

**COMMODITY FUTURES TRADING COMMISSION**

**RIN 3038-AF40**

**Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative  
Contracts; Request for Comment.**

**AGENCY:** Commodity Futures Trading Commission

**ACTION:** Proposed guidance; request for comment.

**SUMMARY:** The Commodity Futures Trading Commission (the “Commission” or “CFTC”) is issuing for public comment this proposed guidance regarding the listing for trading of voluntary carbon credit (“VCC”) derivative contracts. Specifically, the Commission is proposing to issue guidance to outline factors that designated contract markets (“DCMs”) should consider when addressing certain provisions of the Commodity Exchange Act (“CEA”), and CFTC regulations thereunder, 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 product design and listing may help to advance the standardization of such products in a manner that promotes transparency and liquidity. The Commission requests comment on this proposed guidance and further invites comment on specific questions related to the listing for trading of VCC derivative contracts.

**DATES:** Comments must be received on or before February 16, 2024.

**ADDRESSES:** You may submit comments, identified by “Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts” and RIN 3038-AF40, by any of the following methods:

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- *CFTC Comments Portal:* <https://comments.cftc.gov>. Select the “Submit Comments”

link for this release and follow the instructions on the Public Comment Form.

- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to <https://comments.cftc.gov>. You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (“FOIA”), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission’s regulations.<sup>1</sup>

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from <https://www.comments.cftc.gov> that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the guidance will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

**FOR FURTHER INFORMATION CONTACT:** Lillian A. Cardona, Assistant Chief Counsel, (202) 418-5012, [lcardona@cftc.gov](mailto:lcardona@cftc.gov); Steven Benton, Industry Economist, (202) 418-5617,

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<sup>1</sup> 17 CFR § 145.9.

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**SUPPLEMENTARY INFORMATION:**

**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.<sup>2</sup> 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.<sup>3</sup>

DCMs are CFTC-regulated exchanges that provide participants in the derivatives markets with the ability to execute or trade derivative contracts with one another.<sup>4</sup> In order to obtain and maintain designation with the CFTC, DCMs must comply with statutory “Core Principles” that are set forth in the CEA,<sup>5</sup> as well as applicable CFTC rules and regulations.<sup>6</sup> The statutory Core

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<sup>2</sup> CFTC Mission Statement, available at: <https://www.cftc.gov/About/AboutTheCommission>.

<sup>3</sup> See CEA section 3(b), 7 U.S.C. 5(b).

<sup>4</sup> 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)”).

<sup>5</sup> See, generally, CEA Section 5(d), 7 U.S.C. 7(d). There are 23 statutory Core Principles for DCMs.

<sup>6</sup> CEA section 5(d)(1)(A), 7 U.S.C. 7(d)(1)(A).

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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;<sup>7</sup> provide a competitive, open and efficient market for trading;<sup>8</sup> and monitor trading activity.<sup>9</sup> 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.<sup>10</sup> 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.<sup>11</sup> 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.<sup>12</sup>

Additionally, each DCM has a specific statutory obligation, under DCM Core Principle 3, to only list for trading contracts that are not readily susceptible to manipulation.<sup>13</sup> As discussed in

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<sup>7</sup> 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 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.

<sup>8</sup> 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.

<sup>9</sup> *See, e.g.*, DCM Core Principles 4, 5, and 12, discussed *infra*.

<sup>10</sup> CEA section 5(d)(4) 7 U.S.C. 7(d)(4). *See also* 17 CFR §§ 38.250-258.

<sup>11</sup> CEA section 5(d)(5), 7 U.S.C. 7(d)(5). *See also* 17 CFR §§ 38.300-301.

<sup>12</sup> CEA section 5(d)(12), 7 U.S.C. 7(d)(12). *See also* 17 CFR §§ 38.650-651.

<sup>13</sup> CEA section 5(d)(3), 7 U.S.C. 7(d)(3). *See also* 17 CFR §§ 38.200-201.

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greater detail below, a DCM may generally 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,<sup>14</sup> or by seeking Commission approval of the contract.<sup>15</sup> In either case, the DCM must submit the contract’s terms and conditions, and other prescribed information relating to the contract, to the Commission prior to listing.<sup>16</sup>

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.<sup>17</sup> These implementing rules are set forth in Part 38 of the Commission’s regulations.<sup>18</sup> The Commission has also adopted, in Appendix B to Part 38,<sup>19</sup> guidance and acceptable practices for DCMs to take into consideration with respect to certain of the Core Principles.<sup>20</sup>

With respect to the DCM Core Principle 3 requirement that a DCM only list for trading contracts that are not readily susceptible to manipulation, the Commission has adopted guidance that is set forth in Appendix C to Part 38 of the Commission’s regulations (the “Appendix C Guidance”).<sup>21</sup> The Appendix C Guidance outlines certain relevant considerations for a DCM when

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<sup>14</sup> CEA section 5c(c)(1), 7 U.S.C. 7a-2(c)(1). *See also* 17 CFR § 40.2.

