

# Clients & Friends Memo

## CFTCs Increased Reach over Environmental Commodities

December 15, 2023

During 2023 the Commodity Futures Trading Commission (CFTC) engaged in several regulatory actions aimed at further clarifying its jurisdictional reach over environmental commodity markets generally and the voluntary carbon credit (VCC) markets in particular. First, on June 20, 2023, the CFTC issued an alert seeking whistleblower tips relating to carbon market misconduct. CFTC noted that many VCCs serve as the underlying commodity for futures contracts that are listed on CFTC designated contract markets (DCMs) over which the CFTC has full enforcement authority as well as the regulatory oversight. Importantly, the CFTC also noted that it has anti-fraud and anti-manipulation enforcement authority over the related spot markets for VCCs as well as carbon allowances and other environmental commodities products that are linked to futures contracts.<sup>1</sup>

Second, on July 19, 2023 the CFTC held its second convening where several market participants expressed the view that reliability, integrity and resilience of VCCs will be significantly improved with greater regulatory involvement.<sup>2</sup>

Third, in response to a growing demand to become more actively involved in environmental commodity markets on December 4, 2023, the CFTC issued proposed Guidance Regarding the Listing of Voluntary Carbon Credits Derivatives and Request for Comment (VCC Guidance).<sup>3</sup> The VCC Guidance “outlines factors for a DCM to consider in connection with product design and listing [of futures contracts on VCCs] to advance the standardization of such products in a manner that promotes transparency and liquidity.”

The VCC Guidance is remarkable because: (i) it is non-binding (*i.e.*, it is only guidance, not a regulation – stating that DCMs “should consider”); (ii) it notes several times that “for the avoidance of doubt, this proposal is not intended to modify or supersede the Appendix C Guidance” [to Part 38 of CFTC regulations];<sup>4</sup> (iii) it addresses the already existing regulatory requirements for DCOs

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<sup>1</sup> <https://www.cftc.gov/PressRoom/PressReleases/8723-23>

<sup>2</sup> <https://www.cftc.gov/PressRoom/Events/opaeventvoluntarycarbonmarkets071923>

<sup>3</sup> <https://www.cftc.gov/PressRoom/PressReleases/8829-23>

<sup>4</sup> <https://www.ecfr.gov/current/title-17/chapter-I/part-38/appendix-Appendix%20C%20to%20Part%2038>

(i.e., Core Principle 3 – the requirement that all listed futures are not readily susceptible to manipulation);<sup>5</sup> (iv) it attempts to reach over spot physically-settled VCC markets over which the CFTC does not have the regulatory jurisdiction and can only exercise its limited enforcement anti-fraud and anti-manipulation jurisdiction; (v) it requires DCMs to “consider” a number of VCC characteristics that are clearly outside of DCM’s control and probably competency, which include transparency, additionality, permanency and risk of reversal, robust quantification, governance and tracking mechanisms, and measures to prevent double-counting of VCCs; (vi) it requires DCMs to submit to the CFTC “explanation and analysis of the contract” it intends to list; (vii) it requires DCMs to actively monitor VCC contracts to ensure that they continue to meet these standards; and (viii) notes that the same standards should apply to swap execution facilities (SEFs) that may list swaps on VCCs. Finally, this VCC Guidance is followed by a number of questions and an open comment period ending on February 16, 2024.

The VCC Guidance is an important step forward to promoting transparency and integrity of VCC markets within the jurisdictional constraints of the CFTC. Even though the VCC Guidance does not (and cannot) impose any additional compliance requirements on DCMs and SEFs short of promulgating a rulemaking in compliance with the Administrative Procedure Act, it is clear that DCM’s compliance burden with respect to listed VCC contracts before the VCC Guidance was issued are clearly different than after the VCC Guidance would become effective. Further, unlike other physically-deliverable commodities that serve as underliers to futures contracts on DCMs, VCCs traded in spot and forward markets are treated differently and will probably be in the same category as virtual currencies.

<https://icvcm.org/>

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If you have any questions, please feel free to contact the following Cadwalader attorneys.

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<sup>5</sup> <https://www.law.cornell.edu/uscode/text/7/7>