

 Columbia Law School | COLUMBIA CLIMATE SCHOOL  
SABIN CENTER FOR CLIMATE CHANGE LAW

October 7, 2022

Christopher Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street NW  
Washington, D.C. 20581

Re: Request for Information on Climate-Related Financial Risk  
87 Fed. Reg. 34856; June 8, 2022

Dear Mr. Kirkpatrick,

Columbia Law School's Sabin Center for Climate Change Law ("Sabin Center") respectfully submits these comments in response to the Commodity Futures Trading Commission's ("Commission") request for information ("RFI") on climate-related financial risk.<sup>1</sup>

The Commission's acknowledgement that climate change involves financial risk is consistent with the findings of regulators and investors across the global financial markets.<sup>2</sup> What was once viewed by the finance community as an ethical issue has now clearly been recognized as a source of financial risk that impacts investors and financial institutions.<sup>3</sup>

Regulations to address this risk are consistent with the Commission's mandate to ensure the integrity of transactions under the Commodities Exchange Act and to avoid systemic risk in the derivatives market and underlying commodities market. The Sabin Center strongly supports the Commission's efforts to respond to the financial consequences of climate change, and offers the below comments regarding the legal basis for appropriate rule-making to address these risks.

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1. Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856 (June 8, 2022) [hereinafter "CFTC RFI"].
  2. *See generally* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, FINANCIAL MARKETS AND CLIMATE TRANSITION: OPPORTUNITIES, CHALLENGES AND POLICY IMPLICATION 15-22 (2021), <https://perma.cc/F36N-HA58>.
  3. *See generally* BANK OF INTERNATIONAL SYSTEMS, THE GREEN SWAN: CENTRAL BANKING AND FINANCIAL STABILITY IN THE AGE OF CLIMATE CHANGE (2020).

## 1. Climate Change Creates Risk in the Financial Markets

### a. *Climate Change Causes Systemic Financial Risk to the Derivatives Market*

There is overwhelming scientific consensus on the fundamental reality of climate change: human activities are increasing atmospheric greenhouse gas (“GHG”) concentrations, which is causing global average temperatures to rise. In a 2021 report, the United Nations Intergovernmental Panel on Climate Change (“UN IPCC”) concluded that “[i]t is unequivocal that human influence has warmed the atmosphere, ocean and land.”<sup>4</sup> The IPCC found that “[e]ach of the last four decades has been successively warmer than any decade that preceded it since 1850. Global surface temperature in the first two decades of the 21st century (2001-2020) was 0.99 [degrees Celsius] higher than 1850-1900.”<sup>5</sup> Rising temperatures are increasing the frequency and severity of many types of weather extremes, such as heatwaves and floods, and contributing to sea-level rise and other slow-onset phenomena.

The adverse impacts on financial assets associated with these and other consequences of climate change are undeniable and increasing.<sup>6</sup> Numerous studies confirm the conclusion that climate risk is not extraneous to the financial marketplace. Indeed, a 2019 study by the CDP, a not-for-profit organization that measures climate risk, found that 215 of the largest companies globally face almost \$1 trillion in potential financial risk from climate change, with approximately half of that risk identified as “likely, very likely, or virtually certain to materialize [...] [within] five years.”<sup>7</sup> More recently, in its 2021 report on Climate-Related Financial Risk, the Financial Stability Oversight Council (“FSOC”) noted that “[t]he intensity and frequency of extreme weather and climate-related disaster events are increasing and already imposing substantial economic costs.”<sup>8</sup> The FSOC recognized that, as the magnitude of climate hazards and associated costs increases in coming years, so too will risks to the financial system.<sup>9</sup>

Indeed, in the same report, the FSOC noted that “climate-related financial risks are an emerging threat to the financial stability of the United States.”<sup>10</sup> This is partially due to an under-appreciation of the risk. The UN IPCC has warned that “climate-related financial risks remain greatly

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4. United Nations (“UN”) Intergovernmental Panel on Climate Change (“IPCC”), *Summary for Policymakers, in CLIMATE CHANGE 2021: THE PHYSICAL SCIENCE BASIS. CONTRIBUTION OF WORKING GROUP I TO THE SIXTH ASSESSMENT REPORT OF THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE 4* (V. Masson-Delmotte et al., eds, 2021).

5. *Id.* at 5.

