



Carbon market oversight

Emission allowances as financial instruments

Directorate General for Climate Action

European Commission

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Emission allowances as financial instruments

- Classification as a financial instrument
- Application of MiFID
- EU legislation cross-referring to MiFID
- Questions

Classification as financial instruments

- Emission allowances and other ETS compliance units would be classified as financial instruments
 - a new class of financial instruments listed in Annex I Section C of the Markets in Financial Instruments Directive (MiFID, 2004/39/EC)
- MiFID is currently subject to broad review
 - COM proposal to be adopted before summer break
 - Several exemptions will be eliminated or narrowed down significantly

MiFID:

- A harmonised regime for the provision of investment services (brokerage, advice, dealing etc.) by investment firms and banks
- Grants authorised entities a “passport” for providing investment services across the EEA
- Requires them to comply with both organisational and reporting requirements as well as comprehensive rules designed to ensure investor protection (including minimum capital and participation in an investor compensation scheme)
- The result is a more competitive trading landscape benefitting investors

- Intermediation in spot carbon trading would be an investment service
- ALL exchanges trading spot EUAs would need to be authorised and supervised
- ALL intermediaries would have to obtain an authorisation and be supervised
- ETS operators dealing on own account in emission allowances would **not** be required to obtain authorisation
 - “Dealing on own account” must be ancillary to the main business
 - ETS operator is not part of a financial group

- Transactions between two ETS operators concluded on a bilateral basis would be exempt from MiFID
- Some (moderate) calibration of the MiFID rules to accommodate the specificities of the ETS is possible via:
 - Implementing measures to be developed by the Commission
 - Exemptions and proportionality clauses which will be retained in the revised MiFID
- Any divergences from the general MiFID rules will need to be well examined and justified:
 - Otherwise risk of fragmentation, increased compliance costs and lower standards of integrity and investor protection

EU legislation cross-referring to MiFID (1)

- Several EU measures cross-refer to MiFID and/or its definition of financial instruments
- As a rule, consequential application of other EU measures concerning financial instruments
- To avoid unintended consequences in those other areas some adaptations may be necessary (e.g. for VAT)

EU legislation cross-referring to MiFID (2)

- **Market Abuse Directive (2003/6/EC)**
 - Reviewed in parallel with MiFID
 - Would apply in full to all market participants, some limited adjustments may be needed (definition of inside information, duty to disclose inside information by issuer)
- **Prospectus Directive (2003/71/EC), Listings Directive (2001/34/EC), Transparency Directive (2004/109/EC), UCITS Directive (2009/65/EC)**
 - Would not apply – emission allowances classified as financial instruments would still fall outside the scope
 - those directives not suitable in the carbon trading context

EU legislation cross-referring to MiFID (3)

- Settlement Finality Directive (98/26/EC)
 - Would apply to transactions in emission allowances settled through the systems covered by that directive
- Financial Collateral Directive (2002/47/EC)
 - Would not apply, unless modifications to the scope were made
 - If applicable, it would allow clearing houses and banks to accept emission allowances as collateral
 - Beneficial to market participants and enhancing liquidity

EU legislation cross-referring to MiFID (4)

- Several COM proposals in the pipeline concerning post-trade issues:
 - European Markets Infrastructure Regulation
 - Will apply to trade in derivatives but not to spot allowances classified as a separate class of financial instruments
 - Proposal on Central Securities Deposits (CSD)
 - Will apply to activity of settlement systems
 - Single ETS registry to be excluded from scope
 - Securities Law Directive
 - Will provide for harmonised rules for holding and disposing financial instrument, with rules applicable to custodians and settlement systems
 - Would apply to emission allowances classified as financial instruments, but remains to be considered how it would deal with the single ETS registry

EU legislation cross-referring to MiFID (5)

- Anti-Money Laundering Directive (AML, 2005/60/EC)
 - Would apply to the activity of intermediaries in the spot carbon trade
 - Would involve application of all standard AML checks and duties in their dealings with clients
 - Would not extend to the activity of auction platforms, which have AML responsibilities on the basis of Auctioning Regulation
- VAT Directive (2006/112/EC)
 - Trade in financial instruments exempt from VAT
 - A change (carve-out for emission allowances) would be required in VAT legislation to continue with existing approach

- Is classification a comprehensive and sustainable solution? Should EUAs be also classified as transferable securities?
- Should purely bilateral trade in EUAs (not covered by MiFID) be subject to some form of reporting?
- Would classification impact how market participants access the carbon markets and/or manage their exposure (incl. for accounting and tax)?

- What additional knock-on effects of classification?
- Impacts of classification for compliance costs of your organisation?
- Would classification help reduce the uncertainty around the legal status of allowances?