



# Carbon market oversight

**Joint procurement of an auction monitor –  
Information day**

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**Disclaimer: The views expressed are purely those of the speaker and may not in any circumstances be regarded as stating an official position of the European Commission**

# Carbon market

## WHAT IS TYPICALLY COUNTED?

- European carbon market – EU Emissions Trading System (EU ETS)
- Clean Development Mechanism (CDM) and Joint Implementation (JI)
- Assigned Amount Units
- Regional Greenhouse Gas Initiative (RGGI)
- New Zealand ETS
- New South Wales Greenhouse Gas Abatement Scheme (NSW GGAS)
- Compliance and pre-compliance offsets in North America

# European carbon market today (1)

## WHO TRADES?

ETS operators are "natural" participants in this market

- **Typically they sell surplus allowances or buy deficit**
- **A few largest ones (i.e. electricity companies, largest industrials) have developed a strong trading arm serving other ETS operators**

Brokers, banks and (energy) commodity traders

- **Dealing on their own account or for their clients**

CER/ERU producers and aggregators

- **Specific subset of companies operating in the segment of carbon credits**

# European carbon market today (2)

## WHAT IS TRADED?

Emission allowances are traded mostly in the form of derivatives contracts (futures and options).

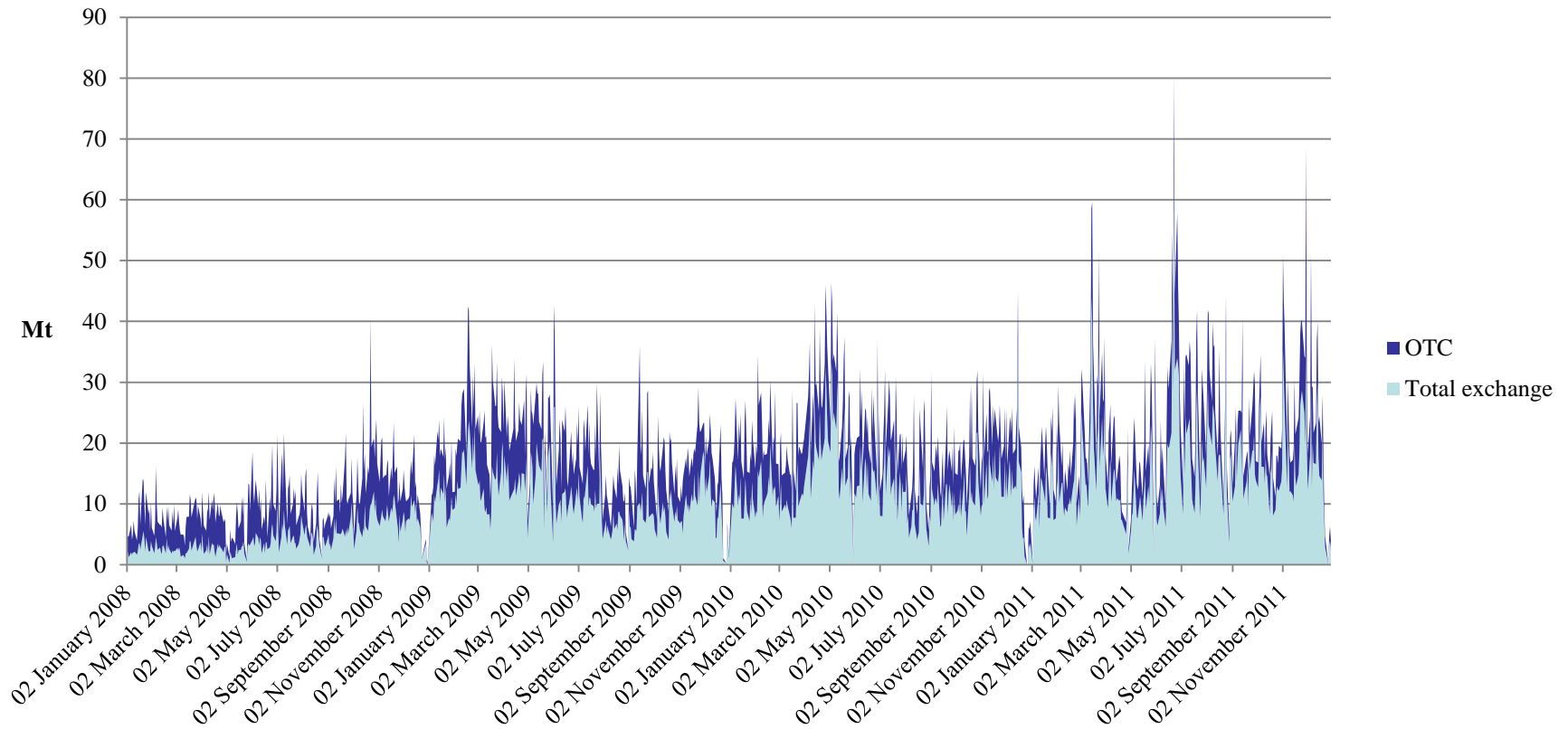
- **Spot trading activity accounts for less than 10% of the overall volume.**

