



October 7, 2022

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

Re: Request for Information on Climate-Related Financial Risk

Ladies and Gentlemen:

Better Markets¹ appreciates the opportunity to comment on the above-captioned request for information (“RFI” or “Release”) issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”).² In the RFI, the CFTC seeks information that will “better inform its understanding and oversight of climate-related financial risk as pertinent to the derivatives markets and underlying financial markets.”³ In this letter, we provide some background on climate change, including the risks it poses to commodity derivatives markets, the financial system, and the broader economy. We then suggest three areas that should inform future CFTC actions: revisiting position limit regulations, strengthening risk management frameworks, and leveraging oversight of voluntary carbon credits.

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

² Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34,856 (June 8, 2022) (hereinafter Release); *see also* Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 43,501, 43,501 (July 21, 2022) (extending the comment period to October 7, 2022).

³ Release, 87 Fed. Reg. at 34,856.

BACKGROUND ON CLIMATE CHANGE

Concerns that human-generated carbon dioxide emissions and emissions of other greenhouse gases (“GHG”) might cause a warming of the Earth’s climate date back to at least the late 19th century, with Nobel Prize winning chemist Svante Arrhenius positing the idea of a “greenhouse effect” and the notion that human activities might contribute to this phenomenon.⁴ At that time, Arrhenius’s hypothesis, like many others in the then-nascent study of how and why the Earth’s climate changes over time, was speculative.⁵ However, in the ensuing decades, as climatology evolved and as scientists became better able to measure and model climatic changes and discern the causes behind them, it became increasingly clear that the broad contours of Arrhenius’s hypothesis were correct—carbon in the atmosphere was increasing, and the result was higher global temperatures. By the 1980s, scientists were increasingly alarmed about the warming of the climate and the potentially catastrophic consequences, with Dr. James Hansen’s congressional testimony in 1988 as a notable example of the increasing visibility of the issue.⁶ In 1992, as part of a summit between world leaders to discuss environmental issues, more than 150 countries signed the Framework Convention on Climate Change. They agreed to work to address the issue and to meet periodically, but not much more.⁷ In 1997, those countries met in Kyoto, Japan, and the result was the 1998 Kyoto Protocols, which included the first binding commitments to reduce global greenhouse gases.⁸

At the same time, as climate change became more visible and more people, including scientists, began advocating for aggressive policy interventions to address it, the issue also became more politicized. This was in no small part because addressing climate change would necessarily mean imposing costs on certain industries. When he was President, George W. Bush rejected the Kyoto Protocols, contending that adhering to the Kyoto Protocols would harm the U.S. economy. And, as did many climate change deniers at the time, he pointed to supposed uncertainty surrounding (1) whether the climate was warming, (2) whether, if it was, human activity was to

⁴ Elizabeth Kolbert, *FIELD NOTES FROM A CATASTROPHE* 39–42 (2006).

⁵ *See id.* at 41 (“By today’s standards, Arrhenius’s work seems primitive. . . . He was missing crucial pieces of information about spectral absorption, and he ignored several potentially important feedbacks.”). Arrhenius, working far before the widespread adoption of the automobile, also did not fully grasp how quickly the phenomenon he had identified would change the Earth’s climate, predicting that doubling the atmospheric concentration of carbon would take 3,000 years, but he “was off by 2800 years.” Timothy E. Wirth, *A Way Forward on Climate Change*, 2 *HARV. L. & POL’Y REV.* 313, 313 (2008).

⁶ Joseph Allan MacDougald, *Paris, Policy, and the Grid: History and Context*, 33 *CONN. J. INT’L L.* 409, 414 (2018).

⁷ *See* Daniel Bodansky, *The United Nations Framework Convention on Climate Change: A Commentary*, 18 *YALE J. INT’L L.* 451, 454 (1993).

⁸ Joseph Allan MacDougald, *Paris, Policy, and the Grid: History and Context*, 33 *CONN. J. INT’L L.* 409, 415 (2018).

blame, and (3) whether, assuming climate change were real and caused by humans, its adverse impact would be serious enough to justify the costs of addressing it.⁹

In the ensuing years, the scientific consensus that climate change was real, caused by humans, and threatened a significant adverse impact, only increased. In 2001, the same year that President Bush withdrew the U.S. from the Kyoto Protocols, the Intergovernmental Panel on Climate Change (“IPCC”) released an assessment stating, among other things, that an “increasing body of observations gives a collective picture of a warming world,” that the 1990s were “very likely” the warmest decade on record, that there was “new and stronger evidence that most of the warming observed over the last 50 years is attributable to human activities,” and that there would likely be significant adverse impacts as a result of climate change.¹⁰ In other words, despite claims that continue to persist from some about significant uncertainty surrounding the reality and impact of climate change, the scientific consensus has for decades been coalescing around the reality of the phenomenon and the need for urgent action. The IPCC’s 2014 report was even more explicit: It cited to unmistakable warming and “confirm[ed] that human influence on the climate is clear and growing, with impacts observed across all continents and oceans.”¹¹

Reflecting the widespread, global consensus regarding the need to combat climate change, in 2015, nearly every country on Earth joined the Paris Climate Agreement, pledging to reduce greenhouse gas emissions so as to limit warming to less than 2 degrees Celsius from pre-industrial levels.¹² More recently, the U.S. and other nations have redoubled their commitment to combating climate change, pledging to cut emissions by even more than originally agreed; these new commitments have been described as both aggressive yet potentially insufficient, which

⁹ Riley Beggin, *The Last Time a U.S. President Dumped a Climate Deal*, ABCNEWS (Jun. 1, 2017), <https://abcnews.go.com/Politics/time-us-president-dumped-global-climate-deal/story?id=47771005>.

¹⁰ IPCC, CLIMATE CHANGE 2001 SYNTHESIS REPORT 4–6 (https://gridarendal-website-live.s3.amazonaws.com/production/documents/:s_document/285/original/spm.pdf?1488203630).

¹¹ IPCC, CLIMATE CHANGE 2014 SYNTHESIS REPORT v, https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf.

¹² United Nations, PARIS AGREEMENT (last visited Jun. 7, 2021), <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>. Reflecting the ongoing politicization of climate issues in the U.S., in 2017 former President Donald Trump withdrew America from the Paris Agreement. Michael D. Shear, *Trump Will Withdraw U.S. From Paris Climate Agreement*, N.Y. TIMES (Jun. 1, 2017), <https://www.nytimes.com/2017/06/01/climate/trump-paris-climate-agreement.html>. Reflecting the fact that the arguments against acknowledging the reality of climate change and the necessity of combating it are not based in anything approaching fact or reality, Trump’s speech announcing the withdrawal was littered with falsehoods. Vanessa Schipani, et al., *FactChecking Trump’s Climate Speech*, FACTCHECK.ORG (Jun. 1, 2017), <https://www.factcheck.org/2017/06/factchecking-trumps-climate-speech/>. As one of his first acts in office, President Biden rejoined the Paris Agreement. Nathan Rott, *Biden Moves to Have U.S. Rejoin Climate Accord*, NPR (Jan. 20, 2021), <https://www.npr.org/sections/inauguration-day-live-updates/2021/01/20/958923821/biden-moves-to-have-u-s-rejoin-climate-accord>.

underscores the inevitability of dramatic societal and economic transformation in the face of climate change.¹³

Ultimately, nearly 100% of climate scientists agree that the climate is warming, that humans are a significant driving factor in causing that warming, and that the adverse consequences, both financial and otherwise, from this warming will be significant.¹⁴ Scientists broadly agree that there needs to be a drastic reduction in greenhouse gas emissions in a short period of time, with the U.N. estimating in 2019 that emissions will need to drop by 7.6% each year from 2020–2030 to prevent the Earth from warming more than 1.5 to 2 degrees Celsius above pre-industrial levels. The scientific consensus identifies this path as the essential target we must reach to avoid the worst effects of climate change.¹⁵

The impact from both the effects of climate change itself and the significant policy changes required to forestall the worst of those effects will be broad, touching nearly every aspect of society. This, of course, includes the economic impacts, which one study confirmed will be negative and will apply broadly “to poor or rich, and hot and cold countries alike, as economic growth is affected not only by higher temperatures but also by the degree of climate variability.”¹⁶ By one estimate, the impact of climate change could result in a loss to the American economy of 2% of GDP per year.¹⁷ Another study determined that climate change could wipe off \$23 trillion in global wealth by 2050.¹⁸

Indeed, we are already seeing the consequences of climate change play out commercially and economically, as the “price of homes along the U.S.’s eastern seaboard battered by fiercer

¹³ Brad Plumer & Nadja Popovich, *The U.S. Has a New Climate Goal. How Does it Stack Up Globally?*, N.Y. TIMES (Apr. 22, 2021), <https://www.nytimes.com/interactive/2021/04/22/climate/new-climate-pledge.html>.

