

CFTC Publishes Proposed Guidance on Futures Exchanges' Listings of Voluntary Carbon Credits and What this Means in the Context of Other Developments in this Market

January 4, 2024

On December 4, 2023, the Commodity Futures Trading Commission (“CFTC”) issued for public comment proposed guidance regarding the listing by designated contract markets (“DCMs”) of voluntary carbon credit (“VCC”) derivative contracts (the “**Proposed Guidance**”). The Proposed Guidance acknowledges challenges that market participants have faced in VCC markets, such as a lack of standardization, transparency, and integrity, as the sector has expanded. The CFTC’s Proposed Guidance aims to address these concerns specifically in relation to VCC futures listed on DCMs. This alert memo follows our prior alert ([available here](#)) providing a summary and preliminary analysis of the key aspects of the Proposed Guidance, but also provides a significant in-depth analysis of how the CFTC’s Proposed Guidance may affect voluntary carbon markets and the current patchwork of standardization efforts.

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The Proposed Guidance identifies factors that DCMs should address in the design of a VCC derivatives contract to avoid the possibility of manipulation, including:

- **Quality Standards** such as (i) transparency, (ii) additionality, (iii) permanence and risk of reversal, and (iv) robust quantification;
- **Delivery Points and Facilities**, taking into account the governance framework and tracking mechanisms of the crediting program underlying the VCCs, as well as the crediting program’s measures to prevent double-counting; and
- **Inspection Provisions** or certification procedures for verifying compliance with the latest procedures in the voluntary carbon markets.

Comments on the proposal are due February 16, 2024.

Background

Voluntary carbon markets allow carbon emitters to purchase credits that are awarded to projects that remove or reduce atmospheric carbon. These credits offset the carbon emitters’ emissions in furtherance of a voluntary commitment to reduce “net” emissions. The voluntary carbon markets can be distinguished from “compliance” carbon markets, where a government or regulator issues a carbon allowance that participants must not exceed unless they can purchase additional compliance allowances from another participant under a cap-and-trade program. In both types of carbon markets, each credit typically corresponds to one metric ton of reduced, avoided, or removed carbon dioxide or equivalent greenhouse gas.

The importance of voluntary carbon markets in mitigating climate change and its effect on the U.S.

economy is growing,¹ and with it, the CFTC’s increasing attention to this market. In 2020, the CFTC’s *Climate-Related Market Risk Subcommittee* issued a report concluding that climate change poses a major risk to the stability of the U.S. financial system and, in turn, the American economy, and presented fifty-three recommendations to mitigate the risks that climate change poses to the financial markets.² In March 2021, then CFTC Acting Chairperson Rostin Behnam established the Climate Risk Unit to “[focus] on the role of derivatives in understanding, pricing, and addressing climate-related risk and transitioning to a low-carbon economy.”³ One month later in June 2021, the CFTC issued a Request for Information on climate-related financial risk last year, including inquiries about the VCC market. The CFTC has also organized two Voluntary Carbon Markets Convenings in the past two years – in June 2022 and July 2023 – to discuss issues concerning the market for VCC derivatives contracts.⁴ And in June of this year, the CFTC issued a Whistleblower Alert, urging individuals to report misconduct in carbon markets, and announced the establishment of the Environmental Fraud Task Force to combat environmental fraud and misconduct in relevant derivatives and spot markets. To date, the CFTC has not brought any enforcement matters related to fraud in connection with voluntary carbon credits.

Increased interest in the VCC markets is not limited to the CFTC, however. The day before the Proposed Guidance was released, the International Organization of Securities Commissions (“**IOSCO**”) published a consultation report outlining “Good Practices” for

¹ According to the Taskforce on Scaling Voluntary Carbon Markets, voluntary carbon markets need to grow by more than 15-fold by 2030 in order to support the investment required to deliver the Paris Agreement’s goal of limiting the global average temperature increase to below 1.5°C above pre-industrial levels. TSVCM (January 2022) at 4, available [here](#).

² Rostin Behnam et al., *Managing Climate Risk in the U.S. Financial System: Report of the Climate-Related*

Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, Commodity Futures Trading Comm’n (2020), available [here](#) (full report).

³ Press Release, CFTC Acting Chairman Behnam Establishes New Climate Risk Unit, Commodity Futures Trading Comm’n (March 17, 2021), available [here](#).

⁴ See Cleary’s Alert Memo on the CFTC’s Second Voluntary Carbon Markets Convening [here](#).