<sup>15</sup> CEA sections 5c(c)(4)-(5), 7 U.S.C. 7a-2(c)(4)-(5). *See also* 17 CFR § 40.3.

<sup>16</sup> *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.

<sup>17</sup> 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).

<sup>18</sup> 17 CFR part 38.

<sup>19</sup> 17 CFR part 38, Appendix B.

<sup>20</sup> 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.

<sup>21</sup> 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.

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developing derivative contract terms and conditions, and providing supporting documentation and data in connection with the submission of the derivative contract to the Commission.<sup>22</sup> The Commission takes these considerations into account when determining whether, with respect to the contract, the DCM is satisfying its Core Principle obligation only to list 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.<sup>23</sup> 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.<sup>24</sup> 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.<sup>25</sup> The Appendix C Guidance outlines certain criteria that should be addressed in the contract's terms and conditions, including contract size, the period for making and taking delivery under the contract, delivery points, quality

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<sup>22</sup> 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, with one another, derivative contracts that are swaps. Like DCMs, SEFs are obligated by statute only to permit trading in 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.

<sup>23</sup> 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.

<sup>24</sup> Appendix C Guidance, paragraph (b)(1).

<sup>25</sup> *Id.*

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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.<sup>26</sup>

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 contract upon the expiration of trading, inform the pricing of the contract. Addressing these criteria clearly in the contract's terms and conditions, in a manner that reflects the individual characteristics of the underlying commodity, 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. Further, 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.

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.<sup>27</sup> 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.<sup>28</sup> 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

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<sup>26</sup> Appendix C Guidance, paragraph (b)(2).

<sup>27</sup> Appendix C Guidance, paragraph (c)(1).

<sup>28</sup> Appendix C Guidance, paragraph (c)(2).

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reliability of that price as an indicator of cash market values.<sup>29</sup> Appropriate consideration also should be given to the commercial acceptability, public availability, and timeliness of the price series that is used to calculate the cash settlement price.<sup>30</sup>

### B. Voluntary Carbon Markets

#### 1. Overview of Voluntary Carbon Markets

As discussed further below, this proposed guidance addresses an emerging class of climate-related derivative contracts listed for trading by DCMs, where the underlying commodity is a VCC.<sup>31</sup>

In addition to direct greenhouse gas (“GHG”) emissions reduction initiatives, market-based mechanisms, such as carbon markets,<sup>32</sup> 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<sup>33</sup> that represent GHG emission reductions or removals from the atmosphere. Carbon markets are intended to harness market forces to incentivize carbon

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> This proposed guidance uses the term “voluntary carbon credits” rather than “verified carbon credits,” as the proposed 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](https://www.isda.org/2022-ISDA-Verified-Carbon-Credit-Transactions-Definitions-FAQs-061323.pdf).

<sup>32</sup> While the term “carbon” is generally intended to also include other greenhouse gases, such as methane, nitrous oxide, sulfur hexafluoride, hydro fluorocarbons and perfluorocarbons, most emissions trading involves emissions trading of carbon dioxide.

<sup>33</sup> 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 Fed Reg 48208 (August 13, 2012).



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mitigation activities. Carbon markets generally fall into two categories: (i) mandatory (or compliance) markets, and (ii) voluntary carbon markets.

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.<sup>34</sup> 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”).<sup>35</sup> 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.<sup>36</sup>

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

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<sup>34</sup> 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”).

<sup>35</sup> 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>.

<sup>36</sup> 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>.

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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.<sup>37</sup>

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;<sup>38</sup> 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<sup>39</sup> 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.

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<sup>37</sup> The Board of the International Organization of Securities Commissions (“IOSCO”) published 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. Voluntary Carbon Markets, Discussion Paper, CR/06/22, November 2022, *available at*: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD718.pdf>.

<sup>38</sup> Currently, the four largest crediting programs in the voluntary carbon markets are the American Carbon Registry, the Climate Action Reserve, the Gold Standard and the Verified Carbon Standard.

<sup>39</sup> A baseline scenario is the predicted or assumed outcome in the absence of the incentives created by carbon credits, holding all other factors constant.

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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 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 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.<sup>40</sup>

*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, particularly, whether they accurately reflect 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

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<sup>40</sup> 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, once issued.

