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**COMMODITY FUTURES TRADING COMMISSION**

**RIN 3038-AF40**

**Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts**

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Final guidance.

**SUMMARY:** The Commodity Futures Trading Commission (the "Commission" or "CFTC") is issuing this guidance to outline factors for consideration by designated contract markets ("DCMs"), when addressing certain provisions of the Commodity Exchange Act ("CEA"), and CFTC regulations thereunder, that are relevant to the listing for trading of voluntary carbon credit ("VCC") derivative contracts. The Commission recognizes that VCC derivatives are a comparatively new and evolving class of products, and believes that guidance that outlines factors for consideration by a DCM, in connection with the contract design and listing process, may help to advance the standardization of such products in a manner that promotes transparency and liquidity.

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**SUPPLEMENTARY INFORMATION:**

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# I. Background

## A. The Regulatory Framework for DCMs

The CFTC's mission is to promote the integrity, resilience, and vibrancy of the U.S. derivatives markets through sound regulation.[1] An independent agency of the U.S. federal government, the CFTC exercises the authorities granted to it under the CEA to promote market integrity, prevent price manipulation and other market disruptions, protect customer funds, and avoid systemic risk, while fostering responsible innovation and fair competition in the derivatives markets.[2]

DCMs are CFTC-regulated exchanges that provide participants in the derivatives markets with the ability to execute or trade derivative contracts with one another.[3] In order to obtain and maintain designation with the CFTC, DCMs must comply with statutory "Core Principles" that are set forth in the CEA,[4] as well as applicable CFTC rules and regulations.[5] The statutory Core Principles for DCMs reflect the important role that these exchanges play in promoting the integrity of derivatives markets. DCMs are self-regulatory organizations, and each DCM has Core Principle obligations to, among other things, establish and enforce rules for trading on the DCM;[6] provide a

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[1] CFTC Mission Statement, *available at*: https://www.cftc.gov/About/AboutTheCommission.
[2] *See* CEA section 3(b), 7 U.S.C. 5(b).
[3] *See* CEA section 1a(6), 7 U.S.C. 1a(6). ("The term 'board of trade' means any organized exchange or other trading facility"); CEA section 1a(51)(A), 7 U.S.C. 1a(51)(A) ("The term 'trading facility' means a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions— (i) by accepting bids or offers made by other participants that are open to multiple participants in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching or execution algorithm"); and CEA section 5(d)(1)(A), 7 U.S.C. 7(d)(1)(A) ("To be designated, and maintain a designation, as a contract market, a board of trade shall comply with—(i) any core principle described in this subsection; and (ii) any requirement that the Commission may impose by rule or regulation pursuant to [CEA] section 8a(5)").
[4] *See, generally,* CEA Section 5(d), 7 U.S.C. 7(d). There are 23 statutory Core Principles for DCMs.
[5] CEA section 5(d)(1)(A), 7 U.S.C. 7(d)(1)(A).
[6] DCM Core Principle 2 requires, among other things, that a DCM establish, monitor, and enforce compliance with the rules of the DCM, including access requirements, the terms and conditions of any contracts to be traded on the DCM, and rules prohibiting abusive trade practices on the DCM. DCM Core Principle 2 also requires a DCM to

competitive, open and efficient market for trading;[7] and monitor trading activity.[8] For example, DCM Core Principle 4 requires a DCM to have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process, through market surveillance, compliance, and enforcement practices and procedures.[9] DCM Core Principle 5 requires a DCM to adopt for each contract that it lists for trading, as is necessary and appropriate, position limitations or position accountability for speculators, in order to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month.[10] DCM Core Principle 12 requires a DCM to establish and enforce rules to protect markets and market participants from abusive practices, and to promote fair and equitable trading on the DCM.[11]

Additionally, each DCM has a specific statutory obligation, under DCM Core Principle 3, to only list for trading derivative contracts that are not readily susceptible to manipulation.[12] As discussed in greater detail below, a DCM may elect to list a new derivative contract for trading either by certifying to the Commission that the contract complies with the CEA and CFTC regulations,[13] or by seeking Commission approval of the contract.[14] In either case, the DCM must

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have the capacity to detect, investigate, and apply appropriate sanctions to any person that violates any rule of the DCM. CEA section 5(d)(2), 7 U.S.C. 7(d)(2). *See also* 17 CFR 38.150–160. DCM Core Principle 13 requires that a DCM establish and enforce disciplinary procedures that authorize the DCM to discipline, suspend, or expel members or market participants that violate the DCM's rules. CEA section 5(d)(13), 7 U.S.C. 7(d)(13). *See also* 17 CFR 38.700–712.

[7] DCM Core Principle 9 requires, among other things, that a DCM provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the DCM. CEA section 5(d)(9), 7 U.S.C. 7(d)(9). *See also* 17 CFR 38.500.

[8] *See, e.g.,* DCM Core Principles 4, 5, and 12, discussed *infra.*

[9] CEA section 5(d)(4), 7 U.S.C. 7(d)(4). *See also* 17 CFR 38.250–258.

[10] CEA section 5(d)(5), 7 U.S.C. 7(d)(5). *See also* 17 CFR 38.300–301.

[11] CEA section 5(d)(12), 7 U.S.C. 7(d)(12). *See also* 17 CFR 38.650–651.

[12] CEA section 5(d)(3), 7 U.S.C. 7(d)(3). *See also* 17 CFR 38.200–201.

[13] CEA section 5c(c)(1), 7 U.S.C. 7a-2(c)(1). *See also* 17 CFR 40.2.

[14] CEA sections 5c(c)(4)–(5), 7 U.S.C. 7a-2(c)(4)–(5). *See also* 17 CFR 40.3.

submit the contract's terms and conditions, and other prescribed information relating to the contract, to the Commission prior to listing.[15]

For a number of the statutory Core Principles for DCMs, the Commission has adopted rules that establish the manner in which a DCM must comply with the Core Principle.[16] These implementing rules are set forth in Part 38 of the Commission's regulations.[17] The Commission has also adopted, in Appendix B to Part 38,[18] guidance and acceptable practices for DCMs to consider with respect to certain of the Core Principles.[19]

With respect to the DCM Core Principle 3 requirement that a DCM only list for trading derivative contracts that are not readily susceptible to manipulation, the Commission has adopted guidance that is set forth in Appendix C to Part 38 - Demonstration of Compliance That a Contract is Not Readily Susceptible to Manipulation (the "Appendix C Guidance").[20] The Appendix C Guidance outlines certain relevant considerations for a DCM when designing a derivative contract, and providing supporting documentation and data in connection with the submission of the derivative contract to the Commission.[21] The Commission takes the considerations outlined in the

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[15] *See, generally,* 17 CFR 40.2 and 40.3. Amendments to contract terms and conditions also must be submitted to the Commission in accordance with procedures set forth at CEA section 5c(c), 7 U.S.C. 7a-2(c), and Part 40 of the Commission's regulations.

[16] Unless otherwise determined by the Commission by rule or regulation, a DCM has reasonable discretion in establishing the manner in which it complies with a Core Principle. CEA section 5(d)(1)(B), 7 U.S.C. 7(d)(1)(B).

[17] 17 CFR part 38.

[18] 17 CFR part 38, Appendix B.

[19] Guidance provides contextual information regarding a Core Principle, including important concerns which the Commission believes should be considered in complying with the Core Principle. The guidance for a DCM Core Principle is illustrative only of the types of matters that a DCM may address, and is not intended to be used as a mandatory checklist. Acceptable practices are more detailed examples of how a DCM may satisfy particular requirements of a DCM Core Principle. Similar to guidance, acceptable practices are for illustrative purposes only, and do not establish a mandatory means of Core Principle compliance. 17 CFR part 38, Appendix B.

[20] *See* 17 CFR part 38, Appendix C. Guidance set forth in Appendix B to Part 38 states that a DCM may use the Appendix C Guidance as guidance in meeting DCM Core Principle 3 for both new product listings and existing listed contracts. 17 CFR part 38, Appendix B, Core Principle 3 Guidance.

[21] *See* Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 at 36632 (June 19, 2012). The Appendix C Guidance is also relevant to swap execution facilities ("SEFs"), another category of CFTC-regulated exchange that provides eligible contract participants with the ability to execute or trade derivative contracts that are swaps with one another. Like DCMs, SEFs are obligated by statute only to permit trading in

Appendix C Guidance into account when determining whether, with respect to the contract, the DCM is satisfying its DCM Core Principle 3 obligation only to list derivative contracts that are not readily susceptible to manipulation.

Among other things, the Appendix C Guidance outlines, for both physically-settled and cash-settled derivative contracts, certain considerations in connection with the design of the contract's rules and terms and conditions.[22] With respect to physically-settled derivative contracts, the Appendix C Guidance states, among other things, that the contract's terms and conditions should conform to the most common commercial practices and conditions in the cash market for the underlying commodity.[23] The Appendix C Guidance also states that the contract's terms and conditions should be designed to avoid impediments to the delivery of the underlying commodity, so as to promote convergence between the price of the contract and the cash market value of the underlying commodity at the expiration of trading in the contract.[24] The Appendix C Guidance outlines certain criteria for a DCM to consider addressing in the contract's terms and conditions,[25] including contract size, the period for making and taking delivery under the contract, delivery points, quality standards for the underlying commodity, and inspection/certification procedures for verifying compliance with those quality standards or any other related delivery requirements under the contract.[26]

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contracts that are not readily susceptible to manipulation. *See* CEA section 5h(f)(3), 7 U.S.C 7b-3(f)(3); 17 CFR 37.301.

[22] Physically-settled derivative contracts are contracts that may settle directly into the commodity underlying the contract. If the holder of a position in a physically-settled derivative contract still has an open position at the expiration of trading in the contract, then the position holder must, in accordance with the rules for delivery set forth in the contract, make or take delivery (as applicable) of the underlying commodity. By contrast, cash-settled derivative contracts are, at the expiration of trading in the contract, settled by way of a cash payment instead of physical delivery of the underlying commodity.

[23] Appendix C Guidance, paragraph (b)(1).

[24] *Id.*

[25] Appendix C Guidance, paragraph (b)(2)(1) ("For physical delivery contracts, an acceptable specification of terms and conditions would include, but may not be limited to, rules that address, as appropriate, the following criteria …").

[26] Appendix C Guidance, paragraph (b)(2).

The criteria outlined in the Appendix C Guidance that relate to the quality and other attributes of the underlying commodity that would be delivered under a physically-settled derivative contract upon the expiration of trading, inform the pricing of the derivative contract. Addressing these criteria clearly in the derivative contract's terms and conditions, in a manner that reflects the individual characteristics of the underlying commodity, helps to ensure that trading in the derivative contract is based on accurate information about the underlying commodity. This, in turn, helps to promote accurate pricing and helps to reduce the susceptibility of the derivative contract to manipulation. Further, when a derivative contract's terms and conditions help to ensure that, upon delivery, the quality and other attributes of the underlying commodity will be as expected by position holders, this helps to prevent price distortions and fosters confidence in the contract that can incentivize trading and enhance liquidity.

With respect to cash-settled derivative contracts, the Appendix C Guidance states that an acceptable specification of the cash settlement price would, among other things, include rules that fully describe the essential economic characteristics of the underlying commodity, as well as how the final settlement price is calculated.[27] The Appendix C Guidance states that the utility of a cash-settled contract for risk management and price discovery purposes would be significantly impaired if the cash settlement price is not a reliable or robust indicator of the value of the underlying commodity.[28] The Appendix C Guidance states that, accordingly, careful consideration should be given to the potential for manipulation or distortion of the cash settlement price, as well as the reliability of that price as an indicator of cash market values.[29] Appropriate consideration also

[27] Appendix C Guidance, paragraph (c)(1).
[28] Appendix C Guidance, paragraph (c)(2).
[29] *Id.*

should be given to the commercial acceptability, public availability, and timeliness of the price series that is used to calculate the cash settlement price.[30]

## B. Voluntary Carbon Markets

### 1. *Overview of Voluntary Carbon Markets*

As discussed further below, this final Commission guidance addresses an emerging class of climate-related derivative contracts listed for trading by DCMs, where the underlying commodity is a VCC.[31]

In addition to direct greenhouse gas ("GHG") emissions reduction initiatives, market-based mechanisms, such as carbon markets,[32] have developed to support emissions reduction efforts. A carbon market generally refers to an economic mechanism to support the buying and selling of environmental commodities[33] that represent GHG emission reductions or removals from the atmosphere. Carbon markets are intended to harness market forces to incentivize carbon mitigation activities. Carbon markets generally fall into two categories: (i) mandatory (or compliance) markets, and (ii) voluntary carbon markets.

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[30] *Id.*

[31] This guidance uses the term "voluntary carbon credits" rather than "verified carbon credits," since the guidance is focused on the quality and other attributes of the intangible commodity underlying a *derivative contract*. The Commission recognizes that market participants in the *cash or secondary market* for voluntary carbon credits may choose to use a set of standardized terms for the trading and retirement of "verified carbon credits," as defined by the International Swaps and Derivatives Association ("ISDA"), in the market participants' physically-settled *spot*, *forward or option* transactions. *See* 2022 ISDA Verified Carbon Credit Transactions Definitions ("VCC Definitions") Frequently Asked Questions, *available at*: 2022-ISDA-Verified-Carbon-Credit-Transactions-Definitions-FAQs-061323.pdf.

[32] While the term "carbon" is generally intended to also include other GHGs, such as methane, nitrous oxide, sulfur hexafluoride, hydro fluorocarbons and perfluorocarbons, most emissions trading involves emissions trading of carbon dioxide.

[33] An agreement, contract or transaction in an environmental commodity may qualify for the forward exclusion from the "swap" definition set forth in section 1a(47) of the CEA, 7 U.S.C. 1a(47), if the agreement, contract or transaction is intended to be physically-settled. For further discussion of the Commission's interpretation of whether agreements, contracts, or transactions in environmental commodities fall within the forward exclusion from the swap definition, *see* Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule, 77 FR 48208 (August 13, 2012).

Mandatory markets, such as cap-and-trade programs, emissions trading systems and allowance trading systems, are established and regulated by national, regional, or international governmental bodies.[34] Entities subject to the requirements of a mandatory market generally must demonstrate compliance by directly reducing their emissions from their own operations or activities, or by purchasing eligible compliance credits representing emission reductions or removals achieved by others.

Voluntary carbon markets are not established by any government body. They enable market participants to purchase, on a voluntary basis, carbon credits that upon retirement represent reductions or removals of GHG emissions. A voluntary carbon credit, or "VCC," is a tradeable intangible instrument that is issued by a carbon crediting program ("crediting program").[35] The general industry standard is for a VCC to represent a GHG emissions reduction to, or removal from, the atmosphere equivalent to one metric ton of carbon dioxide.[36]

A participant in the voluntary carbon markets may purchase a VCC, representing an emissions reduction or removal by another party, to supplement emissions reductions or removals achieved from the participant's own operations or activities. Liquid and transparent markets in high-integrity VCCs may serve as a tool to facilitate emissions reduction efforts.[37]

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[34] *See,* for example, the United Nation's Clean Development Mechanism ("CDM"), the California Compliance Offset Program, the Regional Greenhouse Gas Initiative ("RGGI"), the Alberta Emission Offset System ("AEOS"), and the EU Emissions Trading System ("ETS").

[35] *See, e.g.,* The Integrity Council for the Voluntary Carbon Market Carbon Core Principles, Section 5 Definitions, *available at:* https://icvcm.org/wp-content/uploads/2023/07/CCP-Section-5-R2-FINAL-26Jul23.pdf.

[36] This is calculated as the difference in GHG emission reductions or removals from a baseline scenario, to the emission reductions or removals occurring under the carbon mitigation project or activity, with any adjustments for leakage. *See* The Integrity Council for the Voluntary Carbon Market Carbon Core Principles, Section 5 Definitions, *available at*: https://icvcm.org/wp-content/uploads/2023/07/CCP-Section-5-R2-FINAL-26Jul23.pdf.

[37] The Board of the International Organization of Securities Commissions ("IOSCO") published, in November 2022, a Voluntary Carbon Markets consultation for public comment. The IOSCO consultation paper sought feedback on a potential approach that regulatory authorities and market participants could take to foster sound and well-functioning voluntary carbon market structure and, as a consequence, scale up these markets to allow them to achieve their environmental objectives. *See,* Voluntary Carbon Markets, Discussion Paper, CR/06/22, November 2022, *available at*: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD718.pdf. In December 2023, IOSCO

The process by which VCCs are issued deserves careful consideration, as that process informs VCC quality and, by extension, the overall integrity and effective functioning of voluntary carbon markets. Generally, parties that play a role in the issuance of a VCC include: (1) the developer of a mitigation project or activity that is intended to reduce or remove GHG emissions from the atmosphere ("project developer"); (2) a crediting program that, among other things, issues VCCs for mitigation projects or activities that satisfy the crediting program's standards;[38] and (3) an independent third party that verifies and validates the mitigation project or activity.

A project developer must first select the crediting program with which it seeks to certify its mitigation project or activity. The crediting program will certify the project or activity if it satisfies the crediting program's standards for issuing VCCs. A crediting program generally engages an independent third party to review project or activity documentation, including, among other things, to verify the accuracy of the estimated amount of emission reductions or removals that are expected to be associated with the project or activity, based on the project's or activity's baseline scenario[39] and the crediting program's methodology or protocol for quantifying reduction or removal levels. The estimated emission reductions or removals serve as the basis for the determination of the number of VCCs to be issued for the project or activity.

Once the crediting program determines that the mitigation project or activity satisfies the crediting program's standards for issuing VCCs, the project or activity will be certified. The

published its Voluntary Carbon Markets Consultation Report, CR/06/23, December 2023 (outlining a proposed set of good practices to promote the integrity and orderly functioning of voluntary carbon markets) *available at*: CR06/2023 Voluntary Carbon Markets (iosco.org). *See also*, Voluntary Carbon Markets Joint Policy Statement and Principles ("Joint Policy Statement on Voluntary Carbon Markets"), U.S. Department of the Treasury, May 2024, *available at*: https://home.treasury.gov/system/files/136/VCM-Joint-Policy-Statement-and-Principles.pdf.

[38] Currently, the four main crediting programs in the voluntary carbon markets are the American Carbon Registry, the Climate Action Reserve, the Gold Standard and the Verified Carbon Standard.

[39] A baseline scenario is the predicted or assumed outcome in the absence of the incentives created by carbon credits, holding all other factors constant. *See, e.g.,* The Integrity Council for the Voluntary Carbon Market, Core Carbon Principles Section 5: Definitions; January 2024, Version 2, at 104.

crediting program typically operates or makes use of a registry, which serves as a central repository for tracking certified mitigation projects or activities and their associated VCCs. Once registered, VCCs associated with a certified mitigation project or activity may be bought and sold to end users (businesses or individuals) or to intermediaries such as brokers or aggregators that provide liquidity to voluntary carbon market participants.[40]

2. *Initiatives to Promote Transparency, Integrity and Standardization in the Voluntary Carbon Markets*

As the voluntary carbon markets have continued to develop and mature, private sector and multilateral initiatives have sought to address certain issues—relevant to both the supply side (generation of VCCs from carbon mitigation projects or activities), and the demand side (businesses or individuals purchasing VCCs)—impacting the speed at which transparent, robustly traded markets for high-integrity VCCs are scaled.

On the supply side, a key focus has been on the quality of VCCs, and particularly, whether they accurately represent the nature and level of GHG emission reductions or removals that they are intended to represent. Given the current absence of a standardized methodology or protocol to quantify emissions reduction or removal levels, there is a possibility that methodologies or protocols of differing degrees of robustness may calculate different reduction or removal impacts for two projects that are identical in type and size (or even for the same project). This could result in different amounts of carbon credits being issued for each project, despite their actual reduction or removal impact being the same. It may also create incentives for project developers to seek to apply the quantification protocol or methodology, or to seek to certify with the crediting program,

[40] Funding by investors for a mitigation project or activity could begin as early as the planning stage. Early investors may enter into agreements with a project developer for funding in exchange for discounted VCCs, if and when issued.

that would result in the issuance of the most credits. Among other things, these possibilities create challenges for accurately pricing VCCs. Further, it can be difficult to discern the extent to which the price of any particular VCC reflects the price of one metric ton of carbon dioxide equivalent reduced or removed from the atmosphere, and the extent to which the price of the VCC reflects understandings or concerns relating to the mitigation project or activity for which the VCC was issued, or other aspects of the process for issuing the VCC.[41]

Challenges with respect to accurately ascertaining VCC quality, and associated pricing challenges,[42] can erode confidence in voluntary carbon markets. Furthermore, opaque or inadequate calculation methodologies or protocols, which can obscure or mischaracterize the carbon impact of a mitigation project or activity, can undermine both the integrity and purpose of voluntary carbon markets.

