CFTC or other government bodies would risk duplicating effort at best and creating confusion in the marketplace at worst.

C2ES appreciates that the Proposal acknowledges the role of the ICVCM and its CCPs.[5] Based on a close reading of the Proposal's recommended criteria for DCMs to address in evaluating VCCs and crediting programs,[6] as well as on C2ES's deep familiarity with the ICVCM CCPs, **C2ES finds that CFTC's specified criteria are fully satisfied by the ICVCM CCPs. As a result, a CCP label—demonstrating that the associated VCCs have been assessed by ICVCM as meeting the CCPs—should be a sufficient means of demonstrating alignment with the criteria in the Proposal in all its considerations regarding the integrity of the underlying mitigation activity and carbon credit issuance (supply side quality).**

This finding has an important implication for DCMs seeking to align with the proposed guidance. **It means that in general, a DCM could be assured it meets the Proposal's criteria—and thus is relying on high-integrity VCCs—by designing VCC derivative contracts to require underlying VCCs to be CCP-eligible.** In this way, going beyond referencing standards like the ICVCM to actually using the outcomes of assessments made by such initiatives (e.g., CCP-labelled credits) to demonstrate compliance to the Proposal can substantially decrease the burden of contract design by DCMs. Moreover, encouraging the **use of standardized quality credits (e.g., CCP-labelled) could provide a safeguard for contract delivery** in that a DCM would be able to hedge for risks of non-delivery from a specific carbon crediting program or project while ensuring the buyer gets the same quality threshold credits regardless of the type of underlying mitigation activity. Should the CFTC decide to provide its own guidance (e.g., by articulating additional criteria beyond those covered by independent voluntary standards), we strongly encourage close alignment with ICVCM, VCMI, and ISSB as relevant.

In addition, there are strong arguments linked to price formation and alignment with international climate policy that would make it **relevant for DCMs to consider VCC characteristics linked to sustainability impacts and safeguards, and contribution toward net-zero emissions by mid-century**—a part of the COP28 outcome.[7] Importantly, the ICVCM CCPs already incorporate sustainable development and contribution toward net-zero emissions. As a result, the general recommendation outlined above—that adherence to the CFTC's proposed criteria would be satisfied by the use of CCP-eligible VCCs—would continue to apply if the CFTC decides to include consideration of these additional characteristics in its final guidance. Please refer to questions 1, General section, and 16 and 17, Sustainable Development Benefits and Safeguards section, of the table below and for detailed comments on these aspects.

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[5] Proposal Section B. Voluntary Carbon Markets, footnotes 35, 36, 46.
[6] See criteria for Quality Standards, Delivery Points and Facilities, and Inspection Provisions—Third-Party Validation and Verification, in Proposal section "II.A A DCM Shall Only List Derivative Contracts That Are Not Readily Susceptible to Manipulation."
[7] 4/CMA.5 draft decision, First Global Stocktake, particularly paragraph 28. letter d), https://unfccc.int/event/cma-5?item=4#agenda_documents.

## Table 1: Tabulated comments

| AREA | REQUEST FOR COMMENT (SHORTHAND QUESTIONS)[8] | COMMENT |
|---|---|---|
| *General* | 1. Other relevant/ Non-relevant characteristics informing the integrity of carbon credits. | 1. All VCC commodity characteristics identified in this Proposal are relevant. Other relevant characteristics are: sustainable development and safeguards (including quantified sustainable development goals [SDG] impacts); contribution to net-zero emissions; host country authorization under Article 6 of the Paris Agreement;[9] and share of proceeds for adaptation finance. The ICVCM has explored these characteristics and requires CCP-eligible credits to comply with sustainable development and safeguards requirements, and provide a contribution to the net-zero transition. Host country authorization under Article 6, share of proceeds for adaptation finance, and quantified positive SDG impacts are optional attributes to be added to the CCP tag where relevant. See comments to questions 16 and 17 for more detail.<br><br>In general, correlations between quality and price have strengthened over the last 18 months, so analysts appear to be relatively confident the CCP-eligible credits will trade at a premium. Ecosystem Marketplace's State of VCM 2023 report[10] indicates VCC prices are at their peak, with nature-based credits taking the biggest market share and showing a 78 percent price premium when associated with certified environmental and social co-benefits.<br><br>Also, research indicates buyers prefer newer credits (recent vintages) featuring more robust methodologies, and the market is looking for new high-quality credits. |
| | 2. Recognized standards that a DCM should incorporate into VCC derivative contracts' T&C | 2. Yes. We suggest DCMs should incorporate: at least the CCP requirements for carbon credit supply quality and issuance; but also, ISSB Standards (IFRS S2 Climate related disclosures) and VCMI standards for carbon credit use where relevant. |