¹⁴ David Herring, *Isn't There a Lot of Disagreement Among Climate Scientists About Global Warming*, CLIMATE.GOV (Feb. 3, 2020), <https://www.climate.gov/news-features/climate-qa/isnt-there-lot-disagreement-among-climate-scientists-about-global-warming>.

¹⁵ Brady Dennis, *In Bleak Report, U.N. Says Drastic Action Is Only Way to Avoid Worst Effects of Climate Change*, WASH. POST (Nov. 26, 2019), <https://www.washingtonpost.com/climate-environment/2019/11/26/bleak-report-un-says-drastic-action-is-only-way-avoid-worst-impacts-climate-change/>.

¹⁶ See Matthew E. Kahn, et al., LONG-TERM MACROECONOMIC EFFECTS OF CLIMATE CHANGE: A CROSS-COUNTRY ANALYSIS 4, (NBER Working Paper No. 26167) (Aug. 2019) (finding that climate change has a negative impact on long-term growth and that “our empirical findings apply equally to poor or rich, and hot or cold countries”), https://www.nber.org/system/files/working_papers/w26167/w26167.pdf.

¹⁷ The Hamilton Project and the Stanford Institute for Economic Policy Research, TEN FACTS ABOUT THE ECONOMICS OF CLIMATE CHANGE AND CLIMATE POLICY 7 (2019), https://www.brookings.edu/wp-content/uploads/2019/10/Environmental-Facts_WEB.pdf.

¹⁸ Christopher Flavelle, *Climate Change Could Cut World Economy by \$23 Trillion in 2050, Insurance Giant Warns*, N.Y. TIMES (Apr. 22, 2021), <https://www.nytimes.com/2021/04/22/climate/climate-change-economy.html>.

storms and higher seas is lagging behind those inland” while the “price of farmland is rising in North America’s once-frigid reaches, partly because of bets it will become more temperate.”¹⁹ Ultimately, climate change and the efforts to ameliorate its worst effects will have a significant impact on where and how people live and work, their travel patterns, patterns of energy consumption, the value and insurability of assets, how goods move, and every other aspect of the economy. Such significant dislocations to economic and commercial activity can be expected to have a noticeable impact on nearly every business and commercial enterprise operating in what is a globally interconnected economy.

PHYSICAL AND TRANSITION RISKS FROM CLIMATE CHANGE

The Release subdivides the economic risks from climate change into two categories: physical risk and transition risk. This division comports with a growing consensus on analytical frameworks for responding to climate change,²⁰ and these concepts are now firmly entrenched in financial regulatory discourse, as evidenced by the recent work of both the Financial Stability Oversight Council²¹ and the CFTC’s own Market Risk Advisory Committee.²² Each type of risk creates its own implications for the CFTC’s statutory mandates and mission. Although both types of risk are highly likely to have significant impacts over the long term, they entail significant uncertainty in timing, scope, and magnitude, and their realization at particular points in time, place, or domain is difficult to predict.

A. Physical Risks

The Release explains physical risks as “characterized by harm caused by acute, climate-related events such as hurricanes, wildfires, floods, and heatwaves; and chronic shifts in precipitation patterns, sea level rise, and ocean acidification.”²³ Advances in modeling and other techniques have better enabled scientists to approximate the degree to which climate change is driving increased physical risk through extreme events and disaster. Accordingly, scientists have

¹⁹ Bradley Hope & Nicole Friedman, *Climate Change Is Forcing the Insurance Industry to Recalculate*, WALL ST. J (Oct. 2, 2018), https://www.wsj.com/graphics/climate-change-forcing-insurance-industry-recalculate/?mod=article_relatedinline.

²⁰ See, e.g., Task Force on Climate-Related Disclosures, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES 5–6 (2017), <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf>.

²¹ See Financial Stability Oversight Council (“FSOC”), REPORT ON CLIMATE-RELATED FINANCIAL RISK 2021 12 (2021), <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>.

²² See Mkt. Risk Advisory Comm., CFTC, MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM: REPORT OF THE CLIMATE-RELATED MARKET RISK SUBCOMMITTEE ch. 2 (2020), <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>.

²³ Release, 87 Fed. Reg. at 34,857.

confidently concluded that climate change has made devastating wildfires, such as those that have raged in Australia, California, and other places in recent years, more likely to occur and more damaging when they do occur.²⁴

Scientists have also pointed to climate change as a likely contributing factor behind 2020's record-shattering hurricane season, in which there were so many named storms that the World Meteorological Organization's list of names for the season was exhausted and the organization had to resort to naming storms using the Greek alphabet.²⁵ Ultimately, the number of ecological and climate disasters causing at least \$1 billion in damage has increased, with 2020 seeing an astonishing and record-setting 22 such events costing \$95 billion in damage and over 250 lives, a trend scientists attribute to climate change.²⁶ As time goes on, the urgency of climate change only becomes more apparent. For example, it was recently reported that, in 2021, 40% of Americans live in counties hit by climate-related disasters.²⁷ A major credit rating agency estimates that "92% of the world's largest companies will have at least one asset at high exposure to a climate change physical hazard by the 2050s."²⁸

B. Transition Risks

The Release defines transition risks as "stresses to certain financial institutions or sectors that result from shifts in policy, regulations, customer and business preferences, technology, credit or insurance availability, or other market or social forces that can affect business operations."²⁹ Addressing these transition risks has long been recognized as a growing imperative for many businesses. In a 2007 issue of the *Harvard Business Review* dedicated to climate change, the editors explained that as the widespread impacts from climate change make themselves felt,

²⁴ Henry Fountain, *Climate Change Affected Australia's Wildfires, Scientists Confirm*, N.Y. TIMES, (Mar. 4, 2020), <https://www.nytimes.com/2020/03/04/climate/australia-wildfires-climate-change.html>; Henry Fountain, *In a Warming California, a Future of More Fire*, N.Y. TIMES (Dec. 7, 2017), <https://www.nytimes.com/2020/09/08/climate/california-wildfires-climate.html>.

²⁵ James H. Ruppert, Jr. & Allison Wing, *This Year's Record Breaking Hurricane Season is Raising More Concerns About Climate Change*, PBS NEWSHOUR (Dec. 1, 2020), <https://www.pbs.org/newshour/science/this-years-record-breaking-atlantic-hurricane-season-is-raising-more-concerns-about-climate-change>.

²⁶ Thomas Frank, *Billion-Dollar Disasters Shattered U.S. Record in 2020*, SCIENTIFIC AMERICAN (Jan. 11, 2021), <https://www.scientificamerican.com/article/billion-dollar-disasters-shattered-u-s-record-in-2020/>.

²⁷ Sarah Kaplan & Andrew Ba Tan, *More than 40 percent of Americans live in counties hit by climate disasters in 2021*, WASH. POST (Jan. 5, 2022), <https://www.washingtonpost.com/climate-environment/2022/01/05/climate-disasters-2021-fires/>.

²⁸ Press Release, "S&P Global Sustainable1 Launches Physical Risk Exposure Scores and Financial Impact," S&P GLOBAL (Sept. 15, 2022), https://press.spglobal.com/2022-09-15-S-P-Global-Sustainable1-Launches-Physical-Risk-Exposure-Scores-and-Financial-Impact?mkt_tok=NDkxLVZORy03OTAAAAGG4EPYiEMLBeQtjVCWRIx03UdYKTvWAj1skST9SvZ004NXeqqmislpu6iM2nGwZpLpPYb73fMiyntQ8Hlv6A.

²⁹ Release, 87 Fed. Reg. at 34,857.