On the demand side, concerns have been raised that, in connection with meeting their carbon mitigation goals, businesses or individuals may be utilizing low integrity VCCs which do not accurately reflect the nature or level of GHG emission reductions or removals that are associated with the projects or activities for which the VCCs have been issued.[43] This can raise

[41] Factors that may affect the price of VCCs issued for any particular mitigation project or activity may include the type of the project or activity, the geographic location of the project or activity, and the methodology or protocol used to measure the levels of emission reductions or removals associated with the project or activity. Types of carbon mitigation projects or activities for which VCCs are issued include renewable energy, industrial gas capture, energy efficiency, forestry initiatives (avoiding deforestation), regenerative agriculture, wind power, and biogas. The location of a mitigation project or activity may, for example, impact the cost of implementing and/or operating the project or activity. Mitigation projects and activities for which VCCs are issued are located in countries worldwide. *See* Berkeley Voluntary Registry Offsets Database, *available at:* https://gspp.berkeley.edu/research-and-impact/centers/cepp/projects/berkeley-carbon-trading-project/offsets-database.

[42] Observed trading of VCCs is not as readily transparent as for other financial instruments. Spot markets for VCCs are still largely bespoke, with buyers purchasing directly from project developers or via intermediaries. Some exchanges for trading VCCs have been established and are evolving. For example, the AirCarbon Exchange (https://acx.net/acx-singapore/), located in Singapore; Carbon Trade Exchange (https://ctxglobal.com/ ), located in the United Kingdom; and Xpansiv CBL (https://xpansiv.com/cbl/), located in the United States.

[43] *See, e.g.,* Forbes, Carbon Neutral Claims Under Investigation In Greenwashing Probe (June 16, 2023), *available at:* https://www.forbes.com/sites/amynguyen/2023/06/16/carbon-neutral-claims-under-investigation-in-greenwashing-probe/?sh=2a6170466431.

questions not only about the business's or individual's progress towards their carbon mitigation goals, but also about whether any claims related to those goals are misleading.[44] Market participants that are purchasing VCCs to help meet their carbon mitigation goals may be focused largely or primarily on price, and also may not have ready access to all of the information that they need to make informed evaluations, and comparisons, of VCC quality. All of this may incentivize, intentionally or not, the purchase of lower quality VCCs. This may be facilitated by the opaque pricing of VCCs.

Private sector and multilateral efforts have spearheaded the development of various initiatives to address the above challenges, and to promote transparency, integrity and standardization in the voluntary carbon markets. To support and promote VCC quality, these private sector and multilateral initiatives have focused on developing standards for high-integrity VCCs.[45] Among other things, these standards are intended to help provide assurance that the VCCs that have been issued for a carbon mitigation project or activity accurately reflect the actual GHG emissions reduction or removal levels associated with that project or activity. These standards also generally highlight the importance of effective crediting program processes, procedures, and governance arrangements, in ensuring that a crediting program is issuing high-integrity VCCs.

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[44] *See, e.g.,* Federal Trade Commission, *Guides for the Use of Environmental Marketing Claims*, Regulatory Review Notice and Request for Public Comment, 87 FR 77766 (December 20, 2022) (Federal Trade Commission request for public comment on updating its Green Guides to include claims made regarding carbon offsets).

[45] *See*, *e.g.,* The Integrity Council for the Voluntary Carbon Market's Core Carbon Principles (July 2023), *available at*: https://icvcm.org/wp-content/uploads/2023/07/CCP-Book-R2-FINAL-26Jul23.pdf; the International Civil Aviation Organization's Carbon Offsetting and Reduction Scheme for International Aviation ("CORSIA") (2023), *available at*: https://www.icao.int/environmental-protection/CORSIA/Pages/default.aspx; the G7 Principles of High Integrity Carbon Markets (2023), *available at*: https://www.meti.go.jp/information/g7hirosima/energy/pdf/Annex004.pdf. *See also*, Joint Policy Statement on Voluntary Carbon Markets, *available at*: https://home.treasury.gov/system/files/136/VCM-Joint-Policy-Statement-and-Principles.pdf.

Standards that assist market participants in making informed evaluations, and comparisons, of VCC quality may promote accurate pricing and enhance confidence that the voluntary carbon markets can serve as a tool to assist in emissions reduction efforts. Such standards can thereby play a valuable role in supporting market transparency and liquidity, and the scaling of high-integrity voluntary carbon markets.

Such standards may also support initiatives being developed to address concerns about the accuracy of claims made by purchasers of VCCs regarding the role that VCCs play in the purchasers' progress toward carbon mitigation goals.[46] Such standards could serve as a foundation for criteria that purchasers of VCCs could voluntarily adhere to, in order to demonstrate their commitment to using high-integrity VCCs to support their carbon mitigation goals, and to being transparent in their progress towards those goals.

## C. The Commission and Voluntary Carbon Markets

### 1. *Derivative Contracts on Environmental Commodities, Including VCCs*

Derivative contracts on environmental commodities have been trading on CFTC-regulated exchanges for decades. Derivative contracts on mandatory emissions program instruments have been trading since 2005, with GHG emissions-related instruments first listed for trading in 2007.[47] There are currently over 150 derivative contracts on mandatory emissions program instruments

[46] *See, e.g.,* the World Wildlife Fund ("WWF"), Environmental Defense Fund ("EDF") and Oeko-Institut's Carbon Credit Quality Initiative (https://carboncreditquality.org/); the Tropical Forest Credit Integrity Guide for Companies: Differentiating Tropical Forest Carbon Credit by Impact, Quality, and Scale (https://tfciguide.org/); and the Voluntary Carbon Markets Integrity Initiative's Claims Code of Practice (https://vcmintegrity.org/vcmi-claims-code-of-practice/).

[47] The Chicago Climate Futures Exchange ("CCFE") listed a Sulfur Financial Instruments Current Vintage Delivery futures contract in 2005. In 2006, the New York Mercantile Exchange ("NYMEX") listed a nitrogen oxide ("$NO_X$") Emissions Allowance futures contract. In 2007, CCFE listed the first Carbon Financial Instrument futures contract and other emission contracts. In 2008, NYMEX listed the first RGGI futures contract. In 2011, Green Exchange listed its European Union Allowance futures contract. In 2012, NYMEX listed its California Carbon Allowance futures contract. To date, there have been over 1,500 futures and options contracts on mandatory emissions program instruments listed for trading on various DCMs. The vast majority of these contracts are no longer listed for trading.

listed for trading on DCMs.[48] As of August 2024, twenty-nine derivative contracts on voluntary carbon market products have been listed for trading by DCMs.[49] Three of those contracts currently have open interest.[50]

Physically-settled derivative contracts on VCCs base their price on the spot price of VCCs. If the holder of a position in a physically-settled VCC derivative contract still has an open position at the expiration of trading in the contract, then the position holder must, in accordance with the rules for delivery set forth in the contract, make or take delivery (as applicable) of VCCs that meet the contract's rules for delivery eligibility.[51]

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[48] Examples of derivatives contracts on mandatory emissions program instruments, such as renewable energy credits ("RECs") and renewable fuel standards ("RFS"), that currently have open interest include: the ICE Futures US ("ICE US") PJM Tri Qualified Renewable Energy Certificate Class I futures contract; the ICE US Texas Compliance Renewable Energy Certificate from CRS Listed Facilities Front Half Specific futures contract; the ICE US New Jersey Compliance Renewable Energy Certificate Class II futures contract; the Chicago Mercantile Exchange ("CME") Ethanol T2 FOB Rotterdam Including Duty (Platts) futures contract; the ICE US Biofuel Outright - D4 RINS (OPIS) futures contract; the ICE US RGGI Vintage 2024 futures contract; and the ICE US California Carbon Allowance Current Auction futures contract.

[49] NYMEX lists the following physically-settled futures contracts on voluntary carbon market products: 1) the CBL Global Emissions Offset (GEO) futures contract; 2) the CBL Nature-Based Global Emissions Offset (N-GEO) futures contract; 3) the CBL Core Global Emissions Offset (C-GEO) futures contract; 4) the CBL Nature-Based Global Emissions Offset Trailing futures contract; and 5) the CBL Core Global Emissions Offset Trailing futures contract. Nodal Exchange ("Nodal") lists the following physically-settled futures and options contracts on voluntary carbon market products: 1) Verified Emission Reduction - Nature-Based Vintage 2017 futures and options contracts; 2) Verified Emission Reduction - Nature-Based Vintage 2018 futures and options contracts; 3) Verified Emission Reduction - Nature-Based Vintage 2019 futures and options contracts; 4) Verified Emission Reduction - Nature-Based Vintage 2020 futures and options contracts; 5) Verified Emission Reduction - Nature-Based Vintage 2021 futures and options contracts; 6) Verified Emission Reduction - Nature-Based Vintage 2022 futures and options contracts; 7) Verified Emission Reduction - Nature-Based Vintage 2023 futures and options contracts; 8) Verified Emission Reduction - Nature-Based Vintage 2024 futures and options contracts; 9) Verified Emission Reduction - Nature-Based Vintage 2025 futures and options contracts; 10) Verified Emission Reduction - Nature-Based futures and options contracts; 11) Verified Emission Reduction - CORSIA-Eligible futures and options contracts; 12) Carbon Removal futures contract; and 13) Global Emission Reduction futures contract.

[50] The NYMEX CBL GEO futures contract; the NYMEX CBL N-GEO futures contract; and the NYMEX CBL C-GEO futures contract are currently the only futures contacts listed for trading on DCMs with open interest and trading volume. Information is *available at:* https://www.cmegroup.com/markets/energy/emissions/cbl-global-emissions-offset.volume.html.

[51] For example, NYMEX's CBL Global Environmental Offset futures contracts, and Nodal's Verified Emission Reduction futures and options contracts, are physically-settled contracts. The NYMEX futures contracts permit VCCs to be delivered from the Verified Carbon Standard ("VCS") Verra Registry, and the registries of the American Carbon Registry ("ACR"), and the Climate Action Reserve ("CAR"). The Nodal futures and options contracts permit VCCs to be delivered from VCS's Verra Registry and from the Gold Standard Impact Registry, as well as from the ACR registry for certain contracts.

2. *CFTC Initiatives Relating to Voluntary Carbon Markets*

i. First Voluntary Carbon Markets Convening

In June 2022, Chairman Behnam held the first-ever Voluntary Carbon Markets Convening to discuss issues related to the supply of and demand for high-quality carbon credits, including product standardization and the data necessary to support the integrity of carbon credits' GHG emissions removal and reduction claims.[52] A further goal of the convening was to gather information from a wide variety of participants in the voluntary carbon markets to better understand the potential role of the official sector in these markets, particularly in connection with the emergence of CFTC-regulated derivatives referencing VCCs. The convening included participants from carbon credit standard setting bodies, a crediting program, private sector integrity initiatives, spot platforms, DCMs, intermediaries, end-users, public interest groups, and others.

ii. Commission Request for Information

In June 2022, the Commission issued for public comment a Request for Information ("RFI on Climate-Related Financial Risk")[53] in order to better inform the Commission on how, consistent with its statutory authority, to address climate-related financial risk as pertinent to the derivatives markets and underlying commodities markets.[54]

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[52] For the official announcement of the convening and related materials, *see* CFTC Announces Voluntary Carbon Markets Convening, *available at:* https://www.cftc.gov/PressRoom/Events/opaeventcftccarbonmarketconvene060222.

[53] Request for Information on Climate-Related Financial Risk, 87 FR 34856 (June 8, 2022) ("RFI on Climate-Related Financial Risk").

[54] In addition to soliciting public feedback on all aspects of climate-related financial risk as it may pertain to the derivatives markets, underlying commodities markets, registered entities, registrants, and other related market participants, the RFI on Climate-Related Financial Risk requested feedback on specific questions relating to: 1) Data, 2) Scenario Analysis and Stress Testing, 3) Risk Management, 4) Disclosure, 5) Product Innovation, 6) Voluntary Carbon Markets, 7) Digital Assets, 8) Financially Vulnerable Communities, 9) Public-Private Partnerships/Engagement, and 10) Capacity Coordination. The RFI on Climate-Related Financial Risk stated that the Commission may use information provided in response to the RFI on Climate-Related Financial Risk to inform potential future actions including, but not limited to, the issuance of new or amended guidance, interpretations, policy statements, or regulations, or other potential Commission action. *Id.*

The responsive comments that the Commission received included feedback on specific questions relating to product innovation and voluntary carbon markets.[55] Several commenters expressed support for the Commission to take steps that could support transparency and confidence in the voluntary carbon markets, particularly through recognition or support of private sector and multilateral initiatives to promote standardization and integrity.[56] In connection with product innovation, certain commenters expressed the view that the Commission's current statutory framework and regulations are sufficient to regulate voluntary carbon market derivatives products.[57] While there were comments expressing different views on the reach of the Commission's jurisdiction to regulate voluntary carbon markets,[58] many commenters supported the Commission utilizing its spot market anti-fraud and anti-manipulation authority in the voluntary carbon market space.[59]

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[55] Twenty-five commenters on the RFI on Climate-Related Financial Risk responded to questions regarding product innovation and 44 commenters on the RFI on Climate-Related Financial Risk responded to questions regarding the voluntary carbon markets.

[56] *See, e.g.,* International Swaps and Derivatives Association ("ISDA") response to the RFI on Climate-Related Financial Risk, at 6; American Petroleum Institute ("API") response to the RFI on Climate-Related Financial Risk, at 4; Center for American Progress response to the RFI on Climate-Related Financial Risk, at 10; Environmental Defense Fund ("EDF") response to the RFI on Climate-Related Financial Risk, at 12; Futures Industry Association ("FIA") response to the RFI on Climate-Related Financial Risk, at 9; Intercontinental Exchange, Inc. ("ICE") response to the RFI on Climate-Related Financial Risk, at 4.

[57] *See, e.g.,* CME Group ("CME") response to the RFI on Climate-Related Financial Risk, at 10, FIA response to the RFI on Climate-Related Financial Risk, at 3; ISDA response to the RFI on Climate-Related Financial Risk, at 7.

[58] *See, e.g.,* Heritage Foundation response to the RFI on Climate-Related Financial Risk, at 7; API response to the RFI on Climate-Related Financial Risk, at 2–4; Commercial Energy Working Group ("CEWG") response to the RFI on Climate-Related Financial Risk, at 2–3.

[59] *See, e.g.,* API response to the RFI on Climate-Related Financial Risk, at 3; ISDA response to the RFI on Climate-Related Financial Risk, at 6; Verra response to the RFI on Climate-Related Financial Risk, at 2. With respect to the Commission's spot market anti-fraud and anti-manipulation authority, as well as its spot market authority with respect to false reporting, *see, e.g.,* CEA section 6(c)(1), 7 U.S.C. 9(1), which among other things prohibits any person from using or employing, or attempting to use or employ, in connection with a contract for sale of any commodity in interstate commerce, any manipulative or deceptive device or contrivance, in contravention of rules and regulations promulgated by the Commission; CEA section 9(a)(2), 7 U.S.C. 13(a)(2), which among other things makes it a felony for any person to manipulate or attempt to manipulate the price of any commodity in interstate commerce; and implementing Commission rules at Part 180 of the CFTC's regulations, 17 CFR part 180. In June 2023, the CFTC's Whistleblower Office issued an alert notifying the public about how to identify and report potential CEA violations connected to fraud or manipulation in the carbon markets. *See* CFTC Whistleblower Alert, *available at*: https://www.whistleblower.gov/sites/whistleblower/files/2023-06/06.20.23%20Carbon%20Markets%20WBO%20Alert.pdf. Also in June 2023, the CFTC's Division of

iii. Second Voluntary Carbon Markets Convening

In July 2023, Chairman Behnam held the Second Voluntary Carbon Markets Convening. The purpose of this convening was to discuss recent private sector initiatives for high quality carbon credits; current trends and developments in the cash and derivatives markets for carbon credits; public sector initiatives related to carbon markets; and market participants' perspectives on how the CFTC can promote integrity for high quality carbon credit derivatives.[60]

## D. Proposed Guidance Regarding the Listing of VCC Derivative Contracts

On December 4, 2023, the Commission issued proposed guidance outlining factors for consideration by DCMs when addressing certain provisions of the CEA, and CFTC regulations thereunder, that are relevant to the listing for trading of VCC derivative contracts (the "Proposed Guidance").[61] In developing the Proposed Guidance, the Commission considered those public comments on the RFI on Climate-Related Financial Risk that addressed product innovation and voluntary carbon markets. The Commission stated in the Proposed Guidance that, taking into account those public comments, it believed that guidance outlining factors for a DCM to consider in connection with the design and listing of VCC derivative contracts would further the mission of the CFTC, "and may help to advance the standardization of VCC derivative contracts in a manner that fosters transparency and liquidity, accurate pricing, and market integrity."[62]

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Enforcement announced the creation of an Environmental Fraud Task Force to combat environmental fraud and misconduct. Specifically, the Task Force's mission is to address fraud and other misconduct in both the derivatives markets and the relevant spot markets (*e.g.,* voluntary carbon markets) and to examine, among other things, fraud with respect to the purported environmental benefits of purchased carbon credits. *See* CFTC Release Number 8736-23 ("CFTC Division of Enforcement Creates Two New Task Forces"), *available at:* https://www.cftc.gov/PressRoom/PressReleases/8736-23.

[60] For the official announcement of the convening and related materials, *see* CFTC Announces Second Voluntary Carbon Markets Convening on July 19, *available at*: https://www.cftc.gov/PressRoom/Events/opaeventvoluntarycarbonmarkets071923.

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

[62] *Id.* at 89416.

With a focus, primarily, on the design and listing of physically-settled VCC derivative contracts, the Proposed Guidance addressed certain Core Principle compliance considerations, as well as certain requirements relating to the submission of new contracts, and contract amendments, to the Commission. More specifically, the Proposed Guidance addressed certain considerations with respect to Core Principles 3 and 4 for DCMs, and the contract submission provisions set forth in CEA section 5c(c) and Part 40 of the Commission regulations.

The Proposed Guidance addressed, first, the DCM Core Principle 3 requirement that a DCM only list for trading derivative contracts that are not readily susceptible to manipulation.[63] As discussed above, the Appendix C Guidance outlines certain relevant considerations for a DCM when developing a contract's terms and conditions, and providing supporting documentation and data in connection with the submission of the contract to the Commission. The Commission takes these considerations into account when determining whether, with respect to the contract, the DCM is satisfying its DCM Core Principle 3 obligations.

In connection with a physically-settled derivative contract, the Appendix C Guidance states that the terms and conditions of the contract "should describe or define all of the economically significant characteristics or attributes of the commodity underlying the contract."[64] In the Proposed Guidance, the Commission noted that, among other things, failure to specify the economically significant attributes of the underlying commodity may cause confusion among market participants, who may expect a commodity of different quality, or with other features, to underlie the contract. This may render the precise nature of the commodity that the contract is pricing ambiguous, and make the contract susceptible to manipulation or price distortion.[65]

[63] CEA section 5(d)(3), 7 U.S.C. 7(d)(3).
[64] Appendix C Guidance, paragraph (b)(2)(i)(A).
[65] 88 FR at 89416.

The Appendix C Guidance further states that, for any particular contract, the specific attributes of the underlying commodity that should be described or defined in the contract's terms and conditions "depend upon the individual characteristics of the commodity."[66] The Commission stated in the Proposed Guidance that, in its view, the very fact that standardization and accountability mechanisms for VCCs are still developing is, itself, "an individual characteristic of the commodity" that a DCM should take into account when designing a VCC derivative contract and addressing the underlying commodity—the VCC—in the contract's terms and conditions.[67] The Commission additionally recognized in the Proposed Guidance that, while standardization and accountability mechanisms for VCCs are currently still being developed, there are certain characteristics that have been identified broadly—across both mandatory and voluntary carbon markets – as helping to inform the integrity of carbon credits.[68] The Commission identified what it preliminarily believed these characteristics to be—referring to them, for purposes of the Proposed Guidance, as "VCC commodity characteristics"—and stated that it believed that a DCM should take these VCC commodity characteristics into consideration when designing a physically-settled VCC derivative contract, and addressing in the contract's terms and conditions the underlying VCC.[69]

The Proposed Guidance stated that, as a general matter, the Commission believed that a DCM should consider the VCC commodity characteristics when selecting one or more crediting programs from which eligible VCCs, meeting the contract's specifications, may be delivered at the contract's expiration.[70] More specifically, the Commission stated that it preliminarily believed

[66] Appendix C Guidance, paragraph (b)(2)(i)(A).
[67] 88 FR at 89416.
[68] *Id*.
[69] *Id*.
[70] For additional clarity, the final guidance states that a DCM should consider the VCC commodity characteristics when selecting one or more crediting programs from which eligible VCCs, meeting the contract's specifications, may be delivered at the contract's "settlement," rather than expiration.

that a DCM should, at a minimum, consider the VCC commodity characteristics when addressing the following criteria in connection with contract design:

- Quality standards
- Delivery points and facilities
- Inspection provisions

These are among the criteria identified in the Appendix C Guidance as criteria relating to the underlying commodity that a DCM should consider addressing in the terms and conditions of a physically-settled derivative contract.[71] As discussed above, addressing these criteria clearly in the contract's terms and conditions, in a manner that reflects the underlying commodity's individual characteristics, helps to ensure that trading in the contract is based on accurate information about the underlying commodity. This, in turn, helps to promote accurate contract pricing and reduce the susceptibility of the contract to manipulation. Moreover, when a contract's terms and conditions help to ensure that, upon delivery, the quality and other attributes of the underlying commodity will be as expected by position holders, this helps to prevent price distortions and fosters confidence in the contract that can incentivize trading and enhance liquidity.