[8] See full question drafting in the Proposal's Request for Comment.
[9] Article 6 of the Paris Agreement includes Article 6.2 Cooperative approaches, that is, country-led bilateral cooperation involving transactions of "ITMOs," between Parties toward NDCs or between a Party and a non-Party for other international mitigation purposes such as the VCM, which need to be authorized thus correspondingly adjusted to avoid double counting; and Article 6.4 mechanism, UNFCCC centralized crediting mechanism successor to the CDM, with a supervisory body, which approves methodologies and projects and issue A6.4 ERs, akin to a carbon crediting program.
[10] "Voluntary Carbon Credit Buyers Willing to Pay More For Quality," December 4, 2023, https://carboncredits.com/voluntary-carbon-credit-buyers-willing-to-pay-more-for-quality and Ecosystem Marketplace (October 2023), 2023 State of the Voluntary Carbon Markets Report, https://www.ecosystemmarketplace.com/publications/state-of-the-voluntary-carbon-market-report-2023/

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| | 3. Other criteria a DCM should consider for monitoring the continual appropriateness of VCC derivative contracts T&C. | 3. DCMs should periodically reassess the appropriateness of VCC derivative contracts T&C against latest versions of the abovementioned guidance. |
| | 4. Other factors to consider by DCM in analysis of contract susceptibility to manipulation. | 4. Analysis of whether or not a VCC derivative contract would be readily susceptible to manipulation can be informed by a crediting program providing third-party assurance that VCCs are ICVCM CCP-(/ISSB-/VCMI, where relevant) compliant, with particular emphasis on the conflict of interests policy—which should be included in supply-side quality criteria (in Transparency and/or Governance) and especially Inspection Provisions—Third-Party Validation and Verification. Rules could be considered in the context of managing any conflicts of interest raised by the issuance, verification, certification, transfer, and retirement of carbon credits. These could include adequate disclosures by a crediting program of potential legal or beneficial relationships between project developers, validation and/or verification bodies, and carbon crediting programs, as well as registries (generally part of the carbon crediting program), marketplaces and exchanges, and intermediaries, among others. We also note that these risks are not generally present in the relationships between this group of actors due to most programs being not-for-profit organizations and most validation and/or verification bodies being subject to rules preventing them having interests in project development companies as part of their accreditation to operate in this market. |
| | 5. Relevance of these VCC derivative contract characteristics for submissions made by a registered foreign board of trade. | 5. Yes. While still fragmented, VCM markets are potentially global and regulation should be aligned with international standards to ensure fungibility and scalability of the market. |
| *Transparency* | 6. Criteria for DCM to assess whether a crediting program is providing sufficient access to information on projects/ activities it credits. | 6. The CCP rules (criterion 3.1) already contains comprehensive transparency requirements under the CCP on Transparency, including the requirement to make all information about the projects and its project rules public. |
| *Additionality* | 7. Criteria for DCM to assess whether a crediting program has the procedures in | 7. As part of CCP approval, ICVCM conducts a rigorous assessment of carbon crediting programs and their methodologies (see criteria in section 4 of the ICVCM guidance, the Assessment Framework) to ensure that they have procedures and processes that ensure additionality. CCP-eligible programs have passed the threshold, so a DCM can |

