October 6, 2022

Via: CFTC Comments Portal (https://comments.cftc.gov)

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Request for Information on Climate-Related Financial Risk (CFTC-2022-0029-0001)

Dear Mr. Kirkpatrick:

Kepos Capital LP ("Kepos") is pleased to provide these comments in response to the Commodity Futures Trading Commission (the "Commission") Request for Information on Climate-Related Financial Risk published in 87 Fed. Reg. 34856 on June 8, 2022 ("RFI").

Introduction

Kepos is a New York based investment adviser with approximately $2 billion of assets under management. Kepos' clients are predominantly universities, foundations, endowments, and pension funds. Along with our core portfolio of systematic macro investments, we have extensive investments in compliance market carbon allowances, futures on carbon allowances, voluntary carbon offsets and other climate change related investments. While the RFI is seeking commentary on a broad set of questions related to various aspects of climate related financial risk, this comment is narrowly focused on only one aspect: development of high quality carbon accounting in the voluntary carbon offset market. Consequently, our comments relate to Questions 22 and 23 of the RFI.

Commission's Authority to Regulate VCMs

Increasingly, voluntary carbon offset market ("VCM") offsets[1] are being used as a reference asset for a growing number of futures contracts issued on US exchanges[2]. We do not offer a view as to whether the Commission has the power to regulate VCM market directly, but we believe that the Commission is certainly empowered to regulate US futures markets, including futures on VCM.

[1] The term "VCM" in this comment letter will be used to refer to the underlying instruments.

[2] For instance, CBL Global Emissions Offset Futures or CBL Nature-Based Global Emissions Offset Futures.

Challenges of Accounting in Voluntary Carbon Markets

The VCM market is a rapidly growing area of carbon trading. It is estimated that the market in VCMs grew from $300 million in 2018 to $1 billion in 2021[3]. A McKinsey Consulting report suggested that VCM market could reach $180 billion by 2030[4]. End users of VCMs typically use them to offset carbon footprint that such end user generates. Each unit of VCM is supposed to represent a one ton reduction of greenhouse gasses ("GHG") in the atmosphere. In fact, end users, many of whom are publicly traded companies, are relying on the accuracy of a VCM unit equaling at least a one ton reduction in order to be able to accurately state that their emissions are being reduced by a specific number of CO2 (or other GHG) equivalent) tons. If the VCM on which the end user relied to make the assertion in fact does not reduce CO2 by one ton, the end user is misled, as are the stake holders of the end user, including investors, and the public at large.

Currently, VCMs suffer from lack of standardization and reliable verification. VCMs should properly be thought of as a commodity – one ton of atmospheric GHG. Just as one ounce of gold or a bushel of corn represent precise, measurable and generally reliable quantity of a physical object, even if such measures are incorporated into financial instruments, such as future contracts, VCM must similarly reach a point of reliability as to the underlying physical commodity. VCM must be reliably understood to represent one ton of GHG removed from the atmosphere or prevented from being emitted.

The current ambiguity presented in VCM trading has been written about extensively, but, in brief, present the challenge of *additionality, permanence, leakage and double counting*.

> *Additionality*. "Additionality" is the causal link that justifies giving credit for a GHG reduction. Additionality requires that the GHG-reducing activity of an offset project would not have occurred but-for the incentive to generate offsets. In other words, had the primary-market purchaser not bought the offset, the project seller would not have undertaken the carbon-reducing activity.
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> *Permanence*. "Permanence" is a measure of whether a GHG reduction is permanent (or at least of a long duration, with 100 years being a common measure). This concept is of particular usefulness in evaluating forestry or other nature-based approaches to VCM generation, although would also be applicable to evaluating technology based solutions such as carbon sequestration.
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> *Leakage*. "Leakage" occurs when the suppression of a GHG emitting in one location results in an increase in that activity elsewhere. For instance, if protecting a forest trigger a move to deforestation in other adjacent, but not protected, areas, this would be considered leakage.
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> *Double Counting*. Generally speaking, "double counting" occurs when two parties take full credit for the same GHG reduction.

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[3] CARBONCREDITS.COM, *Carbon Offsets Being Used by Oil & Gas to Decarbonize*, https://carboncredits.com/carbon-offsets-being-used-by-oil-gas-to-decarbonize/.

[4] MCKINSEY & COMPANY, *Putting Carbon Markets to Work On The Path To Net Zero*, at 28 (Oct. 2021), https://www.mckinsey.com/business-functions/sustainability/our-insights/putting-carbon-markets-to-workon-the-path-to-net-zero.

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Recommended Regulatory Action

Investors and end users in VCM need to have confidence that the instrument purchased actually has a "real world" analog – a one-ton reduction in atmospheric GHG. The Commission can assist with this goal,by advancing one or more of the proposals below.

1. The Commission can exercise its authority to improve the transparency of the key characteristics of VCMs. Having robust and uniform information available to market participants will make it easier for end-users, investors and the public to assess the quality of the projects generating VCMs.

2. The Commission can set out clear accounting rules for any particular VCM project's calculation of GHG. In addition to creating a set of criteria that a VCM project would need to satisfy in calculating its purported GHG reduction, a common set of criteria will facilitate investors' ability to compare diverse projects.

3. The Commission can facilitate the creation of a standard setting body for VCMs traded in United States. The body could be an existing profession or organization or could take the form of a new standard setting entity, such as a self-regulatory organization for entities seeking to create and offer VCMs to the end-users and investors.

Guidelines vs. Best Practices

Since VCM industry is still a young and rapidly developing one, enshrining specific rules may be premature and could, in fact, serve to reduce innovation in this vital GHG reducing area. The industry is experimenting with a variety of approaches to creating and certifying VCMs and it may be premature to require a particular approach. The Commission could thus offer guidelines instead of rules. By establishing guidelines, the Commission would push the industry towards a best practice which will likely be incorporated into protocol development by VCM certifying entities and investors. The guidelines could also be used as a first step in determining what regulation would best promote the efficiency and safety of the evolving VCM market.

We wish to thank the Commission for tackling this complex and vital topic and appreciate the opportunity to submit these comments. If you have any questions, please do not hesitate to reach out to Simon Raykher at simon@keposcapital.com.

Respectfully submitted,

Simon Raykher
General Counsel