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CFTC Urges Potential Whistleblowers to Report Carbon Credit Misconduct

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The Whistleblower Office of the Division of Enforcement of the Commodity Futures Trading Commission ("CFTC") issued an alert on June 20, 2023 advising the public on how to identify and report potential violations connected to fraud or manipulation in the carbon markets, including:

- Manipulative and wash trading in carbon market futures contracts;
- "Ghost" or "illusory" credits listed on carbon market registries;
- Double counting or other fraud related to carbon credits;
- Fraudulent statements relating to material terms of the carbon credits, including quality, quantity, additionality, project type, environmental benefits, permanence or duration, or the buffer pool; and
- Manipulation of tokenized carbon markets.

Voluntary carbon markets can help support the transition to a low-carbon economy through market-based initiatives in which high-quality carbon credits, also called carbon offsets, are purchased and sold bilaterally or on spot exchanges, the CFTC said in a statement. Carbon credits are the underlying commodity for futures contracts that are listed on CFTC designated contract markets ("DCMs"). The commission has enforcement authority and regulatory oversight over DCMs and any trading in those markets.

The alert directs individuals with a potential CEA claim to complete a Form TCR (Tip, Complaint, Referral) on the CFTC's Whistleblower Program website. Whistleblowers may be eligible for confidentiality and anti-retaliation protections, as well as an award of between 10% and 30% of the monetary sanctions collected from a subsequent enforcement action. Whistleblower awards are paid from the CFTC Customer Protection Fund, which is financed through monetary sanctions paid to the commission. Since 2014, the CFTC has granted whistleblower awards totaling approximately $330 million. Awards associated with enforcement actions have resulted in monetary sanctions totaling more than $3 billion.

Final Thoughts

The CFTC's whistleblower alert follows a request by a group of Democratic senators in October 2022 that the Commission improve regulation of the carbon credits market, as we previously reported. The carbon credit market has grown – and is expected to continue to grow— rapidly, as the world aims to reach net zero goals by 2050. Estimates of the value of the market vary widely. According to a report issued by Morgan Stanley in April of this year, the voluntary carbon offsets market is expected to grow from approximately $2 billion in 2022 to $100 billion by 2030, and to $250 billion by 2050.

However, the carbon offset market has come under heavy scrutiny, including by the United Nations and at COP27 in November 2022, with critics (including the Democratic senators in their letter) pointing to the potential for companies to engage in greenwashing and the risk that carbon credits may in fact reduce incentives for corporations to actively work towards carbon reduction. As the Democratic senators' letter points out: "The purchase of offsets allows many of these multinational 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. Several studies have highlighted that carbon offset projects are frequently illegitimate, and those that do contribute to meaningful emissions reductions are often representative of broader 'pay to pollute' schemes that place profit over protecting frontline communities."

The letter exhorted the CTFC to take action across a number of fronts, including "[p]ursu[ing] cases of individual project fraud," and "[d]evelop[ing] a working group to study both the risk to investors associated with carbon offsets and derivatives (legal, reputational, and regulatory) and the systemic climate financial risk created by their availability and usage." The senators closed by reminding the CTFC that it "has a duty to promote the integrity of U.S. markets through sound regulation and to hold companies accountable for fraud or misrepresentation, and we urge you to set meaningful standards to address these issues in the offset market." The decision by the CTFC to bring carbon credits within their whistleblowing awards remit indicates that it may be starting to comply with calls to act to prevent fraud associated with carbon credits. As we have previously discussed, it remains unclear how the CFTC would exercise its regulatory authority in practice and what the implications are for the developments of voluntary carbon markets. The UK Financial Conduct Authority (FCA) is also paying close attention to potential fraud in the carbon credit trading markets, has established an information and reporting portal and has taken enforcement action against individuals using carbon credits to defraud investors.

As we have noted, the regulation of the carbon offset market is a topic of international interest, with the International Organization of Securities Commissions (IOSCO), an international policy forum for securities regulators, announcing the publication of a consultation report and discussion paper on carbon markets in November 2022, and publishing its final report on "Compliance Carbon Markets" just last month, in July 2023.

(This article originally appeared in Cadwalader Climate, a twice-weekly newsletter on the ESG market.)