The Commission stated in the Proposed Guidance that, in connection with derivative contract design, it preliminarily believed that a DCM should consider the following VCC commodity characteristics when addressing quality standards for underlying VCCs: (a) transparency, (b) additionality, (c) permanence and accounting for the risk of reversal, and (d) robust quantification.[72] When addressing delivery procedures for underlying VCCs, the Commission stated that it preliminarily believed that a DCM should consider the following VCC

[71] Appendix C Guidance, paragraph (b)(2)(1) ("For physical delivery contracts, an acceptable specification of terms and conditions would include, but may not be limited to, rules that address, as appropriate, the following criteria …").
[72] 88 FR at 89417.

commodity characteristics: (a) governance, (b) tracking, and (c) no double counting.[73] When addressing inspection or certification procedures for verifying compliance with quality requirements or any other related delivery requirements under the contract for underlying VCCs, the Commission stated that it preliminarily believed that a DCM should consider the validation and verification procedures of the crediting program.[74]

In addition to the above-described considerations in connection with DCM Core Principle 3, the Proposed Guidance also addressed considerations in connection with the requirement, under DCM Core Principle 4, for a DCM to prevent manipulation, price distortion, and disruptions of the physical delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures. The Commission stated that it preliminarily believed that the monitoring by a DCM of the terms and conditions of a VCC derivative contract, as contemplated under DCM Core Principle 4 and Commission regulations thereunder, should include continual monitoring of the appropriateness of the contract's terms and conditions that includes, among other things, monitoring to ensure that the delivery instrument— that is, the underlying VCC—conforms or, where appropriate, updates to reflect the latest certification standard(s) applicable for that VCC.[75]

Finally, the Proposed Guidance highlighted certain requirements in connection with the submission of a VCC derivative contract to the Commission pursuant to CEA section 5c(c)(5)(C) and Part 40 of the Commission's regulations, and the Commission's expectation that information submitted to it by a DCM—including supporting documentation, evidence and data—to describe

[73] *Id.* at 89418–19.
[74] *Id.* at 89419.
[75] *Id.* at 89420.

how the contract complies with the CEA and applicable Commission regulations, will be complete and thorough.[76]

The Proposed Guidance was subject to a 75-day public comment period. In addition to requesting comment on all aspects of the Proposed Guidance, the Commission requested comment on 17 specific questions relating to the listing of VCC derivative contracts. The public comment period closed on February 16, 2024. The Commission received approximately 90 comments on the Proposed Guidance, including the specific questions posed by the Commission. After thorough agency review of the comments received, the Commission has determined to finalize the Proposed Guidance with certain clarifications and revisions, as discussed below.

## II. Comments on the Proposed Guidance

### A. Overview

Comments on the Proposed Guidance were submitted by a variety of interested parties, including derivatives exchanges, industry and trade associations, public interest organizations, climate advocacy groups, carbon credit rating agencies and standard setting bodies. Many commenters expressed their general support for the Proposed Guidance. For example, S&P Global Commodity Insights ("S&P Global") stated that the Proposed Guidance correctly noted that outlining factors for a DCM to consider in connection with the design and listing of VCC derivatives may help the standardization of such products in a manner that promotes transparency and liquidity.[77] Better Markets stated that "the Proposed Guideline is a good step in establishing a fair, transparent, and efficient market for voluntary carbon credits."[78] The Food, Agriculture

[76] *Id*.
[77] S&P Global at 2.
[78] Better Markets at 3.

Climate Alliance ("FACA") stated that the "CFTC can play a role in promoting integrity and building confidence in high-quality carbon credits."[79]

A number of commenters were supportive of the VCC commodity characteristics identified in the Proposed Guidance, or confirmed that they are characteristics that have been identified broadly as helping to inform the integrity of carbon credits.[80] Certain commenters suggested additional characteristics that the Commission should recognize as helping to inform carbon credit integrity, or clarifications or revisions to the descriptions of the VCC commodity characteristics preliminarily identified by the Commission.[81]

Some commenters raised concerns related to the integrity of the voluntary carbon markets more generally, discussing issues addressed at a high level in Section I.B.2 hereto. Some commenters encouraged the Commission to prescribe the specific attributes that a VCC must possess in order to be eligible to serve as the underlying for a VCC derivative contract.[82] Other commenters encouraged the Commission to ensure that the guidance was clearly tailored to reflect DCM obligations and expertise.[83] A number of commenters recommended that the Commission acknowledge industry-recognized standards for high-integrity VCCs as tools that DCMs could look to, or rely upon, when considering the VCC commodity characteristics in light of a particular crediting program or particular VCCs.[84]

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[79] FACA at 2.
[80] *See*, *e.g.,* Anew Climate at 3; Bipartisan Policy Center ("BPC") at 2; Woodwell Climate Research Center ("Woodwell") at 1; WWF at 1.
[81] *See*, *e.g.,* Americans for Financial Reform Education Fund ("AFREF") at 9; The American Forest & Paper Association ("AF&PA") at 6; BeZero Inc. ("BeZero") at 5; Clean Air Task Force ("CATF") at 12–13; Carbon Direct Inc. ("Carbon Direct") at 2; California Climate Exchange at 1; Clean Energy Policy Institute ("CEPI") at 3; Kita Earth Ltd. ("Kita") at 1; Institute for Policy Integrity at NYU School of Law ("NYU Policy Integrity") at 6–7; Sylvera at 2.
[82] *See*, *e.g.,* Business Alliance to Scale Climate Solutions ("BASCS") at 1; EDF at 9; TNC at 1; WWF at 1.
[83] *See, e.g.,* Better Markets at 13; CEWG at 3.
[84] *See, e.g.,* Center for Climate and Energy Solutions ("C2ES") at 2; International Emissions Trading Association ("IETA") at 2; ISDA at 2; Puro.earth Oy ("Puro") at 2; Verra at 7.

## B. Specific Comments

1. *Scope and Application of Guidance*

Feedback from certain commenters indicated that their understanding was that the Commission's guidance would establish new obligations for DCMs.[85] The Commission emphasizes that its guidance does not establish new obligations for DCMs. The Commission's guidance is not intended to modify or supersede existing statutory or regulatory obligations, or existing Commission guidance that addresses the listing of derivative contracts by CFTC-regulated exchanges, including the Appendix C Guidance. Rather, in recognition that VCC derivative contracts are a comparatively new and evolving class of products[86] which have certain unique attributes, as do voluntary carbon markets themselves, the Commission's guidance is intended to assist DCMs in addressing existing obligations, when designing and listing such VCC derivatives. For example, the guidance takes into account that standardization and accountability mechanisms for VCCs are currently still developing, and outlines how that may inform a DCM's contract design and listing considerations. A DCM's obligations remain those that are set forth in the CEA and the Commission's regulations, including (but not limited to) those statutory and regulatory requirements that are addressed in the Commission's guidance, such as the obligation under DCM Core Principle 3 for a DCM only to list for trading contracts that are not readily susceptible to manipulation.

Some commenters asserted that the existing contract listing framework for DCMs is both sufficient and appropriate for addressing the listing of VCC derivative contracts. For example, Nodal stated that it was not necessary for the Commission to adopt the Proposed Guidance because

[85] *See, e.g.,* CME at 2; ICE at 4; Nodal at 2–5.
[86] In 2022, ISDA published a whitepaper providing background on the cash and derivatives markets for voluntary carbon credits. *See* Voluntary Carbon Markets: Analysis of Regulatory Oversight in the US. (2022), *available at*: https://www.isda.org/2022/06/02/voluntary-carbon-markets-analysis-of-regulatory-oversight-in-the-us/.

"the existing DCM regulatory framework … already provides the appropriate requirements, guidance, and flexibility to manage the listing of VCC derivatives."[87] Intercontinental Exchange ("ICE") and CME similarly stated that the existing contract listing framework is effective, and already enables DCMs to develop contract terms and conditions that account for relevant market factors, and that are appropriately designed to the characteristics of the underlying asset.[88] Both ICE and Nodal noted that the Appendix C Guidance does not address a specific underlying asset class, with ICE adding that the Appendix C Guidance "does not mandate a set of criteria or attributes for any particular asset class."[89] In this regard, the Commission reiterates that its guidance with respect to the listing of VCC derivative contracts is not intended to establish new obligations for DCMs, or modify or supersede existing statutory or regulatory requirements or the Appendix C Guidance. Rather, at this juncture in the evolution of VCC derivatives as a product class, and taking into account certain unique attributes of VCC derivatives and the voluntary carbon markets more generally,[90] the Commission does believe that there is a benefit to outlining certain factors for consideration by a DCM in connection with the listing of VCC derivative contracts for trading. The guidance is intended as a tool for DCMs, to facilitate contract design, by helping to clarify how certain aspects of the existing contract listing framework may apply in the context of this particular class of products. The Commission believes that this can help to ensure that, upon delivery, the quality and other attributes of VCCs underlying a derivative contract will be as expected by position holders. The Commission believes that this, in turn, can support accurate pricing, help reduce the susceptibility of the contract to manipulation, and foster confidence in the contract that can enhance liquidity.

[87] Nodal at 2.
[88] *See* CME at 4; ICE at 5.
[89] ICE at 5; Nodal at 4.
[90] *See supra*, Sections I.B.1 and I.B.2.

As discussed in more detail below, certain commenters expressed concern that the Proposed Guidance, if adopted, could obligate a DCM to independently confirm the sufficiency of a crediting program's policies and procedures for ensuring high-integrity VCCs – a responsibility which, these commenters asserted, extended beyond what was expected of DCMs under the existing contract listing framework and for which DCMs may not have the requisite expertise.[91] For example, Nodal stated that while the existing contract listing framework contemplates consideration by a DCM of whether the commodities underlying a derivative contract are subject to quality standards, "DCMs are not required to possess the expertise necessary to opine on the sufficiency of these standards."[92] BPC stated that, given their role within financial markets, DCMs "may not today have the in-house scientific or technical expertise needed to comprehensively evaluate"[93] carbon crediting programs. Likewise, Verra stated that performing an evaluation of VCC quality "requires substantial specialized technical expertise that DCMs may not adequately possess or be reasonably expected to acquire, given their specific roles …."[94] Verra observed that it was not realistic to expect a DCM, whose core competency is derivatives markets, to develop the same level of expertise in the complexities of VCC issuance and certification as those that are directly involved in the voluntary carbon market infrastructure, such as standard setting bodies, crediting programs, and spot market participants.

Other commenters similarly identified standard setting bodies, crediting programs, and/or market participants, as best positioned to establish, or assess adherence with, VCC integrity standards.[95] Some of these commenters suggested that a DCM's primary focus should be on

[91] *See, e.g.,* Ceres at 2–3; CME at 7; ICE at 10; IETA at 1; Nodal at 2; Public Citizen at 13; Terra Global Capital, LLC ("Terra") at 6; Verra at 6; Xpansiv Limited ("Xpansiv") at 4.
[92] Nodal at 2.
[93] BPC at 3.
[94] Verra at 2.
[95] *See, e.g.,* Ceres at 2–3; CME at 7; IETA at 1–2; Terra at 6; Xpansiv at 4.

whether the crediting program for underlying VCCs is making information about its policies and procedures, and the projects or activities that it credits, publicly available, to assist derivative market participants in making their own informed evaluations, and comparisons, of VCC quality. For example, CME expressed its belief that it is "preferable for the crediting program to publish its methodology … and for the market participants to render their own judgment."[96] ICE stated that, while it is important for market participants to have sufficient information to make an informed decision about the quality of VCCs that may underlie a DCM contract, "such information is best created by the crediting program and reviewed in the context of other information published by the program."[97] CME asserted that the "lion's share" of the criteria identified by the Commission as informing the integrity of a VCC is publicly available: "As such, participants in the VCC derivatives markets are free to transact, or not, based on their assessment of the data points that matter to them."[98]

A number of commenters recommended an acknowledgment, in the Commission's guidance, that industry-recognized standards for high-integrity VCCs are tools that may assist DCMs in their consideration, with respect to a particular crediting program, of the VCC commodity characteristics identified by the Commission in the guidance.[99] For example, ICE noted that certain crediting program operators and their methodologies have been approved under standards set by private sector initiatives that have been subject to open consultation.[100] ICE also noted the ongoing initiatives by the International Organization of Securities Commissions ("IOSCO") to develop a set of good practices to promote the integrity and orderly functioning of

[96] CME at 7.
[97] ICE at 6.
[98] CME at 8.
[99] *See, e.g.,* C2ES at 2; ICE at 7; IETA at 2; Puro at 5; Verra at 7.
[100] ICE at 7.

voluntary carbon markets.[101] ICE recommended that the Commission permit DCMs to reasonably rely on assurances by a crediting program or registry that adheres to, and is audited against, threshold standards for high-quality carbon credits established by "international organizations such as IOSCO, The Integrity Council for the Voluntary Carbon Market ("ICVCM"), and International Civil Aviation Organization ("ICAO"), or similar standard setting bodies."[102] Verra similarly recommended that the Commission permit DCMs "to rely on VCC certification and compliance set forth under relevant nongovernmental and governmental initiatives."[103] Some commenters recommended that the Commission go so far as to require DCMs only to list VCC derivatives contracts whose underlying VCCs are approved or certified by an industry-recognized standards program for high-integrity VCCs.[104]

In responding to the above-described comments the Commission first addresses the suggestion that a DCM's primary focus, when listing for trading a VCC derivative contract, should be on whether the crediting program for underlying VCCs is making information about the program publicly available. As discussed below, the Commission supports a DCM's consideration of whether the crediting program for underlying VCCs is making detailed information about its policies and procedures, and the projects or activities that it credits, publicly available in a searchable and comparable manner.[105] The Commission believes that making such information publicly available can assist market participants in evaluating the substance and sufficiency of crediting program policies and procedures, and making informed evaluations and comparisons of VCC quality.

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[101] ICE at 8.
[102] ICE at 7.
[103] Verra at 7.
[104] *See, e.g.,* Duke Financial Economics Center at 9; Puro at 1; Terra at 2.
[105] *See* discussion of the VCC commodity characteristic of "Transparency," in section II.B.2.iii.1, *infra.*

That said, DCMs do have statutory and regulatory obligations that are relevant to the design and listing for trading of derivative contracts, including an obligation under DCM Core Principle 3 to only list contracts that are not readily susceptible to manipulation. As discussed herein, the Appendix C Guidance outlines certain relevant considerations for DCMs in this regard, and the considerations that are outlined in the Appendix C Guidance are not limited to whether information regarding the commodity underlying a derivative contract is publicly available. For example, the Appendix C Guidance outlines certain criteria for a DCM to consider addressing in a derivative contract's terms and conditions, including quality standards for the underlying commodity, delivery points and facilities, and inspection/certification procedures for verifying compliance with quality standards or related delivery requirements under the contract. This guidance discusses certain characteristics that have been identified broadly as helping to inform the integrity of carbon credits, and addresses how consideration of these characteristics may inform the manner in which a DCM addresses quality standards, delivery points and facilities, and inspection/certification procedures—again, criteria already identified in the Appendix C Guidance—in connection with the design of a VCC derivative contract. The Commission further believes that consideration of these characteristics will help a DCM ensure that it understands economically significant attributes of the commodity—the VCC—underlying the contract.

Notwithstanding the foregoing, and as more fully discussed below, the Commission has made certain revisions to this guidance to further ensure that the guidance appropriately reflects DCM obligations and expertise. Moreover, the Commission acknowledges the specialized, technical nature of crediting program policies, procedures, and technologies, as well as the fact that certain private sector and multilateral initiatives have engaged in extensive undertakings, involving public consultation, to develop standards for high-integrity VCCs against which such

policies, procedures and methodologies can be assessed. The Commission is therefore clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs can serve as tools for DCMs in connection with their consideration of the VCC commodity characteristics outlined in this guidance.

2. *A DCM Shall Only List Derivative Contracts That Are Not Readily Susceptible to Manipulation - VCC Commodity Characteristics*

i. General

A number of commenters expressed their support for the VCC commodity characteristics identified in the Proposed Guidance.[106] For example, API stated that it "supports the CFTC's reference to the broad core principles of additionality, permanence, robust quantification of emissions reductions and removals, no double counting, effective governance, tracking, transparency, and robust independent third-party validation and verification in the Guidance."[107] Similarly, a number of commenters confirmed that the VCC commodity characteristics identified in the Proposed Guidance were recognized broadly as helping to inform the integrity of carbon credits.[108] For example, BPC expressed agreement that the Proposed Guidance "identifies appropriate VCC commodity characteristics that have also been part of the [voluntary carbon markets] literature and policy discourse for many years."[109]

ii. Social and Environmental Factors

A number of commenters addressed the specific questions posed by the Commission in the Proposed Guidance, regarding whether, in addition to the VCC commodity characteristics preliminarily identified by the Commission, there were other characteristics informing the integrity

[106] *See*, *e.g.,* API at 2; Woodwell at 1; WWF at 1.
[107] API at 2.
[108] *See*, *e.g.,* Carbon Direct at 2; Carbon Removal Alliance ("CRA") at 2.
[109] BPC at 2.

of carbon credits that were relevant to the listing of VCC derivative contracts—or whether there were VCC commodity characteristics that were identified in the Proposed Guidance that were *not* relevant to the listing of VCC derivative contracts. In response to these questions, several commenters responded that the Commission should recognize the social and environmental impacts of a mitigation project or activity, beyond the project or activity's GHG reduction or removal benefits, as characteristics that inform the integrity of the carbon credits issued with respect to such project or activity.[110] For example, Carbon Direct stated that it considered avoidance of negative impact on economic, social, and environmental systems, maximization of benefits to local communities and ecosystems, and environmental justice (equitable distribution of environmental benefits and harms resulting from GHG removal projects) as characteristics that are "essential to evaluating the quality of a VCC."[111] WWF recommended that the Commission recognize a VCC commodity characteristic that explicitly addresses project safeguards,[112] stating that such safeguards "are common attributes of high integrity development projects and should be included so that communities and surrounding ecology are not negatively impacted…."[113] TNC and ICVCM suggested that the Commission should further align its guidance with ICVCM's Core Carbon Principles by also including considerations with respect to social and environmental

[110] *See, e.g.,* aDryada at 1; BASCS at 1; BCarbon Inc ("BCarbon") at 3; Carbon Direct at 2; EDF at 9; ICVCM at 6; Terra at 7; The Nature Conservancy ("TNC") at 1; WWF at 1.
[111] Carbon Direct at 2.
[112] Project safeguards are policies, standards and operational procedures designed to identify, avoid and mitigate adverse environmental and social impacts that may arise in connection with a carbon mitigation project or activity.
[113] WWF at 1.

safeguards, as well as net zero alignment.[114] BASCS and EDF also encouraged the Commission to consider guidance in this area that aligned with the ICVCM's Core Carbon Principles.[115]

Similarly, the majority of commenters responding to a specific question on this matter in the Proposed Guidance expressed support for the consideration by a DCM, when designing a VCC derivative contract, of whether the crediting program for underlying VCCs has implemented measures to help ensure that credited mitigation projects or activities: (i) meet or exceed best practices on social and environmental safeguards and (ii) 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.[116]

Several commenters stated that there was an association between the social and/or environmental impacts of a mitigation project or activity, and the price of the related VCCs. EDF asserted that "social safeguards … are economically significant attributes of the carbon credits. Sustainable development benefits and safeguards materially influence contract pricing, directly impact the extent to which the credit will be delivered and influence the political durability of those credits."[117] TNC asserted that the social and environmental safeguards associated with a mitigation project or activity can significantly influence contract pricing, as projects infringing on the rights of local communities or adversely damaging ecosystems will be shunned by market stakeholders."[118] ICVCM stated that "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."[119]

[114] ICVCM at 6; TNC at 1.
[115] BASCS at 5–6; EDF at 9.
[116] *See, e.g.,* AFF at 4–5; BASCS at 5–6; C2ES at 9; Flow Carbon at 5–6; TNC at 4; WWF at 1.
[117] EDF at 9.
[118] TNC at 3.
[119] ICVCM at 10.

