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**Ministry of the Environment Sweden**

*Division for Environmental Quality*

*David Mjureke*

*E-mail david.mjureke@environment.ministry.se*

**Swedish response to the consultation paper "Technical Aspects of EU Emission Allowances Auction"**

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**General remarks**

Sweden would like to thank the Commission and its consultants for preparing the informative consultation paper and for organising the consultation process. Sweden welcomes that Member States and stakeholders are given this opportunity to provide input at an early stage of the development of the regulation on auctioning.

With the consultation paper a questionnaire has been distributed which is for any stakeholder to answer. The Commission welcomes answers from Member States but many questions are of a technical nature and not specifically aimed at Member States. Accordingly, several specific questions are not answered.

Sweden is still in the process of analysing the complex auctioning issue and the comments provided in this document should be considered as preliminary.

Headings refer to sections in the consultation paper and numbers refer to specific questions.

**What and when to auction? (question 1 to 17)**

1. As a general rule throughout the trading period, in your opinion, are early auctions necessary?

If allowing for early auctions, one must also consider when in time they should begin (2011, 2012 or 2013). The energy sector is asking for auctions as early as 2011. Auctions already in 2011 increase the risk that Member States cannot deliver sold allowances on time, for example due to registry constraints. The early auction issue is also linked to the question regarding selling spots or/and futures. Sweden wants a

simple, clear and harmonised system - however, the system must also consider the behaviour of the largest stakeholders that take part in the auctions (i.e. electricity producers) which in most instances use hedging strategies to secure their future costs and deliveries.

Sweden believes that having early auctions in 2011 or 2012 will be a good strategy to secure and ease the market's worries concerning EUAs. The share that should be auctioned early in 2011 or 2012 should however be quite low, perhaps 5-10 % of 2013/2014 vintage allowances, not to disturb the already functioning secondary market that also can be used for hedging strategies.

2. Do you think there is a need to auction futures? If so, why so?

In relation to question 1 regarding early auctions, Sweden believe it to be important for some of the sectors inside ETS that both spots and futures are available for auctioning. Even so, it must be carefully analysed how much this would complicate the system and also for how many years in advance futures should be sold. As earlier noted the secondary market of ETS is functioning and is as such also capable of handling the hedging strategies. An issue that needs careful consideration is how the Member States' revenues can be guaranteed when auctioning futures. One option would be to have a clearing house involved to mitigate credit and market risk.

3. What share of allowances should be auctioned spot and what share should be auctioned as futures each year?

Sweden proposes that the share of futures in the primary market always should be smaller than the share of spots (auctions in 2011 and 2012 excluded).

4. Should the common maturity date used in futures auctions be in December?

Sweden does not see any problems with December as a common maturity date.

5. and 6. For spot auctions what would be optimum/minimum/maximum frequency of auctions? and For spot auctions what should be the optimum/minimum/maximum action size?

This question also closely relates to if one opts for a centralised or decentralised system. Sweden is opting for a centralised system which would imply quite large auctions that would take place for the whole of EU ETS. The transaction- and administrative costs for both the Member States and the compliance parties will most likely be very high if the auctions are held to frequently. From the Swedish viewpoint a maximum frequency would be monthly and the minimum would be quarterly. This position is not final and we are still analysing the issue.

Another reason why Sweden does not think frequent auctions are needed is that the secondary market is fully functioning and it is far more important to give the market clear information regarding how much EUAs that will be auctioned and when in time the auctions will take place.

7. and 8. For future auctions what would be optimum/minimum/maximum frequency of auctions? and For future auctions what should be the optimum/minimum/maximum action size?

We believe that future auctions should take place at the same time as spot auctions.

9. Should volumes of spot allowances be auctioned evenly throughout the year?

Yes, we agree with a flat and homogenous distribution over the year, especially if the auctions should sell both futures and spots. In order to keep the auctions simple both for the auctioneers and the participants we believe this to be the best solution.

10. Should the volumes for spot and futures auctions be spread over the year in the same manner?

Yes, for same reason as above – to keep the system simple and clear for all involved.

11. Does the Regulation need to have provisions to avoid holding auctions during a short period of time before the surrounding date?

See answer below.

12. Which dates should be avoided?

Since Sweden favours rather infrequent auctions, public holidays in most Member States can and should be avoided. We also believe it to be a good idea to avoid dates that could lead to market disturbance, such as days when emissions data is released or surrendering days.