VCC markets.⁵ And last year, International Swaps and Derivatives Association (“ISDA”) published industry documentation for trading VCCs, including definitions and related template confirmations for spot, forward, and options contracts.⁶ Also, the Office of the Comptroller of Currency, Board of Governors of the Federal Reserve, and the Federal Deposit Insurance Corporation proposed amendments to U.S. bank regulatory capital rules applicable to large banks that would include a prescribed risk weight for “carbon trading.”⁷

The CFTC does not have full authority to directly regulate VCC markets, however, they do have anti-fraud and anti-manipulation authority over spot and exempt, physically settled forward transactions in commodities, including VCC markets, as well as substantive regulatory oversight and rulemaking authority with regard to commodity derivative markets. DCMs, the financial exchanges where standardized derivatives contracts are traded, are self-regulatory organizations operated under the oversight of the CFTC and must adhere to specific core principles (the “**DCM Core Principles**”) to ensure fair and transparent trading practices, including regarding the trading and listing of futures contracts (such as VCC contracts). Understanding that the VCC market is still novel and evolving, the Proposed Guidance describes the CFTC’s expectations of how DCMs can comply with the DCM Core Principles with respect to VCC contracts.

While the Proposed Guidance focuses on physically-settled VCC contracts, the CFTC has indicated that these considerations are also relevant for cash-settled transactions and swap execution facilities (“SEFs”) offering such products. Market participants in bilateral, over-the-counter markets should also

consider how the Proposed Guidance may affect their regulatory obligations and liabilities across spot, forward, and swap transactions involving VCCs.

Key Elements of the Proposed Guidance

The Proposed Guidance lays out factors that DCMs should consider in order to comply with the Commodity Exchange Act (“CEA”) and CFTC regulations on VCC derivative contracts. The Proposed Guidance would not modify existing law, regulation, or guidance by the agency, but rather would provide an outline of “particular matters” for DCMs to consider to comply with the existing laws and regulation.⁸ The focus of the Proposed Guidance is primarily limited to DCMs that list VCC derivative contracts that are physically settled, given that every currently-listed VCC derivative contract is physically settled rather than cash settled.

The Proposed Guidance would direct DCMs to consider the following particular matters when listing VCC derivative contracts for trading:

- 1) Listing for trading VCC derivative contracts that are not readily susceptible to manipulation;
- 2) Monitoring the terms and conditions of listed VCC derivative contracts as they relate to the underlying commodity market; and
- 3) Meeting the product submission requirements under part 40 of the CFTC’s regulations and CEA section 5c(c).

⁵ IOSCO publishes a Consultation Report to promote the integrity and orderly functioning of the Voluntary Carbon Markets (VCMs), IOSCO (Dec. 3, 2023), available [here](#).

⁶ ISDA Launches Standard Definitions for the Voluntary Carbon Market, (Dec. 13, 2022), available [here](#).

⁷ See Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant

Trading Activity, Office of the Comptroller of the Currency, Federal Reserve System, and Federal Deposit Insurance Corporation (Sept. 18, 2023), available [here](#).

⁸ Proposed Guidance, Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts, Commodity Futures Trading Comm’n (Dec. 4, 2023), at 19 (citing CEA section 5(d)(3), 7 U.S.C. 7(d)(3)), available [here](#).

I. A DCM Should Only List Derivative Contracts That Are Not Readily Susceptible to Manipulation

Under the **DCM Core Principle 3**, DCMs must make sure that derivative contracts listed for trading must not be readily susceptible to manipulation. The CFTC adopted Appendix C to 17 CFR Part 38 (the “**Appendix C Guideline**”) to outline considerations for DCMs when they draft terms and conditions of contracts and submit such contracts with supporting documents to the CFTC.

For physically settled contracts, the Appendix C Guidance requires the terms and conditions of the contracts to address relevant criteria to show that they are not readily susceptible to manipulation. Under the quality standards criterion, for example, the commodity contract must include a description or definition of specific economically significant characteristics of the underlying commodity “depend[ing] upon the individual characteristics of the underlying commodity.” The CFTC’s Proposed Guidance would expand upon the “individual characteristics” in Appendix C Guidance by defining the characteristics that “help[] to inform the integrity of carbon credits” as “VCC commodity characteristics” in the Proposed Guidance. Furthermore, the Proposed Guidance would require DCMs to consider such characteristics for at least three criteria listed in the Appendix C Guideline when developing terms and conditions of VCC derivative contracts: 1) quality standards, 2) delivery points and facilities, and 3) inspection provisions.