Several commenters suggested that DCMs look to standards for high-integrity VCCs developed by private sector or multilateral initiatives, and adherence by a crediting program to such standards, when considering the crediting program's measures with respect to social and environmental safeguards and/or net zero alignment. For example, TNC recommended that a DCM consider "whether a crediting program has procedures that follow the recommendations of CORSIA's safeguard requirements," and whether the crediting program requires projects or activities to generate net positive social and environmental outcomes.[120]

As noted above, TNC, as well as ICVCM, BASCS and EDF, referenced the ICVCM's Core Carbon Principles as a standard to inform consideration of social and environmental safeguards and net zero alignment. Charm Industrial ("Charm") and CRA, meanwhile suggested that a DCM consider whether a crediting program ensures that a mitigation project or activity complies with applicable U.S. regulations and legal requirements,[121] and Forest Peoples Programme Amerindian Peoples Association Rainforest Foundation US ("Forest Peoples") stated that a DCM should consider whether a crediting program has social safeguard requirements that align with the rights of indigenous persons under international law, such as the UN human rights treaties and the UN Declaration on the Rights of Indigenous Peoples.[122]

A few commenters expressed concerns associated with the consideration, by a DCM, of a crediting program's measures with respect to social and environmental safeguards and/or net zero alignment. Iconoclast Industries, LLC ("Iconoclast") stated that consideration of a crediting program's measures with respect to net zero alignment would "make this a zero-sum game. Incremental steps should be acceptable and … the market will continue facilitating the evolution

[120] TNC at 3.
[121] *See* Charm at 5; CRA at 3.
[122] Forest Peoples at 5.

towards" the 2050 goal.[123] Terra similarly raised concerns regarding a DCM's consideration of whether a crediting program has measures with respect to net zero alignment, and commented that "the perfect has been the enemy of the good over many years."[124]

As discussed above, a number of commenters on the Proposed Guidance stated that a crediting program's measures with respect to social and environmental safeguards may have a bearing on how participants in the voluntary carbon markets evaluate the quality—and by extension the price—of the VCCs that are issued by the crediting program.[125] Also as discussed above, addressing in a derivative contract's terms and conditions the quality of the underlying commodity that would be delivered upon physical settlement, can help to promote accurate pricing and reduce the susceptibility of the contract to manipulation.[126]

After consideration of the comments received, the Commission agrees that a crediting program's measures with respect to social and environmental safeguards may be relevant to how market participants evaluate VCC quality. Accordingly, a DCM may determine that it is appropriate, when addressing quality standards in connection with derivative contract design, to consider whether the crediting program for underlying VCCs has implemented measures to help ensure that credited mitigation projects or activities (i) meet or exceed best practices on social and environmental safeguards, and (ii) 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. The Commission has determined to finalize its guidance accordingly. The Commission emphasizes, however, that it does not expect that a DCM will necessarily be

[123] Iconoclast at 5.
[124] Terra at 7.
[125] While certain commenters disagreed that a DCM should consider such matters in connection with derivative contract design, their comments did not contradict those commenters who stated that market participants may recognize such matters as informing VCC quality.
[126] *See* section I.A, *supra.*

evaluating the specifics of the crediting program's measures with respect to social and environmental safeguards and net zero alignment, and this guidance does not prescribe any such measures. The Commission is simply noting that, because such measures may be relevant to how market participants evaluate VCC quality, a DCM may decide to consider whether a crediting program has implemented such measures when addressing quality standards in connection with the design of a VCC derivative contract. The Commission believes that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standard setting program, can serve as tools for a DCM, in connection with its consideration of the crediting program's measures with respect to social and environmental safeguards and net zero alignment.

iii. Quality

a. Transparency

Commenters broadly agreed that DCMs should provide, in a VCC derivative contract's terms and conditions, information about the VCCs that are eligible for delivery under the contract, including information that readily specifies the crediting program(s) from which VCCs that are eligible for delivery under the contract may be issued.[127] Ceres, ICE, and IETA agreed that the crediting programs for eligible VCCs should be identified in the contract's terms and conditions.[128] Better Markets supported the inclusion of "comprehensive information about the eligible VCCs

[127] *See, e.g.,* ANSI National Accreditation Board ("ANAB") at 5; Better Markets at 8; CarbonPlan at 6–7; CATF at 8; Ceres at 3; CEWG at 11; Climeworks Corporation ("Climeworks") at 3; Flow Carbon Inc. ("Flow Carbon") at 3; IETA at 2; New York State Society of Certified Public Accountants ("NYSSCPA") at 3; Xpansiv at 9.
[128] Ceres at 3; ICE at 6; IETA at 2.

for delivery," and stated that such transparency would ensure that "contract pricing represents the quality of the underlying VCCs."[129]

Commenters also broadly agreed that DCMs should consider whether a crediting program for underlying VCCs is making information regarding the crediting program's policies and procedures, and the projects or activities that it credits, publicly available.[130] For example, Anew Climate stated that "a crucial component of high-quality VCCs is that the crediting program that issues those VCCs be transparent and make sufficient information about its projects and project activities publicly available."[131]

Certain commenters addressed the specific questions posed by the Commission in the Proposed Guidance, regarding whether there are criteria, factors or information that a DCM 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, and whether there is sufficient transparency about credited projects or activities.[132] CarbonPlan stated that DCMs should consider whether "data about VCCs are shared under terms that support both public access and reuse."[133] Isometric HQ Limited ("Isometric") stated that crediting programs "should be required to provide the highest degree of transparency possible (only excluding, where relevant, confidential information) in relation to all credits that they issue."[134] ICE meanwhile, took the position that "market participants, and not DCMs, are best placed to assess whether the information made available by a crediting program

[129] Better Markets at 8.
[130] *See, e.g.,* Anew Climate at 4; Flow Carbon at 3; Sylvera at 3–4.
[131] Anew Climate at 4.
[132] *See, e.g.,* Anew Climate at 4; CarbonPlan at 6–7; CATF at 8; Ceres at 3; Isometric at 3; Xpansiv at 9.
[133] CarbonPlan at 6–7.
[134] Isometric at 3.

is sufficient and detailed in respect of the crediting program's policies and procedures and the projects or activities that it credits."[135]

Some commenters suggested that DCMs look to standards for high-integrity VCCs developed by private sector or multilateral initiatives, when considering a crediting program's transparency measures.[136] For example, C2ES and ICVCM referenced ICVCM's standards with respect to transparency, particularly the requirement under the ICVCM Core Carbon Principle Assessment Framework that a crediting program "make all information about the projects and its project rules public."[137] Berkeley and Sylvera, meanwhile, referred to California Assembly Bill 1305, the "Voluntary Market Disclosures Business Regulation Act," which requires a business entity that is marketing or selling VCCs within the state to publicly disclose, among other things, specific details regarding the mitigation project in respect of which the VCCs are generated, as well as "[t]he pertinent data and calculation methods needed to independently reproduce and verify the number of emissions reduction or removal credits issued" for the project.[138] Flow Carbon similarly suggested that publicly available project information should be sufficient to allow a buyer or third party to verify the accuracy of the claimed emission reductions.[139]

Some commenters recommended that DCMs should provide project- or activity-level information in the terms and conditions of a VCC derivative contract.[140] For example, CATF stated that access to information at the level of the individual project or activity is necessary because of the flexibility that is given to project developers regarding the quantification of credits. CATF thus recommended that the terms and conditions for a VCC derivative contract provide

[135] ICE at 6.
[136] *See, e.g.,* ANAB at 5; Berkeley Carbon Trading Project ("Berkeley") at 5; C2ES at 5; EDF at 6; ICVCM at 7; Sylvera at 3–4.
[137] C2ES at 5; ICVCM at 7.
[138] Berkeley at 5; Sylvera at 3–4.
[139] Flow Carbon at 3.
[140] *See, e.g.,* CATF at 8; Ceres at 3; Isometric at 3; Terra at 4.

buyers with access to specific information about how a crediting program's protocols are implemented for a given project or activity, including "baseline scenario assumptions and quantification metrics …, verification reports, annual reports, risk rating and justification, and the location of projects."[141] ICE, meanwhile, stated that while a VCC derivative contract "will have to identify clearly what is and is not deliverable under it … details as to the specific types of projects or activities for which [a crediting program] issues credits are made publicly available by the crediting programs on their websites and through their registries," where they can be reviewed and assessed by market participants.[142]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to transparency as proposed, with certain revisions. The Commission continues to believe that a DCM should provide, in the terms and conditions of a VCC derivative contract, information about the VCCs that are eligible for delivery under the contract.[143] While the information that is provided about eligible VCCs need not be "comprehensive"—for example, the terms and conditions would not necessarily have to identify each specific mitigation project or activity in respect of which VCCs that are eligible for delivery under the contract may be issued—the Commission agrees that the terms and conditions should make clear to market participants what is, and what is not, deliverable under the contract, including by providing information that readily specifies the crediting program, or programs, from which eligible VCCs may be issued.[144] To the extent that eligible VCCs are associated with a specific category of mitigation project or activity—such as

[141] CATF at 8.
[142] ICE at 6.
[143] *See* 88 FR at 89417. *See also* 17 CFR 40.1(j)(i) (Defining the "terms and conditions" of, *inter alia,* a futures contract to include "Quality and other standards that define the commodity or instrument underlying the contract.").
[144] *Id.*

nature-based projects or activities—this also should be readily evident from the contract terms and conditions.[145]

Additionally, and after consideration of the comments received, the Commission continues to believe that, as part of the contract design process, a DCM should consider whether the crediting program for VCCs that are eligible for delivery under a derivative contract is making detailed information about the crediting program's policies and procedures, and the projects or activities that it credits, publicly available in a searchable and comparable manner.[146] Where such information is made available by a crediting program, it can assist market participants in making informed evaluations, and comparisons, of the quality of the VCCs that underlie derivative contracts, which can help to support accurate pricing.

With respect to comments recommending that the terms and conditions of a VCC derivative contract should provide project- or activity-specific information, the Commission reiterates that this guidance focuses on considerations for a DCM at the *crediting program* level. As detailed more fully herein, the Commission believes that the policies and procedures that a crediting program has in place, along with its governance framework, inform the quality and other attributes of the VCCs that the crediting program issues. The Commission does not expect that a DCM will necessarily be considering the specific mitigation projects or activities for which eligible VCCs may be issued; the Commission expects that the DCM's focus will be on its consideration of the crediting program itself. Nor, as discussed above, does the Commission expect that information regarding the specific mitigation projects or activities for which eligible VCCs may be issued would necessarily be included in the terms and conditions of a VCC derivative contract. The Commission's view in this regard is predicated, however, on its view that the contract's terms

[145] *Id.*
[146] 88 FR at 89417.

and conditions should include information that readily specifies the crediting program or programs from which eligible VCCs may be issued, so that market participants can evaluate the substance and sufficiency of project- and activity-level information that such crediting programs make publicly available.

Likewise, while the Commission continues to believe that a DCM should consider a crediting program's policies and procedures for making program information (including mitigation project and activity information) publicly available, the Commission is persuaded by comments stating that information regarding such policies and procedures is not the type of information that typically would be included in a derivative contract's terms and conditions and has determined to revise its guidance accordingly.

Finally, after taking into account comments received on the Proposed Guidance, the Commission clarifies its view that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standards setting program, can serve as tools for a DCM, in connection with its consideration of the crediting program's transparency measures.

b. Additionality

In the Proposed Guidance, the Commission noted that additionality is viewed by many as a necessary element of a high quality VCC, and stated that it preliminarily believed that, as part of its contract design market research, a DCM should consider whether a crediting program can demonstrate that it has procedures in place to assess or test for additionality.[147] The Commission preliminarily recognized 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

[147] *Id.*

created by the revenue from carbon credits. The Commission specifically requested comment on whether this was the appropriate way to characterize additionality for purposes of its guidance, and also specifically requested comment on whether there were particular criteria or factors that a DCM should take into account when considering whether the procedures that a crediting program has in place provide a reasonable assurance that GHG emission reductions or removals will be credited only if they are additional.[148]

Commenters on the Proposed Guidance generally supported a DCM's consideration, as part of the contract design process, of whether a crediting program for underlying VCCs can demonstrate that it has in place procedures to assess or test for additionality.[149] Better Markets and Carbon Direct characterized additionality as a "cornerstone" of quality mitigation projects and their resulting carbon credits.[150]

However, some commenters raised concerns about recognizing additionality as a characteristic of a high-integrity VCC, due to challenges in evaluating and/or verifying this characteristic.[151] The Center for International Environmental Law ("CIEL") stated that "[t]he evaluation of whether or not a project is additional, or of whether a marginal ton of removed carbon dioxide is additional, will rarely be straightforward."[152] Public Citizen similarly took the position that additionality "is simply not possible to guarantee, ensure, or measure." [153]

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[148] *Id.*
[149] *See, e.g.,* Scientists affiliated with: Wilkes Center for Climate Science & Policy, University of Utah; University of California, Santa Barbara; University of California, Irvine ("Affiliated Scientists") at 1–2; American Forest Foundation ("AFF") at 3; Anew Climate at 4; BASCS at 3; Berkeley at 5; Better Markets at 9; C2ES at 5–6; Carbon Direct at 3; Carbonplace UK Ltd. ("Carbonplace") at 3; CEPI at 5; Ceres at 3–4; EcoBalance Global LLC ("Ecobalance") at 2; Flow Carbon at 3–4; ICVCM at 7; Isometric at 3; Kita at 3; Nodal at 5; Sky Harvest at 10; Sylvera at 4; Terra at 5; Xpansiv at 9–10.
[150] Better Markets at 9; Carbon Direct at 3.
[151] *See, e.g.,* BCarbon at 2; CIEL at 17; Context Labs at 2; Harvard Business School, University of Oxford Blavatnik School of Government, Law School, Stanford Doerr School of Sustainability, and the E-liability Institute ("Harvard *et al*") at 14; Iconoclast at 4–6; Nori at 8; Public Citizen at 14; Simon Counsell at 3.
[152] CIEL at 17.
[153] Public Citizen at 14.

With respect to whether there are particular criteria or factors that a DCM should take into account when considering a crediting program's procedures to assess or test for additionality, some commenters suggested that DCMs look to standards for high-integrity VCCs developed by private sector or multilateral initiatives.[154] For example, Carbonplace suggested that DCMs should consider CORSIA standards, or third-party assessments of crediting programs by carbon credit ratings providers or under standards such as the ICVCM's Core Carbon Principles.[155]

Meanwhile, ICE stated that, although it was reasonable for a DCM to consider whether a crediting program can demonstrate that it has procedures in place to assesses or test for additionality, ICE disagreed that DCMs should be required to assess whether those procedures are of sufficient rigor to provide a reasonable assurance that GHG emission reductions or removals are credited only if they are additional: "This responsibility should be borne by the crediting program operators."[156] CME likewise asserted that, while as a factual matter a DCM could confirm that procedures are in place to assess for additionality, "it should not be expected to opine on the accuracy, robustness, or appropriateness of such procedures."[157] Similarly, Nodal recommended that, if the Commission chose to finalize the Proposed Guidance, then the Commission should omit the reference to a DCM's consideration of whether a crediting program's procedures are "sufficiently rigorous and reliable" to provide a reasonable assurance that GHG emission reductions or removals are credited only if they are additional."[158]

[154] *See, e.g.,* AFF at 3; Anew Climate at 4; BASCS at 3; Carbonplace at 3; CarbonPlan at 8; CEPI at 5; ICVCM at 7; Terra at 5; Sylvera at 4.
[155] Carbonplace at 3.
[156] ICE at 7.
[157] CME at 6.
[158] Nodal at 5.

Several commenters supported how the Commission characterized additionality in the Proposed Guidance.[159] CATF stated that "there is broad consensus for defining additionality as demonstrating that the project or activity would not have taken place without the monetary incentive of a carbon credit, especially for voluntary carbon credits."[160] Similarly, Xpansiv stated that the characterization of additionality in the Proposed Guidance was "in line with the market consensus."[161]

As noted above, the Commission specifically requested comment in the Proposed Guidance on whether another characterization of additionality would be more appropriate, such as characterizing additionality 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.[162] Some commenters supported characterizing additionality with reference to this "regulatory test" for "legal" additionality, *as well as* with reference to "financial" additionality.[163] For example, AFREF stated that "the Commission should add this regulatory test to its characterization of additionality."[164] Meanwhile, Charm stated its view that legal additionality was implicit in the Commission's proposed characterization of additionality, but should be explicitly stated "to ensure all projects meet both thresholds."[165]

Several commenters did not support recognizing additionality based on the "regulatory test."[166] Affiliated Scientists stated that the regulatory test "is a necessary, but wholly insufficient

[159] *See, e.g.,* AFF at 3; Affiliated Scientists at 1–2; Berkeley at 5; Carbon Direct at 3–4; CATF at 9; C2ES at 6; ICVCM at 7; Xpansiv at 10.
[160] CATF at 9.
[161] Xpansiv at 10.
[162] 88 FR at 89421.
[163] *See, e.g.,* AFF at 3; AFREF at 10; Berkeley at 5; Carbon Direct at 4; CarbonPlan at 8; Charm at 3; CRA at 3–4; Natural Resources Defense Council at 8; NYSSCPA at 4; NYU Policy Integrity at 1, 5–6; Public Citizen at 14; Sky Harvest at 10; WWF at 1.
[164] AFREF at 10.
[165] Charm at 3.
[166] *See, e.g.,* Affiliated Scientists at 1–2; CATF at 10; Institute for Agriculture and Trade Policy ("IATP") at 21.

element of a robust definition of additionality."[167] CATF stated that "even where regulatory requirements focus on the legal minimum to determine additionality … demonstration of additionality requires a comparison to a conservative business-as usual scenario" to provide a "comparison to a counterfactual without the revenue provided from the credit."[168]

Meanwhile, Ecosystem Services Market Consortium ("ESMC") stated that projects with additionality features "should be characterized as implemented in response to market incentives, and the definition should not extend beyond this market-incentives framework to incorporate emission reductions resulting from projects or activities that go above-and-beyond the letter of the law."[169]

Some commenters suggested other alternatives to the Commission's proposed characterization of additionality.[170] Ceres suggested that DCMs should consider a range of approaches for testing additionality and did not believe that the "financial" additionality described in the Proposed Guidance should be the only measure of additionality.[171] Among other approaches, Ceres cited performance standards and barrier analysis.[172] BeZero similarly believed that "the additionality of a carbon project cannot and should not be assessed through a single lens - e.g. carbon accounting, financial or legal. Rather, a holistic analysis considering a range of factors is necessary."[173] BCarbon expressed concern that "[w]e see the continued conservation of thriving ecosystems as essential to mitigation of climate change, yet the current form of additionality provides no mechanism for these activities to be financially valued."[174] CATF,

[167] Affiliated Scientists at 1–2.
[168] CATF at 10.
[169] ESMC at 8.
[170] *See, e.g.,* BCarbon at 2; BeZero at 6; CATF at 10; Ceres at 3–4; Climeworks at 4; IATP at 21; Kita at 3; Sylvera at 4; TNC at 2.
[171] Ceres at 3–4.
[172] Ceres at 4.
[173] BeZero at 6.
[174] BCarbon at 2.

meanwhile, emphasized the need to take into account that the accepted meaning of the term additionality is likely to evolve.[175] Similarly, Xpansiv stated that the characterization of additionality in the Commission's guidance should not be "overly prescriptive to ensure DCMs are able to follow evolving VCC market developments, including revised or broadened definitions of key criteria."[176] In that regard, CME noted that while there may be broad consensus that additionality is an important element of a high quality VCC, "the question of how additionality is defined and calculated is a complex and nuanced issue and does not appear to have reached industry consensus."[177] According to CME, neither the Commission nor DCMs should dictate the definition.[178]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to additionality as proposed, with certain revisions. While the Commission appreciates that there may be some complexity involved in characterizing, and measuring, additionality, the comments on the Proposed Guidance support the Commission's observation that additionality is broadly understood to be a "cornerstone" characteristic of a high quality VCC. If holders of positions in a VCC derivative contract understand and intend for VCCs that are eligible for delivery under the contract to be additional, but in fact they may not be, then the pricing of the derivative contract may not accurately reflect the quality of the VCCs that may be delivered under the contract. Thus, the Commission continues to believe that, as part of the contract design process, a DCM should consider whether a crediting program has procedures to assess or test for additionality—and

[175] CATF at 10.
[176] Xpansiv at 10.
[177] CME at 6.
[178] *Id.*

whether those procedures provide a reasonable assurance that GHG emission reductions or removals are credited only if they are additional.

