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Energy for a Changing World

Preparing for European carbon allowance auctions

State of play

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Chartering new territory

- Move to auctioning represents a fundamental change to the EU ETS:
  - ➢ Phase 3 auctioning will be more than half the annual cap. Phase 1: less than 1%. Phase 2: 3-4%
  - ➢ Assuming 1 billion allowances: weekly auction = 20 million. Current trading = 10-20 million / day.
  - ➢ First large-scale auctioning in environmental markets world-wide

Thorough preparation:

- ➢ Learn from phase 2 experience
- ➢ Open stakeholder consultation 3 June – 3 August 2009
- ➢ Stakeholder meetings in September and October 2009

Objectives, Article 10(4)

- Adopt “a Commission Regulation on the timing, administration and other aspects of auctioning”
- Aim is to ensure that auctions are:
  - Open
  - Transparent
  - Harmonised
  - Non-discriminatory
  - Predictable auction calendar
  - Cost-efficient, avoiding undue administrative costs
  - Access to SMEs and small emitters
- Strengthen secondary market, not distort it
- Revenues go to Member States - efficiency

auctioning spot, not futures

Disadvantages of auctioning futures:

- More complex and less accessible, in particular for SMEs and small emitters
- Strong impact on the secondary market: locking in trade until its maturity
- Liquidity in spot market not increased until maturity
- Product specification may not suit all. No immediacy: not possible to buy in an auction and buy a fuel future at the same time (‘spread trading’)
- Reduced participation => higher risk of market abuse
- Potentially high financing cost for Member States

Auction calendar

- Weekly auctions of equal distribution, but
  - ½ volumes in August
  - no auctions 2 weeks over Xmas
- 2011+2012 volume (if any): to be decided within 3 months from adoption of the Regulation
- 2013 volume: to be decided by January 2012
- 2014 volume: to be decided by January 2013, etc.
- Annual volume to be auctioned is calculated on the basis of a) cap minus free allocation and b) early auctions.
  - Straightforward and fixed formula => predictability

Use of a trading platform - auction design

- Make use of existing infrastructure, experience and commercial relationships
- Directly accessible for all allowed bidders
- Selection of auction platform through a competitive dialogue procurement procedure
  - Best value for money – lowest cost for participants

- Single-round, sealed-bid, uniform-price auctions

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Bidders

- ETS operators
  - Parent or sister undertakings, associations
- Banks and investment firms covered by the Anti-Money-Laundering and Financial Markets legislation
  - When bidding on account of clients, the latter must be accepted bidders
- Commodity traders exempted from Financial Markets legislation
  - e.g. oil and gas traders
  - Provided that they are authorised
- Option to add further categories

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Overall approach

- Options:
  - ➢ Centralised auction process
  - ➢ Co-ordinated approach with a limited number of auction processes
  - ➢ Hybrid approach with several platforms but one clearing system
- Consultation response: strong support for a **single auctioning process;** coordinated approach by far least popular
  - ➢ Auctioned value is relatively small compared to other markets. In 2009, UK and DE auctioned government bonds to the amount of £ 203 billion and € 153 billion respectively.

Advantages of centralised approach

- most cost efficient:
  - set-up cost – transaction cost – pre-registration
- most open and transparent – best access for SMEs
- best mitigates risk of market abuse
  - Avoid spreading volume and participation over several platforms
- reputation and credibility world-wide

Co-ordinated approach bears risk of de facto discriminatory rules

- Any platform must be open to any bidder without discrimination: no possibility to select “national platform”
- Even the most detailed legislation cannot exclude discrimination in detailed implementing rules

Competitive selection

- Appointment for 5 year period - repeat open and competitive selection procedure
  - Low barriers to entry: setting up an auction platform does not involve ‘high tech’
  - Auctioning spot only, no immediate impact on futures markets
- Market development is uncertain under all three models:
  - under the co-ordinated approach, the same exchange could be selected several times
  - under the hybrid approach, winning bids may be concentrated with one single exchange

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Full, fair and equitable acces for SMEs and small emitters

- SMEs and small emitters may access the auctions:
  - Directly, becoming member of exchange and clearing/settlement system
  - Directly on the exchange, but clearing via clearing/settlement system (‘order routers’)
  - Indirectly through intermediaries.

- Selected exchange must offer full, fair and equitable access through the first option, or otherwise through the other two options

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Mitigating risk of market abuse

- Simple auction design, high frequency
- Bidders are ETS operators and authorised intermediaries. Strict know-your-customer checks
- Rules of the exchange apply
  - regulated markets' or similar protections
- Auction monitor, transparency rules
- Random resolution of tied bids
- Option of maximum bid-size
- Centralised approach: maximise participation

Commission will also examine whether the carbon market is sufficiently protected from market abuse.