6. *See, e.g.*, FINANCIAL STABILITY OVERSIGHT COUNCIL (“FSOC”), REPORT ON CLIMATE-RELATED FINANCIAL RISK (2021), <https://perma.cc/6V34-EU4F>; BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FINANCIAL STABILITY REPORT (2020), <https://perma.cc/2VWA-67LV>; BANK OF INTERNATIONAL SYSTEMS, *supra* note 3.

7. CDP, MAJOR RISK OR ROSY OPPORTUNITY: ARE COMPANIES READY FOR CLIMATE CHANGE? (2019), <https://perma.cc/XVL3-YF7T>.

8. FSOC, *supra* note 6, at 10.

9. *Id.*

10. *Id.*

underestimated by financial institutions and markets,”<sup>11</sup> leading to market distortions driven largely by the failure of market participants to price in these risks.

Climate-related financial risk can also increase the likelihood of market volatility. Consider a simple example: market participants in the derivatives market may rely on assumptions about the weather to hedge against changes in commodity prices. Without an appreciation of extreme weather hazards, climate impacts can increase the risk of transaction instability. Wisely, the Commission has recognized that climate change poses significant financial risks to market participants and the financial system more generally.<sup>12</sup> The Commission’s Climate-Related Market Risk Subcommittee has concluded that climate-related risks “are already impacting, or are anticipated to impact, nearly every facet of the U.S. economy” and “may affect the functioning of markets essential for economic activity.”<sup>13</sup> The Commission’s own Climate Risk Unit, which focuses on accelerating action on climate risk and “building a climate-resilient financial system,” is a response to these threats.<sup>14</sup>

*b. Climate-Related Financial Risk Directly Impacts Climate-Related Derivatives Products*

The derivatives and commodities markets, both of which fall within the regulatory authority of the Commission, are notable for their rapid development of products that adapt to new circumstances. With respect to climate risk, the commodities market has evolved in recent years to include derivative products aimed at addressing the financial harms of climate change, facilitating an expansion of renewable energy, and reducing emissions. These include, for example, ESG-linked derivatives, catastrophe swaps, carbon and renewable energy derivatives, and financial (virtual) power purchase agreements.<sup>15</sup>

Derivative products are also expressly sought by market participants seeking opportunities to transition to a carbon neutral economy. The International Swaps and Derivatives Association (“ISDA”) has stated that “[d]erivatives markets can play an essential role in facilitating the transition to a sustainable economy.”<sup>16</sup> In the U.S. market, for example, power purchase agreements are widely utilized by large multinational corporations for their transition to reliance on renewable energy sources.<sup>17</sup> Virtual power purchase agreements (“vPPAs”) are a type of derivative contract that allows energy purchasers to hedge against renewable energy pricing risks (sometimes caused by weather events, seasonal demand, or market volatility) and also receive

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11. See UN IPCC, *Summary for Policymakers*, in CLIMATE CHANGE 2022: MITIGATION OF CLIMATE CHANGE. CONTRIBUTION OF WORKING GROUP III TO THE SIXTH ASSESSMENT REPORT OF THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE Ch. 15 (J. Skea, et al., eds, 2022).

12. See CFTC RFI, 87 Fed. Reg. 34856. See also COMMODITY FUTURES TRADING COMMISSION (“CFTC”) CLIMATE-RELATED MARKET RISK SUBCOMMITTEE OF THE MARKET RISK ADVISORY COMMITTEE, MANAGING CLIMATE RISK IN THE U.S. FINANCIAL SYSTEM (2020), <https://perma.cc/6RHX-XTW7> [hereinafter “CFTC Climate-Related Market Risk Subcommittee”].

13. CFTC Climate-Related Market Risk Subcommittee, *supra* note 12, at 11 & 28.

14. Press Release, CFTC, CFTC Acting Chairman Behnam Establishes New Climate Risk Unit, Release Number 8368-21 (Mar. 17, 2021), <https://perma.cc/ZD8W-LHPR>.

15. See generally International Swaps and Derivatives Association (“ISDA”), Overview of ESG-related Derivatives Products and Transactions (Jan. 2021), <https://perma.cc/GN8K-DN9J>.

16. *Id.* at 2.