The comments on the Proposed Guidance indicate, however, that there is variation across the voluntary carbon markets in how, precisely, additionality is characterized. For example, while some commenters on the Proposed Guidance supported the Commission's preliminary discussion of financial additionality, a number of commenters recommended other approaches, including performance standards, and approaches that addressed both financial additionality and legal additionality. The Commission further recognizes that as the voluntary carbon markets continue to develop, industry consensus on how to characterize additionality may evolve.

Accordingly, the Commission has determined not to provide in its guidance a definition of additionality. Taking into account comments received on the Proposed Guidance, the Commission is clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs can serve as tools for a DCM, *both* in connection with its consideration of a particular crediting program's characterization of additionality, and in connection with the DCM's consideration of whether the crediting program's procedures to assess or test for additionality provide reasonable assurance that GHG emission reductions or removals will be credited only if they are additional, as so characterized.

Further, the Commission is persuaded by comments stating that specific information regarding a crediting program's procedures for assessing or testing for additionality is not the type of information that typically would be included in a derivative contract's terms and conditions, and has determined to revise its guidance accordingly.

c. Permanence and Accounting for the Risk of Reversal

A number of commenters on the Proposed Guidance supported a DCM's consideration, as part of the contract design process, of whether a crediting program for VCCs that are eligible for delivery under the contract has measures in place to address and account for the risk of reversal.[179] However, certain commenters expressed concern about a DCM's capacity and responsibility to assess the sufficiency of the crediting program's measures in this regard. For example, Nodal recommended that, if the Commission finalized its guidance, the Commission should omit reference to a DCM's consideration of whether the crediting program's measures provide reasonable assurance that, in the event of a reversal, an underlying VCC will be replaced by a VCC of comparably high quality that meets the contemplated specifications of the contract,[180] arguing that the Commission would otherwise be asking DCMs "to evaluate the sufficiency of VCC quality standards, which are normally addressed by the underlying markets."[181] BCarbon, meanwhile, stated that it would be helpful for the Commission to elaborate on what constitutes a "similar" VCC for purposes of replacement.[182]

The Commission specifically requested comment on whether there were criteria or factors that a DCM should take into account when considering a crediting program's measures to address reversal risk, particularly where the underlying VCCs are sourced from nature-based products or activities such as agriculture, forestry or other land use initiatives.[183] Some commenters suggested that a DCM consider a crediting program's definition of "permanence," as applied to mitigation

[179] *See, e.g.,* aDryada at 1; Anew Climate at 6; Better Markets at 9; BCarbon at 2–3; Carbonplace at 4; Carbon Market Watch at 5; Ceres at 4–5; CEPI at 5; Emergent at 2; ESMC at 5; Isometric at 5; Kita at 3; NYSSCPA at 5; NYU Policy Integrity at 1; Sylvera at 5; Terra at 6; TNC at 2; WWF at 1; Xpansiv at 11.
[180] Nodal at 5.
[181] *Id.*
[182] BCarbon at 2.
[183] 88 FR at 89421.

projects or activities for which the crediting program issues VCCs, and the crediting program's transparency regarding that definition**.**[184]

A number of commenters explicitly supported consideration of whether a crediting program has a buffer "pool" or "reserve" in place to address the risk of reversal.[185] Some commenters recommended that DCMs should consider the quality of the VCCs in a crediting program's buffer reserve.[186] For example, Isometric suggested, one possibility would be to ensure that credits in the buffer reserve are derived from high-durability projects which themselves have a low risk of reversal, "in order to partially mitigate cascading risk events that could overwhelm the buffer [reserves'] ability to compensate for reversals."[187] Other commenters similarly suggested that DCMs consider whether a crediting program has mechanisms in place to account for the continuing sufficiency of the buffer reserve.[188] For example, Affiliated Scientists stated that "DCMs should only accept carbon credits from crediting programs that have updated (and will continue to update as the science evolves) their buffer pools to reflect the latest science on disturbance risk to make such buffer pools sufficiently capitalized."[189] Meanwhile, BCarbon stated that it was worth noting that buffer pools are not the only measure that exists for mitigation of reversal risk.[190]

Some commenters suggested that DCMs look to standards for high-integrity VCCs developed by private sector or multilateral initiatives, and adherence by a crediting program to such standards, when considering the crediting program's measures to address and account for the

[184] *See, e.g.,* aDryada at 1; Anew Climate at 5; Carbon Market Watch at 5; CRA at 4; C2ES at 6; NYSSCPA at 5; Sylvera at 5; TNC at 2.
[185] *See, e.g.,* Ceres at 4; WWF at 1; Xpansiv at 10.
[186] *See, e.g.,* Affiliated Scientists at 2; BCarbon at 2; CEPI at 5; Emergent at 2; Isometric at 4; Kita at 3.
[187] Isometric at 4.
[188] *See, e.g.,* Affiliated Scientists at 2; Carbonplace at 4; CarbonPlan at 9; Charm at 4; Terra at 5; Sky Harvest at 11.
[189] Affiliated Scientists at 2.
[190] BCarbon at 2.

risk of reversal.[191] For example, Sylvera noted that "industry initiatives such as IC-VCM have already developed quality frameworks that consider factors such as reversal risk," and encouraged Commission alignment with these frameworks.[192]

Some commenters noted specific issues or factors for consideration when VCCs underlying a derivative contract are sourced from nature-based mitigation projects or activities, with many highlighting the heightened risk of reversal associated with such projects or activities.[193] To provide more transparency regarding this risk, CATF recommended providing location-specific data that adjusts with risk assessments over time.[194] Public Citizen stated that "[d]ue to significant risk of reversal in the case of nature-based projects or activities, the DCM should either prohibit the listing of derivative contracts based on the same, or only list those whose underlying projects maintain a buffer pool equal to 100% of the carbon credit value."[195]

The Commission also specifically requested comment on how a DCM should account for a reversal, should one occur with respect to a VCC that is eligible for delivery under a derivative contract, and whether there are specific terms and conditions, or other rules that a DCM should consider including in a VCC derivative contract to account for reversal risk.[196] Generally, commenters supported DCMs looking to the crediting program's measures for addressing a reversal.[197] For example, Anew Climate stated that DCMs should rely on the requirements and procedures of the respective crediting program: "The DCM should consider how the crediting

[191] *See, e.g.,* Anew Climate at 5; CATF at 11; Carbonplace at 4; CEPI at 6; Charm at 4; C2ES at 6; Ducks Unlimited, Inc. ("Ducks") at 3; Emergent at 2; Flow Carbon at 4; Sylvera at 5; Terra at 6.
[192] Sylvera at 5.
[193] *See, e.g.,* CATF at 11; ESMC at 5; Public Citizen at 15; Simon Counsell at 4.
[194] CATF at 11. The CATF recommends adaptive risk ratings because climate change has the potential to impact carbon credits in certain localities.
[195] Public Citizen at 15.
[196] 88 FR at 89421.
[197] *See, e.g.,* aDryada at 1; Anew Climate at 6; BCarbon at 2–3; Better Markets at 9; Carbonplace at 4; Carbon Market Watch at 5; CEPI at 5; Ceres at 4–5; ESMC at 5; Emergent at 2; Isometric at 5; Kita at 3; NYSSCPA at 5; NYU Policy Integrity at 1; Sylvera at 5; Terra at 6; TNC at 2; WWF at 1; Xpansiv at 11.

program addresses avoidable and unavoidable reversals when they do occur and requirements related to buffer pool contributions."[198]

Some commenters suggested that DCMs should design contracts in a manner that differentiates VCCs based on assessments of reversal risk.[199] For example, Isometric stated that VCCs based on projects with higher risk of reversal should be identifiable and distinct from those VCCs based on projects with low or negligible risks of reversals: "This will enable more effective price discovery and better functioning markets."[200] Meanwhile, 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."[201]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to permanence and accounting for reversal risk as proposed, with certain revisions. After considering the comments, the Commission continues to believe that, in connection with the design of a VCC derivative contract, a DCM should consider whether the crediting program for underlying VCCs has measures in place to address and account for the risk of reversal**.**[202] Market participants that are utilizing physically-settled VCC derivative contracts to help meet their carbon mitigation goals have an interest in ensuring that, upon physical settlement, the underlying VCCs will actually reduce or remove the amount of emissions that they were intended to reduce or remove.

[198] Anew Climate at 5.
[199] *See, e.g.,* BCarbon at 2; IATP at 22; Isometric at 4; Terra at 6.
[200] Isometric at 4.
[201] IATP at 22.
[202] *See* 88 FR at 89417.

Accordingly, the Commission believes that the risk of reversal—and the manner in which it is accounted for by a crediting program—is tied to the quality of the underlying VCCs and, by extension, to the pricing of the derivative contract.

The Commission believes that comments on the Proposed Guidance support the Commission's view that a DCM should consider whether a crediting program for underlying VCCs has a buffer reserve or other measures in place to address reversal risk[203]—as well as the Commission's view that relevant considerations with respect to a crediting program's buffer reserve could include whether the crediting program regularly reviews the methodology by which the size of its buffer reserve is calculated, and whether there is a mechanism in place to audit the continuing sufficiency of the buffer reserve. In response to comments received, the Commission clarifies that a crediting program may, now or in the future, have measures other than, or in addition to, a buffer reserve to address the risk of credited emissions reductions or removals being reversed; this guidance contemplates that a DCM should consider whether a crediting program has a buffer reserve and/or other measures in place to address such risk.[204]

The Commission is also clarifying the statement, in the Proposed Guidance, that a DCM should consider whether a crediting program's buffer reserve or other measures provide reasonable assurance that, in the event of a reversal, the VCCs intended to underlie a derivative contract will be replaced by VCCs of comparably high quality that meet the contemplated specifications of the contract. The Commission understands that VCCs in a buffer reserve are generally *drawn down and cancelled* to compensate for reversals associated with a project or activity, rather than being

[203] *See id.* at 89418.
[204] The Commission understands that each crediting program, and the registry that it operates or uses, may handle reversals in its own way. Measures to address reversals that do not involve the cancellation of credits in a buffer reserve may include limiting future sales of credits, cancelling unsold credits, or having affected projects procure credits from other projects to offset the reversal, among other measures.

*drawn upon to replace* VCCs issued for such project or activity, and has determined to clarify its guidance accordingly.

Furthermore, in response to comments received, the Commission is clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standards setting program, can serve as tools for a DCM, in connection with its consideration of a crediting program's measures to address and account for the risk of reversal.

While the Commission acknowledges comments stating that there is a heightened risk of reversal associated with nature-based mitigation projects and activities—including comments suggesting that VCCs issued for such projects or activities should not be permitted to underlie a derivative contract, or that derivative contracts should be designed in a manner that differentiates VCCs based on assessments of reversal risk—the Commission emphasizes that the purpose of this guidance is not for the Commission to make recommendations, or proscriptions, regarding the specific types of VCC derivative contracts that a DCM should list for trading. Rather, the guidance is intended to outline factors for the DCM, itself, to consider in connection with its contract design and listing activities, in order to help ensure that the DCM is complying with its statutory and regulatory obligations. The comments with respect to nature-based mitigation projects and activities do, however, underscore the Commission's view that a VCC derivative contract's terms and conditions should clearly identify what is deliverable under the contract—including by making it clear if eligible VCCs are associated with a specific category of mitigation projects or activities, such as nature-based products or activities. Transparency in this regard will help to make sure that market participants understand what VCCs can be expected to deliver under the contract, and to make an assessment of the VCCs' quality, which will help to support accurate pricing.

The Commission is persuaded by comments stating that specific information regarding a crediting program's measures for estimating, monitoring, and addressing the risk of reversal is not the type of information that typically would be included in a derivative contract's terms and conditions, and has determined to revise its guidance accordingly.

d. Robust Quantification

Commenters on the Proposed Guidance broadly agreed that the quantification methodologies or protocols used by a crediting program for calculating GHG reduction or removal levels help to inform the quality of VCCs issued by the crediting program.[205] In the Proposed Guidance, the Commission stated that it preliminarily believed that, as part of its contract design market research, a DCM should consider the methodology or protocol used by a crediting program to calculate emission reduction or removals for VCCs underlying a derivative contract, and whether the crediting program can demonstrate that such methodology or protocol is robust, conservative, and transparent.[206] The Commission specifically requested comment on whether there were particular criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract's terms or conditions, whether a crediting program applies a robust, conservative and transparent methodology or protocol.[207] A number of commenters suggested criteria or factors.[208]

CEPI and Ducks recommended that DCMs consider whether there are independent review procedures for a crediting program's quantification methodologies, such as a public consultation

[205] *See*, *e.g.,* Anew Climate at 6; BCarbon at 2–3; Carbon Market Watch at 1; Carbonplace at 4; CEPI at 6; Ceres at 4–5; CIEL at 11; Context Labs at 2; Iconoclast at 5; Isometric at 5; NYSSCPA at 5; NYU Policy Integrity at 1; Puro at 7–8; Terra at 6; Sylvera at 5; Xpansiv at 11.
[206] 88 FR at 89418.
[207] *Id.* at 89421.
[208] *See, e.g.,* Centre for Competition Policy at 4; CEPI at 6; Ceres at 3; Charm at 4; CIEL at 11; Context Labs at 2; Ducks at 4; Flow Carbon at 4; NYU Policy Integrity at 6; Sylvera at 3–4; TNC at 3.

or peer review process.[209] CEPI additionally recommended that DCMs consider whether a crediting program relies on scientific evidence to develop its quantification methodologies, and whether there are "mechanisms for the periodic review and/or revision of the methodologies."[210] Similarly, TNC stated that any quantification methodology should use baselines that are periodically reviewed.[211] CIEL stated that, in order to enable transparency, a crediting program "must make its methodology, and how it has been applied to individual projects, available to public scrutiny."[212] Sylvera noted that robust quantification is only verifiable by third parties if there are sufficient disclosures by the project developers to allow third parties to check the accounting.[213] NYU Policy Integrity and TNC believed that DCMs should consider "leakage risk" in quantification methodologies.[214] Ceres cautioned against overly focusing on conservative accounting, which might lead to an underestimation of emission reductions or removals, and recommended balancing conservativeness with the ultimate goal of accuracy.[215]

Other commenters, meanwhile, raised concerns similar to those noted in Section I.B.2, regarding the lack of standardization across the voluntary carbon markets with respect to quantification methodologies and protocols, and how this may create issues with over-crediting and reliability.[216] CEPI recommended that a crediting program have procedures in place to suspend or withdraw the use of a quantification methodology where there is sufficient evidence that the emission removals or reductions have been overstated.[217]

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[209] *See* CEPI at 6; Ducks at 4.
[210] CEPI at 6.
[211] TNC at 3.
[212] CIEL at 11.
[213] Sylvera at 3–4.
[214] *See* NYU Policy Integrity at 6; TNC at 3.
[215] Ceres at 3.
[216] *See, e.g.,* CATF at 13; Center for American Progress at 4; Public Citizen at 13.
[217] CEPI at 6.

Some commenters did recommend quantification standards,[218] such as the International Organization for Standardization ("ISO")14060 standards for quantifying, monitoring, reporting and validating GHG emissions,[219] or the GHG Protocol.[220] Certain commenters recommended that DCMs look to standards for high-integrity VCCs developed by private sector or multilateral initiatives, such as the robust quantification standards under the ICVCM's Core Carbon Principles ("CCP") and CCP Assessment Framework, and adherence by a crediting program to such standards.[221]

Other commenters expressed concern with the view that a DCM should consider whether a crediting program's quantification methodology or protocol is robust, conservative and transparent.[222] ICE stated that expecting a DCM to engage in such an assessment would lead to unnecessary duplication of extensive, public consultation processes to which crediting program methodologies already are subject.[223] Verra expressed concern that carrying out such an assessment would require a DCM to obtain specialized technical expertise about topics that are beyond its core competency in overseeing derivatives markets.[224] Likewise, CME stated that it would be impractical for DCMs to develop the expertise to make such an assessment of a crediting program's quantification methodology or protocol, and stated that it was also possible, "if not likely," that various DCMs and market participants could have different views as to what level of robustness, conservatism and transparency is sufficient.[225] CME believed that "it is preferable for

[218] *See, e.g.,* Carbonplace at 4; NYSSCPA at 5; Sylvera at 5; Terra at 6.
[219] *See, e.g.,* Carbonplace at 4. Carbonplace suggested that at a minimum, DCMs focus on standards which are supported by ISO certification.
[220] *See* NYSSCPA at 5.
[221] *See, e.g.,* BASCS at 4; Ceres at 4–5; C2ES at 6; Ducks at 4; ICVCM at 8; Sylvera at 5.
[222] *See*, *e.g.,* Center for American Progress at 4; Ceres at 2–3; CME at 7; ICE at 7; Nodal at 5; Public Citizen at 13; Verra at 6.
[223] ICE at 7.
[224] Verra at 6.
[225] CME at 7.

the crediting program to publish its methodology … and for market participants to render their own judgment."[226] Ceres similarly stated that DCMs should not conduct additional due diligence and should rely on crediting programs to demonstrate they have processes/procedures to achieve high quality credits.[227] Nodal recommended that, if the Commission finalized its guidance, the Commission omit reference to a DCM's consideration of whether the crediting program's quantification methodology or protocol is "robust, conservative and transparent", arguing that the Commission would otherwise be asking DCMs "to evaluate the sufficiency of VCC quality standards, which are normally addressed by the underlying markets."[228]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to robust quantification as proposed, with certain revisions. As recognized in the Proposed Guidance, and highlighted by some commenters, there are not currently standardized methodologies or protocols that are used across the voluntary carbon markets to quantify emission reduction or removal levels. Given the current absence of such standardized methodologies or protocols, the Commission continues to believe that robustness, conservativeness and transparency are factors that inform the extent to which a quantification methodology or protocol applied by a crediting program helps to ensure that the number of VCCs that are issued for a mitigation project or activity accurately reflects the emission reduction or removal levels associated with that project or activity.[229] Market participants that are utilizing physically-settled VCC derivative contracts to help meet their carbon mitigation goals have an interest in ensuring that, upon physical settlement,

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[226] *Id.*
[227] Ceres at 2–3.
[228] Nodal at 5.
[229] *See* 88 FR at 89418. The Commission agrees that, ultimately, the accuracy of estimations is a key objective—one that informs confidence that the voluntary carbon markets can serve as a tool to assist in emissions reduction efforts, as well as accurate pricing by market participants.

the underlying VCCs will actually reduce or remove the amount of emissions that they were intended to reduce or remove. Accordingly, the Commission believes that the robustness, conservativeness and transparency of the quantification methodology or protocol that is applied with respect to the underlying VCCs can inform their quality—and, by extension, the pricing of the derivative contract.

Furthermore, the Commission continues to believe that where the quantification methodology or protocol used to calculate the amount of VCCs for a particular project is robust, conservative, and transparent, the DCM should have a more reliable basis from which to form a deliverable supply estimate for exchange-set position limits purposes.[230]

Given the relevance with respect to VCC quality, as well as deliverable supply estimates, although the Commission acknowledges that a DCM may not have the specialized, technical expertise to determine whether a crediting program *has demonstrated* that the quantification methodology or protocol that it uses to calculate GHG emission reduction or removal levels for VCCs underlying a derivative contract is robust, conservative, and transparent, the Commission does believe that the DCM should consider whether there is *reasonable assurance* that the methodology or protocol used by the crediting program is robust, conservative and transparent.[231] In this regard, the Commission acknowledges and supports commenters' suggestions that factors that may inform the robustness, conservativeness, and transparency of a quantification methodology or protocol could include whether the methodology or protocol has been developed with reference to scientific evidence, whether the methodology or protocol has been subject to

[230] *Id.*

[231] In the Proposed Guidance, the Commission generally referred to a crediting program's methodology or protocol used for calculating the level of GHG reductions or removals associated with a mitigation project or activity. The Commission recognizes that crediting programs typically have multiple quantification methodologies or protocols, and has made certain revisions to its guidance to account for this.

independent review procedures, and whether there are mechanisms for the periodic review and/or revision of the methodology or protocol. In response to ICE's comment suggesting that all crediting program methodologies are subject to extensive, public consultation procedures, the Commission notes that review and consultation procedures may be crediting-program specific and the implementation by any particular crediting program of extensive public consultation procedures should not be taken as a given.

Furthermore, and particularly in light of the comments received that highlighted the technical and specialized nature of a crediting program's quantification methodologies or protocols, the Commission is clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standard setting program, can serve as tools for a DCM, in connection with its consideration of a crediting program's quantification methodologies or protocols, including consideration of whether there is reasonable assurance that the methodology or protocol used to calculate emission reductions or removals for VCCs underlying a derivative contract is robust, conservative and transparent.