A. Quality Standards

For quality standards, the CFTC proposes that DCMs consider four VCC commodity characteristics for ensuring quality standards in drafting a VCC derivative contract’s terms and conditions:

1. transparency;
2. additionality;

3. permanence and accounting for the risk of reversal; and
4. robust quantification.

a. Transparency

To ensure transparency of the underlying VCCs, the Proposed Guidance would require DCMs to provide adequate and accessible information about the VCCs under the contract. These measures would help market participants match the quality and pricing of VCCs under the contract, thereby reducing the chance of manipulation or price distortion. Transparency would be achieved in several ways.

- *First*, the terms and conditions of the contract must specify the crediting programs and types of projects or activities that may issue VCCs eligible for delivery.
- *Second*, DCMs should also check that information regarding the carbon-removing or -reducing projects or activities and policies and procedures of the crediting program for the underlying VCCs are publicly available.

Under the Appendix C Guidance, such information may need to be described or defined in the contract terms and conditions as an economically significant characteristic of the underlying VCC.

b. Additionality

For the additionality characteristic, the Proposed Guidance would require the DCMs to ensure that the GHG emission reductions or removals are “additional,” meaning that they would not have occurred without “the added monetary incentive created by the revenue from the sale of carbon credits.”⁹ Ensuring additionality is a necessary component in addressing quality standards, as VCCs without such additionality would not serve the purpose of mitigating emissions.

To test for additionality, the Proposed Guidance would require DCMs to check whether the crediting program has rigorous and reliable procedures. Similar to the

⁹ *Id.* at 25.

transparency characteristic, such procedures may need to be included in the terms and conditions of VCC contracts as economically significant characteristic of the underlying VCC.

c. Permanence and Accounting for the Risk of Reversal

For the permanence and risk of reversal characteristic, the Proposed Guidance would require DCMs to address the risk of reversal, which is the risk of an event that reverses the reduction or removal of carbon and thereby cancels or recalls an issued VCC. The CFTC noted in the Proposed Guidance that the risk of reversal is related to the quality of the underlying VCCs as market participants rely on the VCC contracts to meet their carbon mitigation agenda.

To ensure the quality of the underlying VCCs, therefore, the Proposed Guidance would require DCMs to evaluate whether the crediting program for a VCC addresses the risk of reversal with “reasonable assurance” of replacing the recalled or canceled VCC with another of a comparable quality.¹⁰

As most crediting programs make use of “buffer reserves” to replace VCCs, DCMs must evaluate whether such buffer reserves exist and whether they are regularly reviewed by the crediting program to address outside events (e.g., climate change) that may impact the risk of reversal.¹¹

d. Robust Quantification

For the robust quantification characteristic, the Proposed Guidance would require DCMs to consider whether the crediting program’s quantification methodology to calculate GHG emission reduction or removals is “robust, conservative, and transparent.”¹² Similar to the transparency and additionality characteristics, the methodology may need to be included in the terms and conditions of VCC contracts as an economically significant characteristic of the underlying VCC. A robust, conservative, and transparent quantification methodology would allow

DCMs to form a reliable deliverable supply estimate, and DCMs would be able to use that estimate to set effective exchange-set speculative position limits as required for each listed VCC derivative contract and reduce the possibility of manipulation.

These quality standards are targeting the same issues underlying potential instances of fraudulent statements that the CFTC identified in its Whistleblower Alert, such as “quality, quantity, additionality, project type, methodology substantiating the emissions claim, environmental benefits, the permanence or duration, or the buffer pool.”

B. Delivery Points and Facilities

Under the Appendix C Guideline, contracts settled by physical delivery must have delivery procedures that “seek to minimize or eliminate any impediments to” delivery.¹³ For delivery procedures of VCC derivative contracts that are physically settled, the CFTC’s Proposed Guidance would require DCMs to evaluate the credit program for the underlying VCCs for its governance framework, tracking mechanisms, and measures taken to prevent double-counting.

a. Governance Framework

The Proposed Guidance would require the DCMs to show that there is a proper governance framework for “the crediting program’s independence, transparency and accountability.”¹⁴ To ensure that the crediting program has an effective governance framework, DCMs should consider several key processes and policies as follows: the process of decision-making, the procedures to report and disclose information, policies to manage risks, and engagement processes for the public and stakeholders.

Information on the governance framework may need to be included in the terms and conditions of VCC derivative contracts that are physically settled, given

¹⁰ *Id.* at 27.

¹¹ *Id.* at 27-28.

¹² *Id.* at 28.

¹³ *Id.* at 29.