17. *Id.* at 11.

renewable energy certificates without physically taking possession of the renewable energy.<sup>18</sup> Large corporations with already substantial vPPA engagements include McDonald’s, Verizon, General Motors, Facebook, Amazon and Google.<sup>19</sup> The ISDA has also published support templates for trading in U.S. renewable energy certificates, which represent the property rights to the environmental and other non-power attributes of renewable electricity generation.<sup>20</sup> Meanwhile, in California, the Low Carbon Fuel Standard (“LCFS”), a greenhouse gas reduction program, focuses on incentivizing the transportation sector to use low-carbon fuel and alternative transportation methods.<sup>21</sup> LCFS credits are also sold as futures in other jurisdictions.<sup>22</sup> The Commission’s Energy and Environmental Markets Advisory Committee is also exploring the role of carbon markets in the transition to a net-zero economy, including the linkages between primary, secondary, and derivative carbon markets.<sup>23</sup> The complex and innovative nature of these new products—and the high likelihood of future products that will emerge in response to changing conditions—underscores the need for the Commission to regulate these transactions and ensure that the market remains a productive and fraud-resistant space for all participants.

*c. Climate-Related Financial Risk is Measurable*

The financial risks associated with climate change are typically divided into two general categories: (1) physical risks arising from the impacts of climate change on companies’ assets, operations, and supply chains; and (2) transition risks arising from government and market responses to climate change.

Climate scientists can model the causes and effects of climate change, including the risks arising from the impacts of climate change on a company’s operations, and market participants can use climate information to evaluate their exposure to these risks and hazards.<sup>24</sup> While all financial modeling involves assumptions, it is important to understand that the outcomes cannot be derided as simply “guesses.”<sup>25</sup>

A 2021 report from the United Nations Environment Programme Finance Initiative (“UNEP FI”) illustrates the range of data and analytical techniques available to assess climate hazards; evaluate potential impacts on assets, operations, and supply chains; and communicate useful information about exposure to physical climate-related risks.

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18. ISDA, *supra* note 15, at 11.

19. *Id.* at 11-12.

20. *Id.* at 12.

21. *Id.* at 13.

22. *Id.*

23. FSOC, *supra* note 6, at 35-37.

24. According to the IPCC, “risk” is “the potential for adverse consequences for human or ecological systems,” and a ‘hazard’ is “the potential occurrence of a natural or human-induced physical event or trend that may cause loss of life, injury, or other health impacts, as well as damage and loss to property infrastructure, livelihoods, service provision, ecosystems, and environmental resources.” See IPCC, *Summary for Policymakers*, in CLIMATE CHANGE 2022: IMPACTS, ADAPTATION AND VULNERABILITY. WORKING GROUP II CONTRIBUTION TO THE IPCC SIXTH ASSESSMENT REPORT SPM-4 & SPM-5 (Hans-Otto Pörtner et al. eds., 2022).

25. See David Burton, The Heritage Foundation, Comment to CFTC RFI 4-5 (Aug. 8, 2022), <https://perma.cc/BL48-Z3CC> [hereinafter “Heritage Foundation – Comment”].

The report, titled *The Climate Risk Landscape* (“Landscape Report”), surveyed various climate risk assessment tools used by financial institutions to evaluate and disclose physical and transition risks associated with climate change.<sup>26</sup> The Landscape Report reviews nineteen commercially-available tools for assessing physical climate risk, and eighteen commercially-available transition risk assessment tools.<sup>27</sup> With respect to the former, the Landscape Report finds that existing tools can be used to evaluate acute risks associated with extreme weather events, flooding, wildfires, and landslides, as well as chronic risks associated with slow-onset climate change impacts, such as sea level rise.<sup>28</sup> The Landscape Report further notes that existing tools are “being constantly updated to allow for more granular analysis that takes into account a broader, more plausible set of scenarios,” and enables financial institutions to “provide consistent and market-ready disclosures.”<sup>29</sup> According to the Landscape Report, physical risk data is becoming easier to access in formats that are “easily usable by financial institutions.”<sup>30</sup>

Following release of the 2021 Landscape Report, UNEP FI ran a pilot program in which forty-eight global banks and investors were given an opportunity to trial twelve commercially-available climate risk assessment tools.<sup>31</sup> The tools modeled impacts under several scenarios of greenhouse gas concentration trajectories adopted by the IPCC (“Representative Concentration Pathways,” or “RCPs”).