“businesses that continue to sit on the sidelines will be badly handicapped relative to those that are now devising strategies to reduce risk and find competitive advantage in a warming, carbon-constrained world.”³⁰ In that same issue, business academics explained that climate change had transitioned from a “social responsibility” issue to an issue that will directly impact a business’s competitiveness and, ultimately, bottom line:

Companies that persist in treating climate change solely as a corporate social responsibility issue, rather than a business problem, will risk the greatest consequences. Of course, a company’s climate policies will be affected by stakeholder expectations and standards for social responsibility. But the effects of climate on companies’ operations are now so tangible and certain that the issue is best addressed with the tools of the strategist, not the philanthropist.³¹

Unsurprisingly, the direct link between the necessary steps to address climate risk and businesses’ bottom line has only become clearer since the admonitions of the *Harvard Business Review* in 2007. One catalyst for this was the 2015 Paris Accords, in which nearly every country on Earth committed to significant reductions in carbon emissions to limit warming to 1.5 to 2 degrees Centigrade and avoid the worst effects of climate change. This resolve signaled that policymakers around the world were committed to taking drastic action to combat climate change, drastic action that will clearly have a commercial impact.³²

Transition risks have become more apparent and acute as the physical risks of climate change have become apparent in the last few years in a way in which they were not previously evident. As explained above, there has been a significant increase in costly environmental disasters, including large storms, severe droughts, and devastating wildfires, which improvements in modeling have allowed scientists to tie to climate change. This has had an impact on businesses’ assessment of climate change in at least two related ways. First, it illustrated the degree to which climate change makes sudden, catastrophic events that could pose an existential threat to a company more likely, challenging assumptions that the threats from climate change would be more

³⁰ Editor’s Note in *Climate Business/Business Climate*, HARVARD BUSINESS REVIEW (Oct. 2007), <https://hbr.org/2007/10/climate-business--business-climate>.

³¹ Michael E. Porter & Forest L. Reinhardt, *Grist: A Strategic Approach to Climate* in *Climate Business/Business Climate*, HARVARD BUSINESS REVIEW (Oct. 2007), <https://hbr.org/2007/10/climate-business--business-climate>.

³² David Hodari, *For Business, Climate Change Has Become Real*, WALL ST. J. (Dec. 17, 2019) (“The turning point for business came in 2015, with the United Nations Climate Change Conference in Paris. . . . Activists were already calling for more government oversight on industry, and investors were pressuring companies on environmental issues. The agreement accelerated those trends, and was a crucial driver in making the corporate sector take climate change into account when doing business.”), https://www.wsj.com/articles/business-worries-about-climate-intensify-their-actions-less-so-11547643600?mod=article_inline.

gradual and, perhaps, less widespread.³³ Deloitte recently explained that climate change and extreme weather alone “directly impact 70% of all economic sectors worldwide routinely.”³⁴ Second, it made the impacts of climate change more concrete and real for consumers, investors, and other individuals whose dollars companies are ultimately trying to attract. As one CEO cogently explained, businesses need to abandon merely symbolic gestures because consumers now know more clearly than ever what is at stake:

“Consumers had first-hand exposure to the real-life impacts of climate change this year with record-breaking wildfires and the worst air pollution the U.S has ever seen. Now that they’re painfully aware that this is directly affecting them, they will no longer be amused by far-off climate initiatives with symbolic names like ‘Vision 2030.’”³⁵

This has led to a widespread recognition that businesses must account for climate change as a part of their primary mission of maximizing profits. At a recent conference on climate change, the impact on businesses was put in stark terms:

The climate-related shift could be as transformational as the advent of the internet. Businesses that do not adapt will be at risk, while those that embrace change will see greater opportunities. Dr. Bell [the Asia-Pacific climate change and sustainability services leader for Ernst & Young] describes climate change as “the greatest economic transformation in our lifetime, because it impacts on every single industry sector. Nobody’s immune.”³⁶

As with physical risks, transition risks are likely to result in greater or extreme volatility in markets for commodity derivatives. Energy futures are perhaps the iconic example as a wide variety of private and public sector pressures drive reductions in the carbon intensity of power production.³⁷ The transition to cleaner forms of energy generation might prove orderly and smooth, or it might prove precipitous and disruptive to financial markets, including commodities derivatives. As one industry voice puts it, “migrating futures market liquidity from one contract

³³ See Russell Gold, *PG&E: The First Climate-Change Bankruptcy, Probably Not the Last*, WALL ST. J. (Jan. 18, 2019), <https://www.wsj.com/articles/pg-e-wildfires-and-the-first-climate-change-bankruptcy-11547820006>.

³⁴ Kristen Sullivan, et al., *Climate Change 101 for Business Leaders*, DELOITTE INSIGHTS (Jan. 6, 2021), <https://www2.deloitte.com/us/en/insights/topics/strategy/economic-impact-climate-change.html>.

³⁵ Edward Segal, *Here’s How Climate Change Crisis Could Impact Business Operations And Policies In 2022*, FORBES (Jan. 1, 2022), <https://www.forbes.com/sites/edwardsegal/2022/01/01/heres-how-climate-change-crisis-could-impact-business-operations-and-policies-in-2022/?sh=717e57fc1568>.

³⁶ Lucy Colback, *The Role of Business in Climate Change*, FIN. TIMES (Dec. 17, 2020), <https://www.ft.com/content/7ab0bfb0-b37c-463d-b132-0944b6fe8e8b>.

³⁷ See Futures Indus. Ass’n, *HOW DERIVATIVES MARKETS ARE HELPING THE WORLD FIGHT CLIMATE CHANGE* 14–15 (2020), https://www.fia.org/sites/default/files/2020-08/FIA%20Climate%20Change%20Policy%20Paper_0.pdf.

to another cannot be done overnight. Market participants need time to unwind their existing positions and bring new contracts into their trading and clearing systems. Transition periods managed ineffectively may result in a lack of real price discovery and increased price volatility for end users and throughout the real economy.”³⁸

COMMENTS

As explained above, climate change poses a real and urgent risk to the financial system and broader economy. Financial regulators, including the CFTC, by definition, have a key role to play in addressing and mitigating the risks posed to the financial system and must proactively do so within their core competencies and statutory authorities. Thus, the Securities and Exchange Commission’s recent proposal on climate-related disclosures for investors focused, appropriately, on requiring issuers to provide comparable and decision-useful information on climate-related risks to investors, so that investors will have critical information on climate risks as they attempt to use the securities markets to secure their financial future.³⁹ The markets the CFTC oversees are primarily concerned with allowing producers of real goods to manage price risk and access a reliable source of price discovery, ultimately helping to maintain stable prices for American consumers. Accordingly, the key role for the CFTC to play in protecting Americans from the financial risks posed by climate change is to ensure that assessment of climate risks is appropriately integrated into risk management frameworks, and to promote stability in commodities derivatives markets and the real economy to which they are tied. Areas the CFTC should focus on, then, include establishing stronger position limits, establishing more robust reporting requirements, ensuring CFTC-regulated entities appropriately account for climate risk, and ensuring integrity in the markets tied to voluntary carbon credits.

1. Strengthen Position Limits to Reduce Harmful Volatility **Release Questions 18–19, 21, 26–27**

Congress has determined that “[e]xcessive speculation” in commodity derivatives “causing sudden or unreasonable fluctuations or unwarranted changes in the price of such commodity, is an undue and unnecessary burden on interstate commerce.”⁴⁰ Congress, therefore, charged the CFTC with the duty to “proclaim and fix [position] limits on the amounts of trading which may be done or positions which may be held by any person, including any group or class of traders” “from time to time” and “[f]or the purpose of diminishing, eliminating, or preventing such burden.”⁴¹ The Commission is further charged by Congress to set position limits, “to the **maximum** extent

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Id.

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The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (Apr. 11, 2022).

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7 U.S.C. § 6a(a)(1).

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Id.

practicable,” to “diminish, eliminate, or prevent excessive speculation” and “ensure that the price discovery function of the underlying market is not disrupted.”⁴²

Position limits enacted under this mandate are critical tools for the CFTC to combat price volatility and ensure the derivatives markets work for commercial producers and the consumers they serve, not for profiteers and speculators looking to make a quick buck. As we have explained before,⁴³ the CFTC’s most recent position limits rulemaking fails to strike the right balance between the producers and consumers the derivatives markets are supposed to serve, and the speculators who have an important, but limited, role to play in derivatives markets.

As climate change, and the attempts to mitigate it, continue to change where people live and work, impact physical infrastructure, disrupt supply chains, and affect commodities production and supply, price pressures on producers and consumers will only get worse, as will price volatility. In short, physical and transition risks will alter commodity supply, demand, and pricing, creating new opportunities for excessive speculation. These threats thus warrant the Commission’s renewed attention to position limits aimed at curbing excessive speculation. Below, we identify specific scenarios for the CFTC to explore, but the CFTC should address these scenarios as part of a broader rulemaking or at least an investigation into current position limits. If the CFTC fails to remedy the deficient position limits rule and to ensure that there are real, meaningful limits on excessive speculation, producers and consumers will suffer even more economic harm from price volatility due to climate change.

A. The CFTC should expand the scope of its aggregate position limits to protect the economy’s transition to lower-carbon technologies.

Certain commodities play an outsized role in the country’s decarbonization transition. The CFTC’s Energy and Environmental Markets Advisory Committee has begun exploring the transition role of some metals especially,⁴⁴ and the CFTC must act now through expanded position limits to ensure that excessive speculation will not disrupt climate-related transitions.