13. Is a harmonised 10-12 hrs CET auction slot desirable?

That would work.

14. How long in advance should each element of the calendar be determined?

All information in the auction calendar should be released as early as possible, a year in advance should be an absolute minimum. This is of course an important element in order to assure the market that the EUAs will be available on the market and to assure simple, clear and transparent auctions.

15. What should be the volume of allowances to be auctioned in 2011 and 2012?

See answers to question 1 and 2.

16. What should be the rule with respect to allowances not auctioned due to force major?

As stated in the consultation paper, what should be ensured is that respective volume is auctioned without unnecessary delay. Setting a limit of 1 or 3 months depends on the reason for the force majeure to trigger in.

17. Is 1,000 allowances the most appropriate lot size?

There is evidence from the Germany and UK auctions that even lot sizes down to 500 might be needed not to restrict the access for SMEs and small emitters. However, since the most common lot size of the European carbon exchanges today is 1,000, this size may be the easiest for the compliance parties and the auctioneers to handle.

#### **Auction design (question 18 to 25)**

18. Is a single-round sealed-bid auction the most appropriate auction format for auctioning EUAs?

Sweden supports the use of single-round sealed-bid auctions. We believe this system to be the easiest for the market and most actors are used to this kind of systems. Another upside of using single-round sealed-bid auctions is that it is the format used in RGGI.

19. What is the most appropriate pricing rule for the auctioning of the EUAs?

To keep with the simple, clear and transparent design of the auctioning system Sweden supports the use of uniform-price. Uniform pricing is known by most of the large compliance parties and should as such reduce transaction- and information costs.

20. Should the rules for solving ties in the Regulation be; random selection or pro-rata re-scaling of bids?

Sweden supports the pro-rata re-scaling of bids. RGGI uses the random approach but the compliance parties in the US do not have a sizable secondary market up and running. The RGGI scheme is also considerably smaller than the EU ETS.

21. Should a reserve price apply?

The purpose of a reserve price can be more than one – it can for example be connected to a force majeure clause or it can be used as a general price threshold (ensuring that the price never goes under a

certain level related to the secondary market price). There are risks with introducing a reserve price – the buyers may find out what the reserve price is and never bid much above it. Hence, the risk of market manipulation might even rise with the use of a reserve price. If a reserve price is introduced, it should hopefully never kick in.

Sweden can support a reserve price that can kick in only in cases of unexpected events such as disruptions in the bidding process. Sweden is sceptical to the general use of a reserve price.

22. In case a reserve price would apply, should the methodology/formula for calculating it be kept secret?

Yes, a reserve price might not work as intended if the methodology/formula of how to set it was public. There is a risk that the reserve price, if available to the market players, would serve as a focal point for bidding strategies. However, as stated in the answer to the previous question, it is not unlikely the market players will figure out even a secret reserve price.

23. Is a maximum bid-size per single entity desirable in a Uniform-price auction? In a discriminatory-price auction?

Sweden does not see the added value of having a maximum bid-size per single entity, not in a uniform-price auction nor in a discriminatory-price auction. Since not only compliance parties will be able to buy EUAs in the auctions a maximum bid-size rule would be difficult to enforce. Some compliance parties might also purchase EUAs on behalf of other compliance parties. The information gathering and monitoring concerning each buyer would have to be massive should such a rule apply.

24. If so, what is the desirable bid-size limit?

Not applicable, see answer to question 23.

25. In case only one of the two following options would be chosen to limit the risk of market manipulations or collusion which one would be preferable; a discriminatory-price auction format or a maximum bid-size per single entity?

Sweden does not see the added value of the maximum bid-size per single entity (see answer to question 23) and prefers a uniform-price auction format (see answer to question 19). Between the two, Sweden prefers the discriminatory-price auction format.

## **How will the auction(s) be implemented (question 26 to 67)**

### 26-32. Various issues on pre-registration

Once again, Sweden wants to emphasize the importance of a clear, simple, harmonised, non-discriminatory and transparent system for both sellers and buyers. The pre-registration issues are important for the trust in the system and its functioning. However, it is important that information required from buyers is truly needed and that confidentiality issues are taken into consideration. The pre-registration issue could become very complicated and time-consuming for buyers if auctions are performed in a decentralised manner.

### 33-36 Various issues on collateral

Sweden aims for a harmonised auction system – this should of course also include issues concerning collateral. It may be advisable to use the principles that exist on the secondary market today as a starting point to make use of existing knowledge and experience. It might be practical having a clearing house involved to mitigate credit and market risk when it comes to auctioning futures. This could imply that the risk would be lower both for the Member States involved and for the buyers of the EUAs.