The program participants included TD Asset Management Inc. (“TDAM”), which manages \$434 billion in assets on behalf of three million investors.<sup>32</sup> TDAM trialed emissions analysis, climate scenario alignment analysis, transition risk analysis, and physical risk analysis tools made available by Institutional Shareholder Services (“ISS”) ESG.<sup>33</sup> We focus here on the physical risk analysis tool, which TDAM used to “measure[] the potential financial impact of the six most costly natural climate hazards such as floods, droughts or wildfires on the value of” a global equity portfolio that held 195 securities from over thirty countries.<sup>34</sup> TDAM’s analysis showed that physical climate risks are projected to result in a 1.6% and 2.8% change in portfolio value by 2050 under the most-likely and worst-case RCP scenarios, respectively, and that “80% of the climate value-at-risk of the portfolio can be attributed to just 30 securities.”<sup>35</sup> TDAM also used the ISS ESG tool to evaluate the financial risks posed by specific climate impacts, and found that wildfires and heat stress presented the greatest risk to its portfolio.<sup>36</sup>

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26. PAUL SMITH, UN ENVIRONMENT PROGRAMME FINANCE INITIATIVE (“UNEP FI”), *THE CLIMATE RISK LANDSCAPE: A COMPREHENSIVE OVERVIEW OF CLIMATE RISK ASSESSMENT METHODOLOGIES* (2021), <https://perma.cc/89ET-EKWT>.

27. *Id.* at 15 & 29.

28. *Id.* at 32.

29. *Id.* at 35 & 37.

30. *Id.* at 37.

31. DAVID CARLIN & ALEXANDER STOPP, UNEP FI, *THE CLIMATE RISK TOOL LANDSCAPE: 2022 SUPPLEMENT* (2022), <https://perma.cc/6SGP-WM9T>.

32. TD Asset Management, *About Us*, <https://perma.cc/8AR9-AXPN> (last visited Oct. 3, 2022).

33. CARLIN & STOPP, *supra* note 31, at 38-39.

34. *Id.* at 39.

35. *Id.* at 42.

36. *Id.* at 43.

Another participant in the pilot program was Intesa Sanpaolo, an Italian bank that serves 13.5 million customers and has €341 billion in assets under management.<sup>37</sup> Intesa Sanpaolo worked with Risk Management Solutions, Inc. (“RMS”), which has developed over 300 catastrophe risk models that can be used to assess “how frequently a given location can be expected to be impacted” by a particular hazard (e.g., flooding in excess of six feet), as well as “the frequency and severity of the economic impact caused by” the hazard.<sup>38</sup> RMS used the models to quantify the flood risk of a sample of Intesa Sanpaolo’s mortgage portfolio in regions throughout Italy under RCP6.0 and RCP8.5.<sup>39</sup> Using RMS data, Intesa Sanpaolo calculated the impact on Loss Given Default and the Probability of Default to range from 5% to 39% of the initial values.<sup>40</sup> Intesa Sanpaolo further estimated, under RCP8.5, the average annual loss would increase 50% over the baseline in the provinces of Rome and Naples by 2040.<sup>41</sup>

A third pilot program participant was Desjardins Group, a financial cooperative with over seven million members and customers, and over \$397 billion in assets.<sup>42</sup> Desjardins partnered with The Climate Service (“TCS”), which used its Climanomics platform to evaluate physical and transition risks across fifty of Desjardins’ real assets.<sup>43</sup> The Climanomics platform models absolute climate risk, measured in millions of USD and relative climate risk, reported as percent of asset value.<sup>44</sup> The analysis of Desjardins’ assets revealed that fluvial flooding is the greatest physical risk to the assets under both RCP4.5 and RCP8.5 scenarios.<sup>45</sup> Drought was identified as the second greatest physical risk to the assets.<sup>46</sup> Desjardins was also able to conduct asset-level risk analyses. For example, the analysis showed that a dairy farm located northeast of Montreal, Canada, would “face a modeled average annual loss (“MAAL”) of 6.7% to 8.5% for RCP4.5 and RCP8.5, respectively.”<sup>47</sup> The analysis further showed that “[t]he highest risks faced are from temperature extremes, followed to a lesser degree by fluvial flooding and drought at both RCP4.5 and RCP8.5 scenarios. The largest difference among the two is temperature extremes representing a 5.7% MAAL in RCP8.5 and 3.9% MAAL in RCP4.5.”<sup>48</sup>

The above examples demonstrate how companies can, and do, use existing tools to evaluate and disclose the physical risks they face from flooding, drought, and other climate change impacts. As the Landscape Report has noted, climate risk assessment methodologies are advancing rapidly, and new tools continue to become available.<sup>49</sup> UNEP FI predicts that physical risk models will continue to improve and provide increasingly “granular” data that will “allow[] more accurate risk analysis.”<sup>50</sup>

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37. Intesa Sanpaolo, *Business*, ABOUT US, <https://perma.cc/QU5L-VXT2> (last updated Oct. 3, 2022).