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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, 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 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.<sup>41</sup>

Challenges with respect to accurately ascertaining VCC quality, and associated pricing challenges,<sup>42</sup> 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 those 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

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<sup>41</sup> 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 emissions 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>.

<sup>42</sup> 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.

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associated with the mitigation projects or activities for which the VCCs have been issued.<sup>43</sup> This can raise questions not only about the business’s or individual’s progress towards their goals, but also about whether any claims related to those goals are misleading.<sup>44</sup> Market participants that are purchasing VCCs to help meet their 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, as described above – and by the fact that, recently, supplies of VCCs are generally considered to be high relative to demand.<sup>45</sup>

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.<sup>46</sup> 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

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

<sup>44</sup> Federal Trade Commission, *Guides for the Use of Environmental Marketing Claims*, Regulatory Review Notice and Request for Public Comment, 87 Fed Reg 77,766 (December 20, 2022) (Federal Trade Commission request for public comment on updating its Green Guides to include claims made regarding carbon offsets).

<sup>45</sup> Transcript of Commission’s Second Voluntary Carbon Markets Convening (July 19, 2023), Kyle Harrison, stating, “Because you have an oversupply, you have a surplus of cheaper credits and companies can go ahead and use those in many cases as a band-aid solution, as opposed to de-carbonizing and reducing their gross emissions,” available at: [https://www.cftc.gov/sites/default/files/2023/11/1700165549/SVCMC\\_transcript071923.pdf](https://www.cftc.gov/sites/default/files/2023/11/1700165549/SVCMC_transcript071923.pdf).

<sup>46</sup> 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>.

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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.

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.<sup>47</sup> Such standards could serve as a foundation or reference for criteria that purchasers of VCCs could voluntarily adhere to, in order to demonstrate their commitment to using high integrity VCCs to support their 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 in 2007.<sup>48</sup> There are

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<sup>47</sup> See, e.g., the World Wildlife Fund (WWF-US), 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/vcimi-claims-code-of-practice/>).

<sup>48</sup> 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

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currently over 150 derivative contracts on mandatory emissions program instruments listed on DCMs.<sup>49</sup> As of November 2023, eighteen futures contracts on voluntary carbon market products have been submitted by DCMs to the Commission for listing.<sup>50</sup> Three of those contracts currently have open interest.<sup>51</sup>

Derivative contracts on VCCs base their prices on the spot price of VCCs. For example, NYMEX’s CBL Global Environmental Offset futures contracts, and Nodal Exchange’s Verified Emission Reduction futures and options contracts, are physically-settled contracts. If the holder of a position in the contract still has an open position at the expiration of trading in the contract,

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(“NOX”) 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 mandatory emissions-related futures and options contracts listed for trading on various DCMs. The vast majority of those contracts are no longer listed for trading.

<sup>49</sup> 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.

<sup>50</sup> For example, NYMEX lists the following physically-settled futures contracts based on voluntary carbon market products: 1) CBL Global Emissions Offset (GEO) futures contract; 2) CBL Nature-Based Global Emissions Offset (N-GEO) futures contract; 3) CBL Core Global Emissions Offset (C-GEO) futures contract; 4) CBL Nature-Based Global Emissions Offset Trailing futures contract; and 5) CBL Core Global Emissions Offset Trailing futures contract. Nodal Exchange lists the following physically-settled futures and options contracts based 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 contract; 8) Verified Emission Reduction - Nature-Based Vintage 2024 futures contract; 9) Verified Emission Reduction - Nature-Based Vintage 2025 futures contract; 10) Verified Emission Reduction - Nature-Based futures and options contracts; 11) Carbon Removal futures contract; 12) Verified Emission Reduction - CORSIA-Eligible futures and options contracts; and 13) Global Emission Reduction futures contract.

<sup>51</sup> The NYMEX CBL Global Emissions Offset (GEO) futures contract; the NYMEX CBL Nature-Based Global Emissions Offset (N-GEO) futures contract; and the NYMEX CBL Core Global Emission Offset (C-GEO) futures contract are currently the only listed futures contracts with open interest and trading volume. Information is available at: <https://www.cmegroup.com/markets/energy/emissions/cbl-global-emissions-offset.volume.html>.

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then the position holder must, in accordance with the rules for delivery set forth in the contract, make or take delivery (as applicable) of 1,000 VCCs that meet the contract’s rules for delivery eligibility.<sup>52</sup>

*2. Initiatives Relating to Voluntary Carbon Markets*

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.<sup>53</sup> A further goal of this convening was to gather information from a wide variety of market 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.