### 37-39 Various issues regarding payment and delivery

Sweden would like to stress the need for harmonised rules. We would like this issues to be dealt with in a way that the market is used to and these issues are dealt with today on the secondary market. The main objective must be not to create an expensive and unnecessarily complicated system.

### 40-41 Transaction rules under the Regulation

The system should build on what is already market practice. Harmonisation and simplicity should be the guiding principles.

### 42-48 Various issues concerning cost effective participation

These issues, of course, are linked with which auction model is chosen. There is a difference in what kind of auctioneer is needed if the chosen system is decentralised, centralised or a hybrid. There will also be different needs if what is traded is spot, futures or both. The importance of simplicity, transparency and harmonisation can not be emphasised enough.

It could be cost effective to have existing exchanges perform the auctions - the major players on the ETS market would probably be happy with such a solution. Simple and affordable access for SMEs and small emitters must however be ensured.

In regards to the proposed intermediaries system that is used in the UK, we think that the disadvantage of not letting compliance parties trade for themselves is a major drawback for the system. It is important that the chosen system is non-discriminatory. We do agree with the consultation paper's conclusion that SMEs and small emitters will most likely trade through intermediaries but that does not mean one should create a system were they are obliged to do so.

49-54 Issues relating to SMEs and small emitters

A harmonised, simple and transparent system would facilitate auction participation for SMEs and small emitters. Uniform-pricing, among other design features, would help achieving this. A small amount of non-competitive bids might be another way of helping SMEs and small emitters get access to the primary market. However, one should bear in mind that making special rules for SMEs and small emitters should not complicate the system as a whole, and that the transaction- and information costs could be higher by introducing special requirements for SMEs and small emitters.

55-60 Various issues on auction information disclosure

These questions are linked with the questions discussing the auction calendar. After an auction, the information on volume, clearing bids etc. that is not of any confidential kind should be given to market as soon as possible.

61-62 Issues relating to auction monitoring and reporting

Given that Sweden supports a harmonised and transparent system we also support that an auction monitor should be appointed centrally to monitor all EU-auctions.

63. Is there a need for harmonised market abuse provisions in the Regulation to prevent insider dealing and market manipulation?

Yes, in order to ensure a harmonised and transparent system we support this.

64-67 Issues on enforcement of the provisions of the Regulation

Sweden supports harmonisation on an EU level.

#### **Who auctions? Auction processes and auctioneer(s) (question 68 to 75)**

68. Which of the three approaches for an overall EU auction model do you prefer? Please rate the options below (1 being the most preferable, 3 being the least preferable); i) limited number of coordinated auction processes ii) full centralisation based on a single EU-wide auction process, iii) the hybrid

approach where different auction processes are cleared through a centralised system.

Sweden opts for a fully centralised system based on a single EU-wide auction process and platform. We do not think that Sweden on its own should (or perhaps even could) have our own auctioning platform.

We do not think a compliance party or an intermediate would like to take part in several different auction processes at different platforms in order to purchase needed allowances - a large market player buying EUAs would most likely want to buy these on one single auction platform. An EU-centralised system could save a lot of administrative costs for Member States and industry alike.

We would like to see the hybrid approach sketched out by the consultation paper more elaborated on, this might be an opening for a more decentralised system. At the same time, we do not really see the added value, especially for smaller Member States. It seems likely major market players on aggregate will use one or a few auctioning platforms, leaving the other ones with very little business.

69. If a limited number of coordinated auction processes develops, what should be the maximum number?

Sweden does not favour this option. If still chosen, the number of processes should be kept low.

70. Is there a need for a transitional phase in order to develop gradually the optimal auction infrastructure?

Yes, this is most likely the case.

71-75 Issues regarding key requirements for the auctioneer(s) and auction processes, fees and appropriate and timely preparation of auctions

The aspects brought up in question 71 is a good starting point for the important discussion about requirements on the auctioneer(s) and the auction process(es). The same rules should apply to all Member States regardless of auction design chosen.

#### **How to organise auctions of EU aviation allowances? (question 76-86)**

Sweden wants the EUAAs auctions to be performed in the same manner as the EUAs auctions. More or less the same rules should apply since this would facilitate auction participation for compliance parties involved in buying EUAAs (aircraft operators) that also have the possibility to use EUAs for their compliance.