SUBMISSION TO THE COMMODITY FUTURES TRADING COMMISSION (CFTC)

IN REPSONSE TO REQUEST FOR COMMENT ON

THE CFTC GUIDANCE REGARDING THE LISTING OF VOLUNTARY CARBON CREDIT DERIVATIVE CONTRACTS

by

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About Clean Energy Policy Institute

Clean Energy Policy Institute was established in 2021 to advocate for a global clean energy transition through research and policy advisory. Our mission is to facilitate a just energy transition by accelerating the adoption of renewable energy and supporting the growth of carbon markets as a way towards a low-carbon economy. Research areas include clean energy transition, climate finance, and development of carbon markets.

About the Author

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Comments

If you have any comments or questions about this submission, you may reach the author via email at omonigho.erigha@gmail.com.

Introduction

The proposed guidance sets out certain criteria and factors to be considered by Designated Contract Markets (DCMs) regarding the listing of VCC derivative contracts. This submission provides responses to some specific questions raised in the request for comments.

Responses to Specific Questions

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?*

   In addition to the VCC commodity characteristics listed in the proposed guidance, it is proposed that the following criteria should be included:

   (a) No Carbon Leakage: The underlying VCCs should be generated from projects that do not result in increased CO_2 emissions in a different location. This should be independently assessed, and any risks of emissions leakages should be adequately mitigated and publicly disclosed.

   (b) No net harm: The underlying VCCs should be generated from projects that do not violate applicable local or international laws and regulations including those relating to environmental and social requirements. The VCC programs should ensure that these claims are independently assessed and verified and the ESG and climate risk assessment reports for the underlying projects should be publicly available.

   These criteria are generally recognised and widely accepted characteristics of high-integrity carbon credits[1]. Where carbon credits do not meet these criteria, the prices of such VCCs could be subject to price manipulation which could lead to market distortion.

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?*

   Yes, DCMs could incorporate certain standards recognized by the private sector or multilateral initiatives into the terms and conditions of a VCC derivative contract. These include:

   (i) The Core Carbon Principles issued by The Integrity Council for the Voluntary Carbon Market; and
   (ii) The Principles for Responsible Carbon Finance in Clean Cooking being developed by the Clean Cooking Alliance in respect of VCC derivative contracts for clean cooking projects.

[1] CORSIA (Carbon Offsetting and Reduction Scheme for International Aviation) Emissions Unit, Eligibility Criteria, March 2019 issued by the Internation Civil Aviation Organisation (CORSIA Eligibility Criteria).

3. *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 a VCC derivative contract would be readily susceptible to manipulation?*

A DCM should consider whether ex-ante carbon credits (those issued before the emissions reductions or avoidance have occurred and been independently verified) should qualify as underlying carbon credits for the purpose of VCC derivative contracts.

Under the CORSIA Eligibility Criteria, emissions reductions are required to be measured and verified by an accredited and independent third party. The verification of a project's emissions is required prior to the issuance of a carbon credit. Similarly, under the assessment framework of the ICVCM, ex-ante carbon credits are not eligible for a CCP label[2].

For ex-ante carbon credits, it will be difficult to independently verify the emissions reduced or avoided at the time of issuance of the credits and these could lead to price distortion if there is any variance in the estimate and the actual emissions reduction from the underlying project.

In addition, DCMs may consider whether the third party responsible for verifying the emissions reductions under the underlying carbon credits should be accredited by an international accreditation body. ICVCM requires such third parties to be accredited by a recognized international accreditation standard (e.g. according to the current edition of ISO 14065 and ISO 14066, or per rules relating to the UNFCCC Kyoto Protocol Clean Development Mechanism or Paris Agreement Article 6, paragraph 4 Supervisory Body)[3].

4. *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?*

Yes.

Transparency

5. *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?*

In addition to the information stated in the proposed guidance, a DCM should consider whether the crediting program is transparent about:

- whether the underlying mitigation project has any co-benefits other than emissions reductions or removals? and
- how the proceeds of the carbon credits will be distributed? That is, whether any amounts would be paid to the local communities where the underlying mitigation project was developed and/or whether any proceeds will be deployed for adaptation e,g. paid into the Adaptation Fund.

[2] ICVCM Assessment Framework
[3] Ibid

The ICVCM allows carbon crediting programs to tag specific attributes to carbon credits[4] where they meet certain criteria. It is important to be transparent about these issues as it could directly impact the price of the underlying carbon credit.