The Commission is persuaded by comments stating that specific information about the quantification methodology or protocol used by a crediting program to calculate GHG emissions reductions or removals is not the type of information that typically would be included in a derivative contract's terms and conditions, and has determined to revise its guidance accordingly.

iv. Delivery Points and Facilities

a. Governance

Generally, commenters agreed that, as part of the contract design process for a VCC derivative contract, a DCM should consider whether the crediting program for underlying VCCs

has a governance framework that supports the program's independence, transparency and accountability.[232] Better Markets, for example, stated that "DCMs should rigorously evaluate the governance frameworks…employed by the crediting programs of the underlying VCCs."[233]

In the Proposed Guidance, the Commission stated that, with respect to a crediting program's governance framework, it preliminarily believed that a DCM should consider, among other things, a crediting program's decision-making procedures, reporting and disclosure procedures, public and stakeholder engagement processes, and risk management policies, as well as whether information regarding those procedures and policies is made publicly available.[234] The Commission specifically requested comment on whether there were other criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract's terms or conditions, whether a crediting program's governance framework effectively supports transparency and accountability.[235]

Several commenters responded to highlight conflicts of interest considerations.[236] For example, Anew Climate recommended that DCMs consider whether a crediting program has policies in place to identify and mitigate potential conflicts of interest between various stakeholders.[237] ICVCM and C2ES similarly recommended that consideration of a crediting program's governance framework include consideration of the program's conflict of interest policy.[238] Likewise, Simon Counsell believed that a crediting program's governance framework should address conflicts of interest, and also should include independent review processes and an

[232] *See, e.g.,* AFREF at 6; ANAB at 5; Anew Climate at 6; BASCS at 4; Better Markets at 11; CATF at 13–14; C2ES at 7; Forest Peoples at 5; ICVCM at 8; Isometric at 5; NYSSCPA at 5; Simon Counsell at 4–5; Sylvera at 6; Terra at 6; WWF at 1; Xpansiv at 11.
[233] Better Markets at 11.
[234] 88 FR at 89419.
[235] *Id.* at 89421.
[236] *See, e.g.,* Anew Climate at 6; C2ES at 7; ICVCM at 8; Isometric at 5; Simon Counsell at 4–5; Sky Harvest at 13.
[237] Anew Climate at 6.
[238] *See* C2ES at 7; ICVCM at 8.

appeal process.[239] Anew Climate similarly stated that DCMs should consider "whether a grievance process and procedures by which to address those grievances are in place."[240] With respect to transparency, Xpansiv recommended that DCMs specifically consider a crediting program's transparency and responsiveness in connection with significant changes to project or credit status.[241]

Some commenters suggested that DCMs look to standards for high-integrity VCCs developed by private sector or multilateral initiatives, such as the governance standards under CORSIA, the International Carbon Reduction and Offset Alliance ("ICROA") and the ICVCM's Core Carbon Principles, and adherence by a crediting program to such standards.[242]

ICE believed that a DCM should not be responsible for determining the adequacy of a crediting program's governance, and that a DCM should instead be permitted to rely on recognized standard setting bodies, "to establish threshold standards for high-quality carbon credits which the crediting programs should adhere to and be audited against."[243] CME was similarly of the view that a DCM should not determine the effectiveness of a crediting program's independence, transparency, and accountability, because "DCMs are not experts in registry governance structures, and it is impractical to expect DCMs to develop such expertise."[244]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to governance as proposed, with certain revisions. Given the importance of a crediting program's governance framework in ensuring the overall quality of the VCCs issued by the program, as well

[239] Simon Counsell at 4–5.
[240] Anew Climate at 6.
[241] Xpansiv at 11.
[242] *See e.g.,* Sylvera at 6; Terra at 6.
[243] ICE at 7.
[244] CME at 7.

as the potential importance of a crediting program's registry in facilitating delivery under a physically-settled VCC derivative contract, the Commission continues to believe that, as part of the contract design process, a DCM should consider the governance framework of the crediting program for underlying VCCs.[245] More specifically, and after considering the comments received, the Commission believes that a DCM should consider whether the crediting program's governance framework supports the crediting program's independence, transparency, and accountability. With respect to particular criteria or factors that may inform such independence, transparency, and accountability, and in acknowledgment that a number of commenters highlighted these points, the Commission is revising its guidance to expressly recognize conflict of interest measures as a factor which may inform a crediting program's independence, and appeals mechanisms as a factor which may inform a crediting program's accountability.

Furthermore, in response to comments received, the Commission is clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standards setting program, can serve as tools for a DCM, in connection with its consideration of a crediting program's governance framework, including whether the governance framework supports the crediting program's independence, transparency, and accountability.

Finally, the Commission is persuaded by comments stating that specific information regarding a crediting program's governance framework is not the type of information that typically would be included in a derivative contract's terms and conditions,[246] and has determined to revise its guidance accordingly.

[245] 88 FR at 89419.
[246] *See e.g.,* CME at 7; ICE at 7.

b. Tracking

In the Proposed Guidance, the Commission stated that it preliminarily believed that a DCM should consider whether a crediting program for underlying VCCs can demonstrate that it has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer, and retirement of VCCs.[247] The Commission stated that the DCM should consider whether the crediting program operates or makes use of a registry that has measures in place to effectively track issuance, transfer, and retirement; to identify who owns or retires a VCC; and to make sure that each VCC is uniquely and securely identified and associated with a single emission reduction or removal of one metric ton of carbon dioxide equivalent.[248] The Commission stated that, where the registry will serve as the delivery point for a physically-settled VCC derivative contract, it may be appropriate for the DCM to include as a condition of the contract that the registry have such measures to address tracking in place.[249]

In its comments on the Proposed Guidance, ISDA highlighted that, because registries currently serve as delivery points for futures contracts, "[i]t is important to ensure registries have consistent and transparent rules on how VCCs are verified, counted and transferred. Failure to correctly track and safeguard carbon credits, or a gap in standards in the creation of a carbon credit itself, could lead to fraudulent practices, such as greenwashing and double counting."[250] ISDA went on to say that it believes the "CFTC has a regulatory interest in ensuring that VCC registries (that act as delivery points for carbon futures contracts) adopt appropriate procedures for tracking the buying and selling of credits in the context of VCC futures and other bilateral markets."[251]

[247] 88 FR at 89419.
[248] *Id.*
[249] *Id.*
[250] ISDA at 3.
[251] *Id.*

ICE stated that "[i]t is important to distinguish between the role of carbon crediting programs and registries," noting that the two roles are often "conflated."[252] ICE stated that "the physical delivery of VCCs is effectuated by transferring the VCC from the seller to the buyer in the registry operated by the crediting program."[253] ICE stated that, because "market participants value the delivery mechanism as an important risk management function offered by DCMs and DCOs," it believed that a "DCM should seek confirmation from a crediting program utilizing a registry that it has appropriate measures in place to effectively track the issuance, transfer and retirement of VCCs."[254]

The Commission received several responses to its request for comment regarding whether there were other factors, in addition to those identified in the Proposed Guidance, that a DCM should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether a crediting program's registry has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer and retirement of VCCs.[255]

Like ISDA, some commenters highlighted the importance of transparent registry rules regarding VCC tracking and retirement.[256] For example, Anew Climate responded that "DCMs should assess whether the crediting program has published transparent operating procedures for its registry activities, explaining how these processes work, as well as terms of use that govern

[252] ICE at 8.
[253] *Id.*
[254] *Id*.
[255] *See, e.g.,* Anew Climate at 7; BASCS at 4; C2ES at 7; Carbon Direct at 7; Carbonplace at 5; CEPI at 6; Differentiated Gas Coordinating Council ("DGCC") at 6; Ecobalance at 2; Flow Carbon at 5; Harvard *et al* at 18; Iconoclast at 5; ICVCM at 10; ISDA at 3; Nodal at 6; Nori at 5; NYSSCPA at 10; Public Citizen at 16; Sky Harvest at 14; Sylvera at 6; Terra at 6; Xpansiv at 12.
[256] *See, e.g.,* Anew Climate at 7; Carbon Direct at 7; DGCC at 6; Flow Carbon at 5; Harvard *et al* at 18; ISDA at 3; Nori at 5; Sky Harvest at 14.

participation in the program."[257] Other commenters supported specific accounting frameworks for tracking to help ensure accuracy.[258]

NYSSCPA supported tracking VCCs by assigning them a "unique serial number" and having the crediting program, or registry, track the VCC throughout its life cycle, including changes in ownership following delivery and the VCC's retirement.[259] ICVCM similarly stated that unique identifiers "can dramatically improve transparency and reduce risk of double counting."[260]

Sylvera, BASCS, ICVCM, and C2ES responded in support of ICVCM's standards with respect to tracking and double counting.[261] The ICVCM CCP Assessment Framework requires crediting programs to have registry provisions that prevent double registration of mitigation activities, double use of a carbon credit after it has been cancelled or retired for a specific use, and measures to prevent double claiming with mandatory domestic mitigation programs or incentivization schemes (*e.g.,* Renewable Energy Certificates).[262]

A few commenters expressed concern with the view that a DCM should consider the effectiveness of a crediting program's tracking measures.[263] Terra stated that this should be handled by the crediting program.[264] Nodal recommended that, if the Commission finalized the Proposed Guidance, the Commission should omit reference to a DCM's consideration of whether a crediting program operates or makes use of a registry that has measures in place to "effectively" track VCCs, arguing that the Commission would otherwise be asking DCMs "to evaluate the

[257] Anew Climate at 7.
[258] *See, e.g.,* Carbon Direct at 7; Harvard *et al* at 18; Stanford Doerr School of Sustainability Stanford Law School ("Stanford Doerr") at 1.
[259] NYSSCPA at 10.
[260] ICVCM at 10.
[261] *See, e.g.,* BASCS at 4; C2ES at 7; ICVCM at 10; Sylvera at 6.
[262] ICVCM at 10.
[263] *See e.g.,* ICE at 8; Nodal at 5–6; Terra at 6.
[264] Terra at 6.

sufficiency of VCC quality standards, which are normally addressed by the underlying markets."[265]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to tracking as proposed, with certain revisions. As discussed in the Proposed Guidance, market participants that are utilizing physically-settled VCC derivative contracts to help meet carbon mitigation goals have an interest in ensuring that, upon physical settlement, the underlying VCCs will actually reduce or remove the emissions that they were intended to reduce or remove. It is therefore important for each credited VCC to be uniquely associated with a single emission reduction or removal of one metric ton of carbon dioxide. Processes and procedures to help ensure clarity and certainty with respect to the issuance, transfer and retirement of VCCs can help support this. Conversely, if there is not a reasonable assurance that the VCCs underlying a derivative contract are each unique, then, among other things, this could distort or obscure the accuracy of the derivative contract's pricing. The fact that the current voluntary carbon market structure typically relies on the registries used or operated by crediting programs to effectuate the physical delivery of VCCs underlying a derivative contract further supports the Commission's view that a DCM should consider whether there is reasonable assurance of the effectiveness of the tracking measures that a crediting program has in place.

In response to comments received, the Commission is clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standard setting

[265] Nodal at 5–6.

program, can serve as tools for a DCM, in connection with its consideration of the crediting program's tracking measures.

Finally, the Commission notes that the Proposed Guidance indicated that it may be appropriate, in certain circumstances, to include in a physically-settled VCC derivative contract certain conditions relating to the tracking measures that the registry used or operated by the crediting program for underlying VCCs has in place. While, based on the specific facts and circumstances in issue, a DCM may determine that inclusion of such conditions in a particular contract is appropriate, the Commission is persuaded by the broader comments that it received regarding the type of information that typically would, and would not, be included in a derivative contract's terms and conditions,[266] and has determined to revise its guidance accordingly.

c. No Double-Counting

In the Proposed Guidance, the Commission stated that it preliminarily believed that a DCM should consider whether the crediting program for underlying VCCs can demonstrate that it has effective measures in place that provide reasonable assurance that credited emission reductions or removals are not double-counted: "That is, that the VCCs representing the credited emission reductions or removals are issued to only one registry and cannot be used after retirement or cancellation."[267] Carbon Market Watch highlighted that the risk of double counting can manifest itself in many ways. For example, a given emission reduction may be claimed by multiple actors, such as various financers of the mitigation project or activity (*e.g.,* a bank that issues a loan to the project or activity, as well as a company that purchases VCCs from the project or activity). [268]

[266] *See, e.g.,* CME at 7; ICE at 7.
[267] 88 FR at 89419.
[268] Carbon Market Watch at 4.

aDryada stated that it believes there is confusion in the voluntary carbon markets regarding the understanding of the term "double counting" (*i.e.*, whether the term refers to double issuance, double use, or double claim).[269] The AFF suggested a clarification to the Commission's "no double-counting" characterization, to recognize that there is no double counting where emission reductions or removals from a mitigation project or activity are counted only once toward achieving mitigation targets or goals.[270]

The Commission specifically requested comment on whether there are 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.[271] CarbonPlan suggested that a DCM should consider whether a crediting program discloses "the precise location and boundaries of projects that generate VCCs."[272] Bloomberg Philanthropies, ICVCM, and C2ES highlighted that the use of unique identifiers can reduce the risk of double counting.[273] Other commenters supported specific accounting frameworks for tracking to help ensure accuracy.[274] Some commenters provided information regarding blockchain technology or digital assets. In general, these commenters supported the use of blockchain or similar technology for VCC-related recordkeeping to help avoid double counting.[275]

[269] aDryada at 1.
[270] AFF at 4.
[271] 88 FR at 89421.
[272] CarbonPlan at 9–10.
[273] *See* Bloomberg Philanthropies at 3; C2ES at 7; ICVCM at 9.
[274] *See, e.g.,* Carbon Direct at 7; Harvard *et al* at 18.
[275] *See, e.g.,* BCarbon at 3; Context Labs at 1; DGCC at 6; Ecobalance at 2; Flow Carbon at 5; Harvard *et al* at 7; Iconoclast at 5; Nori at 6; NYSSCPA at 6; Stanford Doerr at 1.

A few commenters expressed concern with the view that a DCM should consider the effectiveness of a crediting program's measures with respect to double counting.[276] Terra stated that this should be handled by the crediting program.[277] Nodal recommended that, if the Commission finalized the Proposed Guidance, the Commission should omit reference to a DCM's consideration of whether the crediting program can demonstrate that it has "effective measures" in place with respect to double counting,[278] arguing that the Commission would otherwise be asking DCMs "to evaluate the sufficiency of VCC quality standards, which are normally addressed by the underlying markets."[279]

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to double counting as proposed, with certain revisions. The Commission understands that the term "double counting" may be interpreted differently within the voluntary carbon markets, depending, for example, on the context. The Commission clarifies that, since this guidance is focused on considerations for DCMs in connection with the listing for trading of physically-settled VCC derivative contracts, the Commission is primarily concerned with double issuance—*i.e.,* the issuance of the same VCC more than once.

After considering the comments received, the Commission believes that a DCM should consider whether a crediting program for underlying VCCs has measures in place that provide reasonable assurance that credited emission reductions or removals are not double counted. As discussed above in connection with tracking, it is important for each credited VCC to be uniquely associated with a single emission reduction or removal of one metric ton of carbon dioxide

[276] *See, e.g.,* Nodal at 6; Terra at 6.
[277] Terra at 6.
[278] Nodal at 6.
[279] *Id.* at 5.

equivalent to help ensure that VCCs effectively further carbon mitigation goals, and, relatedly, to help avoid the distortion or opaqueness of a VCC derivative contract's pricing. The Commission therefore believes that it is important for a DCM to consider whether a crediting program has measures in place, including measures with respect to double counting, that provide reasonable assurance that the VCCs issued by the crediting program are unique.

In response to comments received, the Commission is clarifying that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standard setting program, can serve as tools for a DCM, in connection with its consideration of the crediting program's measures to prevent double counting.

v. Inspection Provisions – Third-Party Validation and Verification

Certain commenters on the Proposed Guidance highlighted the role that effective crediting program validation and verification procedures play in supporting VCC quality, and supported the Commission's recognition of the benefits of validation and verification by a reputable, disinterested party or body. Better Markets stated that the validation and verification processes "are vital for confirming that credited mitigation projects or activities adhere to the [crediting] program's rules and standards, ensuring that the emission reductions or removals claimed are genuine and verifiable."[280] Better Markets further stated that "the involvement of reputable, independent third-parties in the validation and verification of projects or activities is crucial. Such independent oversight provides assurance that the GHG emissions reductions or removals are accurately achieved, thereby enhancing the quality of the underlying VCCs."[281] WWF, meanwhile, stated that a third-party verification process "should be a requirement to improve the

[280] Better Markets at 12.
[281] *Id.*

integrity of the credit and ultimately the integrity of the voluntary carbon market."[282] Better Markets stated that "best practices in third-party validation and verification should ensure diverse and impartial review by preventing exclusive reliance on a single validator for all projects or activities, and should include mechanisms for addressing performance issues, conducting periodic reviews of validators, and ensuring that ongoing validation and verification are carried out by different parties from those who performed the initial assessments."[283]

Most commenters responding to a specific request for comment on this point agreed that the delivery procedures for a physically-settled VCC derivative contract should describe the responsibilities of registries, crediting programs, or other third parties required to carry out the delivery process.[284] Xpansiv stated that such a description enables buyers and sellers to trade VCC-linked contracts "with a clear understanding of the delivery mechanism, the responsibilities of all parties involved in the delivery process and the chain of custody of VCCs being transferred in the delivery process." [285] Flow Carbon stated that, "[f]or market participants, transparency around the settlement process, coupled with credible third-party review and independent verification, is critical to ensuring that firms have the confidence to deploy capital into these markets and products."[286] Terra stated that delivery procedures should clearly outline the "responsibilities of all parties involved to ensure the integrity and authenticity of the VCCs upon delivery."[287]

ICVCM stated that 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

[282] WWF at 1.
[283] Better Markets at 12.
[284] *See*, *e.g.,* AFF at 4; Carbonplace at 5; CEPI at 7; EDF at 8; IATP at 23; Kita at 5; Public Citizen at 17; Terra at 5; Xpansiv at 12.
[285] Xpansiv at 12.
[286] Flow Carbon at 5.
[287] Terra at 7.

responsibilities by third parties can be managed through usual risk management in contracts by allocating that risk between the contract parties or providing for default/force majeure etc. type risks."[288]

ICE highlighted the role of the DCO in the delivery process.[289] EDF noted that the "responsibilities of registries, crediting programs and other third-parties required to carry out the delivery process are generally articulated in Terms of Use contracts available on registry websites and mandatory for registry account activation."[290] EDF stated that "DCMs should specify which registry or registries will be used, and also how the respective Terms of Use satisfy governance, tracking mechanisms and double-counting prevention measures."[291]

A few commenters expressed concern that, under the Proposed Guidance, DCMs would be expected to assess the sufficiency of a crediting program's procedures for validating and verifying that credited mitigation projects or activities meet the program's rules and standards. CME stated that serving as arbiter of such procedures is not the appropriate role of a DCM.[292] Nodal similarly recommended that, if the Commission finalized the Proposed Guidance, the Commission omit reference to a DCM's consideration of whether a crediting program's procedures contemplated validation and verification by a "reputable, disinterested" party or body, as well as reference to a DCM's consideration of whether the crediting program is employing "best practices" with respect to third-party validation and verification.[293]

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[288] ICVCM at 9.
[289] ICE at 9–10, stating that the "delivery procedures used by the relevant DCO for the [VCC derivative contract] should take account of the functions provided by the relevant registries, specify the responsibilities of parties in the delivery process, and address the risks to the DCO and market participants for delivery failures, consistent with the DCO core principles." The Commission reiterates that this guidance focuses considerations for DCMs in connection with the design, and listing, of VCC derivative contracts.
[290] EDF at 8.
[291] *Id.*
[292] CME at 8.
[293] Nodal at 6.

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance with respect to inspection provisions as proposed, with certain revisions. Consistent with the Appendix C Guidance, the Commission continues to believe that inspection or certification procedures for verifying compliance with quality requirements or any other related delivery requirements for a physically-settled VCC derivative contract should be specified in the contract's terms and conditions. With respect to comments on whether the delivery procedures for a physically-settled VCC derivative contract should describe the responsibilities of registries, crediting programs or any other third parties required to carry out the delivery process, the Commission reminds exchanges and market participants that the Appendix C Guidance states that physically-settled derivative contracts should, among other things, specify appropriately detailed delivery procedures "that describe the responsibilities of deliverers, receivers, and any required third parties in carrying out the delivery process."[294] The Commission clarifies that, in the specific context of physically-settled VCC derivative contracts, a registry or crediting program may be considered a deliverer, receiver or required third party as contemplated in the Appendix C Guidance.

