

## **Summary of ECCP Stakeholder Meeting on Carbon Market Oversight**

***Brussels, 4 May 2011***

The meeting was attended by organizations - members of the European Climate Change Programme (including Member States' authorities, exchanges, compliance emitters, trade organizations, non-governmental bodies and academic institutions).

An agenda and a seven-page Discussion Paper were made publicly available prior to the meeting on the DG Clima website [http://ec.europa.eu/clima/events/0034/discussion\\_paper\\_en.pdf](http://ec.europa.eu/clima/events/0034/discussion_paper_en.pdf).

The meeting proceeded as follows.

### 1. Introduction

The stakeholder meeting was opened by Mary Veronica Tovsak Pleterski, Director in Climate Action Directorate-General responsible for European & International Carbon Markets who welcomed the attendees, presented the Commission's ongoing work on carbon market oversight and introduced the topics for the discussion.

Her remarks were followed by the special address by European Parliament Member Lena Ek, a member of the Parliament's Committee on Industry, Research and Energy. She emphasized the role of the EU ETS<sup>1</sup> as the most important mechanism to fight the climate change and provided her outlook on the legal issues involved in regulating the carbon markets.

Based on her observations the carbon market has been operating in many ways similar to the financial markets and, therefore, "stock market-like regulation" would seem appropriate for the market and would increase investor confidence in its operations. She noted that the growing size and trading opportunities in the carbon market attract attention of legitimate traders and criminals alike. It is important to take steps to protect the reputation of the system.

Making reference to her experience as a lawyer and lawmaker, Ms Ek referred to the choice between existing financial regulation and creating a tailor-made regime for emissions trading and argued that the broader concepts and approaches usually work better. There are very few examples of specialised regulation working better. It would be wise to use a type of regulation that the industry is already familiar with to gain time, effort and save money. Adding a few paragraphs to an existing framework is better than "re-inventing the wheel".

Following the introductory part the meeting was chaired by Yvon Slingenberg, Head of Unit for the Implementation of the Emissions Trading Scheme ("ETS").

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<sup>1</sup> Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003, establishing a scheme for greenhouse gas emissions allowance trading within the Community and amending Council Directive 96/61/EC.

## 2. Enhancements to carbon market oversight.

In the introductory remarks to the panel session the Commission presented the context of the work, the issues to be addressed and the identified objectives and then it set out questions that would need to be addressed before the proper form of carbon market oversight can be implemented.

Among the key points raised was the fact that approximately 90% of the total carbon market volume was trade in financial instruments. The percentage of financial trading appeared to be growing and the percentage of pure "spot" trading seemed to be diminishing. The Commission considered it important to avoid regulatory intervention where regulations already existed. Focus should be on those areas of spot secondary trade where regulatory gaps had been detected. Although it was important that regulation be proportionate, regulations should not be so lax that they could be easily abused.

The objectives identified included: comprehensive cross-border supervision with robust tools for detecting and sanctioning cases of market misconduct; high standards of market transparency and investor protection; a level playing field for intermediaries and trading venues active in the various parts of the carbon market; consistency with other EU directives and regulations; and a regime where costs to the market participants are proportionate to the benefits of enhanced market integrity.

Following the Commission's introduction, the meeting was opened to interventions by the panelists as well as questions and interventions by other participants. A number of points were raised, even if there was broad agreement that the most important goals for enhancing the carbon market regulation were: (1) greater market transparency and (2) enhanced market integrity.

Where there was significant divergence of opinion, was with respect to what the best approach to achieving those goals would be. Many participants favoured a regulatory model that was specifically constructed to take account of the specificities of the carbon market. One participant pointed out that several financial market rules do not fit emissions trading, and he expressed the view that a new structure needs to be built. Inside information needs to be defined for the ETS, balancing the need for openness with the need for protecting business operations. This definition should take into account the characteristics of emissions allowances, particularly the immateriality of the underlying asset. One participant cited the lack of knowledge about all implications of extending the Markets in Financial Instruments Directive ("MiFID")<sup>2</sup> to the carbon spot market as the main reason for his organisation's reluctance to support such an approach.

Another participant expressed the view that the immediate goals of regulation should be to restore confidence in the market; to agree common rules; to prevent market abuse and manipulation; to reduce volatility and price shocks; and to achieve close linkage in the regulation of the primary and secondary markets. He noted that, although the ETS started with a decentralized framework which was necessary for political reasons, there may now be more need for coordination and centralisation.

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<sup>2</sup> Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments amending Council Directive 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC.

There was broad agreement that a new regulatory regime should be introduced quickly, should be operated as economically as possible so as not to impose excessive costs on market participants, and should be operated competently. Most participants agreed that existing financial services regulation offered the most sophisticated and well-tested framework, and that its rules should be built upon and its organisations used with a view to introducing necessary regulation relatively soon, although it may need to be tailored to take account of the special characteristics of emissions allowances.