There are clear signs that excessive speculation is related to transition risks. The transportation sector, for example, has witnessed mounting pressures to electrify vehicle power trains. On the regulatory front, California has adopted measures to phase out the use of internal

⁴² *Id.* § 6a(a)(3)(B)(i), (iv) (emphasis added).

⁴³ See generally Better Markets, Comment Letter: Position Limits for Derivatives (RIN 3038-AD99) (May 15, 2020), https://bettermarkets.org/sites/default/files/Better_Markets_Comment_Letter_on_Position_Limits_for_Derivatives_Upload.pdf.

⁴⁴ See CFTC’s Energy and Environmental Markets Advisory Committee to Meet September 20 in Oklahoma, CFTC (Sept. 20, 2022), <https://www.cftc.gov/PressRoom/Events/opaeventeemac092022>.

combustion engines in passenger vehicles by 2035.⁴⁵ At the same time, consumer tastes have shifted towards electric vehicles,⁴⁶ and electric vehicles might soon reach a tipping point at which adoption accelerates rapidly.⁴⁷

Electric vehicle batteries depend heavily on certain key minerals not widely used in conventional automobiles. Perhaps the most prominent of these critical minerals is lithium, a foundational component of most present and expected battery technology.⁴⁸ Lithium markets have recently exhibited wild price spikes even now as markets look forward to future transitions in transportation methods,⁴⁹ an apparent repeat of past “speculative frenzy” over the element’s role in transitioning away from carbon-based fuels.⁵⁰ Now, some of the largest commodities exchanges have begun offering lithium futures precisely to capture the expected increase in financial appetite.⁵¹

While the development of futures markets has the potential to enhance price discovery and provide options for lithium users or producers to hedge price risk, these new offerings are not

⁴⁵ See Cal. Air Res. Bd., *California moves to accelerate to 100% new zero-emission vehicle sales by 2035*, CALIFORNIA AIR RESOURCES BOARD (Aug. 25, 2022), <https://ww2.arb.ca.gov/news/california-moves-accelerate-100-new-zero-emission-vehicle-sales-2035>.

⁴⁶ See Keith Naughton, *A Quarter of Americans Say Their Next Car Will Be an EV*, BLOOMBERG (July 13, 2022) (“A quarter of Americans surveyed say they will buy an electric vehicle as their next automobile as gasoline prices soar to record levels.”), <https://www.bloomberg.com/news/articles/2022-07-13/a-quarter-of-americans-say-their-next-car-will-be-an-ev?sref=mQvUqJZj>.

⁴⁷ See Tom Randall, *US Crosses the Electric-Car Tipping Point for Mass Adoption*, BLOOMBERG (July 9, 2022) (“The US is the latest country to pass what’s become a critical EV tipping point: 5% of new car sales powered only by electricity. This threshold signals the start of mass EV adoption, the period when technological preferences rapidly flip, according to the analysis.”), <https://www.bloomberg.com/news/articles/2022-07-09/us-electric-car-sales-reach-key-milestone?sref=mQvUqJZj>; see also Ira Boudway, *More Than Half of US Car Sales Will Be Electric by 2030*, BLOOMBERG (Sept. 20, 2022), <https://www.bloomberg.com/news/articles/2022-09-20/more-than-half-of-us-car-sales-will-be-electric-by-2030?sref=mQvUqJZj>.

⁴⁸ See Davide Castelvechi, *Electric cars and batteries: how will the world produce enough?*, NATURE (Aug. 17, 2021), <https://www.nature.com/articles/d41586-021-02222-1>.

⁴⁹ See, e.g., Clara Ferreira Marques, *The Great Lithium Squeeze: Elements by Clara Ferreira Marques*, BLOOMBERG (Sept. 20, 2022), https://www.bloomberg.com/opinion/articles/2022-09-20/the-great-lithium-squeeze-elements-by-clara-ferreira-marques-l8a40661?utm_medium=email&utm_source=newsletter&utm_term=220920&utm_campaign=sharetheview&sref=mQvUqJZj.

⁵⁰ Ryan Browne, *Lithium has investors in a ‘frenzy’ — and soon you’ll be able to trade it too*, YAHOO NEWS (Oct. 4, 2017), <https://www.yahoo.com/news/lithium-investors-frenzy-soon-11-052904968.html>.

⁵¹ See *CME Group to Launch Lithium (Fastmarkets) Futures on May 3*, CME GRP. (Apr. 8, 2021), https://www.cmegroup.com/media-room/press-releases/2021/4/08/cme_group_to_launchlithiumfastmarketsfuturesonmay3.html.

intended solely for those in the electric vehicle supply chain; they are instead intended to “open up the battery metals sector to new investors” and “orientate[] these [markets] toward the financial community rather than the battery industry.”⁵² The end goal might be a shift from a market for lithium specialists to one for “generalist investors.”⁵³ In other words, the financial industry is hoping to open up lithium markets for greater speculation. One industry analyst explained that, “[w]ithout the physical delivery of cargoes, it will be a paper market and there may be the risk of it falling into the space of speculation without providing the security from hedging.”⁵⁴

Unfortunately, history teaches us the disruptive effects of opening the door to mass speculation in commodities. When pure investment players dominate a futures market over physical users and producers, the real economy suffers from price spikes or crashes of key commodities—as happened to a variety of commodities in the late 2000s.⁵⁵ We face that threat again in the context of “climate-related” commodity speculation, even though the markets are configured somewhat differently than they were during the wave of speculation that drove the congressional and regulatory processes leading to the current position limits. For example, lithium futures are not (yet) listed in the major commodity indices that drove earlier institutional investment behind price swings.⁵⁶ But those indices may simply be replaced by widespread perception of lithium futures as a vehicle to promote ESG or sustainability investment goals, which have led to “tremendous growth” in the appetite for derivatives.⁵⁷ A major exchange already lists lithium futures among its “ESG Products.”⁵⁸ And some investment entities appear to trumpet cash-settled futures for lithium and other transition-critical minerals as ESG-consistent investments because they are purely speculative: They change neither consumption nor production

⁵² Camille Erickson, *Launch of lithium futures could entice new investors, experts say*, S&P GLOBAL (July 21, 2021) (internal quotation marks omitted), <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/launch-of-lithium-futures-could-entice-new-investors-experts-say-65553977>.

⁵³ *Id.* (internal quotation marks omitted).

⁵⁴ Annie Lee, *Singapore Bourse Follows Global Rivals With EV Metals Futures*, BLOOMBERG (Sept. 25, 2022) (quoting Leah Chen, analyst at S&P Global Commodity Insights), <https://www.bloomberg.com/news/articles/2022-09-25/singapore-bourse-follows-global-rivals-with-ev-metals-futures?sref=mQvUqJZj>.

⁵⁵ See Michael W. Masters, Testimony Before the Committee on Homeland Security and Governmental Affairs, United States Senate 1–7 (May 20, 2008), <https://www.hsgac.senate.gov/imo/media/doc/052008Masters.pdf>; see also Michael W. Masters & Adam K. White, THE ACCIDENTAL HUNT BROTHERS – ACT 2 1, 3–5 (2008), <https://www.bettermarkets.org/sites/default/files/The%20Accidental%20Hunt%20Brothers%20-%20Part%202.pdf>.

⁵⁶ *See id.*

⁵⁷ Payal Shah, CME Grp., *Four Green Trends to Watch in Financial Markets*, INSTITUTIONAL INVESTOR (May 16, 2022) (discussing demand for ESG-related equity index futures), <https://www.institutionalinvestor.com/article/b1xz09xkgmk01d/four-green-trends-to-watch-in-financial-markets>.

⁵⁸ *ESG Solutions*, CME GRP. (2022) (listing lithium futures under “ESG Products”), <https://www.cmegroup.com/markets/esg.html#overview>.

and therefore do not result in a physical environmental impact.⁵⁹ The stage is thus set for commodities speculation in this arena that could prove extremely disruptive.

These current developments justify at least a Commission investigation as to whether new position limits on lithium futures are necessary to “diminish, eliminate, or prevent excessive speculation.”⁶⁰ The Commission has taken the view that it must make a “necessity” finding before establishing position limits.⁶¹ We have explained in prior comments why the Commodity Exchange Act does not require such a finding.⁶² Nonetheless, the developments described above suggest the Commission would find position limits necessary in transition-critical futures markets based on its current legal framework.

In its last rulemaking on position limits, the Commission identified several factors that could support a necessity finding. Among these is “the especially acute economic burdens that would arise from excessive speculation causing sudden or unreasonable fluctuations or unwarranted changes in the price of the commodities underlying” the contracts at issue⁶³—a concern that hews very closely to the language of the CFTC’s statutory mandate. The economic burden from excessive speculation in futures markets for transition-critical commodities would certainly meet that description.

