



EFET recommendations for the EU ETS

EFET Task Force Emissions Trading

Nice, EMART, November 10, 2005

EFET members

- 80+ companies, 21 European countries
 - Power companies
 - Commodity traders
 - Financial service providers
 - Banks
-
- Experience in emissions trading since 2001 (Denmark, UK, EU ETS, JI, CDM)

Content

General observations

Market functioning

Specific issues

Conclusions

General observations (I)

Implementation

- 2005: successful introduction of a new EU market in CO₂-allowances
- Most efficient way to curb GHG emissions
- Linking Directive provides additional flexibility in meeting the GHG cap
- Active market participants, brokers, exchanges, intermediates, consultants
- Increasing market volume and participation

General observations (II)

market aspects

- Carbon constraint raises power prices
- CO₂-price is determined by supply and demand in the market
- Demand is determined by (expected) E-to-C (fuel, weather, GDP)
- Supply is determined by NAPs, CERs/ERUs and emission reductions
- 2005-2007 short estimated at 200 Mton
- Power sector short, other sectors are long (over all)

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Liquidity can still be improved

- Emission reductions require long term certainty on allocation (10-20 years)
- Demand has entered the market, supply only partially
 - Registries not operational
 - Allowances not transferred into registries
 - Fear of lower allocation 2008-2012
 - Lack of market knowledge
 - Lack of trading capacity
- Linking Directive transposition, ITL, CDM project registration very slow

What does a proper functioning allowance market need?

BASICS

Proper support systems

Level playing field

Transparency

KEY REQUIREMENTS

Timeliness

- Registries, ITR, accredited verifiers
- NAP2 process finalised by mid 2006

Clarity

- Allocation should be certain, ex ante, fixed and long term
- Inclusion of other gases or sectors
- Auctioning? What method?

Harmonization

- Transparent and standardized NAPs
- Rules on closures, transfers, new entrants
- Definition of installations

RESULT

A
Liquid
Market

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SPECIFIC ISSUES (I)

ISSUE	RECOMMENDATION
Other sectors	<ul style="list-style-type: none"> Inclusion is favourable, but only if benefits outweigh the costs. Allocation of emissions has to be feasible. Transaction costs should not be too high. Inclusion of aviation will increase shortage with 20 Mtons/year, which is significant.
JI/CDM	<ul style="list-style-type: none"> MS should transpose Linking Directive asap. No limit on use, nor additional criteria for projects. ITL and CDM registry should be top-priority for Parties. CoP/MoP has to address CDM registration process and issues re forwarding of CERs
New entrants, closures, transfers	<ul style="list-style-type: none"> Clear and unambiguous rules, that can be effectively executed and maintained. Clarity on what happens with surplus from new entrant reserves (auctioned or cancelled?)
Registry management	<ul style="list-style-type: none"> Registries should have been operational by now.. An electronic interface has to be based on existing systems for electricity and gas trading. Registry managers should prepare for December 2005 settlement dates, and share information and best practices.

SPECIFIC ISSUES (II)

ISSUE	RECOMMENDATION
Accounting issues	<ul style="list-style-type: none">• A proper solution has to be provided on the valuation of allowances and emissions. IASB has put this issue on their 2006 (!) agenda. Severe fluctuations in the P&L resulting from market price shifts have to be addressed.
Financial services regulation	<ul style="list-style-type: none">• Emissions trading is imposed on the participants through a European Directive, access to the market should not be hindered by other Directives. The MiFID and CAD Directives should not produce additional financial or regulatory burdens for EU ETS participants. National legislation should be harmonized to avoid fragmentation of the market.
Linking to other schemes	<ul style="list-style-type: none">• Short term: Linking to other schemes/enlargement has to be cornerstone of the post 2012 strategy. Clarity on post 2012 framework of the scheme is necessary.

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Conclusions

The market is working, despite regulatory uncertainties

- Remove barriers that avoid part of supply coming to the market
- Create more long term certainty to facilitate investments in clean technology

EFET offers its assistance in improving the scheme

- ✓ Follow the general principles
- ✓ Address the outstanding issues

→ → → → EU ETS will provide a framework for globally coordinated climate change abatement

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