CADWALADER

Regulation: Oversight for Carbon Offset Market

October 18, 2022

Regulation

By Peter Malyshev
Partner | Financial Services

A group of Democratic senators have written a **comment letter** to the Commodity Futures Trading Commission (CFTC) asking for improved regulation of the market for carbon offsets in response to the CFTC's June 2022 **request for information on climate-related financial risk**. The senators include Bernie Sanders, Elizabeth Warren, Cory Booker and Kirsten Gillibrand. Trading in the offset market has expanded rapidly in recent years, from approximately $520 million in 2020 to approximately $2 billion only one year later. The senators' letter states that often times the offsets do not genuinely deliver the promised environmental benefits and instead may constitute "fraudulent investments" that are "a convenient and profitable way to market climate consciousness without requiring real action to reduce emissions." According to the letter, offsets have allowed companies "to make bold claims about emission reductions and pledges to reach "net zero", when in fact they are taking little action to address the climate impacts of their industry." This appears to be consistent with criticisms raised elsewhere with respect to carbon offsets. For instance, the UK's Climate Change Committee, an advisory group to the government, last week warned that without reform the offset market risked undermining net zero emission plans. The Committee has asked the government to introduce "guidance, regulation and standards."

Taking the Temperature: The carbon offset market has grown rapidly in the last two years driven both by higher prices and strong demand from industry. Some analysts are predicting that the market for carbon credits could be worth in excess of $50 billion by 2030. But there are concerns that carbon credits do not provide real greenhouse gas mitigation unless they are tied to carbon-saving projects and may even reduce incentives for corporates to actively work towards carbon reduction. As a result, the future of carbon markets remains uncertain, including potential regulatory activity. As the market develops, companies utilizing carbon credits should consider additional carbon reduction initiatives to avoid potential greenwashing challenges.

In addition, some of the suggested directives in the letter may not be feasible given the CFTC's current authority. Carbon credits typically do not constitute derivatives, and the CFTC only has limited power with respect to "commodities" in the absence of a derivative component. Under that view, the CFTC would not be able, for instance, to "establish the qualifying standards for carbon offsets that effectively reduce greenhouse gas emissions," or "create a registration framework for offsets, offset brokers, and offset registries."