38. CARLIN & STOPP, *supra* note 31, at 26 & 62.

39. *Id.* at 64.

40. *Id.* at 66.

41. *Id.* at 65.

42. Desjardins Group, *Quick facts about Desjardins*, <https://perma.cc/7HHX-XPXQ> (last visited May 19, 2022).

43. CARLIN & STOPP, *supra* note 31, at 80.

44. *Id.*

45. *Id.* at 84.

46. *Id.*

47. *Id.* at 85.

48. *Id.*

49. *Id.* at 8; SMITH, *supra* note 26, at 35.

50. SMITH, *supra* note 26, at 37.

## 2. The Commission is Authorized to Regulate Climate-Related Financial Risk

The development of climate-related derivative products and the impact of climate-aggravated weather events on the broader derivatives market all point to the natural conclusion that the Commission is compelled to regulate climate-related financial risk. Its authority to do so is discussed below.

### *a. The Commission's Core Function is to Regulate Market Risk*

The regulation of climate-related financial risk is squarely aligned with the Commission's statutory authority to "foster open, transparent, competitive and financially sound derivative trading markets and to prohibit fraud, manipulation and abusive practices in connection with derivatives and other products subject to the [Commodity Exchange Act ('CEA')]."<sup>51</sup> As provided in Section 5(b) of the CEA, the Commission must:

1. deter and prevent price manipulation and other disruptions to market integrity;
2. ensure financial integrity of all transactions;
3. avoid systemic risk to transaction integrity;
4. protect market participants from fraudulent or abusive sales practices; and
5. promote fair competition.<sup>52</sup>

The Commission's general statutory authority over the commodities and derivatives markets is provided in the CEA, which was passed in its original form in 1936.<sup>53</sup> In 1974, Congress passed the Commodity Futures Trading Act, which created the Commission and outlined its jurisdiction over futures commodities (previously, the CEA had only regulated agricultural commodities).<sup>54</sup> In an opinion issued soon after the Commission was established, a federal district court in Illinois confirmed in *R.J. Hereley & Son Co. v. Stotler & Co.*<sup>55</sup> that amendments made to the CEA in 1974 established that the Commission's jurisdiction over "futures contract markets or other exchanges is exclusive[,] and includes the regulation of commodity accounts, commodity trading agreements, and commodity operations."<sup>56</sup> This was affirmed in *Hunter v. FERC*,<sup>57</sup> which held that the Commission, and not the Federal Energy Regulatory Commission, had exclusive jurisdiction over natural gas futures contracts.

In its current form, the CEA sets forth the Commission's statutory authority as well as its exclusive jurisdiction over transactions, accounts, and agreements involving swaps or contracts of sale of a

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51. *Investment Co. Institute v. U.S. Commodity Futures Trading Comm'n*, 891 F. Supp. 2d 162, 168 (D.D.C. 2012), as amended (Jan. 2, 2013), *aff'd sub nom. Investment Co. Institute v. Commodity Futures Trading Comm'n*, 720 F.3d 370 (D.C. Cir. 2013). *See also* Commodity Exchange Act, as amended, 7 U.S.C. § 5 (b) [hereinafter "CEA"].

52. CEA, 7 U.S.C. § 5 (b).

53. ALAN N. RECHTSCHAEN, *THE HISTORY OF THE CFTC in CAPITAL MARKETS, DERIVATIVES, AND THE LAW: POSITIVITY AND PREPARATION* 367 (3d ed.).

54. *Id.* *See also* Commodity Futures Trading Commission Act, 7 U.S.C. § 2 (2) (a) (1974).

55. *R. J. Hereley & Son Co. v. Stotler & Co.*, 466 F. Supp. 345 (N.D. Ill. 1979).

56. *Id.* at 347.