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| | place to test for and provide assurance on additionality. | just require that the carbon credits be CCP carbon credits in order to ensure that they are robust and high integrity. Additionality assessment is detailed starting at page 74 of Section 4 of the Assessment Framework.[11] |
| | 8. Is additionality as characterized in the Proposal appropriate or would another characterization be more so (e.g. legal additionality)? | 8. Characterization of additionality is appropriate as is; no further specification is needed. Criteria by which crediting programs demonstrate additionality (question 7) must include review of existing policy frameworks. (page 32 of Section 3 Summary for Decision Makers of ICVCM's Assessment Framework[12] reads: "Carbon-crediting programs must have program documents which demonstrate that mitigation activities meet existing host country legal requirements, such that the emissions reductions or removals exceed those required due to relevant and enforced legal requirements.") |
| *Risk of Reversal* | 9. Criteria for DCM to assess crediting program's measures to avoid or mitigate reversal risk, especially when the underlying VCC is sourced from nature-based projects.<br><br>10. When projects have reversal risk, criteria DCMs should incorporate in VCC contracts. | 9 and 10. The ICVCM CCP Assessment Framework has several requirements for crediting programs in this regard, as set out in criteria 9 (Permanence) of Section 4 of the Assessment Framework (starting at page 82) including: cancelling or retiring a carbon credit for each ton of carbon dioxide equivalent reversed; estimation of reversal risk and characterization as avoidable or unavoidable; 40-year minimum monitoring, reporting, and compensation period for avoidable reversals for categories with material reversal risk (such as nature-based projects); and establishment of buffer pool reserves proportional to reversal risk over the entire monitoring and compensation period. |
| *Robust Quantification* | 11. Criteria to assess a crediting program has robust, conservative, and transparent quantification methodology. | 11. The CCPs require programs to ensure robust quantification (see Criteria 5 [Robust Quantification of GHG Emissions Reductions and Removals] in Section 4 of the Assessment Framework, found starting at page 58), including through:<br><br>• rules for adopting, updating, suspending, and reviewing methodologies for quantification of emissions reductions and removals, as well as (potential) leakage<br>• conservativeness in determination of baseline scenario and quantification of baseline emissions and removals, including uncertainties<br>• rules on length of crediting period. |

[11] The Integrity Council for the Voluntary Carbon Market (2023), Section 4. Assessment Framework – Core Carbon Principles, January 2024, Version 2, https://icvcm.org/wp-content/uploads/2024/02/CCP-Section-4-V2-FINAL-6Feb24.pdf.
[12] The Integrity Council for the Voluntary Carbon Market (2023), Section 3. Summary for Decision Makers – Core Carbon Principles, January 2024, Version 2.

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| *Governance* | 12. Criteria to assess whether crediting program can demonstrate its governance framework supports transparency and accountability. | 12. The ICVCM CCPs require robust governance structures and processes that ensure transparency and accountability. Three points to further consider for the Proposal are outlined below.<br><br>Since cyber security of digital assets is particularly important to control for, we recommend guidance could be further developed. Another governance point the Proposal makes is ensuring registries have appropriate measures in place to facilitate physical settlement of a VCC derivative contract. This is linked to the 'Effective registries' criterion within Principle 2 (Tracking) in Section 4 of the Assessment Framework found on page 55. DCMs could specifically consider whether the subject VCCs are being tracked in registries that require identification of the entity on whose behalf the carbon credit was retired as well as the purpose of retirement.<br><br>Finally, and as mentioned in response to Question 4 (General), governance assessment requires a focus on the conflicts-of-interest policy. Mentioned in the Proposal's Transparency section, conflict of interest could be reiterated in Inspection Provisions—Third-Party Validation and Verification, and go further by providing guidance on how to assess whether transfers and retirements of carbon credits are conflict of interest free in the relationship between marketplaces, exchanges, intermediaries, and end users. As noted in response to Question 4, risks are not generally present in the relationships between project developers, auditors, and crediting programs, due to most programs being not-for-profit organizations and most validation and/or verification bodies being subject to rules preventing them having interests in project development companies as part of their accreditation to operate in this market. |
| *Tracking and No Double Counting* | 13. Criteria a DCM should consider in a VCC contract with respect to whether a crediting program's operated or utilized registry procedures ensure certainty on issuance, transfer, retirement of VCCs. | 13. ICVCM CCP Assessment Framework requires crediting programs to have registry provisions that prevent double registration (the registration of any mitigation activity that has been registered under another carbon-crediting program and is still active under that program); double use (the further transfer, retirement, or cancellation of a carbon credit once it has been cancelled or retired for a specific use); and doubling claiming with mandatory domestic mitigation programs or incentivization schemes (e.g., RECs). |
| | 14. Criteria to consider to demonstrate a registry ensures no double counting of emissions reductions/ removals. | 14. Unique identifiers and meta-registries can dramatically improve transparency and reduce risk of double counting. |
| *Inspection Provisions* | 15. On whether contracts should describe responsibilities of third-parties (crediting programs, registries, others) | 15. Contracts should not have to describe the responsibilities of third parties if the roles of the third party are known to both parties, and the performance of those responsibilities by those third parties can be managed through usual risk |