## WHERE DOES THE TRADING HAPPEN?

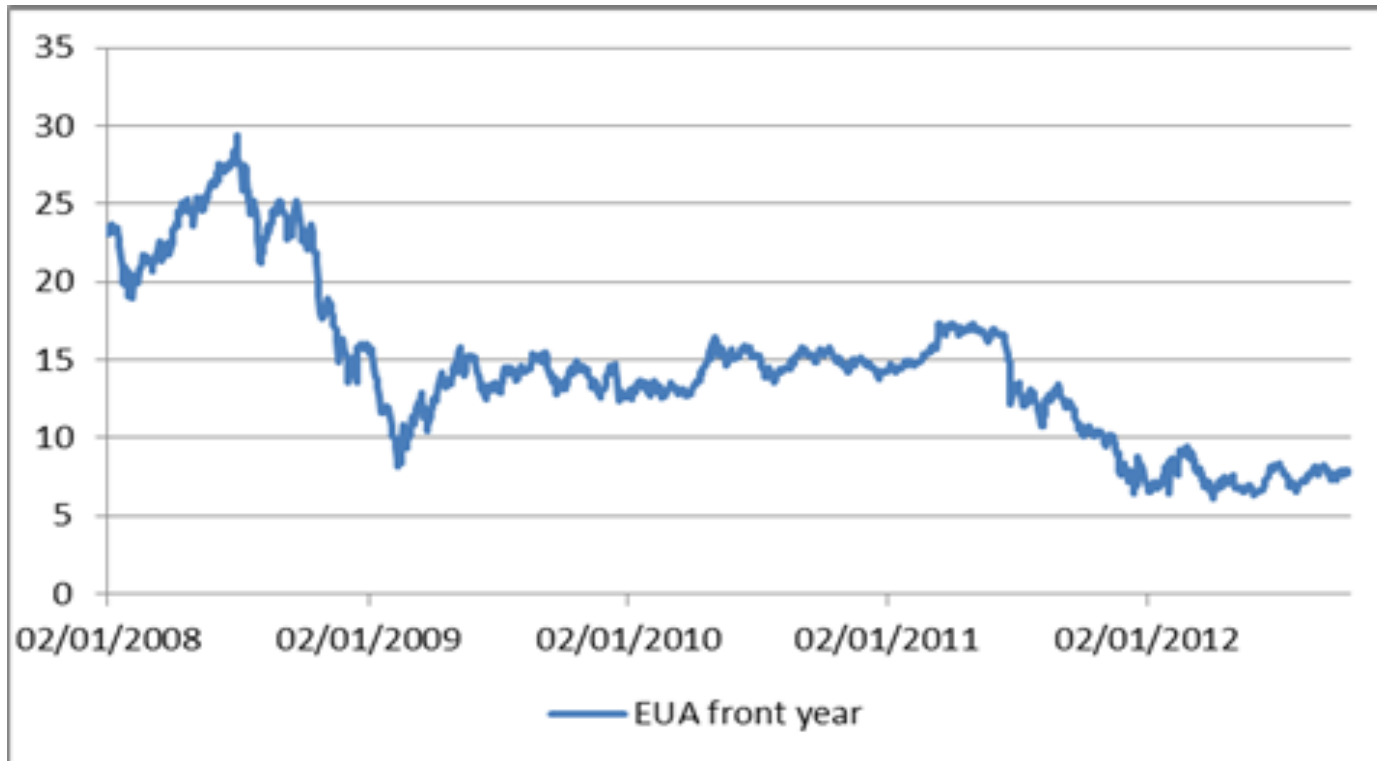
Most of the trading takes place "on exchange".

- **A handful of venues with significant trading activity - most of them hold a regulated market status (in the sense of Markets in Financial Instruments Directive - MiFID)**
- **Only less than 1/3 of the volume is traded OTC of which well over 80% is centrally cleared.**

# European carbon market today (3) - Volumes



# European carbon market today (4) - Prices



# A market bound to evolve (1)

- Volume of trade in the global carbon market grew by almost 20% in 2011 alone
  - **Volume of trade in EU emission allowances grew by 9%**
- Value of trade in the global carbon market reached around €96 billion in 2011
  - **With the trade in EU emission allowances accounting for 80% of its size or €77 billion**
- In Phase 3 (start in 2013) auctioning will become the principal method of allocation of allowances (previously free allocation)
  - **Volumes coming to the primary market will increase**