57. *Hunter v. FERC*, 711 F.3d 155 (D.C. Cir. 2013).

commodity for future delivery (including significant price discovery contracts),<sup>58</sup> and its concurrent jurisdiction (shared with the Securities and Exchange Commission (“SEC”)) over accounts, agreements, and transactions involving a put, call, or other option on one or more securities (as defined under the Securities Exchange Act of 1934 (“Exchange Act”). This includes any group or index of such securities, or any interest therein or based on the value thereof, that is exempted by the SEC pursuant to the Exchange Act.<sup>59</sup> The history of the CEA’s amendments through later legislation, including the expansion of its jurisdiction in the CFTC Reauthorization Act of 2008 (“Reauthorization Act of 2008”), the Commodity Futures Modernization Act of 2000 (“CFMA”), and the Dodd-Frank Wall Street Reform and Consumer Protect Act (“Dodd-Frank Act”), has ensured that the Commission is empowered to protect the stability of the markets.

The regular renewal and expansion<sup>60</sup> by Congress of the Commission’s mandate also underscores its statutory authority to evolve with the commodities and derivatives markets’ increasing complexity. Notably, these Congressional authorizations expanding the Commission’s jurisdiction address the types of products that the Commission must regulate and supervise, and the statutes do not attempt to circumscribe the types of market risks upon which the Commission may act. For example, the CFMA amendments clarified the Commission’s jurisdiction over securities-related futures contracts (vis-à-vis SEC authority).<sup>61</sup> The Dodd-Frank Act, which was passed in response to the 2008 financial crisis, expanded the Commission’s jurisdiction over bilateral swap contracts,<sup>62</sup> while the Reauthorization Act of 2008 expanded the Commission’s jurisdiction to include retail over-the-counter foreign currency transactions.<sup>63</sup> The growth in the list of products over which the Commission has jurisdiction is representative of the crucial role its unique expertise plays in the financial market, and is indicative of a Congressional intent that the Commission regulate high-risk, high-stakes transactions.

Notably, the financial risks caused by climate change are not categorically distinct from other types of market risk that are already regulated by the Commission. Much like other types of systemic market risk regulated by the Commission, climate-related financial risks undermine transaction and market integrity and increase the risk for manipulation and fraudulent practices. In this way, the stability of the commodity and derivative markets directly intersects with physical and transition risks arising from climate change.

*b. The Commission has a History of Responding to Evolving Market Risks*

The Commission is an independent regulatory agency vested, as one federal district court explained, with “a broad authority to adopt rules that, in its judgment, are necessary to carry out the purposes of the [CEA].”<sup>64</sup> In recent decades, the Commission has sought to comply with its mandate by adopting regulations under its broad rulemaking authority that respond to evolutions

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58. CEA, 7 U.S.C. § 2 (a) (1) (A).

59. *Id.* § 2 (C) (ii).

60. RECHTSCHAEN, *supra* note 53, at 367.

61. *Id.* at 373.

62. *Id.* at 382.

63. *Id.* at 386.

64. *Ikon Glob. Markets, Inc. v. Commodity Futures Trading Commission*, 859 F. Supp. 2d 162, 164 (D.D.C. 2012). *See also* *U.S. Commodity Futures Trading Comm’n v. Oystacher*, 203 F. Supp. 3d 934, 951 (N.D. Ill. 2016).



in the marketplace. This responsiveness is evident in the Commission’s enforcement of regulations on cross-border swaps transactions,<sup>65</sup> and the declaration of virtual currencies as a commodity under the CEA.<sup>66</sup> The Commission has always exercised its authority in a way that is sensitive to realities in the market. Former Commission Chairman Giancarlo’s statement on virtual currency is particularly insightful: “One thing is certain: ignoring virtual currency trading will not make it go away. Nor is it a responsible regulatory strategy.”<sup>67</sup> The federal district court cited this statement approvingly and validated the Commission’s response to emerging issues that threaten market stability.<sup>68</sup>

Other important examples include the transition of markets to electronic trading platforms,<sup>69</sup> and the emergence of digital financial products,<sup>70</sup> both of which required the Commission to promulgate new rules in response. To illustrate, the Commission adopted a Final Rule on Electronic Trading Risk Principles (“Electronic Trading Risk Principles”) in 2020 to “address the potential risk of a designated contract market’s (DCM) trading platform experiencing a market disruption or system anomaly due to electronic trading.”<sup>71</sup> The Electronic Trading Risk Principles include a set of “Acceptable Practices”, which are a set of rules and risks controls that DCMs may adopt and implement as these are “reasonably designed to prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading.”<sup>72</sup> To address the proliferation of cryptocurrency platforms and virtual currency transactions in the market, the Commission has developed a “responsible regulator response,”<sup>73</sup> involving the assertion of legal authority, robust enforcement efforts, and government-wide coordination, as well as consumer education and market intelligence gathering.<sup>74</sup>