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Auctioning EU Aviation Allowances

- All the same as for EUAs, except:
  - Lower frequency, which reflects much smaller number of EUAAs to be auctioned
  - No early auctions needed

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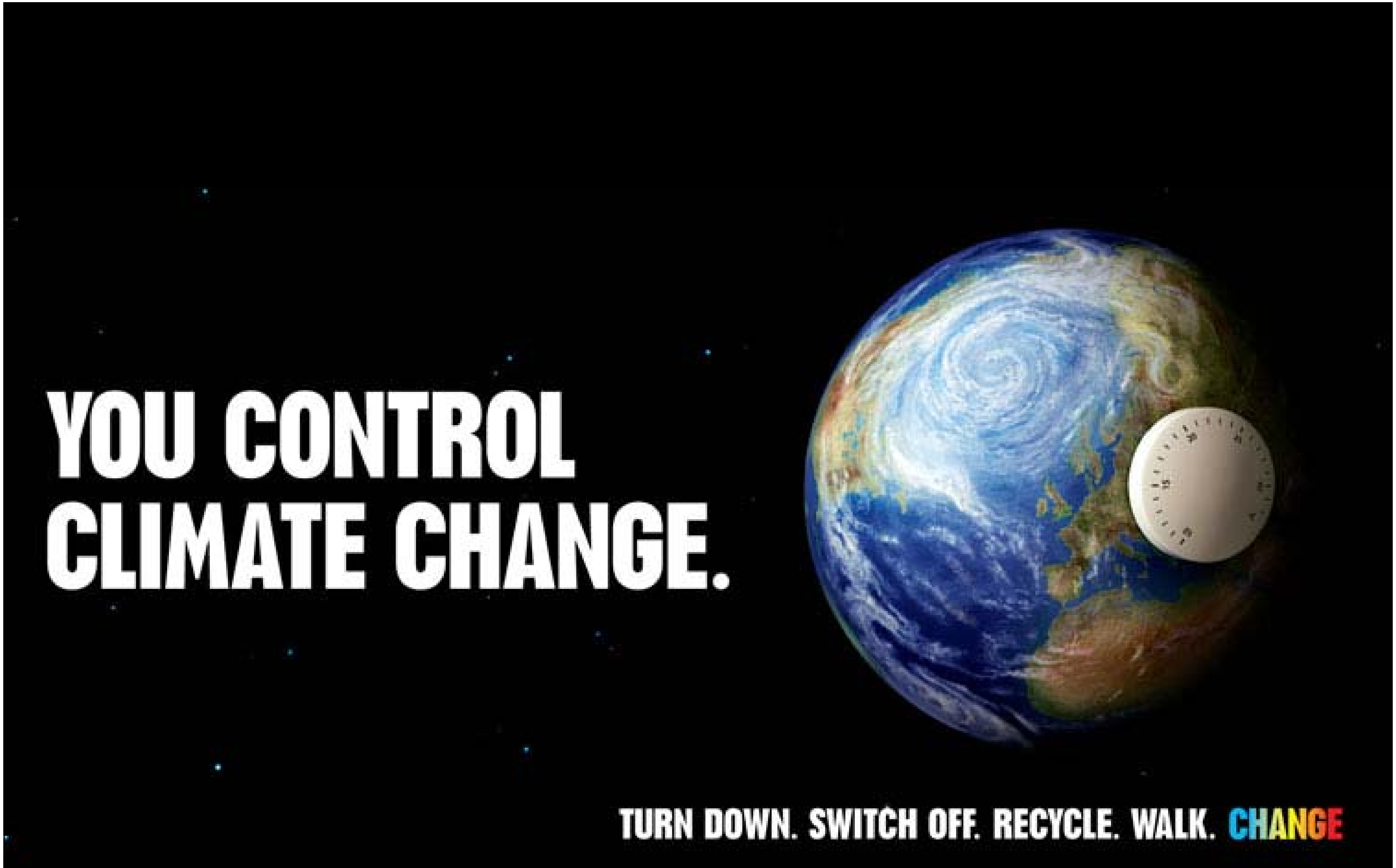
Next steps

- February: Commission to propose draft regulation for vote in Climate Change Committee. After the vote: 3 months scrutiny by European Parliament and Council
- June 2010: adoption of the Regulation
- Further work: start selection process for auction platform, clearing or settlement system and auction monitor

- Auctioning website:

  http://ec.europa.eu/environment/climat/emission/auctioning_en.htm



Info on the Climate Action and Renewable Energy Package at
http://ec.europa.eu/environment/climat/climate_action.htm