February 16, 2024

Delivered Electronically
secretary@cftc.gov and
via https://comments.cftc.gov/

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

Re: Comment Letter on the Proposed Guidance for Listing Voluntary Carbon Credit Derivative Contracts

Dear Chairman and Commissioners,

As a pioneering entity in the voluntary carbon credit (for this letter, "**VCC**") industry with a strong focus on leveraging technology for enhancing market integrity, Flow Carbon Inc. ("**Flowcarbon**") appreciates the opportunity to comment on the proposed guidance from the Commodity Futures Trading Commission ("**CFTC**") for listing VCC derivative contracts (the "**Proposal**").[1] We recognize and support the CFTC's effort as a critical additional step, supplementing the CFTC's many leading efforts towards sustainable climate initiatives in recent years,[2] towards a regulated, robust, and transparent carbon market, aligning with our own mission to facilitate sustainable environmental practices while maintaining market efficiency. We also encourage the CFTC to maintain a whole-of-government perspective when approaching its carbon market initiatives, so that commodity derivatives markets benefit from the work being done and concepts being pursued by many other agencies and offices.[3]

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[1] CFTC, Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment, 88 FR 89410 (Dec. 27, 2023); available at: https://www.cftc.gov/sites/default/files/2023/12/2023-28532a.pdf

[2] E.g., the CFTC's First Carbon Convening: https://www.youtube.com/watch?v=Zx8TyzKcA7c (video of Jun. 2, 2022); the CFTC's Request for Information on Climate-Related Financial Risk, 87 FR 34856 (Jun. 8, 2022); available at: https://www.cftc.gov/sites/default/files/2022/06/2022-12302a.pdf; and the CFTC's Second Carbon Convening: https://www.youtube.com/watch?v=Nq-ewSmP1F4 (video of Jul. 19, 2023).

[3] See, e.g., the Department of Agriculture's July 2023 announcement of a $300 million investment in voluntary carbon markets through Biden's Investing in America agenda (LINK); the Department of Transportation's support of international schemes such as CORSIA to reduce

Flowcarbon and its Participation in CFTC Carbon Market Initiatives

Flowcarbon is an innovative climate technology and markets company supporting the climate ecosystem across its project finance and advisory businesses, its sales and trading efforts, and its initiatives to leverage technology, including blockchain technology, to bring transparency, usability, and liquidity to VCC spot markets. Our mission is to make credible carbon credits accessible and transparent, enabling an efficient and early flow of capital investment directly into projects that combat climate change. Our company is made up of carbon market experts, traditional financial markets professionals, environmentalists, and financial technology specialists driven by a shared purpose of facilitating a better and effective global approach to carbon management.

Flowcarbon supports the efforts of the CFTC in issuing proposed guidance for listing VCC derivatives and the CFTC's parallel emphasis in the Proposal on the importance of standards and credibility in the underlying spot market for VCCs, where the CFTC retains fraud and manipulation authority.[4] Flowcarbon also agrees with the CFTC that standardization in this area is necessary to support the creation of high-integrity VCCs and to accelerate the growth of the carbon market ecosystem. As a reminder, Flowcarbon has been a frequent participant with the CFTC in public discussions to advance the VCC market (see, e.g., our Climate Week NYC 2023 gathering of CFTC Chairman Rostin Behnam along with several industry participants and standard setting bodies;[5] our notes on the policy implications of the CFTC's July 2023 2nd Voluntary Carbon Markets Convening;[6] and our previously submitted public comment letter on the CFTC's June 2022 Request for Information on Climate-Related Financial Risk).[7] We are submitting this letter as a continuation of our CFTC engagement on these topics.

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emissions from the aviation industry and to serve as a core standard for other sectors like international shipping (LINK); the Treasury Department's September 2023 report titled 'Principles For Net-Zero Financing and Investment' (LINK); and the State Department's focus on carbon markets through its Energy Transition Accelerator (LINK).

