Institute for Agriculture & Trade Policy

Media Contact: Ben Lilliston
blilliston@iatp.org, 612-741-8650

FOR IMMEDIATE RELEASE
September 24, 2024

IATP statement on the CFTC approval of guidance to industry on voluntary carbon market credits

MINNEAPOLIS— On Sept. 19, the Commodity Futures Trading Commission (CFTC) voted to approve final guidance to commodity exchanges planning to offer new derivatives contracts whose underlying assets are credits based on projects intended to reduce or remove carbon dioxide and other greenhouse gases. Secretary of Treasury Janet Yellen believes the guidelines will "promote the integrity of carbon credits" and attract more investors, who are wary about buying credits based on low integrity projects, to the contracts. IATP had characterized the proposed guidance as a "high stakes bet" to help the private sector build voluntary carbon markets. Our review of the final guidance (this press release links to a pre-print) does not allay that concern. The stakes are too high. The continued failure to reduce greenhouse gases will accelerate extreme weather events driven by climate change.

The CFTC calls these credits "voluntary" because they are not subject to mandatory government regulation. In July, the Science Based Target Initiative to accelerate corporate climate action concluded, after an extensive and systematic review of evidence, that "various types of carbon credits are ineffective in delivering their intended [emissions] mitigation outcomes" (Page 66). Carbon market proponents are counting on CFTC support for "high integrity" credits to help voluntary carbon credit (VCC) trading overcome both this history of climate performance failure and of very low VCC prices and transaction volume. Although the final guidance is consistent with the CFTC's Core Principles of regulation, it is not at all certain that this history of failure will be overcome.

IATP Senior Policy Analyst Steve Suppan commented, "The CFTC's final guidance confers conditional legitimacy to the trading of credits derived from emissions reduction and avoidance projects that have been plagued with performance failure and even fraud."

IATP wrote in February about the proposed guidance, "Because there is no legislation to authorize the trading of VCC derivatives, the CFTC had to extrapolate from rules developed for tangible commodities, such as wheat, to cover the intangible VCCs." The exchanges (called Designated Contract Markets or DCMs in the rule) are not obliged to provide project level information in the new contracts' "terms and conditions." Instead, they are instructed to provide information about the procedures and policies of the programs that issue the credits for sale, such as Verra. However, the DCMs must design the contracts to comply with CFTC Core Principles of regulation, including to prevent contracts that are susceptible to manipulation and fraud. To help enable compliance, the Commission introduces a new credit commodity characteristic never applied to tangible commodity contracts: the changing of VCC standards are deemed an "individual characteristic of the [VCC] commodity" (Page 84). The final guidance includes this novel characteristic among the commodity characteristics that the DCMs should "consider

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addressing in the terms and conditions" (Page 85) of new carbon derivatives contracts that they self-certify as being consistent with CFTC Core Principles and rules. The CFTC advises DCMs to monitor the crediting programs and carbon credit standards organizations for changes to their accountability mechanisms, procedures and standards that would affect the contracts' terms and conditions (Pages 75-76).

The preamble to the final guidance references IATP's letter on the proposed guidance several times, noting that, "IATP stated that '[i]f we assume that reversals will become more frequent and severe'" due to an increase in extreme weather events, then "DCMs should begin to account for the impact of reversals on VCC estimated deliverable supply and on the possibility of market disruption if uncompensated reversals become widespread" (Page 51 or Page 22 of the IATP letter). Emissions reversals are part of the emissions reduction and removal permanence quality standard.

Crediting program failure to compensate fully for reversals not only undermines carbon credit quality but impedes the ability of DCMs to set contract specific speculative position limits based on the estimated deliverable supply of the carbon credits underlying the derivatives contract. The final guidance states, "the Commission notes that for the derivative contracts that they list, DCMs are required to adopt, as is necessary and appropriate, exchange-set position limits for speculators" (Page 90). If the position limits are set too high, excessive speculation by market participants with no demonstrated need to reduce or remove emissions could result in price manipulation or market disruption.

There is a great deal more that the CFTC can and should do to help manage and reduce the impacts of climate change on all entities and activities regulated by the agency. IATP responded in October 2022 to questions posed in the CFTC's Request for Information about managing climate related financial risk. The questions indicate a wide range of data collection and analysis, guidance and rulemaking that the CFTC could undertake beyond its support for VCMs. IATP hopes the CFTC will undertake such actions in the next administration. We doubt that the share of proceeds from VCC trading will fulfill what appears to be the Biden administration's hope that such revenues will compensate for Congress' repeated failure to appropriate adequate funding for direct domestic and international actions to rapidly reduce emissions and adapt to our future with climate change.

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