All of these efforts are predicated on the need to promote transparency, accountability, and stability in the markets, and to eliminate opportunities for fraud and manipulation. While Congress could not have contemplated the proliferation of virtual currency platforms when it created the Commission in 1974, the agency is nonetheless empowered under its broad authority and mandate to respond to emerging issues such as these in the markets. Indeed, the Commission bears a responsibility to identify market innovations and to update its rules and enforcement efforts in response.

*c. Courts have Consistently Recognized the Commission’s Exercise of Authority*

A brief caselaw review involving the Commission’s regulatory powers offers precedent in support of the regulation of climate-related financial risk. As a threshold matter, courts have acknowledged

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65. See Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45291 (July 26, 2013).
  66. CFTC, Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets (Jan. 14, 2018), <https://perma.cc/Y4WP-GY57> [hereinafter “CFTC Backgrounder – Virtual Currency”].
  67. Commodity Futures Trading Commission v. McDonnell, 287 F.Supp.3d 213, 228 (2018).
  68. *Id.* at 222.
  69. See, e.g., CFTC Electronic Trading Risk Principles, 17 C.F.R. 38 (2021).
  70. See CFTC, Digital Assets, <https://perma.cc/J4CV-SRXK> (last visited Oct. 3, 2022).
  71. Press Release, CFTC, CFTC Approves Two Final Rules at December 8 Open Meeting, Release Number 8331-20 (Dec. 8, 2020), <https://perma.cc/MM4X-XNYZ>.
  72. CFTC Electronic Trading Risk Principles, 17 C.F.R. 38.
  73. CFTC Backgrounder – Virtual Currency, *supra* note 66, at 1.
  74. *Id.* at 1-2.

the Commission’s mandate to “[mitigate] risks that may impact the financial stability of the [U.S.]”<sup>75</sup> In an opinion following the 2008 financial crisis, the Court validated the Commission’s decision to implement a more robust framework to regulate market participants in light of the harm deregulated markets caused the financial sector.<sup>76</sup> The Court explained that the Commission’s rule change was permissible so long as the updated regulation “is permissible under the statute, that there are good reasons for it, and that the agency believes it to be better, which the conscious change of course adequately indicates.”<sup>77</sup>

Courts have also affirmed the Commission’s adoption of regulations to address new areas of market risk, such as the Commission’s inclusion of virtual currency as a commodity under the CEA.<sup>78</sup> In the case, the Court was persuaded by the Commission’s previous interpretations and expressions of intent to absorb virtual currency transactions within the ambit of its authority, which included a Commission order, the definition of a commodity in the CFTC Primer, a press release, and a statement by former Chairman Giancarlo on Virtual Currencies.<sup>79</sup> The Court further opined on the concurrence of jurisdiction between the Commission, SEC, and banking regulators over virtual currencies, and clarified that this overlapping jurisdiction should not, and does not, divest the Commission of jurisdiction over virtual currency transactions that relate to the commodities and derivatives markets.<sup>80</sup> This affirmation may be useful to note in light of the SEC’s Proposed Rule on “The Enhancement and Standardization of Climate Related Disclosures for Investors,”<sup>81</sup> which also pertains to climate-related financial risk. This finding, read together with the statutory language of its jurisdiction in the CEA,<sup>82</sup> bolsters support for any Commission action that might require similar forms of disclosure.

The above-referenced opinions support action by the Commission to regulate climate-related financial risk, and offer guidance on the considerations that should surround this rulemaking. Still, the Commission should be mindful of the prospect of judicial review, particularly as detractors have already made clear their intention to challenge new regulation on the basis of the relatively novel “major questions doctrine,”<sup>83</sup> which establishes that an agency “must point to [‘]clear congressional authorization[’] for the power it claims.”<sup>84</sup>

While further clarification on the Commission’s rulemaking plans is needed in order to determine whether the major questions doctrine would apply, it is helpful to understand the interplay between

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75. *Investment Co. Institute*, 891 F. Supp. 2d at 193. This case involves the Commission’s interpretation of its mandate to protect the integrity of the financial markets following the 2008 financial crisis, and as required under the Dodd-Frank Act. Pursuant to this obligation, and upon assessment of changing circumstances in the markets, the Commission promulgated a Final Rule rescinding certain registration and compliance exclusions for commodity pool operators (“CPOs”). CPOs argued that their registrations with the SEC rendered the Commission’s registration requirements unnecessary.