The Commission acknowledges comments asserting that a DCM may not have the specialized, technical expertise to make an independent determination regarding the conservativeness, robustness, and transparency of a crediting program's validation and verification procedures. However, given the role played by a crediting program's validation and verification procedures in informing the quality of VCCs issued by the crediting program, the Commission does believe that there should be reasonable assurance that the program's validation and verification procedures are up-to-date, robust and transparent. The Commission believes that

[294] Appendix C Guidance, paragraph (b)(2)(i)(B).

comments also support a DCM's consideration of whether there is reasonable assurance that those procedures reflect best practices with respect to third-party validation and verification. The Commission clarifies that, while such *best practices* with respect to third-party validation and verification may include conducting reviews of the performance of validators, procedures for remediating performance issues, not using the same third-party validator to verify every project type or project category, and using a separate third party to conduct ongoing validation and verification from the third party that completed the initial validation and verification process, the Commission does not expect *the DCM itself* to conduct such reviews or implement such procedures. The Commission further clarifies that it does not expect a DCM to specify, in a VCC derivative contract's terms and conditions, or rules, how a registry's Terms of Use address the discussion in this guidance of governance, tracking and double counting.

Taking into account comments received, the Commission is clarifying its view that, as a general matter, industry-recognized standards for high-integrity VCCs, and whether a particular crediting program has been approved or certified as adhering to an industry-recognized standard setting program, can serve as tools for a DCM, in connection with its consideration of the crediting program's validation and verification procedures, including whether there is reasonable assurance that those procedures reflect best practices with respect to third-party validation and verification.

3. *A DCM Shall Monitor a Derivative Contract's Terms and Conditions as They Relate to the Underlying Commodity Market*

The Commission received a few comments regarding the Commission's discussion in the Proposed Guidance of considerations for a DCM under DCM Core Principle 4. Better Markets

supported the Commission's proposal.[295] Iconoclast stated that continual monitoring by the DCM of the appropriateness of a VCC derivative contract's terms and conditions should include price.[296]

BPC noted that, given that DCMs "are at their root financial services companies," they may not currently have "the in-house scientific or technical expertise needed to comprehensively evaluate and continuously monitor for changes in carbon crediting programs that may affect the terms and conditions of VCC derivative contracts."[297] BPC suggested that the "Commission could consider facilitating a community of practice among DCMs to encourage sharing of best practices and developing common evaluation frameworks."[298]

The Commission appreciates the comments that it received on this subject and, after considering the comments, has determined to finalize its guidance with respect to DCM Core Principle 4 as proposed, with one revision. The Commission notes that implementing Commission regulations under DCM Core Principle 4 already require a DCM, among other things, to monitor a physically-settled derivative contract's terms and conditions as they relate to the underlying commodity market and to the convergence of the contract price and the price of the underlying commodity.[299] Given that VCC derivatives are a comparatively new and evolving class of products, and given that standardization and accountability mechanisms for VCCs are still being developed, the Commission does believe that it is appropriate for a DCM's monitoring of a VCC derivative contract to include monitoring of the continued appropriateness of the contract's terms and conditions that includes, among other things, monitoring to ensure that the underlying VCC conforms, or, where appropriate, updates to reflect the latest certification standard(s) applicable

[295] *See* Better Markets at 13.
[296] Iconoclast at 4.
[297] BPC at 3.
[298] *Id*.
[299] *See* 17 CFR 38.252(a).

for that VCC. However, for enhanced clarity, the Commission is replacing its reference in the guidance to "continual" monitoring of a contract's appropriateness, with a reference to "ongoing" monitoring of such appropriateness. For example, where there are changes to either the crediting program or the types of projects or activities associated with the underlying VCC, due for example to new standards or certifications, then the DCM should amend the contract's terms and conditions to reflect this update.

The Commission further notes that it is supportive of exchanges sharing best practices for statutory and regulatory compliance.

4. *A DCM Must Satisfy the Product Submission Requirements Under Part 40 of the CFTC's Regulations and CEA Section 5c(c)*

Some commenters on the Proposed Guidance responded to the Commission's discussion of requirements in connection with the submission of a VCC derivative contract to the Commission under CEA section 5c(c)(5)(C) and Part 40 of the Commission's regulations. WWF believed the Commission should disallow self-certification of VCC derivative contracts "[d]ue to the limited number of voluntary carbon credit derivative contracts and the newness of this function for the CFTC."[300] Similarly, AFREF and EDF supported the development by the Commission of a "heightened review framework for any self-certified climate-related products."[301] The Commission notes that, with specific limited exceptions, the CEA contemplates that a DCM may list a new derivative contract for trading, or amend an existing derivative contract, by way of self-certification, provided that the DCM complies with the substantive and procedural requirements set forth in the statute and the Commission's implementing regulations, including the requirement that the DCM submit certain prescribed information to the Commission, including but not limited

[300] WWF at 1.
[301] AFREF at 7; EDF at 2.

to the contract's terms and conditions.[302] The Commission notes that the CEA also sets forth the standard that must be met by the DCM in order to list or amend a derivative contract—which would include a VCC derivative contract—namely, that the contract comply with the CEA and the regulations thereunder.[303]

The Commission also received a comment regarding the requirement that a contract submission to the Commission—including a submission with respect to a VCC derivative contract—include an "explanation and analysis of the contract and its compliance with applicable provisions of the [CEA], including core principles and the Commission's regulations thereunder."[304] BPC urged the Commission to "encourage consistency across DCMs in their development of the required 'explanation and analysis' of how their VCC derivative contract meets … this proposed guidance." [305]

The Commission notes that each DCM has an obligation to ensure, through its own review and analysis, that the derivative contracts that it seeks to list for trading—including any VCC derivative contracts—comply with the CEA and the regulations thereunder, and the DCM's contract submissions to the Commission should reflect this review and analysis. That said, by outlining certain relevant considerations for a DCM in connection with the design and listing of a VCC derivative contract, the Commission is hopeful that this guidance will help to support the standardization of such contracts in a manner that not only facilitates informed evaluations and comparisons by market participants, but also fosters greater consistency in VCC derivative product submissions to the Commission.

[302] CEA section 5c(c)(1), 7 U.S.C. 7a-2(c)(1); 17 CFR 40.2.
[303] CEA sections 5c(c)(1) and (5), 7 U.S.C. 7a-2(c)(1) and (5).
[304] 17 CFR 40.2(a)(3)(v) (for self-certification) and 40.3(a)(4) (for Commission approval).
[305] BPC at 3.

The Commission appreciates all of the comments that it received on this subject. After considering the comments, the Commission has determined to finalize its guidance regarding the product submission requirements under Part 40 of the CFTC's regulations and CEA section 5c(c)(5)(C) as proposed.

5. *Foreign Boards of Trade*

The Commission requested comment on whether the VCC commodity characteristics identified in the Proposed Guidance should be recognized as being relevant to submissions with respect to VCC derivative contracts made by a registered foreign board of trade ("FBOT") under CFTC regulation 48.10.[306] Most commenters who responded were supportive of the VCC commodity characteristics being recognized as relevant to such FBOT submissions.[307] For example, after noting that both DCMs and registered FBOTs are held to a "not readily susceptible to manipulation" standard,[308] CME stated that if the Commission's guidance was intended to guard against the listing of contracts readily susceptible to manipulation, then the scope of the guidance

[306] 88 FR at 89421. CEA section 4(b)(1)(A), 7 U.S.C. 6(b)(1)(A), provides that the Commission may adopt rules and regulations requiring registration with the Commission for an FBOT that provides the members or other participants located in the United States with direct access to the electronic trading and order matching system of the FBOT, including rules and regulations prescribing the procedures and requirements applicable to the registration of such FBOTs. CEA section 4(b)(1)(A)(i) provides that, in adopting such rules and regulations, the Commission shall consider, inter alia, whether any such FBOT is subject to comparable, comprehensive supervision and regulation by the appropriate governmental authorities in the FBOT's home country. The Commission has adopted rules requiring the registration of FBOTs that seek to provide such direct access to members or other participants located in the United States, which among other things prescribe the procedures and requirements applicable to registration. These rules are set forth at Part 48 of the Commission's regulations. Commission regulation 48.10(a), 17 CFR 48.10(a), provides that a registered FBOT that wishes to make an additional derivative contract available for trading via direct access to members or other participants located in the United States must submit a written request "prior to offering the contracts within the United States," which must include specified information, including the contract's terms and conditions. In general, the registered FBOT can make the contract available for trading by direct access 10 business days after the date of the Commission's receipt of the written request, unless the Commission notifies the FBOT that additional time is needed to complete its review of policy or other issues pertinent to the contract.

[307] *See, e.g.,* AFREF at 9; Carbonplace at 3; CEPI at 4; Charm at 3; CME at 8; C2ES at 5; IATP at 20; ICVCM at 7; NYSSCPA at 3; Public Citizen at 13; Xpansiv at 9.

[308] Commission regulation 48.7(c)(1), 17 CFR 48.7(c)(1), provides, among other things, that that derivative contracts to be made available by a registered FBOT via direct access to members or other participants located in the United States must not be readily susceptible to manipulation. As discussed herein, DCM Core Principle 3, CEA section 5(d)(3), 7 U.S.C. 7(d)(3), provides that a DCM must only list derivative contracts that are not readily susceptible to manipulation. *See also* 17 CFR 38.200–201.

should extend to FBOTs.[309] Conversely, one commenter stated that it did not support the application of the Commission's guidance to contract submissions by registered FBOTs. ICE stated that under the Commission's framework for registered FBOTs, the exchange's home country regulator is generally tasked with the primary oversight of the FBOT's contract terms.[310]

The Commission appreciates all of the comments that it received on this subject. The Commission acknowledges efforts that have been made across jurisdictions—by governmental bodies, private sector and multilateral initiatives, and derivative exchanges themselves—to support transparent markets for high-integrity VCCs. The Commission recognizes that its counterparts in other jurisdictions have similar regulatory interests in the manner in which VCC derivatives, as a product class, evolve—as well as in ensuring, more generally, that the financial markets that they oversee are liquid, fair, and stable, and free from manipulation and other abusive trading practices. The Commission further recognizes that, given the global nature of financial markets—including voluntary carbon markets—international coordination is critical to support market integrity. The Commission looks forward to continuing to coordinate with its regulatory counterparts on efforts to promote the integrity and orderly functioning of voluntary carbon markets, including markets for VCC derivative contracts.

[309] CME at 2.

[310] ICE at 2. The Commission has adopted specific requirements for two types of derivative contracts offered by registered FBOTs for trading via direct access to members and other participants located in the United States: linked contracts and certain securities-related contracts. Commission regulation 48.8(c), 17 CFR 48.8(c), imposes notification and reporting requirements on registered FBOTs related to their offering for trading via direct access of contracts that settle to the price of a futures contract listed on a DCM ("linked contracts"). Commission regulation 48.7(c)(2), 17 CFR 48.7(c)(2), provides that registered FBOTs may only offer via direct access non-narrow-based security index futures and option contracts that have been certified by the Commission pursuant to Commission regulation 30.13, 17 CFR 30.13, in accordance with criteria set forth in Commission regulation 40.11, 17 CFR 40.11.

## III. Guidance Regarding the Listing of VCC Derivative Contracts

The Commission is issuing guidance that outlines factors for consideration by DCMs when addressing certain requirements under the CEA, and CFTC regulations, that are relevant to the listing for trading of VCC derivative contracts. The Commission recognizes that VCC derivatives are a comparatively new and evolving class of products, and believes that guidance that outlines factors for a DCM to consider in connection with the contract design and listing process may help to advance the standardization of such products in a manner that promotes transparency and liquidity.

This guidance does not establish new obligations for DCMs. Unlike a binding rule adopted by the Commission, which would state with precision when particular requirements do and do not apply to particular situations, this guidance is a statement of the Commission's views regarding factors that may be relevant in its evaluation of DCM compliance, and allows for flexibility in application to various situations, including consideration of all relevant facts and circumstances, whether or not explicitly discussed in the guidance. The Commission intends for this guidance to be an efficient and flexible vehicle to communicate the agency's current views, in order to give DCMs the benefit of the Commission's thinking as they address their Core Principle and regulatory compliance obligations.[311]

This guidance is not intended to modify or supersede existing Commission guidance that addresses the listing of derivative contracts by CFTC-regulated exchanges, including the Appendix C Guidance. Rather, taking into account certain unique attributes of VCC derivatives and voluntary carbon markets, this guidance outlines particular matters for consideration by a DCM

[311] For a number of the statutory Core Principles for DCMs, the Commission has adopted rules that establish the manner in which a DCM must comply with the Core Principle. Unless otherwise determined by the Commission by rule or regulation, a DCM has reasonable discretion in establishing the manner in which it complies with a Core Principle. CEA section 5(d)(1)(B), 7 U.S.C. 7(d)(1)(B).

when designing and listing a VCC derivative contract. Among other things, this guidance addresses how certain aspects of the Appendix C Guidance may be considered in the specific context of VCC derivative contracts.

This guidance focuses primarily on the listing by DCMs of physically-settled VCC derivative contracts. In part, this focus reflects the fact that all VCC derivative contracts that are currently listed for trading on DCMs are physically-settled contracts. To date, no DCM has listed for trading a cash-settled VCC derivative contract. In addition, the Commission believes that at this juncture in the evolution of VCC derivatives as a product class, it may be of particular benefit to outline considerations for a DCM that can help to ensure that, upon delivery, the quality and other attributes of VCCs underlying a derivative contract will be as expected by position holders. This will support accurate pricing, help reduce the susceptibility of the contract to manipulation, and foster confidence in the contract that can enhance liquidity.

While this guidance focuses primarily on physically-settled VCC derivative contracts, the Commission continues to believe that, with respect to cash-settled derivative contracts, an acceptable specification of the cash settlement price would include rules that fully describe the essential economic characteristics of the underlying commodity.[312] Accordingly, the Commission believes that discussions in this guidance of VCC commodity characteristics for consideration by a DCM in connection with the design and listing of a physically-settled VCC derivative contract, would also be relevant for cash-settled derivative contracts that settle to the price of a VCC, unless otherwise noted.[313]

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[312] Appendix C Guidance, paragraph (c)(1).

[313] As noted herein, and for the avoidance of doubt, this guidance is not intended to modify or supersede the Appendix C Guidance, which outlines considerations for both cash-settled and physically-settled derivative contracts—including considerations that are not touched on in this guidance. DCMs are reminded to consult and consider the Appendix C Guidance when developing rules, terms and conditions, and contract submissions to the Commission, for all derivative product types—including VCC derivative products.

Further, while this guidance focuses on the listing of VCC derivative contracts by DCMs, the Commission believes that the factors outlined for consideration also would be relevant for consideration by any SEF that may seek to permit trading in swap contracts that settle to the price of a VCC, or in physically-settled VCC swap contracts.[314]

In developing this guidance, the Commission has considered those public comments on the RFI on Climate-Related Financial Risk that addressed product innovation and voluntary carbon markets, as well as comments received in response to the Proposed Guidance. Taking into account these comments, the Commission believes that this guidance furthers the agency's mission and may help to advance the standardization of VCC derivative contracts in a manner that fosters transparency and liquidity.[315]

The Commission recognizes that VCC derivative products and voluntary carbon markets are evolving and that it may therefore be appropriate for the Commission to revisit this guidance or to issue additional guidance in the future,[316] as VCC derivative products and voluntary carbon markets continue to develop and mature.[317]

## A. A DCM Shall Only List Derivative Contracts That Are Not Readily Susceptible to Manipulation

[314] As noted above, the Appendix C Guidance is also relevant for SEFs, which, like DCMs, are obligated by statute only to permit trading in contracts that are not readily susceptible to manipulation. CEA section 5h(f)(3), 7 U.S.C 7b-3(f)(3). Like DCMs, SEFs also are subject to a statutory obligation to monitor trading in swaps to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance, compliance, and disciplinary practices and procedures. CEA section 5h(f)(4) 7, U.S.C 7b-3(f)(4). *See also* 17 CFR 37.400–408.

[315] *See also, e.g.,* International Emissions Trading Association comment in response to the Second Voluntary Carbon Markets Convening at 5–6 (stating that the CFTC is in a fortunate position to leverage the evolving work of existing initiatives to support the drive for quality and integrity in the voluntary carbon markets), and BP America, Inc. comment in response to the Second Voluntary Carbon Markets Convening at 3 (supporting guidance for CFTC-regulated exchanges).

[316] For example, the Commission may in the future revisit this guidance, or issue additional guidance, to further address the listing of cash-settled VCC derivative contracts, including index-based contracts, or to further address the listing of VCC derivative contracts by SEFs.

[317] For the avoidance of doubt, this guidance does not address the regulatory treatment of any underlying VCC or associated offset project or activity, including whether any such product, project or activity may qualify as a swap or be eligible for the forward contract exclusion under Commission's "swaps" definition. See Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping; Final Rule, 77 FR 48208 (August 13, 2012).

DCM Core Principle 3 provides that a DCM shall only list for trading derivative contracts that are not readily susceptible to manipulation.[318] With respect to DCM Core Principle 3, the Appendix C Guidance ("Demonstration of Compliance That a Contract is Not Readily Susceptible to Manipulation")[319] outlines certain relevant considerations for a DCM when developing contract terms and conditions, and providing supporting documentation and data in connection with the submission of a contract to the Commission.[320]

With respect to a physically-settled derivative contract, the Appendix C Guidance states that the terms and conditions of the contract "should describe or define all of the economically significant characteristics or attributes of the commodity underlying the contract."[321] Among other things, failure to specify the economically significant attributes of the underlying commodity may cause confusion among market participants, who may expect a commodity of different quality, or with other features, to underlie the contract. This may render the precise nature of the commodity that the contract is pricing ambiguous, and make the contract susceptible to manipulation or price distortion.

The Appendix C Guidance states that, for any particular contract, the specific attributes of the underlying commodity that should be described or defined in the contract's terms and conditions "depend upon the individual characteristics of the commodity."[322] Where the underlying commodity is a VCC, the Commission recognizes that standardization and accountability mechanisms for VCCs are currently still developing. The Commission believes

[318] CEA section 5(d)(3), 7 U.S.C. 7(d)(3).
[319] 17 CFR part 38, Appendix C.
[320] *See also* section I.A., *supra.* As noted above, the Appendix C Guidance is also relevant to SEFs, which are similarly obligated by statute only to permit trading in derivative contracts that are not readily susceptible to manipulation. CEA section 5h(f)(3); 7 U.S.C 7b-3(f)(3).
[321] Appendix C Guidance, paragraph (b)(2)(i)(A).
[322] *Id*.

that the fact that standardization and accountability mechanisms for VCCs are currently still developing is, itself, an "individual characteristic of the commodity" that should be taken into account by a DCM when designing a VCC derivative contract and addressing the underlying commodity in the contract's terms and conditions.

To that end, the Commission recognizes that, while standardization and accountability mechanisms for VCCs are currently still being developed, there are certain characteristics that have been identified broadly — across both mandatory and voluntary carbon markets – as helping to inform the integrity of carbon credits. The Commission believes that a DCM should take these characteristics — referred to in this guidance as "VCC commodity characteristics" and discussed more fully below — into consideration when designing a VCC derivative contract, and addressing in the contract's terms and conditions the underlying VCC.

As a general matter, the Commission believes that a DCM should consider the VCC commodity characteristics when selecting one or more crediting programs from which eligible VCCs, meeting the derivative contract's specifications, may be delivered at the contract's settlement. The Commission believes that consideration of these characteristics will assist the DCM in understanding key attributes of the commodity — the VCC — that underlies the derivative contract.

More specifically, the Commission believes that, at a minimum, a DCM should consider the VCC commodity characteristics when addressing the following criteria in the design of a VCC derivative contract:

- Quality standards,
- Delivery points and facilities, and
- Inspection provisions.

These are among the criteria identified in the Appendix C Guidance as criteria for a DCM to consider addressing in the terms and conditions of a physically-settled derivative contract. As discussed above, addressing these three criteria clearly in the contract's terms and conditions helps to ensure that trading in the contract is based on accurate information about the underlying commodity. This, in turn, helps to promote accurate pricing and helps to reduce the susceptibility of the contract to manipulation.

The Commission believes that, as a general matter, industry-recognized standards for high-integrity VCCs can serve as tools for DCMs, in connection with their consideration, with respect to a particular crediting program, of the VCC commodity characteristics outlined in this guidance. Where a crediting program for VCCs that are eligible for delivery under a derivative contract has been approved or certified by an industry-recognized standards program for high-integrity VCCs, the DCM should consider clearly identifying the standards program in the contract terms and conditions, along with the crediting program itself.