### **3. A tailor-made regime for spot carbon trade**

The Commission provided an introduction to the panel debate on this issue. It was noted that, although there had been some preliminary discussion about including carbon emissions within the instruments to be covered by the proposed Regulation for Energy Market Integrity and Transparency ("REMIT")<sup>3</sup>, the Commission had decided that carbon emissions did not fit well enough with physical gas and electricity transactions intended to be covered by the REMIT. The Commission was considering three possible approaches for a tailored made regime. The first is to apply appropriate provisions of the MiFID and the Market Abuse Directive ("MAD")<sup>4</sup> to secondary spot trading of EUA's<sup>5</sup> without classifying EUA's as "financial instruments" as defined under MiFID. The second is to build a regulatory system from scratch to regulate spot secondary trade in EUA's. The third would be to combine appropriate elements of the first two approaches. The likely impact of the three approaches on the obligations of market participants was also outlined.

The floor was then opened to comments from panelists and questions and interventions from participants. A number of parties expressed opposition to bringing EUA's within full MiFID regulation. The general concern seemed to be that those opposed to this route believed carbon emissions spot market to be sufficiently different from the financial instruments regulated by MiFID that a "special" regulatory regime would be required for carbon emissions.

Those in favour of a special regime presented different views on how this regime could be constructed. Some argued that a "bespoke" regime should be constructed from scratch for EUAs. Others favoured a more moderate approach of taking appropriate parts of existing legislation (i.e. MiFID and MAD) and combining them into a system that focused on EUAs. Views were expressed that the latter would provide a quicker and less costly route to implementation of an appropriate regulatory regime.

Participants in favour of extending the financial regulation to carbon spot market expressed doubts whether the result of brand new tailor-made rules would be significantly different.

One participant pointed out that although many persons spoke about a tailor-made solution, it was not clear whether they really speaking about "bespoke" regulation or "made-to-measure". While acknowledging that a regime build entirely "from scratch"

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<sup>3</sup> COM(2010) 726 final, Proposal for a Regulation of the European Parliament and of the Council on energy market integrity and transparency.

<sup>4</sup> Directive of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse).

<sup>5</sup> European Union emissions allowances.

would be more suited to the specific needs of the carbon market, the time and costs involved may be disproportionately high to the gain expected from pursuing such approach in particular as the final result would probably not be significantly different. His final view was that the best solution is to apply relevant parts of MiFID and MAD as any regime would need to contain the same kind of authorisation and other requirements.

Some participants expressed concern that there is no clear understanding about whether the carbon market should be supervised by financial regulators, national regulators or an EU-level regulator. They stressed that there should be close cooperation between regulators in order to ensure the most effective supervision of the carbon market. One suggested choice might be that the carbon markets be supervised by authorities at national regulators, but in coordination with the European Securities Markets Authority (ESMA).

#### **4. Emission allowances as financial instruments**

Classifying emission allowances and other ETS compliance units as financial instruments under MiFID was the focus of this session. The Commission's introduction focused on two key issues: (1) the impact of classifying carbon emissions as financial instruments on the obligations of market participants under MiFID; (2) "knock-on" effects of such classification with respect to other EU financial market legislation that cross-referred to the MiFID.

It was pointed out that the MiFID is currently subject to review with a proposal to be adopted before the summer break (see also comment on p. 6). Some advantages of MiFID classification were mentioned: (1) it would lead to a harmonized regime for the provision of investment services including trade in emission allowances and related products; (2) a "passport" would be available to provide services across the EEA without the need for state-by-state authorisation; (3) it would help ensure investor protection and a more competitive trading landscape, benefiting investors.

It was emphasized by the Commission representatives that even if emission allowances were classified as financial instruments, those ETS operators dealing "on own account", would generally NOT be required to obtain authorisation as long as their dealing on own account was ancillary to their main business, and they were not part of a financial group. Therefore, many of the parties who expressed objections to classification as a MiFID financial instrument would continue to remain exempt from MiFID authorisation requirements.

It was pointed out that some modifications may need to be made to accommodate the specificities of the EU ETS. Stakeholders were encouraged to indicate with respect to which provisions such adjustments would be most necessary and in what ways the treatment of carbon market intermediaries and trading venues should be different from that of intermediaries and venues dealing with financial instruments.

The Commission concluded its introduction by referring to a number of EU directives and regulations and discussing the extent to which they might apply to emissions allowances if emissions allowances were classified as financial instruments under MiFID. Generally,

the Prospectus Directive<sup>6</sup>, Listings Directive<sup>7</sup>, Transparency Directive<sup>8</sup>, and the UCITS Directive<sup>9</sup> would not apply. The Settlement Finality Directive<sup>10</sup> would apply to transactions settled through systems covered by that directive. It was pointed out that there may be some benefits if the Financial Collateral Directive<sup>11</sup> was made to apply.