[4] Underscoring the importance of keeping spot markets in focus, Morgan Stanley has observed that the market for carbon credits is projected to grow 50-fold within a decade, from nearly $2 billion in 2022 to nearly $100 billion by 2030, and as much as $250 billion by 2050. See https://www.morganstanley.com/ideas/carbon-offset-market-growth.

[5] The Carbon Smart Summit 2023 event overview is available here: https://www.flowcarbon.com/knowcarbon/flowcarbon-carbon-smart-summit.

[6] See our write-up at https://www.flowcarbon.com/knowcarbon/insights-cftc-vcm.

[7] See our submission at: https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70826&SearchText=.

The Proposal and Request for Comment

We structure our comments around the primary categories that the CFTC addressed in the Proposal - notably, (1) Quality Standards, (2) Delivery Points and Facilities, (3) Inspection Provisions - Third Party Validation and Verification, and (4) Sustainable Development Benefits and Safeguards.

We again commend the CFTC for its leadership regarding the development of VCC markets through issuing ongoing guidance, and we look forward to continuing to engage with the CFTC on these topics.

Quality Standards

a. Transparency:

Transparency (along with credibility) in crediting programs is critical. To the extent any VCC is considered as a deliverable on or reference for a CFTC listed derivatives contract, the provision of detailed information about the underlying project(s), methodologies, and verification processes should be mandatory. Flowcarbon believes that any carbon-crediting program should provide comprehensive and transparent information on all credited mitigation activities and eligible projects. The information should be publicly available in electronic format and should be accessible to non-specialised audiences to enable scrutiny of mitigation activities. In parallel, and at a minimum, buyers should be able to trace the carbon credits back to specific projects or project groups and verify the accuracy of the claimed emission reductions. The CFTC could consider requiring independent verification bodies to upload data on VCCs with requirements that vet the type of VCC as sufficiently transparent to be referenced by an exchange in a derivatives contract. In time, the CFTC may also consider the benefits that may come from utilizing a transparent database, such as a blockchain powered records system, that will permit multiple parties on each of the buy side, sell side, and observer side to assess critical information about the referenced VCCs (including data points such as total outstanding supply, vintage years, retirement data, status of the underlying project, *etc.*).

b. Additionality:

The CFTC's characterization of additionality (i.e., the requirement that the greenhouse gas (GHG) emissions reductions from a given project are genuinely additional, such that the GHG emission reductions or removals from the mitigation activity would not have occurred in the absence of a VCC revenue incentive) aligns with industry best practices. Generally, an exchange referencing a VCC in its derivatives contracts should ensure that the VCC is issued under a credible third party program with robust additionality analysis requirements. At the highest level, the third party analytical program should conclude with some objective demonstration of the additionality that proves on a measurable / quantified basis that absent the VCC revenue incentive, the GHG reductions would not have occurred. We do believe that an appropriately designed and principles-based additionality “proving methodology”

can be applied for many types of projects, ideally avoiding the high cost activity of project-by-project additionality review.

c. Risk of Reversal:

We agree with the proposition that an exchange should ensure that the crediting program for any VCC underlying its derivative contracts includes an evaluation of and addresses the VCC generating project's risk of reversal.[8] In parallel, any given project's "risk of reversal" analysis should be transparently disclosed and made available to VCC market participants. We recommend that the crediting programs adopt a principles based approach to establishing that the risk of reversal has been appropriately addressed, rather than a specific quantitative or prescriptive approach. The approach should also be subject to periodic review and revision, as market practices and capabilities evolve and mature.

d. Robust Quantification:

Crediting programs must employ quantification methodologies that are scientifically sound, conservative, and transparent, and the information made available for any given VCC must include details that the project developer used along with any deviations and discrepancies from standard quantification approaches.