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| | required to carry out the delivery process. | management in contracts by allocating that risk between the contract parties or providing for default/force majeure etc. type risks. Standard contracts for VCCs routinely use annexes to allocate such risks through box ticking exercises.[13]<br><br>International Organization of Securities Commissions (IOSCO) proposes: "Consistent with their respective mandates, relevant regulators and other authorities could consider requiring that VCM participants, including carbon credit project developers, registries, validation and verification bodies, brokers, traders, marketplaces and exchanges, rating agencies, third-party entities, and private sector supply and demand side standardization initiatives, have in place a comprehensive governance framework with clear lines of responsibility and accountability for the functions and activities they are conducting." However, we would note that it is not apparent that in each case the regulator would need to cover all actors in the VCC in the same way and may be able to rely on existing structures to some extent:<br><br>(a) The ICVCM CCPs require this for programs so that a CCP-eligible program would meet this accountability requirement, so a program's registries would also be compliant. Usually carbon crediting programs require the corporate documents of project developers to be submitted as part of the validation process.<br><br>(b) The accrediting body for the relevant validation and verification bodies would impose these requirements on the validation and verification bodies<br><br>(c) Typically, governments would regulate exchanges and traders and brokers.<br><br>Encouraging the use of standardized quality (e.g., CCP-labelled) credits could provide a safeguard for contract delivery in that a DCM would be able to hedge for risks of non-delivery from a specific carbon crediting program or project while ensuring the buyer gets the same threshold of quality credit regardless of the type of mitigation activity underlying it.<br><br>To carry out delivery of VCC contracts, some further work may be needed to understand the relevance of having provisions on alignment between host country rules and the carbon crediting program rules with regards to ownership rights for VCCs (International Swaps and Derivatives Association 2021, Legal Implications of Voluntary Carbon Credits) which may vary depending on the type of mitigation activity and its location. At the current time, carbon crediting programs tend to require projects to "comply with all applicable laws and regulations" by host countries, and, while this is validated, the legal status of ownership may be at risk in certain contexts. |

[13] Example contracts can be found at "IETA, Trading Documents," February 14, 2024, https://www.ieta.org/resources/trading-documents.

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| *Sustainable Development Benefits and Safeguards* | 16. On whether DCMs should consider crediting program's measures to help ensure projects meet or exceed best practices on social and environmental safeguards. | 16. Yes. As raised for Question 1, because verifiable social and environmental attributes beyond mitigation and credit revenues are generally perceived by buyers as increasing the quality of credits, driving higher market prices. Specifically, the ICVCM CCP 9 ([Sustainable Development Benefits and Safeguard] found starting on 40 in Section 3 of the Assessment Framework) requires compliance to best practices and beyond in the following areas: labor rights and working conditions; resource efficiency and pollution prevention; land acquisition and involuntary resettlement; biodiversity conservation and sustainable management of living natural resources; indigenous peoples, local communities, and cultural heritage; respect for human rights; stakeholder engagement; gender equality; robust benefit-sharing; and Cancun safeguards (for specific kinds of avoided deforestation projects falling under these rules). |
| | 17. On whether DCMs should consider crediting program's measures to help ensure projects avoid locking in levels of GHG emissions, technologies or practices incompatible with achieving net-zero emissions. | 17. Yes. As raised for Question 1, because the Paris Agreement goal of "[h]olding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels" depends on achieving net-zero emissions around mid-century, according to science. If the VCM is to help combat climate change, then this characteristic should be considered by a DCM as an important part of a T&C derivative contract. Specifically, the ICVCM deems ineligible for CCP approval the types of carbon projects that undermine a country's effort to move toward a lower carbon economy, that is, those activities that: directly lead to an increase in the extraction of fossil fuels, such as carbon capture and storage technologies used for enhanced oil recovery; relate to unabated coal-fired electricity generation; involve any other unabated fossil fuel-powered electricity generation other than new gas-fired generation as a part of increased zero-emissions generation capacity in support of national low-carbon energy transition plans; focus on road transport that relies on the continued use of solely fossil-fueled engines.<br><br>This CCP requirement is aligned to the work of the Parties (signatories) to the Paris Agreement, including the recent main decision from COP28, which calls on governments to contribute to a series of global efforts including "[t]ransitioning away from fossil fuels in energy systems, in a just, orderly and equitable manner, accelerating action in this critical decade, so as to achieve net zero by 2050 in keeping with the science." |