The panellists gave an overview of advantages and disadvantages of classifying the emission allowances as financial instruments.

One participant expressed the view that it makes sense to classify emissions allowances as financial instruments under MiFID, because there are many reasons to believe that the carbon market has evolved into a financial market. There is not any significant difference between the ETS market and the financial markets in the trading process. However, there are specific characteristics of the positions taken by market participants in the ETS market that may require some "tailoring" of requirements applicable already to financial instruments.

Another pointed out that, currently, emissions allowances are principally traded as financial derivatives.

Some participants held the view that MiFID and MAD are not appropriate to apply to these markets. One participant stressed that energy companies, as a distinct group of ETS compliance buyers with significant carbon market activity, are still different from financial companies and as such should not be made to comply with rules developed for banks and investment firms.

However, other participants pointed out that ETS operators should keep in mind that they will be excluded if they are trading for their own account and that trading is ancillary to their main business, and they are not part of a financial group.

Most participants seemed to agree that transparency and market integrity were important goals to pursue when considering regulatory changes; speed of adoption, cost control and competent regulation must be achieved in any new regulatory regime.

## 5. Single registry and forthcoming amendments to Registries Regulation.

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<sup>6</sup> Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

<sup>7</sup> Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities.

<sup>8</sup> Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

<sup>9</sup> Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

<sup>10</sup> Directive 98/26/EC of the European Parliament and of the Council on finality in payment and securities settlement systems.

<sup>11</sup> Directive 2002/47/EC of the European Parliament and of the Council on financial collateral arrangements as regards linked systems and credit claims.

The Commission presented a number of new security measures that were envisaged as part of the amendments to the Registries Regulation to improve the security of the registries for emissions allowances. These included a 24-hour delay on all transfers of allowances; two factor authentication; technical "out of band" confirmation of transaction orders; the "four eye" principle to establish authenticity; and no central transaction volume limits.

Two types of accounts would also be offered with different levels of security. "Holding accounts" would be subject to stricter rules regarding transfer of allowances, while "trading accounts" would provide account holders with more flexibility to manage their outward transfers. On the whole, this would give holders different options as to how securely they wished their allowances to be held and transferred.

The general consensus was that the new security regulations for registries were very welcome.

## 6. Conclusion

Chairperson Slingenberg made the following points in conclusion;

- The Commission notes that all stakeholders acknowledge the need for further regulation enhancing market oversight for secondary spot trade in emission allowances;
- There is broad support from the participants to build on the measures included in the MiFID and MAD for purposes of addressing the regulatory gap identified in the secondary spot trade in emission allowances;
- It should be kept in mind that a proposal on changes to MiFID is expected before the summer break [*Comment: on 26 May Commissioner M. Barnier announced that the planned adoption of the MiFID review proposal has been postponed to October 2011*];
- The Commission would very much like to have written comments responding to the questions they set out in the discussion paper provided prior to the meeting. Any input would be helpful;
- In particular, it would be helpful if participants would respond by providing specific information about how they believed that emissions trading, and their positions as emissions traders, would be affected by the alternative proposals discussed at the meeting;
- It remains utmost important for the Commission to understand, in concrete terms, how any of the proposals outlined, if adopted, would impact the entirety of the carbon market or specific (groups of) carbon market participants. Any reflections and supporting evidence on this would be appreciated.

The meeting was concluded at 4:30 PM.

Annex:  
Agenda

ECCP Stakeholder Meeting  
on Carbon Market Oversight

4 May 2011

The agenda was organized into the following segments:

1. Introduction [10:00 to 10:30]  
Presented by the Commission  
Introduction by L. Ek, Member of the European Parliament
2. Enhancements to carbon market oversight -- identifying the right scope and substance [10:30 to 11:30]  
Panellists: IETA (S. Ruiz), French Directorate-General for Energy and Climate (H. Martineaud), Université Paris-Dauphine (C. de Perthuis)  
  
Coffee break [11:30 to 11:45]
3. A tailor-made regime or spot carbon trading [11:45 to 13:15]  
Panellists: BusinessEurope (K.P. Horstmann), CEFIC (N. de Warren), Green Exchange (H. Hasselknappe)  
  
Lunch break [13:15 to 14:15]
4. Emission allowances as financial instruments -- making spot carbon trading subject to EU financial legislation [14:15 to 15:30]  
Panellists: Eurelectric (J. Scowcroft), NASDAQ-OMX (G.Reigstad), Dutch Ministry of Finance (S. Dirkzwager), CEPS (D. Valiante)
5. Single registry and forthcoming amendments to the Registries Regulation [15:30 to 16:30]