Commission Request for Information

In June 2022, the Commission issued for public comment a Request for Information (“RFI”) in order<sup>54</sup> to better inform the Commission on how, consistent with its statutory authority,

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<sup>52</sup> The CME Group CBL contracts permit VCCs to be delivered from the Verified Carbon Standard (“VCS”) Verra Registry, the American Carbon Registry (“ACR”), and the Climate Action Reserve (“CAR”). The Nodal contracts permit VCCs to be delivered from VCS’s Verra Registry and from the Gold Standard Impact Registry, as well as from the American Carbon Registry for certain contracts.

<sup>53</sup> For the official announcement of the convening and related materials, *See* <https://www.cftc.gov/PressRoom/Events/opaeventcftccarbonmarketconvene060222>.

<sup>54</sup> Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856 (June 8, 2022).



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to address climate-related financial risk as pertinent to the derivatives markets and underlying commodities markets.<sup>55</sup>

The responsive comments that the Commission received included feedback on specific questions relating to product innovation and voluntary carbon markets.<sup>56</sup> 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.<sup>57</sup> 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.<sup>58</sup> While there were comments expressing different views on the reach of the Commission’s jurisdiction to regulate voluntary carbon markets,<sup>59</sup> many commenters supported the Commission utilizing its spot market anti-fraud and anti-manipulation authority in the voluntary carbon market space.<sup>60</sup>

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<sup>55</sup> In addition to soliciting feedback on all aspects of climate-related financial risk as it may pertain to the derivatives market, the RFI also specifically requested feedback on ten categories of information: 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 stated that the Commission may use responsive information 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.

<sup>56</sup> Twenty-five commenters on the RFI responded to questions regarding product innovation and 44 commenters on the RFI responded to questions regarding the voluntary carbon markets.

<sup>57</sup> International Swaps and Derivatives Association (“ISDA”) at 6; American Petroleum Institute (“API”) at 4; Center for American Progress at 10; Environmental Defense Fund at 12; Futures Industry Association (“FIA”) at 9; Intercontinental Exchange, Inc. (“ICE”) at 4.

<sup>58</sup> CME Group at 10, FIA at 3; ISDA at 7.

<sup>59</sup> Heritage Foundation at 7.

<sup>60</sup> *See, e.g.*, API at 3; ISDA at 6; Verra at 2. With respect to the Commission’s spot market anti-fraud, false-reporting, and anti-manipulation authority, *see, e.g.*, CEA section 6(c)(1), 7 U.S.C. 9(1), which 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 on how to identify and report potential CEA

## 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.<sup>61</sup>

## **II. Guidance Regarding the Listing of VCC Derivative Contracts**

The Commission is proposing guidance that outlines factors that DCMs should consider 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,<sup>62</sup> and believes that guidance that outlines factors for a DCM to consider in connection with product design and listing may help to advance the standardization of such products in a manner that promotes transparency and liquidity.

This proposed guidance addresses certain Core Principle compliance considerations, as well as certain requirements relating to the submission of new contracts, and contract amendments,

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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 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>.

<sup>61</sup> For the official announcement of the convening and related materials, *see* <https://www.cftc.gov/PressRoom/Events/opaeventvoluntarycarbonmarkets071923>.

<sup>62</sup> 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/>.

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to the Commission. This proposed guidance is not intended to modify or supersede existing statutory or regulatory requirements, or existing Commission guidance that addresses the listing of derivative products by CFTC-regulated exchanges, including the Appendix C Guidance. Rather, taking into account certain unique attributes of VCC derivatives and voluntary carbon markets, this proposed guidance outlines particular matters that a DCM should consider, to help ensure compliance with existing requirements when listing a VCC derivative contract. Among other things, this proposed guidance addresses how certain aspects of the Appendix C Guidance should be understood to apply in the specific context of VCC derivative contracts.

This proposed 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, when developing contract terms and conditions, that can help to ensure that, upon delivery, the quality and other attributes of the underlying VCC 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 proposed 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.<sup>63</sup> Accordingly, the

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<sup>63</sup> Appendix C Guidance, paragraph (c)(1).