## A market bound to evolve (2)

- Carbon market to be covered in full by financial markets rules:
  - **Auctions: market abuse framework and rules against money laundering apply; auction platforms to be regulated markets in MiFID sense**
  - **Secondary market: allowances to be covered by the reviewed Markets in Financial Instruments Directive and Regulation (MiFID/MiFIR) and Market Abuse Directive and Regulation (MAD/R) with necessary adjustments**
  - **Allowances to be classified as a new, separate category of financial instruments for MiFID and cross-referring legislation**
- But climate policy continues to have the predominant impact on the EU carbon market



# Why rely on financial market rules?

- Two well-known and tested frameworks to enhance carbon oversight:
  - MiFID/MiFIR – applies to trading venues, professional traders and intermediaries – deals with organisation and transparency of markets – benefits investor protection, market integrity and efficiency
  - MAR/MAD – applies to all market participants – sets out framework against market manipulation and insider dealing
- Efficiency gains – in development and in implementation - for authorities and for market participants
- Appropriate adaptations to carbon market specificities foreseen and exemptions from MiFID for ETS compliance buyers
- Coherence with rules for allowance derivatives
- Some non-EU jurisdictions (e.g. Australia, Japan) also expect to regulate emission allowances under their existing financial market regulation

# Emission allowances as financial instruments

- Allowances and credits in the Union registry – a new class of financial instruments under MiFID (Annex I, Section C, Point 11)
- For market oversight purposes allowances put on equal footing with other financial instruments (i.e. not less safe)
- Will not trigger unintended knock-on effects from other financial market legislation (Prospectus, Transparency, UCITS... do not apply)
  - But, in addition to Anti-Money Laundering Directive, useful rules on short selling and settlement finality will apply to carbon market
- Accounting treatment of allowances at EU level is not dependent on classification under MiFID
- Classification ensures that the regulatory framework for carbon trading will keep pace with regulatory advances for the broader financial market

# Existing link with financial market rules (1) - MiFID

- Pursuant to Article 35(1) of the AR, auctions may only be conducted on a regulated market authorised under the MiFID
- The definitive auction platform (i.e. the regulated market and its market operator) must be authorised for that specific purpose (auctioning) under national implementation of the MiFID rules (Title III and IV)
- The transitional auction platforms will not be required to obtain a specific extended authorisation for auctioning under the MiFID – under the AR, their existing licence of a regulated market will suffice

# Existing link with financial market rules (2) – MiFID

- In practice this means:
  - Member States expecting to be a home jurisdiction for candidate definitive auction platforms need to examine their individual transpositions of the MiFID into national law
  - Where those national laws transposing MiFID do not make it possible for regulated markets (and their market operators) established in their territory to be authorised as definitive auction platforms for the auctioning, the Member States concerned may have to make relevant changes (extensions) to their existing MiFID framework

# Existing link with financial market rules (3) – MAD

## MAD

- Auctioning Regulation (AR) also stipulates that rules on market abuse apply to the auctioning of emission allowances:
  - if the auctioned product is a financial instrument (within the meaning of Article 1(3) MAD), that Directive shall apply to the auctioning of the auctioned products (Art. 36(1) AR)
  - if the auctioned product is not a financial instrument, the provisions of Articles 37 to 43 AR shall deal with market abuse issues arising in the context of the auctioning of the auctioned products (Art. 36(2) AR).

# Impact of review of financial market rules (1) – MiFID/R

- Limited adaptations ex-post:
  - The proposals on MiFID and MiFIR lay down rules concerning the trading activity on the secondary market - their application would not be suitable to primary markets and to auctioning in particular
  - AR should continue to be the legal instrument which sets out the general terms for licensing, on-going operations and supervision of auction platforms by reference to the MiFID/MiFIR framework, which would apply to the activity of those platforms "to the extent relevant" determined by national transpositions (as per Art. 35(4) AR), including after the classification of spot emission allowances as financial instruments

# Impact of review of financial market rules (2) – MAD/R

- AR provisions fully integrated
  - In view of classification of emission allowances as financial instruments, the MAR proposal has been tabled with the objective of constituting a single rule book of market abuse measures applicable to the entirety of the primary and secondary market in emission allowances
  - Once MAR enters into application, it will not only apply to trading in emission allowances on secondary markets but also to auctions in those allowances or other auctioned products based thereon, such as futures (primary market)
  - Before MAR enters into application the provisions dealing with the same matter in the AR will have to be repealed as redundant

# Thank you for your attention

For more information see:

[http://ec.europa.eu/clima/policies/ets/oversight/index\\_en.htm](http://ec.europa.eu/clima/policies/ets/oversight/index_en.htm)

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