*1. Quality Standards*

The Commission believes that a DCM should consider the following VCC commodity characteristics when addressing quality standards in connection with the design of a VCC derivative contract: (i) transparency, (ii) additionality, (iii) permanence and risk of reversal, and (iv) robust quantification.[323]

The Commission also understands that the measures that a crediting program has in place with respect to social and environmental safeguards, and net zero alignment, may have a bearing on how market participants evaluate the quality of the VCCs that are issued by the crediting

[323] As is the case for physically-settled VCC derivative contracts, the Commission believes that for cash-settled derivative contracts that settle to the price of a VCC, it is important to clearly specify the VCC quality standards in the contract's terms and conditions to help ensure that the pricing of the contract reflects the quality of the VCC underlying the contract.

program. In light of this, a DCM may determine that it is appropriate to consider, when addressing quality standards in connection with derivative contract design, whether the crediting program for underlying VCCs has implemented measures to help ensure that credited mitigation projects or activities: (i) meet or exceed best practices on social and environmental safeguards, and (ii) 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.

i. Transparency – Publicly Available Data to Promote Transparency

As a threshold matter, the Commission believes that a DCM should provide, in the terms and conditions of a physically-settled VCC derivative contract, information about the VCCs that are eligible for delivery under the contract. The contract terms and conditions should clearly identify what is deliverable under the contract, including by providing information that readily specifies the crediting program or programs from which underlying VCCs may be issued. To the extent that underlying VCCs are associated with a specific category of mitigation project or activity—such as nature-based projects or activities—this also should be readily evident from the contract's terms and conditions.

Specifying which crediting programs and, as applicable, which types of projects or activities are eligible for purposes of delivery will help to provide clarity to market participants regarding the VCCs that can be expected to deliver under the contract, and will thereby help to ensure that the pricing of the contract accurately reflects the intended quality of the underlying VCCs. Where there is ambiguity or confusion about the quality of the VCCs that may be delivered under the contract, this may render the contract susceptible to manipulation or price distortion.

The Commission believes that, when designing a VCC derivative contract, DCMs should also consider whether the crediting program for underlying VCCs is making detailed information

about its policies and procedures, and the projects or activities that it credits—such as relevant project documentation—publicly available in a searchable and comparable manner. Making such information publicly available would assist market participants in understanding how GHG emission reductions or removals are calculated by the crediting program—including how additionality, which is discussed further below, is assessed—and how GHG emission reductions or removals are quantified. This would assist market participants in making informed evaluations and comparisons of the quality of the VCCs that underlie derivative contracts, which would help to support accurate pricing.

ii. Additionality

The Commission believes that, in connection with the design of a VCC derivative contract, a DCM should consider whether the crediting program for underlying VCCs has procedures in place to assess or test for additionality. Additionality is recognized by many as an important element of a high-quality VCC. If holders of positions in a VCC derivative contract understand and intend for VCCs that are eligible for delivery under the contract to be additional, but in fact they may not be, then the pricing of the derivative contract may not accurately reflect the quality of the VCCs that may be delivered under the contract. The cheapest-to-deliver VCC,[324] that otherwise meets the contract's specifications, may not have additionality. Accordingly, the Commission believes the DCM should consider whether the procedures that a crediting program has in place to assess or test for additionality provide reasonable assurance that GHG emission reductions or removals will be credited only if they are additional.

While additionality is recognized by many as an important element of a high-quality VCC, the Commission understands that there currently is variation across the voluntary carbon markets

[324] The term "cheapest-to-deliver" refers to the least expensive commodity that can be delivered under the derivative contract that otherwise meets the contract's specifications.

in how, precisely, additionality is characterized. For example, an assessment of additionality may focus on whether VCCs are credited only for projects or activities that result in GHG emission reductions or removals that would not have been developed and implemented in the absence of the added monetary incentive created by the revenue from the sale of carbon credits. Alternatively or additionally, an assessment of additionality may focus on whether the project or activity is already required by law, regulation, or any other legally binding mandate applicable in the project's or activity's jurisdiction, or on other approaches such as performance standard approaches.[325] The Commission understands that the factors that inform an assessment of additionality also may vary depending on the type of mitigation project or activity in issue, and that, as the voluntary carbon markets continue to develop, industry consensus on how to characterize and assess additionality may evolve.

In recognition of the foregoing, the Commission is not providing in this guidance a definition of additionality. The Commission believes that, as a general matter, industry-recognized standards for high-integrity VCCs can serve as tools for a DCM, in connection with its consideration of a particular crediting program's characterization of additionality, as well as the DCM's consideration of whether the crediting program's procedures to assess or test for additionality provide reasonable assurance that GHG emission reductions or removals will be credited only if they are additional, as so characterized.

iii. Permanence and Accounting for the Risk of Reversal

The Commission believes that, in connection with the design of a VCC derivative contract, a DCM should consider whether the crediting program for underlying VCCs has measures in place to address and account for the risk of reversal (*i.e.*, the risk that VCCs issued for a project or

[325] *See* Joint Policy Statement on Voluntary Carbon Markets, U.S. Department of the Treasury, May 2024, *available at*: https://home.treasury.gov/system/files/136/VCM-Joint-Policy-Statement-and-Principles.pdf.

activity may have to be recalled or cancelled due to carbon removed by the project or activity being released back into the atmosphere, or due to a reevaluation of the amount of carbon reduced or removed from the atmosphere by the project or activity).

The risk of reversal may impact the risk management needs of VCC derivative market participants. Market participants that are utilizing physically-settled VCC derivative contracts to help meet their carbon mitigation goals have an interest in ensuring that, upon physical settlement, the underlying VCCs will actually reduce or remove the amount of emissions that they were intended to reduce or remove. Accordingly, the risk of reversal—and the manner in which it is accounted for by a crediting program—is tied to the quality of the underlying VCCs and, by extension, to the pricing of the derivative contract. The crediting program's measures to address and account for the risk of reversal may be particularly important where underlying VCCs are issued for project or activity types with a higher reversal risk.

Most crediting programs have established VCC "buffer reserves" to help address the risk of credited GHG emission reductions or removals being reversed. Under this approach, VCCs are set aside into a common buffer reserve (or "pool"). Reserved VCCs can be drawn upon and cancelled, proportional to the magnitude of the reversal. A DCM should consider whether a crediting program has a buffer reserve in place to help address the risk of reversal. Relevant considerations with respect to a crediting program's buffer reserve could include whether the crediting program regularly reviews the methodology by which the size of its buffer pool is calculated in order to address evolving developments that may heighten reversal risk, and whether there is a mechanism in place to audit the continuing sufficiency of the buffer reserve. The Commission recognizes, however, that a crediting program may, now or in the future, have measures other than, or in addition to, a buffer reserve to address the risk of reversal. This guidance

contemplates that a DCM should consider whether a crediting program has a buffer reserve and/or other measures in place to address such risk.

iv. Robust Quantification – GHG Emission Reductions or Removals Should be Conservatively Quantified

Given the current absence of a standardized methodology or protocol to quantify GHG emission reduction or removal levels[326]—not only across crediting programs, but even by a particular crediting program, with respect to different types of projects or activities—the Commission believes that, in connection with the design of a VCC derivative contract, a DCM should consider whether there is reasonable assurance that the quantification methodology(ies) or protocol(s) used by the crediting program for calculating emission reductions or removals for underlying VCCs is robust, conservative, and transparent. A robust, conservative, and transparent quantification methodology or protocol helps to ensure that the number of VCCs that are issued for a project or activity accurately reflects the level of GHG emission reductions or removals associated with the project or activity.

Moreover, 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.[327] To establish exchange-set position limits, a DCM should derive a quantitative estimate of the deliverable supplies of the underlying commodity for the delivery period specified in the

[326] Related specifically to the agriculture and forest sector, the Office of Management and Budget, the White House Office of Science and Technology Policy, and White House Office of Domestic Climate Policy announced the release of the National Strategy to Advance an Integrated U.S. Greenhouse Gas Measurement, Monitoring, and Information System, a Strategy developed by the Greenhouse Gas Monitoring and Measurement Interagency Working Group ("GHG IWG") to enhance coordination and integration of greenhouse gas measurement, monitoring, and information efforts across the Federal government. The GHG IWG issued this Federal Strategy on November 29, 2023, *available at*: https://www.whitehouse.gov/ostp/news-updates/2023/11/29/national-strategy-to-advance-an-integrated-u-s-greenhouse-gas-measurement-monitoring-and-information-system/.
[327] CEA section 5(d)(5), 7 U.S.C. 7(d)(5). *See* also 17 CFR 38.300–301.

contract.[328] A DCM's estimate of a VCC's deliverable supplies is likely to be informed by understanding how the relevant crediting program determines the amount of VCCs that are issued for credited projects or activities. Where the quantification methodology or protocol used to calculate the amount of VCCs is robust, conservative, and transparent, the DCM should have a more reliable basis from which to form its deliverable supply estimate. That deliverable supply estimate, in turn, can be used as the basis for effectively setting the DCM's exchange-set speculative position limits to help reduce the possibility of corners or squeezes that may distort or manipulate the price of the derivative contract.[329]

*2. Delivery Points and Facilities*

The Appendix C Guidance states that the delivery procedures for a physically-settled derivative contract should, among other things, seek to minimize or eliminate any impediments to making or taking delivery by both deliverers and takers of delivery, to help ensure convergence of cash and derivative contract prices at the expiration of the derivative contract.[330] When addressing delivery procedures in connection with the design of a physically-settled VCC derivative contract, the Commission believes that a DCM should consider the governance framework and tracking

[328] Guidance on estimating deliverable supply can be found in the Appendix C Guidance.
[329] For a cash-settled VCC derivative contract, a DCM may similarly consider the deliverable supply of the underlying VCCs when setting exchange-set speculative position limits or historical open interest when establishing non-spot month position accountability levels. *See* 17 CFR 150.5 and Appendix F to Part 150, Title 17.
[330] Appendix C Guidance, paragraph (b)(2)(i)(B).

mechanisms of the crediting program for underlying VCCs, as well as the crediting program's measures to prevent double counting.[331]

i. Governance

The Commission believes that a DCM should consider whether the crediting program for underlying VCCs has in place a governance framework that supports the crediting program's independence, transparency and accountability. As a threshold matter, a governance framework that supports independence, transparency and accountability helps to ensure the overall quality of the VCCs issued by a crediting program. Furthermore, it is the Commission's understanding that a crediting program's registry may be used as a delivery point to facilitate physical settlement for a VCC derivative contract. A registry is a repository for tracking mitigation projects or activities and associated VCCs. An effective crediting program governance framework can help to ensure that the crediting program operates or makes use of a registry that has appropriate measures in place to facilitate the physical settlement of a VCC derivative contract.

Relevant factors when considering a crediting program's governance framework could include, among other things, the program's decision-making procedures, including who is responsible for administration of the program and conflict of interest measures such as how the independence of key functions is ensured; reporting and disclosure procedures; public and stakeholder engagement processes, including whether there are appeals mechanisms; and risk management policies, such as financial resources/reserves, cyber-security, and anti-money laundering policies. A DCM should consider whether detailed information regarding a crediting

[331] While cash-settled VCC derivative contracts do not result in the delivery of a VCC, the Commission believes that considering the VCC commodity characteristics of governance, tracking and no double counting when developing the terms and conditions of a cash-settled VCC derivative contract will help to ensure that the contract terms and conditions address essential economic characteristics of the underlying VCC in a manner that promotes accurate pricing and helps to reduce the susceptibility of the contract to manipulation.

program's governance framework, such as information regarding the above-described procedures and policies, is made publicly available.

ii. Tracking

The Commission believes that a DCM should consider whether the crediting program for the underlying VCCs has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer, and retirement of VCCs. The DCM should consider whether the crediting program operates or makes use of a registry, and whether there is reasonable assurance that the registry has effective measures in place to track the issuance, transfer, and retirement of VCCs; to identify who owns or retires a VCC; and to make sure that each VCC is uniquely and securely identified and associated with a single emission reduction or removal of one metric ton of carbon dioxide equivalent.

iii. No Double-Counting

The Commission believes that a DCM should consider whether the crediting program for the underlying VCCs has measures in place that provide reasonable assurance that credited emission reductions or removals are not double counted. That is, that the VCCs representing the credited emission reductions or removals are issued to only one registry and cannot be used after retirement or cancelation. As discussed above in connection with the VCC commodity characteristics of additionality and permanence, market participants that are utilizing physically-settled VCC derivative contracts to help meet carbon mitigation goals have an interest in ensuring that, upon physical settlement, the underlying VCCs will actually reduce or remove the emissions that they were intended to reduce or remove. In order for VCCs to effectively further carbon mitigation goals, it is important for each credited VCC to be uniquely associated with a single emission reduction or removal of one metric ton of carbon dioxide equivalent; a crediting program

should have measures in place that provide reasonable assurance of this. If there is not a reasonable assurance that the VCCs underlying a derivative contract are each unique, then, among other things, this could distort or obscure the accuracy of the derivative contract's pricing.

In the context of evolving national and international carbon markets and emissions trading frameworks, effective measures to ensure that emission reductions or removals are not double counted may include, among other things, procedures for conducting cross-checks across multiple carbon credit registries.

*3. Inspection Provisions – Third-Party Validation and Verification*

Consistent with the Appendix C Guidance, the Commission believes that any inspection or certification procedures for verifying compliance with quality requirements or any other related delivery requirements for physically-settled VCC derivative contracts should be specified in the contract's terms and conditions.[332] The Commission believes that these inspection or certification procedures should be consistent with the latest procedures in the voluntary carbon markets.

Additionally, the Commission believes that, when designing a VCC derivative contract, a DCM should consider whether there is reasonable assurance that the crediting program for underlying VCCs has up-to-date, robust and transparent procedures for validating and verifying that credited mitigation projects or activities meet the crediting program's rules and standards.

By providing independent confirmation that mitigation projects or activities are achieving the claimed GHG emission reductions or removals, third-party validation and verification can help to ensure that the underlying VCC accurately reflects the quality intended by the DCM and

[332] Appendix C Guidance, paragraph (b)(2)(i)(G) ("To the extent that formal inspection procedures are not used in the cash market, an acceptable specification would contain provisions that assure accuracy in assessing the commodity, that are available at a low cost, that do not pose an obstacle to delivery on the contract and that are performed by reputable, disinterested third party or by qualified designated contract market employees.").

supports voluntary carbon market integrity.[333] Accordingly, a DCM should consider whether there is reasonable assurance that the crediting program's procedures reflect best practices with respect to third party validation and verification. Such best practices may include: crediting program reviews of the performance of its validators; procedures for remediating performance issues; not using the same third-party validator to verify every project type or project category; and using a separate third-party to conduct ongoing validation and verification from the third-party that completed the initial validation and verification process.

### B. A DCM Shall Monitor a Derivative Contract's Terms and Conditions as They Relate to the Underlying Commodity Market

DCM Core Principle 4 requires a DCM to prevent manipulation, price distortion, and disruptions of the physical delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures.[334] For physically-settled derivative contracts, implementing Commission regulations under DCM Core Principle 4 require a DCM, among other things, to monitor the 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 to monitor the supply of the underlying commodity in light of the contract's delivery requirements.[335] Such monitoring will help a DCM identify circumstances that may cause the contract to become susceptible to price manipulation or distortions, and to assess whether the terms and conditions of the contract continue to be appropriate—or whether a change

[333] *Id*.
[334] CEA Section 5(d)(4), 7 U.S.C. 7(d)(4). *See also* 17 CFR 38.250–258.
[335] 17 CFR 38.252.

in circumstances should be addressed, for example, through changes to the contract's terms and conditions.[336]

Given that VCC derivatives are a comparatively new and evolving class of products, and given that standardization and accountability mechanisms for VCCs are still being developed, the Commission believes that the monitoring by a DCM of the terms and conditions of a physically-settled VCC derivative contract should include ongoing monitoring of the appropriateness of the contract's terms and conditions that includes, among other things, monitoring to ensure that the delivery instrument—that is, the underlying VCC—conforms or, where appropriate, updates to reflect the latest certification standard(s) applicable for that VCC. For example, where there are changes to either the crediting program or the types of projects or activities associated with the underlying VCC, due for example to new standards or certifications, then the DCM should amend the contract's terms and conditions to reflect this update. In such circumstances, the DCM should also ensure that it is monitoring the adequacy of the estimated deliverable supply of the underlying VCC to satisfy the contract's delivery requirements.

Finally, the Commission reminds market participants that Commission regulations implementing DCM Core Principle 4 require DCMs to have rules requiring their market participants to keep records of their trading that include records of their activity in the underlying commodity and related derivatives markets.[337] A DCM's rules also must require market participants to make such records available upon request to the DCM.[338] As such, DCM market participants are required, upon request, to make records of their trading in underlying VCC cash markets available to the DCM, in order to assist the DCM in fulfilling its market monitoring

[336] The Commission has, similarly, recognized that a DCM has a responsibility to monitor the continued appropriateness of the terms and conditions of a cash-settled derivative contract. *See, e.g.,* 17 CFR 38.253(a)(2).
[337] 17 CFR 38.254(a).
[338] *Id.*

obligations. These records also are subject to Commission inspection under applicable Commission recordkeeping rules.

### C. A DCM Must Satisfy the Product Submission Requirements Under Part 40 of the CFTC's Regulations and CEA section 5c(c)

There are generally two processes by which a DCM may list a new derivative contract for trading.[339] The DCM may elect to list the contract for trading by providing the Commission with a written certification—a "self-certification"—that the contract complies with the CEA, including the CFTC's regulations thereunder.[340] Alternatively, the DCM may elect voluntarily to seek prior Commission approval of the contract.[341] In each case, the DCM must submit prescribed information to the Commission, including but not limited to the contract's terms and conditions.[342] Amendments to an existing derivative contract also must be submitted to the Commission, along with prescribed information, either by way of self-certification or for prior Commission approval.[343]

This guidance highlights three submission requirements in connection with the listing of VCC derivative contracts. These requirements apply regardless of whether a DCM elects to list the contract by way of self-certification or with prior Commission approval. These requirements generally apply with respect to the listing by a DCM of a derivative contract, regardless of the underlying asset class. However, the Commission wishes to remind DCMs of the importance of fully complying with these requirements in a submission for a VCC derivative contract.

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[339] SEFs also may generally list new contracts by way of either of these two processes. *See*, generally, CEA section 5c(c), 7 U.S.C. 7a-2(c).
[340] CEA section 5c(c)(1), 7 U.S.C. 7a-2(c)(1). *See also* 17 CFR 40.2. The Commission must receive the DCM's self-certified submission at least one business day before the contract's listing. 17 CFR 40.2(a)(2).
[341] CEA sections 5c(c)(4)–(5), 7 U.S.C. 7a-2(c)(4)–(5). *See also* 17 CFR 40.3.
[342] 17 CFR 40.2–40.3.
[343] 17 CFR 40.5–40.6.

The relevant requirements provide, first, that a contract submission to the Commission must include an "explanation and analysis" of the contract and the contract's "compliance with applicable provisions of the [CEA], including core principles and the Commission's regulations thereunder."[344] Second, the relevant requirements provide that the explanation and analysis of the contract "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[.]"[345] Third, the relevant requirements provide that, if requested by Commission staff, a DCM must provide any "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.[346]

Since VCC derivatives are a comparatively new and evolving class of products, and since standardization and accountability mechanisms for VCCs are still being developed, the Commission anticipates that in connection with the submission for a VCC derivative contract, a DCM may provide qualitative explanations and analysis to assist in addressing the three above-described requirements. The Commission expects that the information—including supporting documentation, evidence and data—provided by the DCM to describe how the contract complies with the CEA and applicable Commission regulations, will be complete and thorough. This is especially important given unique and developing aspects of VCCs and VCC derivative markets. Including complete and thorough information will assist the Commission and its staff in their

[344] 17 CFR 40.2(a)(3)(v) (for self-certification) and 40.3(a)(4) (for Commission approval). The "explanation and analysis" requirement for self-certified contracts provides for such explanation and analysis to be "concise." The "explanation and analysis" requirement for contracts submitted for prior Commission approval does not include the "concise" qualifier. The Commission requires DCMs to provide a more detailed explanation and analysis of contracts that are submitted for affirmative Commission approval.
[345] 17 CFR 40.2(a)(3)(v) (for self-certification) and 40.3(a)(4) (for Commission approval).
[346] 17 CFR 40.2(b) (for self-certification) and 40.3(a)(10) (for Commission approval).

understanding of the contract and their analysis of the contact's compliance with applicable statutory and regulatory requirements, including whether or not the contract is readily susceptible to manipulation.

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Chris Kirkpatrick,

*Secretary of the Commission*.