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Commission preliminarily believes that discussions in this proposed guidance of VCC commodity characteristics that a DCM should consider when developing the terms and conditions of a physically-settled VCC derivative contract, should also be considered for cash-settled derivative contracts that settle to the price of a VCC, unless otherwise noted.<sup>64</sup>

Further, while this proposed guidance focuses on the listing of VCC derivative contracts by DCMs, the Commission preliminarily believes that the proposed guidance also should be considered 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.<sup>65</sup>

In developing this proposed guidance, the Commission has considered those public comments on the RFI that addressed product innovation and voluntary carbon markets. Taking into account those public comments, the Commission believes that this proposed 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, accurate pricing, and market integrity.<sup>66</sup>

The Commission recognizes that VCCs and voluntary carbon markets are evolving and that it may therefore be appropriate for the Commission to revisit this guidance or to issue

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<sup>64</sup> As noted herein, and for the avoidance of doubt, this proposed 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 proposed guidance. DCMs are reminded to consult and consider the Appendix C Guidance when developing terms and conditions, and contract submissions to the Commission, for all derivative product types – including VCC derivative products.

<sup>65</sup> As noted above, the Appendix C Guidance is also relevant to 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.

<sup>66</sup> *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.)

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additional guidance in the future,<sup>67</sup> as VCCs and voluntary carbon markets continue to develop and mature.<sup>68</sup>

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

As discussed above, DCM Core Principle 3 provides that a DCM shall only list for trading derivative contracts that are not readily susceptible to manipulation.<sup>69</sup> With respect to DCM Core Principle 3, the Appendix C Guidance 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.<sup>70</sup>

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.”<sup>71</sup> 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

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<sup>67</sup> For example, the Commission may in the future revisit this guidance, or issue additional guidance, to further address the listing of cash-settled VCC derivatives contracts, including index-based contracts, or to further address the listing of VCC derivative contracts by SEFs.

<sup>68</sup> For the avoidance of doubt, this proposed 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 Fed Reg 48208 (August 13, 2012).

<sup>69</sup> CEA section 5(d)(3), 7 U.S.C. 7(d)(3).

<sup>70</sup> As noted above, the Appendix C Guidance is also relevant to SEFs, which are similarly 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)

<sup>71</sup> Appendix C Guidance, paragraph (b)(2)(i)(A).

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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.”<sup>72</sup> Where the underlying commodity is a VCC, the Commission recognizes that standardization and accountability mechanisms for VCCs are currently still developing. The Commission believes 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 preliminarily believes that a DCM should take these characteristics – referred to in this proposed 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. The Commission believes that consideration of these VCC commodity characteristics will help the DCM to ensure that it understands, and is clearly specifying in the contract’s terms and conditions, the economically significant attributes of the underlying VCC.

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<sup>72</sup> *Id.*

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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 expiration. The Commission believes that this will help the DCM evaluate whether the crediting program is a reliable source of high integrity VCCs.

More specifically, the Commission preliminarily 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 that should be addressed in the terms and conditions of a physically-delivered derivative contract. As discussed above, addressing these 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.

*1. Quality Standards*

The Commission preliminarily believes that a DCM should consider the following VCC commodity characteristics when addressing quality standards in the development of the terms and

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conditions of a VCC derivative contract: (i) transparency, (ii) additionality, (iii) permanence and risk of reversal, and (iv) robust quantification.<sup>73</sup>

*a. 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 VCC derivative contract, information about the VCCs that are eligible for delivery under the contract. The contract terms and conditions should include information that readily specifies the crediting program or programs – and, as applicable, the specific types of projects or activities – from which VCCs that are eligible for delivery under the contract may be issued. 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 preliminarily believes that, in developing the terms and conditions of a VCC derivative contract, DCMs should also consider whether the crediting program for the underlying VCCs is making detailed information about the crediting program’s 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

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<sup>73</sup> As is the case for physically-settled VCC derivative contracts, 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.



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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. Accordingly, information regarding the crediting program’s policies and procedures for making program information publicly available may constitute an economically significant attribute of the underlying VCC that should be described or defined in the terms and conditions of the VCC derivative contract.

*b. Additionality – The Underlying VCC Represents 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*

The Commission preliminarily believes that, in developing the terms and conditions of a VCC derivative contract, a DCM should consider whether the underlying VCCs represent GHG emission reductions or removals that are “additional” – in other words, whether the 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.<sup>74</sup> Additionality is viewed by many as a necessary element of a high quality VCC: if a VCC does not represent emission reductions or removals that would not have occurred in the absence of the added monetary incentive created by the revenue from the sale of carbon credits, then the VCC will not serve a market participant’s goals of contributing to emissions mitigation.

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<sup>74</sup> For example, a project or activity may not be considered to be “additional” if 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.

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Accordingly, 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. A DCM should consider whether those procedures are sufficiently rigorous and reliable to provide a reasonable assurance that GHG emission reductions or removals are credited only if they are additional. 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 contract may not accurately reflect the quality of the VCCs that may be delivered under the contract: the cheapest-to-deliver VCC,<sup>75</sup> that otherwise meets the contract’s specifications, may not have additionality.

