BUSINESSEUROPE

POSITION PAPER

1 July 2011

MARKET OVERSIGHT OF THE EU EMISSIONS TRADING SCHEME

Executive Summary

The European Commission is preparing a proposal to enhance the framework for market oversight of the EU Emissions Trading Scheme (ETS).[1] The two main options under consideration are i) to classify carbon certificates as *financial instruments* under the *Markets in Financial Instruments Directive* (MiFID), which currently only covers derivatives of carbon certificates and ii) to design a separate tailor-made regime for the carbon certificates.

BUSINESSEUROPE acknowledges certain shortcomings as regards current oversight of the European carbon market. Overall confidence and trust in the ETS would be further enhanced through a clear regulatory framework governing also the spot-trade in carbon certificates, ensuring robust mechanisms for regular market monitoring. BUSINESSEUROPE therefore supports the five general objectives laid out in the discussion paper presented in view of the European Climate Change Programme (ECCP) stakeholder meeting on May 5,[2] and agrees that they should serve as the basis for any future proposal.

As explained in this position paper, BUSINESSEUROPE underlines in particular that

- Double regulation must be avoided as trade in derivatives of allowances are already covered by MiFID.
- A tailor-made regime for the spot market is needed to avoid unduly burdensome regulation.
- This tailor-made regime must consider the specifics of the carbon market and the actors active on it.

[1] Article 12(1a) of 2009/29/EC stipulates that the Commission shall, by 31 December 2010, examine whether the market for emissions allowances is sufficiently protected from insider dealing or market manipulation and, if appropriate, shall bring forward proposals to ensure such protection.

[2] See page 5 of the discussion paper in view of a European Climate Change Programme stakeholder meeting on carbon market oversight.

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Scope: Avoid double regulation

Approximately 85 percent of the EU carbon trade is in derivatives, which are already covered under the MiFID. No further regulation of the derivatives market is therefore needed. However, as the MiFID currently only covers derivatives of emission allowances, there is a need to regulate the spot and OTC forwards trade of, in particular, EUAs (EU allowances), although not through classifying them as financial instruments, as discussed below. Moreover, as the MiFID only mentions derivatives of "emission allowances" without further specification, it must be clarified whether only EUA derivatives fall within the scope of MiFID, or whether derivatives of CERs (certified emission reductions) and ERUs (emission reduction units) are covered as well.

Consequently, the upcoming proposal should – independently of its legal form – only address regulation of spot-trade and OTC forwards of carbon instruments. CERs, ERUs and VERs (voluntary emission reductions) should be regulated in conformity with the rules set e.g. by UN bodies already governing the global trade of these instruments.

General approach: Tailor-made regime for the spot market

Whilst a robust market oversight framework that meets the needs of the ETS and carbon markets more generally is highly desirable, a classification of emission allowances as financial instruments would make operators subject to unnecessarily burdensome rules such as those for licensing in the MiFID and prudential requirements in the Capital Requirement Directive. In this context, it must be recalled that a considerable share of the trade is expected to be carried out between entities that are on the market to comply with their obligations under the ETS Directive and not for financial gain. An exemption for market participants trading from MiFID to comply with their obligations under the ETS would not be sufficient considering the difficulties in defining what such trade is. Too generous exemptions would work against the overall objective of enhancing market oversight, while too narrow exemptions would result in compliance buyers having becoming subject to MiFID if trade volumes exceed what theoretically would be sufficient to meet their ETS obligations.

BUSINESSEUROPE therefore strongly favours appropriate tailor-made measures for enhancing oversight, transparency and integrity of the spot-trade in carbon instruments rather than classifying the instruments as financial instruments and include them in the scope of MiFID. Such an approach would strike the proper balance between adequate market oversight on the one hand and an acceptable compliance burden on the other.

A subordinate rationale for a tailor-made regime is the uncertainties surrounding the present state of the MiFID revision. The Commission’s proposal has already been delayed and it is far from certain that such a comprehensive and politically sensitive proposal would be swiftly adopted by Council and Parliament, which would be needed to have the framework in place by 31 December 2012 at the latest.

Necessary features of a tailor-made regime:

- *All* market participants with obligations under the ETS, and especially operators of small and medium-sized installations, must be protected from overly burdensome regulations. For this purpose limited and well defined de minimis rules or thresholds, e.g. for transaction reporting obligations, would be helpful to reduce the compliance burden for SMEs.

- Post-trade transparency and availability of fundamental and transaction data should be improved.

- Too far-reaching requirements that would disclose market participants' open positions and business strategies must be avoided.

- Effective market surveillance structures in the Member States, not only for fair auctioning processes, would be beneficial.

- It will be crucial to differentiate between information available to the regulator and the data that are passed on to the general public.

- The regime must be designed as to consider the interrelations between energy and carbon markets.

- The regime must include thorough requirements for supervision and compliance enforcement, be it through Member State authorities or at the European level.

- The carbon market oversight framework should be in place by 31 December 2012, at the latest.

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