¹⁴ *Id.* at 30-31.

the impact of the governance framework on the quality of the VCCs.

b. Tracking Mechanisms of the Crediting Program

Under the Proposed Guidance, the DCMs should ensure that crediting programs have effective tracking mechanisms regarding “the issuance, transfer, and retirement of VCCs.”¹⁵ Notably, the tracking mechanism was one of the principles in the Core Carbon Principles and Assessment Framework drafted by the Integrity Council for the Voluntary Carbon Market (“ICVCM”), which advocated for the use of a registry to track carbon credits.¹⁶

c. Prevention of Double-Counting

DCMs must also ensure that the crediting program does not count the same emission reduction or removals twice as credits. The Proposed Guidance would look for “a reasonable assurance” that there is a match between a VCC underlying a derivatives contract and “a single emission reduction,” but it does not specify a set of measures that DCMs should take to obtain such “reasonable assurance.”¹⁷ Instead, the Proposed Guidance implies there are different effective measures to prevent double counting, including “procedures for conducting cross-checks across multiple carbon credit registries.”¹⁸

Notably, double-counting was also a focus of the CFTC’s Whistleblower Alert.

C. Inspection Provisions: Third-Party Validation and Verification

The Proposed Guidance interprets the Appendix C Guidance to require VCC derivative contracts to specify “any inspection or certification procedures for verifying compliance with quality requirements or any other related delivery requirements.”¹⁹ In addition, the Proposed Guidance would require DCMs to evaluate

the validation and verification procedures for claims about the carbon reduction or removal projects or activities by the crediting program for the underlying VCCs.

To evaluate these procedures, DCMs must look for “up-to-date, robust and transparent” procedures of validation and verification by a third-party and “best practices with respect to third-party validation and verification” within the crediting program.²⁰ Also, DCMs should consider whether the third-party is “a reputable, disinterested party or body.”²¹

II. A DCM Should Monitor a Derivative Contract’s Terms and Conditions as They Relate to the Underlying Commodity Market

Under the **DCM Core Principle 4**, DCMs are required to deploy “market surveillance, compliance, and enforcement practices and procedures” in an effort “to prevent manipulation, price distortion, and disruptions of the physical delivery or cash-settlement process.”²² Compliance with the DCM Core Principle 4 for derivative contracts that are physically settled, in the CFTC’s opinion, requires DCMs to monitor the following: VCC “contract’s terms and conditions as they relate [to] the underlying commodity market[] and to the convergence between the contract price and the price of the underlying commodity” and “the supply of the underlying commodity” as required to be delivered under the contract.²³

The requirement also includes continuous monitoring and updating of the terms and conditions of VCC derivative contracts to reflect any changes that relate to the standard or certification of the underlying VCC. Lastly, DCMs have to comply with the record-keeping

¹⁵ *Id.* at 31.

¹⁶ Deborah North, et al., *Decarbonization in the Wake of COP 27: The Role of Private Capital*, *PLI Current: The Journal of PLI Press*, Vol. 7 (2023), available at <https://www.clearygottlieb.com/-/media/files/decarbonization-in-the-wake-of-cop-27-the-role-of-private-capital.pdf>.

¹⁷ Proposed Guidance at 32.

¹⁸ *Id.*

¹⁹ *Id.* at 33.

²⁰ *Id.*

²¹ *Id.*

²² *Id.* at 34.

²³ *Id.* at 34.

requirements by “requiring their market participants to keep records of their trading” in VCC cash markets.²⁴

III. A DCM Should Satisfy the Product Submission Requirements Under Part 40 of the CFTC’s Regulations and CEA Section 5c(c)

DCMs have two ways to list derivative contracts for trading. DCMs may either self-certify the listed contract’s compliance with the CEA and the relevant CFTC regulation at least one business day before the listing or volunteer to receive an approval from the CFTC before the listing. As both processes involve submission of various information including the terms and conditions of the contracts to the CFTC, the Proposed Guidance emphasizes three submission requirements. *First*, there should be “explanation and analysis of the contract and its compliance with applicable provisions of the [CEA], including core principles and the Commission’s regulations thereunder.”²⁵ *Second*, such explanation and analysis must “either be accompanied by the documentation relied upon to establish the basis for compliance with applicable law, or incorporate information contained in such documentation, with appropriate citations to data sources[.]”²⁶ *Third*, DCMs should respond to the CFTC’s request with “additional evidence, information or data that demonstrates that the contract meets, initially or on a continuing basis, the requirements’ of the CEA or the Commission’s regulations or policies thereunder.”²⁷

IV. Statements of the Chairman and Commissioners

Chairman Rostin Behnam, Commissioner Kristin Johnson, and Commissioner Christy Goldsmith Romero issued statements in connection with the Proposed Guidance.