Additionality

6. *In the 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?*

The criteria for assessing additionality should be expanded in line with internationally recognized standards for additionality. For the purposes of VCC derivative contracts, in addition to the criteria proposed by the CFTC in the proposed guidance, the following characteristics should be considered when assessing additionality.

(i) Regulatory Surplus - Additionality should only be attributed to projects which are not already compulsory under local laws and regulations.
(ii) Prior Consideration – whether there is evidence that voluntary carbon credits were considered during the development of the underlying mitigation project.
(iii) Independent third-party verification – whether the additionality of the emissions reductions or removals has been assessed and verified by an independent third party.

Risk of Reversal

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, 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?*

In addition to the criteria listed in the proposed guidance, DCMs should consider whether the crediting programs have a clear methodology for assessing the risk of reversals in nature-based projects or activities such as agriculture, forestry or other land use initiatives. It is also important to consider the integrity of the mechanism for auditing the sufficiency of the buffer pool, i.e. is it done by an accredited and independent body? Also, DCMs may want to consider whether there is any mechanism to compensate for reversals where the carbon credits in the buffer pool is insufficient to compensate for reversals or where the credit program ceases to exist or is no longer operating the buffer pool.

8. *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?*

The VCC derivative contract should include:

(a) the methodology for assessing the risk of reversal and the frequency of the assessment.

[4] CCP Attribute 2 (Share of Proceeds for Adaptation) and CCP Attribute 3 (Quantified positive SDG impacts)

(b) the nature and proportion of carbon credits to be held the buffer pool.
(c) the mechanism for auditing and monitoring the sufficiency of the buffer pool.
(d) definitions of what constitutes an avoidable reversal and an unavoidable reversal.
(e) the mechanism for compensation in the event of (i) an avoidable reversal; and (ii) an unavoidable reversal.
(f) mechanism for compensating a reversal where the carbon credits in the buffer pool is insufficient to compensate for reversals or where the credit program ceases to exist or is no longer operating the buffer pool.

Robust Quantification

9. *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?*

Based on internationally recognised standards for the assessment of robust quantification[5], DCMs should consider the following:

(a) whether the crediting programs relied on scientific evidence to develop their existing quantification methodology and whether there are any mechanisms for the periodic review and/or revisions of such methodologies.
(b) whether the process of assessment of a quantification methodology is sufficiently robust and includes input from independent experts and a public consultation process.
(c) whether the quantification methodology has been independently assessed by an accredited and independent third party?
(d) Whether the crediting program has procedures in place to suspend or withdraw the use of any quantification methodology where there is sufficient evidence, that the emissions removal or reductions were overstated.

Tracking and No Double Counting

10. *In addition to the factors identified in the 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?*

In addition to the factors identified in the proposed guidance, DCMs should consider the following:
(a) whether a crediting program has a procedure to independently verify that carbon credits are registered only under its crediting program; and
(b) whether the crediting programs have any contractual provisions in place to ensure that project proponents are contractually restricted from registering any carbon credit listed in its registry in any other registry;
(c) a procedure for compensation where the carbon credits are registered in more than one registry or not properly tracked.

11. *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?*

[5] CORSIA Eligibility Criteria and ICVCM Assessment Framework

In addition to the proposed terms in the proposed guidance, a VCC derivative contract should include a condition that the crediting program should (i) independently verify that carbon credits are registered only under its crediting program; and (ii) have a mechanism for compensation where the carbon credits are registered in more than one registry or not properly tracked.

Inspection Provisions

12. *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?*

The physically settled VCC derivative contracts should have procedures for the delivery of physically settled VCC derivative contracts that aligns with the transfer and retirement procedures of the relevant registry.

Sustainable Development Benefits and Safeguards

13. *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?*

Yes, in line with international best practices, DCMs should consider whether crediting programs meet or exceed best practices on social and environmental safeguards as a failure to meet environmental and social obligations may affect the credibility of the underlying mitigation projects and impact the price of the underlying carbon credits.

14. *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?*

DCMs should consider whether a crediting program has implemented measures to ensure that mitigation projects avoid locking in levels of GHG emissions, technologies or carbon intensive practices. However, in doing so, DCMs should assess how the crediting programs determine the net contribution of the mitigation project to achieving net zero transition by 2050.

Ideally, the crediting program should consider the host country's net zero objectives and targets, the common prevalence in the host country, and the nature and net effect of the mitigation activity on emissions, e.g. in a developing country that has a high rate of cooking with dirty fuels, a project that relies on LPG cooking stoves to replace burning of wood for cooking, is likely to have the net effect of lower emissions.