Given that additionality is viewed by many as a necessary element of a high quality VCC, information regarding a crediting program’s procedures for assessing or testing for additionality may constitute an economically significant attribute of the underlying VCCs, which should be described or defined in the terms and conditions of a VCC derivative contract.

*c. Permanence and Accounting for the Risk of Reversal*

The Commission preliminarily believes that, in developing the terms and conditions of a VCC derivative contract, a DCM should consider whether the crediting program for the underlying VCCs can demonstrate that it has measures in place to address and account for the risk of reversal (*i.e.*, the risk that VCCs issued for a project or 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). Understanding and evaluating the measures that a crediting program has in place to

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<sup>75</sup> 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.

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address and account for the risk of reversal may be particularly important where the underlying VCCs are issued for project or activity types with a higher reversal risk.

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. As a result, information regarding a crediting program’s measures for estimating, monitoring, and addressing the risk of reversal may constitute an economically significant attribute of the underlying VCCs that should be described or defined in the terms and conditions of a VCC derivative contract.

As part of its contract design market research, the Commission preliminarily believes that a DCM should consider whether the crediting program for a VCC has measures in place that provide reasonable assurance that, in the event of a reversal, the VCC will be replaced by a VCC of comparably high quality that meets the contemplated specifications of the contract. Most crediting programs have established VCC “buffer reserves” to 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 to compensate for reversals associated with a project or activity. If a reversal occurs, VCCs are drawn upon from the buffer reserve to replace VCCs that are canceled, proportional to the size of the reversal.

A DCM should consider whether a crediting program has a buffer reserve or other measures in place that provide reasonable assurance that, in the event of a reversal, the VCCs

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intended to underlie the derivative contract would be replaced by VCCs of comparable high quality that meets the contemplated specifications of the contract. The DCM could also consider whether the crediting program regularly reviews the methodology by which the size of its buffer pool is calculated in order to address evolving climate risks that may heighten the risk of reversal, and whether there is a mechanism in place to audit the continuing sufficiency of the buffer pool.

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

The Commission preliminarily believes that, as part of its contract design market research, a DCM should consider the methodology or protocol used by a crediting program to calculate the level of GHG emission reductions or removals associated with credited projects or activities. Given the current absence of a standardized methodology or protocol to quantify GHG emission reduction or removal levels<sup>76</sup> – 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 a DCM that lists a VCC derivative contract should consider whether the crediting program for the underlying VCCs can demonstrate that the quantification methodology or protocol that it uses to calculate emission reductions or removals for the 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. Accordingly, information about the quantification methodology or protocol used by

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<sup>76</sup> Related specifically to the agriculture and forest sector, the U.S. Department of Agriculture’s Office of the Chief Economist has published a Request for Information on the Federal Strategy to Advance Measurement and Monitoring Greenhouse Gas Measurement and Monitoring for the Agriculture and Forest Sectors. This Request for Information was issued on behalf of the Administration’s Greenhouse Gas Monitoring and Measurement Interagency Working Group (GHG IWG). *See*, 88 Fed. Reg. 44251 (July 12, 2023).

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the crediting program to calculate GHG emission reductions or removals for projects or activities associated with the underlying VCCs may constitute an economically significant attribute of the underlying VCCs that should be described or defined in the terms and conditions of a VCC derivative contract.

For the derivative contracts that they list, DCMs are required to adopt, as is necessary and appropriate, exchange-set position limits for speculators.<sup>77</sup> 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 contract.<sup>78</sup> 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.<sup>79</sup>

*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

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<sup>77</sup> CEA section 5(d)(5), 7 U.S.C. 7(d)(5). *See also* 17 CFR §§ 38.300-301.

<sup>78</sup> Guidance on estimating deliverable supply can be found in the Appendix C Guidance.

<sup>79</sup> 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.

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cash and derivative contract prices at the expiration of the derivative contract.<sup>80</sup> When addressing delivery procedures for a physically-settled VCC derivative contract, the Commission preliminarily believes that a DCM should consider the governance framework and tracking mechanisms of the crediting program for the underlying VCCs, as well as the crediting program's measures to prevent double-counting.<sup>81</sup>

*a. Governance*

The Commission preliminarily believes that a DCM should consider whether the crediting program for the underlying VCCs can demonstrate that it has a governance framework that effectively supports the crediting program's independence, transparency and accountability. As a threshold matter, a governance framework that effectively supports 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. As discussed above, 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.