- Chairman Behnam issued a statement supporting the Proposed Guidance, highlighting the “whole-of-government approach” and the private-public

partnerships the CFTC leveraged in developing the proposal. Chairman Behnam also recognized that the derivatives markets are “global markets” and invited stakeholders to comment on IOSCO’s recently proposed set of Good Practices, as discussed later in the alert.²⁸

- Commissioner Johnson said that the Proposed Guidance was “necessary, but insufficient.” Johnson identified several issues that the Proposed Guidance does not address but that Commissioner Johnson believes the CFTC needs to implement for all environmental derivatives products including VCCs: material risk disclosures, good faith and fair dealing, and clearing.²⁹
- Commissioner Goldsmith Romero supported the Proposed Guidance, stating that it was a step in promoting market integrity, along with the CFTC’s other initiatives such as the Environmental Fraud Task Force. Commissioner Goldsmith Romero also called for comments regarding the CFTC’s adaption of ICVCM’s Core Carbon Principles, as discussed later in this alert. Commissioner Goldsmith Romero’s requests for comment are included as Appendix B.

Other Developments in Voluntary Carbon Markets

As described above, similar efforts to increase transparency, integrity, and standardization have been underway by self-regulatory organizations (“SROs”) and voluntary bodies, and the CFTC drew upon the work of many of these organizations in preparing its Proposed Guidance.

I. Integrity Council on Voluntary Carbon Markets

On March 29, 2023, the ICVCM, an independent governance body, announced the launch of its Core Carbon Principles (“CCPs”), which have been in development since 2022, and the first part of its

²⁴ *Id.* at 35.

²⁵ *Id.* at 36 (citation omitted).

²⁶ *Id.* at 36-37 (citation omitted).

²⁷ *Id.* at 37 (citation omitted).

²⁸ Statement of CFTC Chairman Rostin Behnam (Dec. 4, 2023), available [here](#).

²⁹ Statement of CFTC Commissioner Kristin Johnson, available [here](#).

Program-Level Assessment Framework, which provides (i) the criteria for whether carbon-crediting programs are CCP-Eligible; (ii) the Assessment Procedures, which explain the process for implementing the CCP label to carbon-crediting programs; and (iii) the CCP Attributes, which programs can apply to CCP-labelled programs to highlight certain features of the programs.³⁰ As of September 14, 2023, ICVCM allows carbon-crediting programs to apply to become CCP-Eligible.³¹

In a statement issued with the Proposed Guidance, Commissioner Christy Goldsmith Romero noted that the Proposed Guidance adapts terminology, concepts, and standards from the ICVCM's CCPs and Assessment Framework.³²

To develop the CCPs, ICVCM worked with carbon-crediting programs and other stakeholders, and drew from a variety of sources including the Taskforce on Scaling Voluntary Carbon Markets ("TSVCM"), the Intergovernmental Panel on Climate Change ("IPCC"), the United Nations Convention on Climate Change's Paris Agreement and Cancun Safeguards, Carbon Offsetting and Reduction Scheme for International Aviation ("CORSA") of the International Civil Aviation Organization ("ICAO"), and the work of Calyx Global and the Carbon Credit Quality Initiative.

Prior to publication of the CCPs, ICVCM held a 60-day public consultation overseen by the British Standards Institute ("BSI") and received 350 submissions from stakeholders including programs and project developers, academics, and non-governmental organizations. In addition, ICVCM organized workshops for Indigenous Peoples and Local Communities ("IPs" and "LCs") to give feedback on the CCPs and reserves three of the 22 seats on its board for IPs and LC members.

³⁰ Press Release, Integrity Council launches global benchmark for high-integrity carbon credits, ICVCM, available [here](#).

³¹ Press Release, How programs can apply for assessment, ICVCM, available [here](#).

The ten CCPs are divided into three categories: governance, emissions impact, and sustainable development.³³

- *Governance.* Carbon-crediting programs must have (1) effective governance, (2) tracking of each credit from issuance to retirement, (3) transparency to enable scrutiny of mitigation activities, and (4) robust, independent third-party validation and verification.
- *Emissions Impact.* The emissions impact of the voluntary carbon credit programs must involve (5) additionality in reducing or removing greenhouse gas emissions, (6) permanence, (7) robust quantification of emission reductions and removals, and (8) no double counting.
- *Sustainable Development.* Procedures should be in place to ensure (9) sustainable development benefits and safeguards and (10) contribution toward the net zero transition.