At the same time, given the scope of variability that may exist across several equally credible quantification methodologies, as well as the likelihood of variability in the risk of reversal and additionality analyses, we believe that it will appropriate in many instances to include a range or series of eligible VCCs as the underlying deliverable or price referenced VCC for a VCC derivatives contract. That is, in order to smooth out project methodology differences and the potential for arbitrage opportunities in a delivery process, the underlier for most VCC derivatives should include a range of eligible project specific VCCs. In this way, settlement may be allowed to resemble, in certain respects, the cheapest-to-deliver concept used for Treasury futures contracts (where a range of instruments are deliverable on a given contract, subject to eligibility requirements and certain haircuts or premiums versus a benchmark instrument). This is also important for allowing liquidity to form for the VCC market generally, rather than forcing liquidity to form separately for each specific VCC project.

Delivery Points and Facilities

a. Governance:

Effective governance frameworks supporting transparency and accountability are vital for the integrity of crediting programs. Each VCC crediting program should have effective

[8] I.e., the risk that VCCs issued for a project or activity may have to be recalled or canceled 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.

governance to ensure transparency, accountability, continuous improvement, and the overall quality of VCCs. We recommend that all carbon-crediting programs should operate or make use of a publicly viewable registry to uniquely identify, record, and track mitigation activities and VCCs issued in order to ensure the VCCs can be identified securely and unambiguously.

Where a registry will be used as a delivery point for a VCC derivative, it is essential that there be a way to standardize the delivery, as there are multiple registries for the VCC markets. It is here that we believe blockchain technology should be considered as one tool to help with ensuring there is appropriate recording of the delivery and other actions necessary at the conclusion of a listed derivatives contract.

b. Tracking and No Double Counting:

Strong registry systems ensuring clear issuance, transfer, and retirement processes are crucial to prevent double counting. We recommend that the CFTC compel crediting programs to provide full transparency around the registry database program they utilize for VCC tracking and retirement, and we also encourage the CFTC to further consider whether there is value to be achieved by using distributed ledger or blockchain based registries to further enhance the trustworthiness and resilience of these records systems.

Inspection Provisions - Third Party Validation and Verification

Understanding and having confidence in the registries and crediting programs that will support physically-settled VCC derivative contracts is necessary for a well functioning settlement and delivery process. For market participants, transparency around the settlement process,coupled with credible third-party review and independent verification, is critical to ensuring that firms have the confidence to deploy capital into these markets and products. Our recommendation is that the CFTC should provide principles-based guidance regarding its expectations on the level of transparency that should be made available to market participants regarding the settlement and delivery process. At a minimum, market participants should be provided with evidence of a third party review and verification of a delivery and registry system (to ensure that the VCCs and registry are legitimate), and market participants should be provided with enough third-party verified information about the eligible VCCs available for delivery on a given contract in order to ascertain facts such as total supply, total available and unretired supply, range of eligible vintages, etc.

Sustainable Development Benefits and Safeguards

We agree that the appropriate and calibrated inclusion of social and environmental safeguards in crediting programs is incrementally supportive of sustainable development. A carbon-crediting program should have transparent and clear guidance, tools, and compliance procedures to ensure mitigation activities conform with or go beyond widely established industry best practices on social and environmental safeguards while delivering positive sustainable development impacts. Similarly, a CFTC exchange should consider whether

a crediting program has implemented measures to meet or exceed best practices on social and environmental safeguards. We believe this consideration is particularly relevant for VCC derivatives, given the broader purpose and goal of these products.

Conclusion:

Flowcarbon is committed to supporting the CFTC's efforts in establishing a regulated VCC derivatives market and remains dedicated to upholding high standards of market integrity in VCC creation, VCC markets, and VCC derivatives transactions. Thank you for considering our comments. We look forward to contributing to the ongoing development of the VCC market and to the ability of robust and well functioning carbon markets to contribute to the CFTC's broader climate initiatives. If we may provide any additional information, please do not hesitate to contact the undersigned at hector@flowcarbon.com.

Sincerely,

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