Lithium, for instance, is central not only to the burgeoning electric vehicle sector but also to battery-centered storage methods to enable renewable power generation.⁶⁴ To the extent that excessive speculation is allowed to disrupt price signals or affordability in such markets, downstream supply chains and manufacturing would suffer, consumers would face higher, and in some cases unacceptable prices, and the national economy as a whole would pay greater costs through unmitigated, or less effectively mitigated, climate change.⁶⁵ The economic burden is therefore far more acute than the current levels of trading in such futures might suggest on their face. The CFTC should therefore examine the prospects for excessive speculation in these markets and act in accordance with its statutory mandate.

⁵⁹ Tim Pickering & Brennan Basnicki, Auspice Capital, COMMODITY INVESTING IN THE AGE OF ESG AND INFLATION 2, 5 (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3947377.

⁶⁰ 7 U.S.C. § 6a(3)(B)(i).

⁶¹ See Position Limits for Derivatives, 85 Fed. Reg. 11,596, 11,664 (proposed Apr. 29, 2020).

⁶² See Better Markets, Comments: Position Limits for Derivatives, *supra* note 43, at 62.

⁶³ Position Limits for Derivatives, 85 Fed. Reg. at 11,664.

⁶⁴ See *Opening Statement of Commissioner Christy Goldsmith Romero Before the Energy and Environmental Markets Advisory Committee*, CFTC (Sept. 20, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement092022>.

⁶⁵ Cf. Position Limits for Derivatives, 86 Fed. Reg. 3236, 3395 (Jan. 14, 2021).

B. The CFTC should revise its current position limits to address the links between climate-related physical risks and excessive speculation.

The entire U.S. economy faces some degree of physical risk from climate change. But the physical risks to some sectors are especially relevant to the CFTC’s statutory mandate to prevent excessive speculation, and the CFTC should revisit some of its prior assumptions or determinations behind existing position limit rules.

Agriculture, for example, is squarely in the crosshairs of climate-related risk.⁶⁶ The Fourth National Climate Assessment sums up the sectoral implications:

Climate change has the potential to adversely impact agricultural productivity at local, regional, and continental scales. Crop and livestock production in certain regions will be adversely impacted both by direct effects of climate change (such as increasing trends in daytime and nighttime temperatures; changes in rainfall patterns; and more frequent climate extremes, flooding, and drought) and consequent secondary effects (such as increased weed, pest, and disease pressures; reduced crop and forage production and quality; and damage to infrastructure). While climate change impacts on future agricultural production in specific regions of the United States remain uncertain, the ability of producers to adapt to climate change through planting decisions, farming practices, and use of technology can reduce its negative impact on production.⁶⁷

As FSOC has recognized, these types of physical risks portend “extreme volatility in commodity and energy markets,”⁶⁸ in part through expected direct and indirect impacts to agricultural production, storage, and transportation.

Recent events provide a sobering illustration. Hurricane Ian has just inflicted enormous damage on the State of Florida, making it “one of the most expensive hurricanes in US history.”⁶⁹ Unfortunately, Ian represents a trend of ever greater and more common destructive power driven by climate change.⁷⁰ Had the same storm occurred a century earlier, it likely would have had much

⁶⁶ See Release, 87 Fed. Reg. at 34,861 (concurring statement of Commissioner Summer K. Mersinger) (calling for greater attention to legacy agriculture contracts or futures markets).

⁶⁷ Prasanna Gowda et al., IMPACTS, RISKS, AND ADAPTATION IN THE UNITED STATES: FOURTH NATIONAL CLIMATE ASSESSMENT, VOLUME II, CHAPTER 10: AGRICULTURE AND RURAL COMMUNITIES 398 (2018), <https://nca2018.globalchange.gov/chapter/10/>.

⁶⁸ FSOC, REPORT ON CLIMATE-RELATED FINANCIAL RISK 2021, *supra* note 21, at 108.

⁶⁹ Lara Williams, *Ian Is a Wake-Up Call on the Real Costs of Climate Paralysis*, BLOOMBERG (Oct. 2, 2022), <https://www.bloomberg.com/opinion/articles/2022-10-02/hurricane-ian-climate-change-makes-storms-bigger-more-expensive-l8rak06o?sref=mQvUqJZj>.

⁷⁰ See *id.* (“Storms have become increasingly more expensive over the past few decades, partly because climate change is altering the hurricanes themselves.”).

less strength.⁷¹ Hurricane Ian was, in other words, a direct manifestation of physical risk. And that risk manifested directly as price swings in the futures markets for agricultural commodities concentrated in Florida.⁷² Hurricane Ian is but one example of a short-term event in one area. But physical risks are expected to drive recurring price swings in other agricultural commodity derivatives over the longer-term.⁷³ In short, the physical risks from climate change threaten exactly the sort of “sudden or unreasonable fluctuations” described in the Commodity Exchange Act as the predicate for position limits.⁷⁴

The potentially extreme and frequent volatility implied by climate-related physical risks points to several specific actions that the CFTC should consider with respect to its core referenced futures contracts and derivatives on those contracts. *First*, the CFTC should reconsider the level of its aggregate limits. When the CFTC last set spot-month limits for 25 core referenced futures contracts, it primarily focused on 25% of deliverable supply, which produced numerical limits that the agency recognized as “relatively high” compared to many then-existing limits imposed by exchanges.⁷⁵ These limits were far too generous to speculators, in large part because the chosen baseline of 25% of deliverable supply for a particular commodity did not sufficiently account for the magnitude of trading in derivatives for that commodity; instead, as Better Markets explained, a rebuttable presumption of 10% of deliverable supply would have been more appropriate to curb speculation.⁷⁶

The implications of physical risk only strengthen the need to reconsider that proposed presumption or otherwise tighten the aggregate limits. The harms from “sudden or unreasonable fluctuations or unwarranted changes in the price of” many commodities, particularly agricultural commodities, will only grow,⁷⁷ and wild price swings will likely be both sharper and more frequent. Position limits can dampen that volatility. Indeed, Congress has determined them to be the best tools to address such problems.

⁷¹ Zahra Hirji, *Hurricane Ian Is a Climate Disaster for the History Books*, BLOOMBERG (Sept. 29, 2022) (quoting “climate scientist Katharine Hayhoe of Texas Tech University and the Nature Conservancy”), <https://www.bloomberg.com/news/articles/2022-09-29/hurricane-ian-is-a-climate-disaster-for-the-history-books?sref=mQvUqJZj>.

⁷² See Tatiana Freitas & Diego Lasarte, *Warped Oranges Far From Ian’s Core Are Bad Sign for Florida*, BLOOMBERG (Sept. 29, 2022) (“Orange juice futures in New York rose 1.1% to \$1.9045 a pound after touching a five-year high on Thursday.”), <https://www.bloomberg.com/news/articles/2022-09-29/warped-oranges-far-from-ian-s-core-are-bad-sign-for-florida-crop?sref=mQvUqJZj>.

⁷³ See, e.g., Rob Jordan, *Climate change may create price volatility in the corn market, say researchers from Stanford and Purdue*, STANFORD NEWS (Apr. 23, 2012) (describing research concluding that “corn price volatility could increase sharply over the period from 2020 to 2040”), <https://news.stanford.edu/news/2012/april/climate-change-corn-041912.html>.

⁷⁴ 7 U.S.C. § 6a(a)(1).

⁷⁵ Position Limits for Derivatives, 86 Fed. Reg. at 3403–04.

⁷⁶ See Better Markets, Comments: Position Limits for Derivatives, *supra* note 43, at 38–43.

⁷⁷ 7 U.S.C. § 6a(a)(1).

Certainly, some of the expected volatility arising from climate-related physical risks can be attributed to basic supply and demand. But the Commission should not assume that physical risks implicate fundamentals alone. Increased volatility would make it easier for speculators to effect corners or squeezes even within current position limits. Similarly, the realization of physical risk can create feedback mechanisms to amplify speculation to extreme levels beyond supply and demand. When, for example, the key physical storage facility for West Texas Intermediate oil at Cushing, Oklahoma began to reach 80% of capacity, futures for WTI began to swing wildly, at one point reaching severely negative prices.⁷⁸ Speculators had been caught by unexpected developments, could not take physical delivery, and were forced to amplify volatility far beyond fundamentals.⁷⁹

Perhaps more fundamentally, the realization of physical risk in particular situations—where, when, how quickly, how often, and how badly extreme events might occur—is highly uncertain, and there is likely to be considerable divergence among forecasts and views of market participants as to physical risk for specific commodities. The divergence in these views is only likely to drive greater speculation as some investors believe they have identified arbitrage opportunities. Indeed, the very prospect of volatility is likely to draw the interest of the sharpest speculators. Recent history demonstrates that commodity-focused hedge funds are “the major beneficiaries of exceptionally volatile commodity markets.”⁸⁰ Price volatility, whether up or down, represents greater opportunities for speculative profit,⁸¹ which in turn can simply sharpen the volatility.