The Program-Level Assessment Framework builds out the CCPs by establishing the requirements for carbon-crediting programs. For example, the Assessment aims to increase the transparency of CCP-labelled carbon credits and the impact they have on emissions, society, and the environment. This transparency is achieved through:

- Comprehensive and accessible disclosure on how projects calculate and quantify emissions impact, additionality, and social and environmental impacts;
- Published documentation including the spreadsheets used to calculate, validated design documents, and projects' monitoring reports; and
- Requirements to ensure high-integrity credits come from "robust social and environmental

³² Statement of CFTC Commissioner Christy Goldsmith Romero (Dec. 4, 2023), available [here](#).

³³ ICVCM, Core Carbon Principles, available [here](#).

safeguards that deliver positive sustainable development impacts.”

CCP-Eligible programs measure impacts including those on IPs and LCs, biodiversity, pollution, human rights, labor rights, and gender equality. Programs must work with IPs and LCs to get free, prior informed consent (“**FPIC**”) and to share the benefits of mitigation activity.

The report also lays out the procedures for how programs and credits can become CCP-Eligible, with a fast-track for CORSIA-Eligible programs.

Commissioner Goldsmith Romero requested comments on whether the Proposed Guidance adapts the “right parts” of the ICVCM standards to encourage integrity and transparency in the voluntary carbon markets and whether the CFTC’s adaptation provides clear, workable expectations.³⁴

II. International Organization of Securities Commissions

On December 3, 2023, IOSCO published a public consultation outlining proposed Good Practices to promote the integrity and orderly functioning of voluntary carbon markets.³⁵ IOSCO proposed a set of 21 Good Practices relating to:

- *Regulatory frameworks*, including domestic and international consistency and cooperation;
- *Primary market issuance*, including standardization, transparency, disclosure, soundness and accuracy of registries, and due diligence;

³⁴ See Appendix B.

³⁵ IOSCO, Voluntary Carbon Markets Consultation Report, available [here](#); Press Release, IOSCO publishes a Consultation Report to promote the integrity and orderly functioning of the Voluntary Carbon Markets (VCMs), IOSCO, available [here](#).

- *Secondary market trading*, including market functioning and transparency, governance and risk management, and market abuse; and

- *Use and disclosure of carbon credits*.

Chairman Behnam’s statement on the Proposed Guidance recognized the work that IOSCO did in focusing on how regulators can encourage transparent and orderly voluntary carbon markets and noted that the Proposed Guidance was drafted to be complementary to IOSCO’s work.³⁶ Chairman Behnam also serves as a co-chair to IOSCO’s Sustainable Finance Task Force’s Carbon Market Workstream.

Chairman Behnam has encouraged CFTC stakeholders to submit comments on IOSCO’s December 2023 Consultation Report. Comments are due on or before March 3, 2024.

III. COP28 Negotiations

At COP28 this month, negotiations failed to adopt Article 6 of the Paris Agreement. Article 6 establishes three approaches for voluntary cooperation with reducing carbon emissions, one of which addresses carbon crediting. Article 6.4 would establish a new UN Climate Change Conference (“**UNFCCC**”) mechanism for the validation, verification, and issuance of high-quality carbon credits with the goal of increasing integrity and transparency of the carbon market globally.³⁷ If finalized, Article 6.4 would create a centralized crediting mechanism administered by the Supervisory Body. Companies and governments would be able to buy verified carbon offsets to achieve nationally determined contributions and net-zero targets.³⁸

³⁶ Statement of CFTC Chairman Rostin Behnam (Dec. 4, 2023), available [here](#).

³⁷ UN Climate Change, Article 6.4 Mechanism, available [here](#).

³⁸ UN Climate Change, Unlocking Climate Ambition: the Significance of Article 6 at COP28 (Dec. 18, 2023), available [here](#).

The Article 6 Supervisory Body worked for a year prior to COP28 to consult with carbon market participants and create a proposal regarding rules, modalities, and procedures of the centralized crediting mechanism. While the Supervisory Body's proposals detailed topics such as the challenge of reversal and reporting requirements, the Supervisory Body's proposal left some questions open such as how offsets would be quantified and which projects would qualify for crediting, which became sticking points at COP28. Some participants believed that the carbon crediting mechanism fell short of the directive to ensure integrity in the carbon markets, while others believed that imposing stricter standards would increase costs of projects and introduce increased complexity. With the negotiations having failed, carbon market participants will be left to rely on the guidance provided by governments and organizations such as ICVCM to determine the integrity of carbon credits for the time being.