In reviewing a crediting program's governance framework, the Commission preliminarily believes that a DCM should consider, among other things, the program's decision-making procedures, including who is responsible for administration of the program and how the

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<sup>80</sup> Appendix C Guidance, paragraph (b)(2)(i)(B).

<sup>81</sup> While cash-settled VCC derivative contracts do not result in the delivery of a VCC, the Commission preliminarily 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.

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independence of key functions is ensured; reporting and disclosure procedures; public and stakeholder engagement processes; and risk management policies, such as financial resources/reserves, cyber-security, and anti-money laundering policies. The DCM also should consider whether information regarding these procedures and policies is made publicly available.

Given the importance of a crediting program’s governance framework in ensuring the overall quality of the VCCs issued by the program, as well as the potential importance of a crediting program’s registry in facilitating delivery, it may be appropriate for the DCM to include information about the crediting program’s governance framework in the terms and conditions of a physically-settled VCC derivative contract.

*b. Tracking*

The Commission preliminarily believes that a DCM should consider whether the crediting program for the 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. The DCM should consider whether the crediting program operates or makes use of a registry that has measures in place to effectively 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. In circumstances 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, as well as effective measures to address double-counting, as discussed below.

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*c. No Double Counting*

The Commission preliminarily believes that a DCM should consider whether the crediting program for the 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. 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 – and a crediting program should have effective 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



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delivery requirements for physically-settled VCC derivatives contracts should be specified in the contract’s terms and conditions.<sup>82</sup> The Commission believes that these inspection or certification procedures should be consistent with the latest procedures in the voluntary carbon markets. To that end, the Commission preliminarily believes that the DCM should consider, among other things, how the crediting program for the underlying VCCs requires validation and verification that credited mitigation projects or activities meet the crediting program’s rules and standards.

The Commission preliminarily believes that, when designing a VCC derivative contract, a DCM should consider whether the crediting program has up-to-date, robust and transparent validation and verification procedures, including whether those procedures contemplate validation and verification by a reputable, disinterested party or body. 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 supports voluntary carbon market integrity.<sup>83</sup>

A DCM should consider whether the crediting program is employing best practices with respect to third-party validation and verification, which 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.

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<sup>82</sup> 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.”).

<sup>83</sup> *Id.*

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**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.<sup>84</sup> For physically-settled derivative contracts, the Commission has recognized DCM Core Principle 4 to include, among other things, an obligation to monitor the contract’s terms and conditions as they relate 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.<sup>85</sup> 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 in circumstances should be addressed, for example, through changes to the contract’s terms and conditions.<sup>86</sup>

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 preliminarily believes that the monitoring by a DCM of the terms and conditions of a physically-settled VCC derivative contract 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.

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<sup>84</sup> CEA Section 5(d)(4), 7 U.S.C. 7(d)(4). *See also* 17 CFR §§ 38.250-258.

<sup>85</sup> 17 CFR § 38.252.

<sup>86</sup> 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).

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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.<sup>87</sup> A DCM's rules also must require market participants to make such records available upon request to the DCM.<sup>88</sup> 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 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.<sup>89</sup> 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

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<sup>87</sup> 17 CFR § 38.254(a).

<sup>88</sup> *Id.*

<sup>89</sup> 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).

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the CFTC’s regulations thereunder.<sup>90</sup> Alternatively, the DCM may elect voluntarily to seek prior Commission approval of the contract.<sup>91</sup> In each case, the DCM must submit prescribed information to the Commission, including but not limited to the contract’s terms and conditions.<sup>92</sup> 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.<sup>93</sup>

This proposed 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.

The relevant requirements provide, first, that a contract submission to the Commission must 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.”<sup>94</sup> 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

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<sup>90</sup> 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).

<sup>91</sup> CEA sections 5c(c)(4)-(5), 7 U.S.C. 7a-2(c)(4)-(5). *See also* 17 CFR § 40.3.

<sup>92</sup> 17 CFR §§ 40.2-40.3.

<sup>93</sup> 17 CFR §§ 40.5-40.6.

<sup>94</sup> 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.

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compliance with applicable law, or incorporate information contained in such documentation, with appropriate citations to data sources[.]”<sup>95</sup> 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.<sup>96</sup>

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. Given unique and developing aspects of VCCs and VCC derivative markets, including complete and thorough information in a submission for a VCC derivative contract will assist the Commission and its staff in their understanding of the contract and their analysis of the contract’s compliance with applicable statutory and regulatory requirements, including whether or not the contract is readily susceptible to manipulation.