Second, the Commission should reconsider its overly accommodating approach to hedging exemptions. This would be necessary in large part to ensure that any revised position limits remained effective. There are numerous problems with the current mechanisms for self-effectuated hedging; we have documented those extensively in past comments and incorporate

⁷⁸ See Better Markets, Comments: Position Limits for Derivatives, *supra* note 43, at 5–8; see also Nathaniel Lee, *How negative oil prices revealed the dangers of the futures market*, CNBC (June 16, 2020); Stanley Reed & Clifford Kraus, *Too Much Oil: How a Barrel Came to Be Worth Less Than Nothing*, N.Y. Times (Apr. 20, 2020), <https://www.nytimes.com/2020/04/20/business/oil-prices.html>.

⁷⁹ See *id.*

⁸⁰ Julie Steinberg, *Commodity-Trading Hedge Funds Are Having a Strong Year*, WALL ST. J. (Oct. 5, 2022), <https://www.wsj.com/articles/commodity-trading-hedge-funds-are-having-a-strong-year-11664958318>.

⁸¹ See *id.* (describing a quantitative trading firm’s decision “to place bets that natural gas and oil would fall” after its “models started reflecting a more bearish outlook”); see also Interagency Working Grp. for the Study on Oversight of Carbon Markets, REPORT ON THE OVERSIGHT OF EXISTING AND PROSPECTIVE CARBON MARKETS 17 (2011) (“Market participants could also seek to enter derivative contracts . . . in an attempt to realize profits through the successful anticipation of price movements, or to take advantage of a perceived mispricing within a given market, or between related markets.”), https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/dfstudy_carbon_011811.pdf.

them again here.⁸² Here, however, we identify one specific problem uniquely tied to physical risks from climate change.

The current position limit rules eliminated requirements to report monthly cash-market positions directly to the Commission, with only indirect, annual reporting as a replacement.⁸³ The loss of this monthly reporting significantly weakened the CFTC’s ability to deter violations of position limits,⁸⁴ and that problem can be expected to worsen under climate-related physical risks. Suppose, for instance, that an extreme weather event destroyed or adversely impacted physical quantities of a commodity held by a producer. The Commission will have very little insight now into the change in facts on the ground, and the producer might simply use the agency’s ignorance of its event to carry on as if its positions were still intended to hedge production that no longer exists.⁸⁵ In short, the Commission would be blind to the fact that *bona fide* hedging parameters had been exceeded.

Revisions to position limit regulations along the lines described above can protect Americans from the costs of excessive speculation tied to climate risks. Although perhaps forward-looking, concerns over these costs are not academic. Excessive speculation harms not only the pocketbooks of every citizen who must purchase food but also the rural farmers and other producers who depend on stable, well-functioning markets.⁸⁶ Thus, a renewed focus on robust position limits can be one “potential policy solution[] addressed to climate-related financial impact that the Commission should consider as it pertains to financially vulnerable populations in particular.”⁸⁷

2. Ensure Risk Management Frameworks and Reporting Account for Climate Risk Release Questions 1–4, 7–12

While position limits can ameliorate the consequences of climate risk for commodities users and producers as well as consumers, the Commission should also take care that climate-related risk does not impair the market infrastructure for commodities. It can do so by updating its regulations for both risk management and reporting.

A. The Commission should fortify risk management mechanisms.

The derivatives markets, including those for commodities, allow risk to migrate to those entities best equipped to handle it. Thus, commercial producers whose operations cannot handle

⁸² See Better Markets, Comments: Position Limits for Derivatives, *supra* note 43, at 46–63.

⁸³ See Position Limits for Derivatives, 86 Fed. Reg. at 3246.

⁸⁴ See Better Markets, Comments: Position Limits for Derivatives, *supra* note 43, at 59.

⁸⁵ See 17 C.F.R. pt. 150, app. A(a)(4).

⁸⁶ See *Opening Statement of Commissioner Christy Goldsmith Romero Before the Energy and Environmental Markets Advisory Committee*, CFTC (Sept. 20, 2022), <https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement092022>.

⁸⁷ Release, 87 Fed. Reg. at 34,860.

price risk use derivatives markets to hedge that risk, unloading it to those that are better able and willing to handle it. Similarly, several intermediaries in the derivatives markets specifically facilitate trading by taking on risks that other market participants cannot take on.

For example, derivatives clearing organizations (“DCOs”)⁸⁸ assume the counterparty credit risk for each of their members by essentially becoming the counterparty to every contract. This helps facilitate trading, but it also means that risk builds up and concentrates at a few entities—if DCOs or other entities that perform similar risk management functions for the derivatives markets fail, it could be disastrous for the financial system. This is why such entities are comprehensively regulated, to ensure they have a risk management framework that will prevent failure even in times of severe stress. Thus, for the CFTC’s regulatory framework to protect against climate-related financial risk—both physical and transition risk—the agency must ensure that the risk management framework of the entities it oversees, particularly DCOs, robustly accounts for climate risks.

Physical risk, for instance, is likely to cause sudden, sharp, or even catastrophic losses to physical inventory or infrastructure needed for physical delivery. This could result in cascading defaults by market participants directly impacted by such events, and their counterparties would suddenly face much greater exposure. Alternatively, transition risks might produce strong, consistent downward or upward price pressures in particular markets, perhaps sharply if precipitated by unexpected regulatory or legislative developments. Perhaps worst of all, the DCO’s own physical facilities or key service providers might be impacted by climate-related disasters.

In principle, the Commission can combat these risks through the existing legal framework of the Commodity Exchange Act and its Core Principles for DCOs,⁸⁹ but the Commission could refine the application of these principles to climate-related risks through new rulemakings. For instance, DCOs should incorporate physical and transition risks into the “extreme but plausible market conditions” under which they determine the adequacy of their financial, operational, and managerial resources.⁹⁰ A DCO’s risk management framework should identify specific physical and transition risks faced by participants and the DCO itself,⁹¹ and the CFTC could incorporate that very type of consideration in its current rulemaking on risk management committees at DCOs.⁹² Margin requirements will need to be updated to account for unique physical or transition

⁸⁸ See generally 7 U.S.C. § 7a-1.

⁸⁹ See *id.* § 7a-1(c)(2).

⁹⁰ 17 C.F.R. § 39.11(a)(1).

⁹¹ See *id.* § 39.13(b) (requiring a written risk management framework that “clearly identifies and documents the range of risks to which the derivatives clearing organization is exposed, addresses the monitoring and management of the entirety of those risks, and provides a mechanism for internal audit”).

⁹² See generally Governance Requirements for Derivatives Clearing Organizations, 87 Fed. Reg. 49,559 (proposed Aug. 11, 2022).

risks behind “particular products or portfolios.”⁹³ Finally, the DCO’s continuity and recovery planning must be able to account for the special physical risks its systems might face.⁹⁴

The Release nods towards climate-based scenario analysis as one tool to aid risk management.⁹⁵ That approach is now a well-established tool for contingency planning around climate-related risks,⁹⁶ and the CFTC should encourage the use of these scenarios through direct cooperation with DCOs or other regulated parties. However, this tool should carry two important qualifications. First, any Commission endorsement of scenario analysis should be clear that approved or exemplary scenarios are meant to introduce users to and inform them about the intricacies of climate risk uncertainty; the scenarios are not intended as official forecasts.⁹⁷ Second, the use of climate-related scenarios should not be pure theater; a DCO or other entity employing scenario analysis must be required to act on any potential vulnerabilities or blind spots identified through these methods.

B. The CFTC should fortify reporting requirements.

The Commission should also update reporting requirements both to identify climate-related risks to commodities markets and to allow those markets to better aid transitions to a climate-friendly economy. As to the former goal, a prerequisite to properly managing risk is having a robust understanding of where risks are originating. Indeed, regulators’ lack of understanding of various risks building up in the financial system helped cause and exacerbate the crisis, as the Financial Crisis Inquiry Commission explained:

As they now realized, regulators did not know nearly enough about over-the-counter derivatives activities at Lehman and other investment banks, which were major OTC derivatives dealers. Investment banks disclosed the total number of OTC derivative contracts they had, the total exposures of the contracts, and their estimated market value, but they did not publicly report the terms of the contracts or the counterparties. Thus, there was no way to know who would be owed how much and when payments would have to be made—information that would be critically important to analyze the possible impact of a Lehman bankruptcy on derivatives counterparties and the financial markets.⁹⁸

⁹³ See 17 C.F.R. § 39.13(g)(2)(i).

