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DATE: June 24, 2024

TO: Members, California State Senate

SUBJECT: SB 1036 (Limón) VOLUNTARY CARBON MARKET OFFSETS
OPPOSE – AS INTRODUCED FEBRUARY 06, 2024

The Futures Industry Association ("FIA")[1] writes to join the California Chamber of Commerce (CalChamber), and the organizations listed on their letter and the Environmental Defense Fund, in their respective letters dated March 13, 2024, in raising concerns that SB 1036 will have unintended consequences and impede the development of robust and well-regulated voluntary carbon markets ("VCMs").

FIA believes in the power of markets and innovation as the United States and the world seek to transition to a lower carbon economy.[2] The listed derivatives markets have a strong track record of success in scaling markets for a variety of commodity asset classes and product types. Futures markets, in particular, provide an efficient way for companies and financial firms to manage risk associated with an asset class, and serve as efficient price discovery tools and provide opportunities for risk management, which are critically important for the transition of the world to a lower carbon economy. Additionally, futures on carbon allowances in compliance markets have become a core component of cap-and-trade schemes. They complement the issuance of allowances by providing a continuous source for price discovery and risk management. While derivative markets themselves do not directly assess the quality of carbon credits, they can indirectly contribute to market efficiency and transparency which supports the integrity of carbon credit transactions. Amongst other things, the price signal of carbon credit derivatives conveys the view of market participants on the quality and integrity of the underlying carbon credits.

VCMs and related voluntary carbon credits ("VCC") derivative contracts, which are currently listed on multiple futures exchanges, help the global economy navigate and manage risks associated with the energy transition and reduction of greenhouse gas ("GHG") emissions. In just the last few years, we have witnessed rapid growth in carbon, climate and sustainability-linked markets. We expect this growth to continue, and indeed accelerate, in the years to come as new technologies emerge and markets evolve.

We understand that the primary challenges with VCMs is not with the derivatives markets, but rather with the underlying VCCs themselves, specifically involving a lack of consistency in methodologies employed by third-party validators and questions relating to the quality of the credits. To that end, there are many important public and private-sector initiatives that are endeavouring to bring increased standardization to VCCs and related derivatives. These are key issues for market strength and growth. Private sector-led initiatives, such as the Integrity Council for the Voluntary Carbon Market ("ICVCM"), CORSIA, IOSCO, VCMI ,[3] are presently working to address these challenges, and we welcome and support their efforts.

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[1] FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. Our membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from about 50 countries as well as technology vendors, law firms and other professional service providers.
[2] FIA white paper titled: "How derivatives markets are helping the world fight climate change" (https://www.fia.org/sites/default/files/2020-08/FIA%20Climate%20Change%20Policy%20Paper_0.pdf)
[3] Information on the ICVCM is available here: https://icvcm.org/.

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The US Treasury Department also recently released a set of principles[4] for voluntary carbon markets to guide how the federal government engages with VCMs and the development and operation of carbon markets, generally.

Although progress has been made to develop and apply objective, reliable standards to VCMs and VCCs, opportunities for improvement remain, aided by emerging technologies, further scientific dialogue, international cooperation[5] and more uniform adoption of standards. We are concerned that the punitive nature of the disclosures and ambiguity of SB 1036 could cause market participants to not utilize VCCs or trade the related derivatives.

As noted in the CalChamber letter, FIA has concerns that "setting standards that are unique to California are going to effectively quash this market by isolating it from the rest of the marketplace."

Additionally, the Section 2(a)(1)(A) of the Commodity Exchange Act ("CEA") provides the Commodity Futures Trading Commission ("CFTC") exclusive jurisdiction over the trading of futures, swaps, and options traded on derivatives exchanges or markets. While SB 1036 does not expressly mention the trading of these derivative commodity products, the ambiguity in the language may lead to unnecessary confusion for market participants. FIA urges the California Senate to amend SB 1036 to specifically exclude derivatives on VCCs from the scope of the legislation.

For these reasons, **FIA opposes SB 1036**, as introduced.

Most respectfully,

Walt L. Lukken

Walt L. Lukken
President and CEO

[4] *See, e.g.*, https://home.treasury.gov/system/files/136/VCM-Joint-Policy-Statement-and-Principles.pdf
[5] *See, e.g.*, https://www.whitehouse.gov/briefing-room/statements-releases/2023/12/13/statement-from-president-joe-biden-on-agreement-reached-at-cop28/.