Public Statements & Remarks

Opening Statement of Commissioner Dan M. Berkovitz before the Energy and Environmental Markets Advisory Committee

Carbon Markets

June 03, 2021

Good morning, and welcome to the Energy and Environmental Markets Advisory Committee (EEMAC). I am pleased that we are able to conduct this meeting by video today, and look forward to when the Committee can meet in person again.

This meeting of the EEMAC will explore the potential role of carbon markets in the transition to a low-carbon economy. Reducing global carbon emissions to net-zero by 2050 is a significant global undertaking. To accomplish this goal, the International Energy Agency is calling for a "transformation of how we produce, transport and consume energy."[1] This transformation will affect all sectors of the economy and retail customers in their daily lives. Although decisive action is necessary to protect our environment and society, the path to net-zero emissions will have significant costs for market participants. Whether incentives, mandates, voluntary reductions, or other approaches are adopted to cut carbon emissions, financial markets can serve to more efficiently allocate the costs and risks of the transition to a low-carbon economy. At today's meeting we will examine the ways in which energy companies, financial firms, and other market participants are using carbon markets to meet their emissions compliance obligations and hedge risks associated with climate change and green lending, and how these markets may continue to evolve to meet current challenges.

The term "carbon markets" refers broadly to primary markets, secondary markets, and derivatives markets for carbon emission allowances and offsets. Primary markets are the mechanism by which allowances and offsets are initially distributed, either through direct allocation by governmental authorities, by auction, or through voluntary measures. Entities may purchase or sell these allowances or offsets in the secondary market for a variety of reasons, including to meet emissions standards, speculate on price movements, or provide liquidity. Entities that purchase allowances and offsets to meet compliance obligations can use the derivatives markets to hedge their exposure to potential changes in the cost of these underlying assets and discover prices over longer time horizons. Speculators, market makers, and intermediaries may also participate in the derivatives market, as they do for other types of commodities. In a well-functioning market system, prices in the primary, secondary, and derivative markets are related economically.

While they can be an important tool to achieve climate goals, financial markets may also be negatively affected by climate change. Last fall, the Climate Subcommittee (Subcommittee) of the CFTC's Market Risk Advisory Committee (MRAC) released a landmark report describing how climate change poses a major risk to the U.S. financial system and to its ability to sustain the American economy.[2] The report details how climate change could create price shocks in a variety of asset classes, potentially disrupting the functioning of the financial markets and the underlying economy. The Subcommittee recommended a variety of actions for financial market participants and regulators to recognize and address these risks. With respect to the CFTC in particular, the Subcommittee recommended that the agency conduct research to understand how climate-related risks could impact markets and their participants under CFTC oversight, including central counterparties, futures commission merchants, traders, and funds. The Subcommittee urged the CFTC to coordinate with other regulators to develop a "robust ecosystem of climate-related risk management products." It further recommended that the CFTC "consider expanding the CFTC's risk management rules and related quarterly risk exposure reports to cover material climate-related risks."[3] I commend the Subcommittee for its work in producing this report and Acting Chair Behnam for his leadership of the MRAC and on the issue of climate change at the CFTC.

I see three principal ways in which the CFTC, as a financial market regulator, can support the transition to a carbon-neutral economy. First, the Commission is charged with ensuring the integrity of the markets it regulates, and this includes carbon derivatives markets. This requires an understanding of how the various carbon markets interact and how companies use them to meet compliance obligations, manage risks, and discover prices. Second, the CFTC should work with exchanges and market participants on the development of new products that will help companies meet these needs. And third, as the Climate Subcommittee recommended, the CFTC should ensure appropriate management and disclosure of climate-related risks.

Market-based mechanisms—such as cap-and-trade programs—are intended to achieve climate goals at a lower cost and to direct investment to cost-effective projects and technologies for reducing emissions. Increased investment in sustainable technologies can lead to more efficient greenhouse gas reductions, but this requires transparent and timely information not only for current prices associated with such reductions, but also for future prices.[4] The relationship between the primary and secondary markets and the derivative markets for carbon can drive more informed decision-making and more effective allocation of resources. The price of carbon allowances also can affect the prices of other commodities, such as fossil fuels. Given these linkages, and the potential for carbon markets to meaningfully contribute to the reduction of carbon emissions, the CFTC should work with other regulators and stakeholders to optimize the effectiveness and integrity of these interrelated markets.

To that end, our first panel will examine the cap-and-trade programs in the United States, European Union, and United Kingdom, as well as lessons learned from these programs and ways in which they may evolve in the future. We are fortunate to be joined today by **Benjamin Grumbles**, the Secretary of the Maryland Department of the Environment, who is here today on behalf of the Regional Greenhouse Gas Initiative; **Rajinder Sahota**, Deputy Executive Officer of Climate Change and Research for the California Air Resources Board; **Hans Bergman**, the Head of Unit for ETS Policy Development and Auctioning within the European Commission's Directorate General for Climate; and **Gordon Bennett**, Managing Director of Utility Markets for Intercontinental Exchange, which hosts allowance auctions for the UK emissions trading system.