### **III. Request for Comment**

The Commission requests comment from the public on all aspects of the Commission’s proposed guidance regarding the listing of VCC derivative contracts, and further invites comments on specific questions related to the listing of such contracts. The Commission encourages all

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<sup>95</sup> 17 CFR §§ 40.2(a)(3)(v) (for self-certification) and 40.3(a)(4) (for Commission approval).

<sup>96</sup> 17 CFR §§ 40.2(b) (for self-certification) and 40.3(a)(10) (for Commission approval).

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comments including background information, actual market examples, and best practice principles. Specifically, the Commission requests comment on the following questions:

**General**

1. In addition to the VCC commodity characteristics identified in this proposed guidance, are there other characteristics informing the integrity of carbon credits that are relevant to the listing of VCC derivative contracts? Are there VCC commodity characteristics identified in this proposed guidance that are not relevant to the listing of VCC derivative contracts, and if so, why not?
2. Are there standards for VCCs recognized by private sector or multilateral initiatives that a DCM should incorporate into the terms and conditions of a VCC derivative contract, to ensure the underlying VCCs meet or exceed certain attributes expected for a high-integrity carbon credit?
3. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider in connection with monitoring the continual appropriateness of the terms and conditions of a VCC derivative contract?
4. In addition to the criteria and factors discussed in this proposed guidance, are there particular criteria or factors that a DCM should consider, which may inform its analysis of whether or not a VCC derivative contract would be readily susceptible to manipulation?
5. Should the VCC commodity characteristics that are identified in this proposed guidance as being relevant to the listing by a DCM of VCC derivative contracts, also be recognized as being relevant to submissions with respect to VCC derivative contracts made by a registered foreign board of trade under CFTC regulation 48.10?

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**Transparency**

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

**Additionality**

7. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract’s terms and conditions, whether the procedures that a crediting program has in place to assess or test for additionality provide a reasonable assurance that GHG emission reductions or removals will be credited only if they are additional?
8. In this proposed guidance, the Commission recognizes VCCs as additional where they are credited for projects or activities that would not have been developed and implemented in the absence of the added monetary incentive created by the revenue from carbon credits. Is this the appropriate way to characterize additionality for purposes of this guidance, or would another characterization be more appropriate? For example, should additionality be recognized as the reduction or removal of GHG emissions resulting from projects or activities that are not already required by law, regulation, or any other legally binding mandate applicable in the project’s or activity’s jurisdiction?

**Risk of Reversal**

9. Are there particular criteria or factors that DCMs should take into account when considering, and/or addressing in a VCC derivative contract’s terms and conditions, a crediting program’s measures to avoid or mitigate the risk of reversal, particularly where the underlying VCC is sourced from nature-based projects or activities such as agriculture, forestry or other land use initiatives?
10. How should DCMs treat contracts where the underlying VCC relates to a project or activity whose underlying GHG emission reductions or removals are subject to reversal? Are there terms, conditions or other rules that a DCM should consider including in a VCC derivative contract in order to account for the risk of reversal?

**Robust Quantification**

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

**Governance**

12. In addition to a crediting program’s decision-making, reporting, disclosure, public and stakeholder engagement, and risk management policies, are there other criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract’s terms and conditions, whether the crediting program can demonstrate that it has a governance framework that effectively supports the program’s transparency and accountability?



**Tracking and No Double Counting**

13. In addition to the factors identified in this proposed guidance, are there other factors that should be taken into account by a DCM when considering, and/or addressing in a VCC derivative contract’s terms and conditions, whether the registry operated or utilized by a crediting program has processes and procedures in place to help ensure clarity and certainty with respect to the issuance, transfer, and retirement of VCCs?
14. Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a VCC derivative contract’s terms and conditions, whether it can be demonstrated that the registry operated or utilized by a crediting program has in place measures that provide reasonable assurance that credited emission reductions or removals are not double-counted?

**Inspection Provisions**

15. Should the delivery procedures for a physically-settled VCC derivative contract describe the responsibilities of registries, crediting programs, or any other third-parties required to carry out the delivery process?

**Sustainable Development Benefits and Safeguards**

16. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities meet or exceed best practices on social and environmental safeguards, as a characteristic that helps to inform the integrity of VCCs issued by the crediting program. When designing a VCC derivative contract, should a DCM consider whether a crediting program has implemented such measures?

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17. Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities would avoid locking in levels of GHG emissions, technologies or carbon intensive practices that are incompatible with the objective of achieving net zero GHG emissions by 2050, as a characteristic that helps to inform the integrity of VCCs issued by the crediting program. When designing a VCC derivative contract, should a DCM consider whether a crediting program has implemented such measures?

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Robert Sidman,

*Deputy Secretary of the Commission.*