⁹⁴ See *id.* § 39.18(c).

⁹⁵ See Release, 87 Fed. Reg. at 34,859.

⁹⁶ See Task Force on Climate-Related Financial Disclosures, TECHNICAL SUPPLEMENT: THE USE OF SCENARIO ANALYSIS IN DISCLOSURE OF CLIMATE-RELATED RISKS AND OPPORTUNITIES 2–4 (2017), <https://assets.bbhub.io/company/sites/60/2021/03/FINAL-TCFD-Technical-Supplement-062917.pdf>.

⁹⁷ See *id.* at 3.

⁹⁸ FINANCIAL CRISIS INQUIRY REPORT 329 (2011), <https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

The CFTC must not make this same mistake with respect to risks posed by climate change. Thus, the CFTC should ensure that its reporting requirements appropriately incorporate data related to climate risks.⁹⁹ One promising proposal is to “benchmark the carbon emissions associated with a commodity contract to determine its emissions footprint.”¹⁰⁰ This would not only help “companies seeking to measure their carbon emissions,”¹⁰¹ thereby aiding their own transitions away from carbon-intensive operations, but, along with other reporting requirements applicable to designated contract markets, swap execution facilities, futures commission merchants, and other entities registered with the CFTC, will allow the CFTC and other regulators to see where climate-related risk is building up within the financial system.

For any proposal to improve reporting, the CFTC should anchor it in the framework of the Greenhouse Gas Protocol. The Protocol is widely used by the private and public sectors to categorize and account for greenhouse gas emissions.¹⁰² Furthermore, the Securities and Exchange Commission has proposed new disclosure requirements based on the Protocol,¹⁰³ and harmonizing the requirements of each agency is likely to aid implementation and promote more robust compliance.

These improvements to reporting would be consistent with regulatory calls for greater transparency in climate risk. The CFTC itself has identified as a major concern for regulators “what we don’t know,” and it has therefore emphasized that:

building on the firm-level disclosures provided by issuers, U.S. financial regulators would be better able to understand the impacts of climate change on financial markets. This greater understanding would allow them to issue relevant guidance or regulation needed to improve the resilience of financial markets in the face of this risk and uncertainty. By the same token, state and local governments—and community members themselves—would be better able to understand how companies in their localities are preparing for climate risks and opportunities that could impact the local economy, labor force, and tax base.¹⁰⁴

⁹⁹ See, e.g., 17 C.F.R. pt. 16.

¹⁰⁰ Todd Phillips, Center for American Progress, *A Climate and Competition Agenda for the Commodity Futures Trading Commission*, CENTER FOR AMERICAN PROGRESS (Feb. 1, 2022), <https://www.americanprogress.org/article/a-climate-and-competition-agenda-for-the-commodity-futures-trading-commission/>.

¹⁰¹ *Id.*

¹⁰² See *Standards*, GREENHOUSE GAS PROTOCOL (last visited Oct. 5, 2022), <https://ghgprotocol.org/standards>.

¹⁰³ See The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334, 21,343–45 (proposed Apr. 11, 2022).

¹⁰⁴ Mkt. Risk Advisory Comm., CFTC, MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM: REPORT OF THE CLIMATE-RELATED MARKET RISK SUBCOMMITTEE, *supra* note 22, at i, 88.

Similarly, FSOC has explained that enhanced disclosure of climate-risks by companies, along the lines suggested in the Release, will not only “better inform investors and market participants about the climate-related risks to those entities,” but also, in combination “these disclosures can also better inform market participants and regulators about climate-related risks to industry sectors and the financial system.”¹⁰⁵ And the Financial Stability Board, for its part, has explained that “[h]igh-quality corporate disclosures enable market participants to make better informed decisions, such as on pricing and allocation of capital, and they help financial authorities to better assess the resilience of financial institutions and the overall financial system to climate-related risks.”¹⁰⁶

3. Ensure Integrity in Markets for Voluntary Carbon Credits and Their Derivatives **Release Questions 22–23, 26**

As the Commission has recognized in its landmark report on climate risk, market mechanisms must play a critical role in any transition to a net-zero emissions economy.¹⁰⁷ And as the Commission has also recognized, voluntary carbon credits (“VCCs”) or carbon offsets can, in theory, facilitate that transition—but only if they generally work as advertised.¹⁰⁸ That these credits will actually serve their purported purpose is far from clear, however, and the Commission should therefore exercise “enhanced . . . oversight” by investigating integrity issues and practices in both the primary and derivatives markets for these credits.¹⁰⁹

VCCs “are certificates representing quantities of greenhouse gases that have been kept out of the air or removed from it.”¹¹⁰ Each credit typically represents one metric ton of carbon dioxide equivalent removed or avoided, and credits are generally serialized, traded, tracked, and retired

¹⁰⁵ FSOC, REPORT ON CLIMATE-RELATED FINANCIAL RISK 2021, *supra* note 21, at 67.

¹⁰⁶ Fin. Stability Bd., FSB ROADMAP FOR ADDRESSING CLIMATE-RELATED FINANCIAL RISKS 1 (2021), <https://www.fsb.org/wp-content/uploads/P070721-2.pdf>.

¹⁰⁷ Mkt. Risk Advisory Comm., CFTC, MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM: REPORT OF THE CLIMATE-RELATED MARKET RISK SUBCOMMITTEE, *supra* note 22, at ii.

¹⁰⁸ *Opening Statement of Chairman Rostin Behnam at the CFTC Voluntary Carbon Markets Convening, Washington, DC*, CFTC (June 2, 2022) (“There is enormous potential for companies in all sectors to meet sustainability goals and net zero commitments. But emission reduction is not a one-size-fits all undertaking. While carbon offsets may provide an efficient and cost-effective means to check that box and populate the balance sheet, if those offsets do not represent true abatement either because they lack integrity, or the underlying infrastructure lacks transparency, then VCMs may remain in a perpetual limbo akin to being stuck in a regulatory sandbox.”), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060222>.

¹⁰⁹ Release, 87 Fed. Reg. at 34,860.

¹¹⁰ Christopher Blaufelder et al., *A blueprint for scaling voluntary carbon markets to meet the climate challenge*, MCKINSEY (Jan. 29, 2021), <https://www.mckinsey.com/capabilities/sustainability/our-insights/a-blueprint-for-scaling-voluntary-carbon-markets-to-meet-the-climate-challenge>.

through private electronic registries.¹¹¹ As the term “voluntary” suggests, VCCs are not required by any binding regulatory program.

If nothing else, the VCC business is booming. “More than 5,000 companies have signed a U.N. pledge to eliminate or offset their greenhouse-gas emissions by 2050. Around a third of the companies in the S&P 500 index now have such pledges.”¹¹² Driven by these pledges, roughly \$2 billion in VCCs changed hands last year alone.¹¹³ Various estimates project that number will climb by orders of magnitude over the coming decades.¹¹⁴

As demand for VCCs boom, service providers have rushed to set up online marketplaces,¹¹⁵ and some large companies are marketing offsets to consumers as complements to their goods or

¹¹¹ See Integrity Council for the Voluntary Carbon Market, CORE CARBON PRINCIPLES, ASSESSMENT FRAMEWORK ASSESSMENT PROCEDURE PART 5: TERMS AND DEFINITIONS 2 (2022) (defining “carbon credit”), <https://icvcm.org/wp-content/uploads/2022/07/ICVCM-Public-Consultation-FINAL-Part-5.pdf>.

¹¹² Shane Shifflett, *Companies Are Buying Large Numbers of Carbon Offsets That Don’t Cut Emissions*, WALL. ST. J. (Sept. 8, 2022), <https://www.wsj.com/articles/renewables-carbon-credits-do-not-cut-emissions-united-nations-verra-gold-standard-11662644900>.

¹¹³ See *id.* (citing *VCM Reaches Towards \$2 Billion in 2021: New Market Analysis Published from Ecosystem Marketplace*, ECOSYSTEM MARKETPLACE (Aug. 3, 2022), <https://www.ecosystemmarketplace.com/articles/the-art-of-integrity-state-of-the-voluntary-carbon-markets-q3-2022/>).