76. *Id.*

77. *Id.* at 194.

78. *McDonnell*, 287 F.Supp. 3d at 228-29.

79. *Id.* at 222, 226.

80. *Id.* at 228.

81. U.S. Securities and Exchange Commission, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 Fed. Reg. 21334 (Apr. 11, 2022).

82. CEA, 7 U.S.C. § 2 (C) (ii).

83. *See, e.g.*, Heritage Foundation – Comment, *supra* note 25.

84. *West Virginia v. Environmental Protection Agency*, 597 U.S. \_\_\_, 19 (2022).

the agency’s statutory authority and the doctrine. Despite quips from opponents that “solving climate change” is analogous to “curing cancer” and other social ills,<sup>85</sup> and thus beyond the reach of the Commission, a rule-making that squarely addresses the financial risk to the derivatives market associated with climate change is likely to fall comfortably within the Commission’s purview.

For its entire existence, the Commission’s remit has been managing risk in the derivatives market. As discussed, climate-related financial risk is another form of systemic risk that the Commission is already empowered to regulate within its broad authority to address market risk.<sup>86</sup> Accordingly, in addressing these risks to the derivatives market, the Commission is neither claiming a new unheralded power nor exercising its statutory authority in a new way. There will always be costs to market participants associated with compliance with new rules, and new regulations can be crafted to ensure the rulemaking delivers net benefits. Further, the derivative market itself has always involved vast economic significance; indeed, the term “commodity”<sup>87</sup> in the CEA encompasses almost all agricultural and industrial products in the country. The protection of the commodities and derivatives markets thus sits at the core of American industry. But courts have not found this impact to be inherently disqualifying. The CEA provides the Commission with ample authority<sup>88</sup> to act on emerging dangers to the commodity and derivative markets, with guiding principles that bolster its actions.<sup>89</sup>

There is no indication that the Commission is seeking to regulate carbon emissions or otherwise act outside its authority. The express goal of the RFI is to “consider how climate-related financial risk may affect any of its registered entities, registrants, or other market participants, and the soundness of the derivatives markets.”<sup>90</sup> As the impacts of climate change are clearly posing financial risks to market participants and the derivatives market, regulatory action by the Commission under the CEA should not only avoid scrutiny under the major questions doctrine but also ensure that the Commission is fulfilling its mandate.

### 3. Conclusion

As the IPCC has recognized, it is “unequivocal” that human activities are warming the planet, leading to “widespread and rapid changes” that pose significant economic risks.<sup>91</sup> Proactive engagement on the part of regulators is necessary to manage these risks and promote market resilience. The Commission’s consideration of climate-related financial risk is consistent with its mandates to prevent fraud and manipulation, to promote fair competition and market integrity, and above all, to avoid systemic risk to transaction integrity. In particular, the frequency and severity of extreme weather events caused by climate change present an emerging systemic threat that the Commission is empowered to guard against. The Sabin Center appreciates the opportunity to comment on the Commission’s consideration of climate-related financial risk to the derivatives market and welcomes rulemaking from the Commission to address this risk.

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85. Heritage Foundation – Comment, *supra* note 25, at 1-2.

86. *See* CEA, 7 U.S.C. § 5 (b).

87. *Id.* § 1a.

88. *Id.* §§ 2 (a) (1) and 5 (b).

89. *Id.* § 5 (b).

90. CFTC RFI, 87 Fed. Reg. at 34858.

91. UN IPCC, *supra* note 4.

Sincerely,

*Eleonor Dyan Garcia*

Fellow and Postdoctoral Research Scholar, Sabin Center for Climate Change Law, Columbia Law School

[erg2181@columbia.edu](mailto:erg2181@columbia.edu)

*Cynthia Hanawalt*

Senior Fellow and Associate Research Scholar, Sabin Center for Climate Change Law, Columbia Law School

[chanawalt@law.columbia.edu](mailto:chanawalt@law.columbia.edu)

*Romany M. Webb*

Senior Fellow and Associate Research Scholar, Sabin Center for Climate Change Law, Columbia Law School

[rmw2149@columbia.edu](mailto:rmw2149@columbia.edu)