Another way in which the CFTC can support the move to a low-carbon economy is through its mandate of promoting "responsible innovation" in markets and among market participants.[5] In order to meet the goal of net-zero emissions by 2050, investment in renewable energy infrastructure projects must ramp up rapidly. Investors will need to manage the risks of these investments with appropriate hedging tools, including both exchange-traded and over-the-counter derivatives. Derivatives also allow commercial entities and investors to manage exposure to changes in the price of their assets due to climate change and transition risks caused by the shift to a net-zero economy. In addition, entities with emissions compliance obligations participate in the physical markets to ensure they have appropriate allowances or offsets to meet those obligations. As energy standards evolve, futures contracts will need to evolve to respond to changes in the physical markets. The Commission should work with exchanges and market participants as they develop climate-related products and services to meet these needs, as well as collaborate with our domestic and international counterparts to develop consistent standards for environmental products.

Our second panel today will explore the current state of exchange-listed carbon derivative products. We will hear from **Gordon Bennett** of ICE; **Christian Schneider**, Managing Director of Strategy for Nodal Exchange; and **Derek Sammann**, Senior Managing Director and Global Head of Commodities at CME Group about the carbon products offered on their exchanges.

Our third panel will feature a diverse group of stakeholders who will provide their perspectives on how the derivatives markets operate as risk management and price discovery tools, and how they expect these markets to change over time. We welcome **Evan Ard**, Executive Managing Director of Evolution Markets, who will discuss the OTC carbon markets; **Suzi Kerr**, Chief Economist of the Environmental Defense Fund, who will discuss the economics of carbon pricing and considerations for developing equitable carbon pricing policies; **Erik Heinle**, Assistant People's Counsel for the Office of the People's Counsel for the District of Columbia, who will share a ratepayer perspective; **Annette Nazareth**, Senior Counsel at Davis Polk, who will discuss the work of the Taskforce on Scaling Voluntary Carbon Markets and its recently issued Public Consultation Report; **Dena Wiggins**, President and CEO of the Natural Gas Supply Association (NGSA), who will talk about why NGSA views carbon pricing as the most effective long-term solution to climate change; and **Matt Picardi**, Vice President of Regulatory Affairs for Shell Energy North America on behalf of the Commercial Energy Working Group, who will discuss carbon market design.

A third area in which the CFTC should play a role in the transition to a low-carbon economy is with respect to the management and disclosure of climate-related risks. For example, the CFTC currently requires commodity pools and advisors to address pool performance and the risks of speculating in derivatives. The CFTC also requires certain registrants, such as swap dealers, to periodically report material risks, such as credit, market, and operational risks.

The Commission should examine how climate-related risks are currently considered and reported by registrants, and determine whether additional considerations of climate-related risks or disclosures are appropriate. While this aspect of risk management is not specific to the carbon markets discussion today, it is an issue that requires further exploration and one that the EEMAC could consider in a future meeting.

On our final panel of the day, we will hear a presentation from CFTC staff—**Rahul Varma** of the Market Intelligence Branch in the Division of Market Oversight, and **Bill Heitner** of the Risk Surveillance Branch in the Division of Clearing and Risk. They will discuss the impact on the derivatives market of the winter storm in Texas in February 2021 that caused widespread power outages and hardship for Texas consumers. I appreciate Rahul and Bill's excellent work in preparing this presentation and the dedication of the CFTC staff in closely monitoring this and other market events.

I would like to conclude by thanking Acting Chair Behnam, Commissioner Quintenz, and Commissioner Stump for their participation in today's meeting. I would also like to thank the EEMAC members and our guest panelists for their contributions to this meeting, **Dena Wiggins** for her dedicated service as the EEMAC Chair, **Lucy Hynes** in my office for her work in supporting this Committee, and mostly, **Abigail Knauff** for her service as Secretary of the EEMAC and for always making these meetings so informative and seamless.

I am very much looking forward to today's meeting and to hearing from our very distinguished panelists. With that, I'll turn it back to Abigail.

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[1] Int'l Energy Agency, Net Zero by 2050: A Roadmap for the Global Energy Sector (May 2021), at 13, https://www.iea.org/reports/net-zero-by-2050 (https://www.cftc.gov/Exit/index.htm?https://www.iea.org/reports/net-zero-by-2050).

[2] Managing Climate Risk in the U.S. Financial System: Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, https://www.cftc.gov/PressRoom/PressReleases/8234-20 (https://www.cftc.gov/PressRoom/PressReleases/8234-20).

[3] *Id.*, at p. 52; *see also* Id. at 52; see also Final Report, Recommendations of the Task Force on Climate-Related Financial Disclosures (June 2017), https://www.fsb-tcfd.org/about/ (https://www.cftc.gov/Exit/index.htm?https://www.fsb-tcfd.org/about/).

[4] Interagency Working Group for the Study on Oversight of Carbon Markets, Report on the Oversight of Existing and Prospective Carbon Markets (Jan. 28, 2011), at 7, https://www.cftc.gov/PressRoom/PressReleases/5965-11 (https://www.cftc.gov/PressRoom/PressReleases/5965-11).

[5] Commodity Exchange Act §3(b), 7 U.S.C. §5(b).

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