¹¹⁴ See *Opening Statement of Chairman Rostin Behnam at the CFTC Voluntary Carbon Markets Convening, Washington, DC*, CFTC (June 2, 2022) (“Some forecast that additional financing from carbon markets could exceed \$1 trillion by 2050.”), <https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060222>; Christopher Blaufelder et al., *A blueprint for scaling voluntary carbon markets to meet the climate challenge*, *supra* note 110 (“Overall, the market for carbon credits could be worth upward of \$50 billion in 2030.”).

¹¹⁵ Brody Ford, *Salesforce Launches Marketplace for Carbon Emission Offsets*, BLOOMBERG (Sept. 20, 2022), https://www.bloomberg.com/news/articles/2022-09-20/salesforce-unveils-marketplace-for-carbon-emission-offsets?cmpid=BBD092322_GREENDAILY&utm_medium=email&utm_source=newsletter&utm_term=220923&utm_campaign=greendaily&sref=mQvUqJZj.

services.¹¹⁶ The growth of VCC issuance has prompted major exchanges to list VCC futures, as well.¹¹⁷ One futures exchange has now witnessed futures trades equal to 135 million VCCs.¹¹⁸

And it should be remembered that VCCs are a *business*; many sponsors or issuers of these credits are for-profit entities. As demand rises and quickly outstrips existing stocks and new supply, issuers have every incentive to cut corners on quality.¹¹⁹ And an abundance of anecdotal evidence suggests that many VCCs lack any true carbon reduction or offsetting function. Indeed, public information alone indicates that some of the most popular VCCs based on forest preservation cover “land [that] was never threatened” and “already . . . well-preserved forests;”¹²⁰ a foreign country halted verification of a 70 million-VCC project for a peat swamp forest;¹²¹ credits based on supporting wind energy in China did not matter to the financial viability of the wind farms;¹²² two of the largest VCC registries have stopped accrediting VCCs based on renewable energy projects for similar reasons;¹²³ regulatory forest preservation offsets in California have systemically overstated carbon reductions;¹²⁴ reductions from VCC projects in Brazilian rainforest

¹¹⁶ See, e.g., *CarbonChoice carbon offset program*, UNITED AIRLINES (2021) (“With our Eco-Skies® CarbonChoice carbon offset sponsorship program, we’ll purchase carbon offsets on behalf of our customers so all their corporate air travel with us is 100% carbon neutral.”), <https://www.united.com/ual/en/us/fly/company/global-citizenship/environment/carbon-offset-program.html>.

¹¹⁷ *CME Group’s Voluntary Carbon Emissions Offset Contracts Surpass 100 Million Offsets Traded*, CME GRP. (Apr. 27, 2022), https://www.cmegroup.com/media-room/press-releases/2022/4/27/cme_group_s_voluntarycarbonemissionoffsetcontractssurpass100mil.html.

¹¹⁸ *ESG Update*, CME GRP. (Aug. 5, 2022), https://www.cmegroup.com/newsletters/quarterly-esg-update/2022-q2-esg-update.html?itm_source=cmegroup&itm_medium=news_tile&itm_campaign=esg_update.

¹¹⁹ See Shane Shifflett, *Carbon-Credit Surplus Could Soon Turn to Shortage*, WALL ST. J. (Sept. 24, 2022) (“The two primary types of credits—renewable energy and forest preservation, which together account for the bulk of credits—have limits to their growth. The risk is that rising demand leads developers to produce credits that do little to reduce carbon emissions. This has already been a problem in the market.”), <https://www.wsj.com/articles/carbon-credit-surplus-could-soon-turn-to-shortage-11663968204>.

¹²⁰ Ben Elgin, *These Trees Are Not What They Seem*, BLOOMBERG (Dec. 9, 2020), https://www.bloomberg.com/features/2020-nature-conservancy-carbon-offsets-trees/?cmpid=BBD092322_GREENDAILY&utm_medium=email&utm_source=newsletter&utm_term=220923&utm_campaign=greendaily&sref=mQvUqJZj.

¹²¹ See Jacquie McNish, *Carbon Credits Are the New Canadian Gold Rush*, WALL ST. J. (Apr. 27, 2022), https://www.wsj.com/articles/carbon-credits-are-the-new-canadian-gold-rush-11651019478?mod=article_inline.

¹²² See *id.*

¹²³ Shane Shifflett, *Companies Are Buying Large Numbers of Carbon Offsets That Don’t Cut Emissions*, WALL ST. J. (Sept. 8, 2022), <https://www.wsj.com/articles/renewables-carbon-credits-do-not-cut-emissions-united-nations-verra-gold-standard-11662644900>.

¹²⁴ See Grayson Badgley et al., *Systematic over-crediting in California’s forest carbon offsets program*, 4 GLOB. CHANGE BIOLOGY 1433, 1442–43 (2021).

have been overstated;¹²⁵ “huge amounts of carbon credits . . . [were] issued for the sake of protecting forests in a national park” in Peru even “though the possibility of reckless exploitation was very low;”¹²⁶ credits were sold for Tennessee forests already protected by conservation easements;¹²⁷ forest-based VCC projects centered on land where trees could only have been extracted by helicopter;¹²⁸ and at least 17 property owners participating in one forestry-based VCC program would have or did grow forests due to independent government programs.¹²⁹

While these examples are not comprehensive data, they do point to a market infected at least by severe information asymmetry and adverse selection, if not outright fraud. Certainly, there are some encouraging efforts in the private sector to identify standards and protocols sufficient to promote integrity in VCCs.¹³⁰ But these efforts are in the early stages, and, according to some observers, no VCCs would meet the standards under development if they were strictly applied.¹³¹

Against this background of obvious market failures, VCC markets seem primed for further action by the CFTC. The CFTC has enforcement authority to prosecute fraud and manipulation “in connection with . . . [a] contract of sale of any commodity in interstate commerce” or commodity futures contracts, even if the act is merely reckless.¹³² The public information available on VCCs suggests that many might well be sold despite intentional or reckless lack of quality, and the Commission should employ its investigative powers to gather more systematic data on this issue.¹³³ If or when consensus standards are finalized and widely adopted, the CFTC could incorporate them as guideposts for appropriate VCCs. But any such standards should be

¹²⁵ Thales A. P. West, *Overstated carbon emission reductions from voluntary REDD+ projects in the Brazilian Amazon*, 117 PNAS 24,188, 24,188 (2020).

¹²⁶ Yuichiro Kanematsu & Mari Ishibashi, *Indonesian carbon credit project appears to betray its purpose*, NIKKEI ASIA (Dec. 13, 2021), <https://asia.nikkei.com/Spotlight/Environment/Climate-Change/Indonesian-carbon-credit-project-appears-to-betray-its-purpose>.

¹²⁷ See Ben Elgin, *This Timber Company Sold Millions of Dollars of Useless Carbon Offsets*, BLOOMBERG (Mar. 17, 2022), <https://www.bloomberg.com/news/articles/2022-03-17/timber-ceo-wants-to-reform-flawed-carbon-offset-market?sref=mQvUqJZj>.

¹²⁸ See *id.*

¹²⁹ See Ben Elgin & Zachary Mider, *The Real Trees Delivering Fake Corporate Climate Progress*, BLOOMBERG (Dec. 17, 2020), <https://www.bloomberg.com/news/features/2020-12-17/the-real-trees-delivering-fake-climate-progress-for-corporate-america?sref=mQvUqJZj>.

¹³⁰ See generally Integrity Council for the Voluntary Carbon Market, CORE CARBON PRINCIPLES, ASSESSMENT FRAMEWORK AND ASSESSMENT PROCEDURE: DRAFT FOR PUBLIC CONSULTATION (2022), <https://icvcm.org/wp-content/uploads/2022/07/ICVCM-Public-Consultation-FINAL-Part-1.pdf>.

¹³¹ Akshat Rathi & Natasha White, *Now Is Your Chance to Fix the Carbon Offset Market*, BLOOMBERG (Aug. 2, 2022) (“If strict criteria were applied, ‘no single carbon credit’ would meet the Core Carbon Principles (CCPs) that the ICVCM has published.”), <https://www.bloomberg.com/news/articles/2022-08-02/now-is-your-chance-to-fix-the-carbon-offset-market?sref=mQvUqJZj>.

¹³² 17 C.F.R. § 180.1(a)(1)–3.

¹³³ See 7 U.S.C. § 9(5).

applied strictly and require demonstrated compliance. In no case can the Commission allow an entity marketing low-quality VCCs to invoke the *imprimatur* of Commission approval, even implicit approval.

CONCLUSION

We hope these comments aid the Commission in determining its agenda for identifying and responding to climate-related financial risk, and Better Markets stands ready to discuss these issues whenever helpful.

Sincerely,



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