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## *CFTC Faces Pressure on Voluntary Carbon Credit Derivative Contracts and Carbon Credit Trading*

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On July 31, 2024, nine Democratic lawmakers from the House and Senate wrote a letter to the Commodity Futures Trading Commission's ("CFTC") Chairman in support of the Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivatives Contracts.<sup>1</sup> In the letter, the lawmakers highlighted the "immature nature of voluntary carbon credit markets" and the "significant financial, environmental, and legal risks" posed to market participants and other stakeholders.

The lawmakers urged the CFTC to implement final guidance in this area that is "as rigorous as possible", and to ensure that the final guidance be clear, consistent, and commonsense, and not "amount to a rubber stamp of existing bad practices." The letter emphasized the fraud and manipulation risks facing the voluntary carbon market and carbon credits and urged the CFTC to "use its anti-fraud and anti-manipulation enforcement authorities to the fullest extent possible." The authors pointed to findings indicating that, for many carbon credits, the claimed reduction or removal of greenhouse gas is inaccurate or misleading and susceptible to manipulation. They also pointed to dubious claims of social benefits associated with carbon credit projects and that, in fact, some have been accused of violating human rights, corruption, and other harmful abuses.

The authors of the letter emphasized the importance of registries as integral for "maintaining the official record of a carbon credit" as well as "essential to evaluating the integrity of each carbon credit and, by extension, crediting methodologies and crediting programs." Because of the important roles registries play as delivery points for physically settled derivative contracts, they are viewed by the legislators as "a lynchpin to implementing the CFTC's guidance for voluntary carbon derivatives" and advancing the standardization of voluntary carbon credit derivative contracts.

The authors also highlighted the lack of public oversight of voluntary carbon credits, noting that third-party verifiers are self-regulating and paid by project developers, "creating an incentive to approve projects," according to the lawmakers. The often-cited point regarding the lack of price discovery mechanisms came up as well – as most carbon credits are traded off-exchange and without public records of price. "The lack of regulation. . . creates direct and indirect financial risk for market participants and threatens the integrity of the commodity markets."

### **CFTC's Proposed Guidance**

The letter points to the CFTC's authority under the Commodity Exchange Act to "regulate derivatives markets, including voluntary carbon credit derivatives, and to take enforcement action against fraud and manipulation in voluntary carbon credit spot markets." On December 4, 2023, the CFTC issued proposed guidance and requested public comment regarding the "listing for trading of voluntary carbon

credit derivative contracts on CFTC-registered Designated Contract Markets (“DCMs”), and outlined certain factors DCMs “should consider when addressing requirements of the [CEA] and CFTC regulations that are relevant to the contract design and listing process.”<sup>2</sup> The CFTC also established an Environmental Fraud Task Force within the Division of Enforcement “to combat environmental fraud and misconduct in derivatives and relevant spot markets, including carbon markets.”<sup>3</sup>

The lawmakers “strongly supported the proposed guidance and urged the CFTC to ensure the final guidance is as rigorous as possible.” Given that evaluating voluntary carbon credits and crediting programs “requires special expertise and is notoriously difficult,”<sup>4</sup> the letter also encouraged the CFTC “to use its anti-fraud and anti-manipulation enforcement authorities to publicly identify credits, crediting programs, methodologies, and types of mitigation activities that are readily susceptible to manipulation.”

### Next Steps

The Lawmakers requested that the CFTC brief Congress one year after finalizing guidance for voluntary carbon credit derivatives regarding the implementation of the guidance, the state of the voluntary carbon credits market, and enforcement actions in such markets. Further, the letter requested that, “as we consider legislative action to strengthen the regulation of voluntary carbon markets,” the CFTC brief the signatories to the letter within 90 days on “whether additional authorities are needed to safeguard the integrity of voluntary carbon credit derivatives markets - and if so, what additional authorities are needed.”

This letter signals increasing pressure from some legislators on regulators to use existing regulatory powers to address shortcomings and pitfalls in the carbon credit market, as well as the larger effort to reduce greenhouse gas emissions. It further appears to signal a recognition that, given the Supreme Court’s decision overturning the Chevron Doctrine<sup>5</sup>, additional legislative action may be advisable to empower the CFTC to address the carbon credit marketplace. Interestingly, this letter was sent one day before the House Committee on Financial Services released a staff report broadly criticizing ESG efforts.<sup>6</sup> The growing focus from legislators, both supportive and critical, is likely to impact the actions of regulators. Entities operating in the carbon credit space should stay up-to-date with the latest legislative and regulatory developments in this quickly developing arena.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Washington, D.C. lawyers:*

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<sup>1</sup> [Matsui Comment Letter on CFTC Carbon Markets Guidance 1.pdf \(house.gov\)](#);  
<https://www.cftc.gov/sites/default/files/2023/12/2023-28532a.pdf>.

<sup>2</sup> [CFTC Issues Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts | CFTC](#).

<sup>3</sup> [CFTC Division of Enforcement Creates Two New Task Forces | CFTC](#)

<sup>4</sup> [Matsui Comment Letter on CFTC Carbon Markets Guidance 1.pdf \(house.gov\)](#).

<sup>5</sup> [22-451 Loper Bright Enterprises v. Raimondo \(06/28/2024\) \(supremecourt.gov\)](#).

<sup>6</sup> [Republican ESG Working Group Releases Final Staff Report | Financial Services Committee \(house.gov\)](#).

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