Article 6 will be up for negotiation again at COP29, which will convene in November 2024 in Baku, Azerbaijan.

IV. International Swaps and Derivatives Association

ISDA has taken steps to develop standard documentation for the voluntary carbon market. In 2022, ISDA released its Verified Carbon Credit Transactions Definitions which included a standard definitional booklet for VCC transactions and template confirmation for VCC spot, forward, and option transactions.³⁹ The release of this documentation followed the publication of ISDA's Legal Implication of Voluntary Carbon Credits whitepaper. ISDA issued a comment letter on the CFTC's Request for Information.

ISDA's contributions to the voluntary carbon market space were cited throughout the Proposed Guidance.

³⁹ 2022 ISDA Verified Carbon Credit Transactions Definitions, available [here](#); ISDA, VCC Definitions FAQ, available [here](#).

⁴⁰ Voluntary Carbon Markets: Analysis of Regulatory Oversight in the US. (2022), available [here](#).

For example, ISDA's whitepaper was cited in the Proposed Guidance to illustrate the evolving nature of VCC products.⁴⁰ Further, the Proposed Guidance preamble noted that ISDA's comment letter supported public sector recognition and support of private sector and multilateral initiatives in the VCC space. Commissioner Goldsmith Romero additionally cited to ISDA's comments that the CFTC should take a "leading role" in voluntary carbon markets.⁴¹

V. California Voluntary Carbon Market Disclosure Act

In November 2023, the state of California adopted Assembly Bill 1305, or the Voluntary Carbon Market Disclosures Act, ("**AB 1305**") which creates disclosure requirements for entities buying or selling VCCs in California and for those making claims regarding net zero emissions or carbon neutrality and which have a nexus to California. The disclosures required under AB 1305 aim to reduce "greenwashing," and with the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261) which California also adopted, increases dramatically the climate-related disclosures that entities operating in California will need to make. Notably, Governor Gavin Newsom vetoed AB 1305's companion bill, SB 390, which would have made it unlawful to verify a voluntary carbon offsets ("**VCO**") project, certify or issue a VCO, maintain a VCO on a registry, or market, offer for sale, or sell without certain disclosures and substantiation. California's passage of this suite of climate-related disclosure laws may lead to similar legislation in other states, but they will likely face legal challenges wherever they are adopted, including the extent to which state laws and regulations are preempted by the federal government's efforts to regulate in this area.

⁴¹ ISDA Comment Letter on CFTC Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), available [here](#).

Further Implications of the Proposed Guidance

I. Effect on market participant engagement with VCCs

The institutional market has been slow to engage in VCC transactions, and market participants have expressed reservations regarding the lack of regulation and the potential for fraud and misconduct. The CFTC has indicated that market participants should not rely only on the diligence performed by crediting agencies to prevent manipulation and fraud in the carbon markets, and so some market participants have taken a more direct role in conducting diligence and have prioritized these issues in contract negotiations. This is a concern especially where an entity learns of an issue with the quality of a VCC subsequently to purchasing and reselling such VCC, since they could then be accused of creating a fraudulent market.

The Proposed Guidance and the CFTC's previous Whistleblower Alert are aimed at addressing quality concerns. To some extent, the Proposed Guidance institutionalizes the CFTC's Whistleblower alert by placing an affirmative obligation on DCMs to perform diligence on VCCs underlying listed derivatives. However, it is unclear whether the Proposed Guidance will lead to meaningfully increased engagement from the market, since DCMs are likely already performing much of the diligence contemplated by the Proposed Guidance, especially in light of the fact that DCMs are already subject to the Core Principles and the Proposed Guidance is consistent with existing best practices.

We also note that DCMs may push some of the diligence burden to crediting programs, which have better access to the relevant information (for example, whether a given emissions reduction program is additional). In fact, much of the Proposed Guidance is focused on encouraging DCMs to push crediting agencies toward robust quality standards, tracking

mechanisms, and internal governance. Still, it is not clear that DCMs will be able, effectively to conduct verification of such diligence performed by crediting programs, and by extension, the extent to which market participants in bilateral OTC markets can reasonably rely on diligence performed by DCMs.

II. Potential for Regulation of Intangible Commodities by Enforcement

The CFTC's approach to regulation of the VCC market may evolve in a similar fashion as its regulation of the digital asset market. CFTC authority over the spot market for commodities such as digital currencies and VCCs, is limited to antifraud/manipulation. As a result, the CFTC has outsourced regulation of crypto and VCCs to self-regulatory organizations (i.e., DCMs, exchanges, and clearinghouses).

Intangible commodities such as VCCs and digital assets are particularly susceptible to fraud and manipulation, and in recent years, we have seen the CFTC aggressively use its enforcement power to regulate crypto and crypto markets. Although the CFTC has not yet brought an enforcement action related to VCCs, there are signs that the CFTC may take a similar approach to regulation by enforcement with respect to VCCs.⁴² In addition to the CFTC's Whistleblower Alert, the CFTC in June established the Environmental Fraud Task Force, signaling VCC enforcement as an area of emphasis.⁴³

Commissioner Johnson's statement about the need for a "comprehensive approach" to voluntary carbon market regulation further shows the CFTC's appetite to regulate VCCs more broadly. Commissioner Johnson specifically highlighted that material risk disclosures, good faith and fair dealing, and clearing as areas where further guidance could benefit voluntary carbon markets and environmental commodities as a whole, all of which happen to be areas where we have seen developments and enforcement actions in the

⁴² See, e.g., Commissioner Goldsmith Romero's opening remarks at the Second Convening on Voluntary Carbon Markets, suggesting that the CFTC "follow a similar

oversight and approach to environmental products as those adopted for digital assets," available [here](#).

⁴³ Press Release, CFTC Division of Enforcement Creates Two New Task Forces, available [here](#).

crypto space in recent years.⁴⁴ The CFTC's next steps in regulating VCCs will very likely go beyond guidance related to its influence on the role of SROs and more directly impact the sell- and buy-sides, potentially through exercise of CFTC enforcement authority.

Requests for Comment

The CFTC has invited comment on a number of questions related to the Proposal. The questions are reproduced in Appendix A.

In her statement, Commissioner Goldsmith Romero asked to hear from commenters on whether the Proposed Guidance will achieve the CFTC's desired result of increasing transparency and integrity. Commissioner Goldsmith Romero's request for comment are reproduced in Appendix B.

Comments on the proposal are due February 16, 2024.

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⁴⁴ Statement of CFTC Commissioner Kristin Johnson, available [here](#).

APPENDIX A

The CFTC has requested comments regarding the Proposal, generally. The specific questions in the Proposal on which the CFTC requested comment are set out below.

General

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?
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?
3. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider in connection with monitoring the continual appropriateness of the terms and conditions of a VCC derivative contract?
4. 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?
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 as being relevant to submissions with respect to VCC derivative contracts made by a registered foreign board of trade under CFTC regulation 48.10?

Transparency

6. Is there particular information that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether a crediting program is providing sufficient access to information about the projects or activities that it credits? Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a contract's terms and conditions, whether there is sufficient transparency about credited projects or activities?

Additionality

7. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether the procedures that a crediting program has in place to assess or test for additionality provide a reasonable assurance that GHG emission reductions or removals will be credited only if they are additional?
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?

Risk of Reversal

9. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, a crediting program's measures to avoid or mitigate the risk of reversal, particularly

where the underlying VCC is sourced from nature-based projects or activities such as agriculture, forestry or other land use initiatives?

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?

Robust Quantification

11. Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a contract's terms and conditions, whether a crediting program applies a quantification methodology or protocol for calculating the level of GHG reductions or removals associated with credited projects or activities that is robust, conservative and transparent?

Governance

12. In addition to a crediting program's decision-making, reporting, disclosure, public and stakeholder engagement, and risk management policies, are there other 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 the crediting program can demonstrate that it has a governance framework that effectively supports the program's transparency and accountability?

Tracking and No Double Counting

13. In addition to the factors identified in this proposed guidance, are there other factors that should be taken into account by a DCM when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether the registry operated or utilized by a crediting program has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer, and retirement of VCCs?

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

Inspection Provisions

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?

Sustainable Development Benefits and Safeguards

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?
17. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities would avoid locking in levels of GHG emissions, technologies or carbon intensive practices that are incompatible with the objective of achieving net zero GHG emissions by 2050, 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?

APPENDIX B

Commissioner Goldsmith Romero separately requested comment on the following.

- 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. As the ICVCM standards have only been recently released, it will be important to monitor the adoption of these standards.
- 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.
- I am interested to hear from commenters, including participants in our previous public consultation, if this guidance meets their needs and helps address concerns they have raised. I especially hope to hear from farmers and others in the agricultural community, several of whom encouraged the CFTC to play a role in ensuring integrity in carbon markets in response to last year's public consultation.