IETA-IEA-EPRI 11th Annual Workshop on Greenhouse Gas Emission Trading

Session 3: Carbon Markets Developments
Are we ready for phase 3?

October 3rd, 2011
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Do we have a clear long term objective (enough to foster future liquidity)?
Long term objective is key for trading

- Security issues have created high uncertainty on the future of the carbon market
- The economic downturn questions the efficiency of the climate policy: is the system structurally long?
- Poland rejected the 2050 Roadmap adoption at the Environment Council in July
  - The roadmap planned to increase the reduction objective to -25% in 2020 and -80 in 2050.
  - Few changes to be expected during Polish presidency.
Should we adjust the supply?

- EU postponed the adoption of the Energy Efficiency Directive
  - 20% of energy efficiency by 2020: one of the 3 objectives of the Energy Climate Package adopted in 2008 and the only one that has not been translated into a Directive;
  - Impact assessment by the EC is confusing: according to the model, if the 20% objective is reached, the carbon price could fall to 0…
  - EE Directive will impact the other two: Commission has inserted a non binding memo allowing to re-adjust the allowance supply in the EU ETS (set aside).
- This opens the debate on ex-post adjustment (set aside? Central bank?)
The necessary move toward a single registry infrastructure
2012: new registry, new rules

- New Registry Regulation adopted in June 2011
- Registries must evolve from 2012 to:
  - Face European market evolutions: inclusion of aviation, phase 3 auctions, end of the first Kyoto commitment period;
    - European units will become independent from the Kyoto sphere (no ITL check)
  - Ensure transactions security:
    - move on a single registry allows for centralized technical support (one unique software) and common access rules.
    - Important security measure should prevent new attacks.
Registries architecture post 2012

- CITL becomes EUTL
- Union Registry is directly connected to EUTL: European aviation units are not backed by AAUs and could thus not be recognized by the ITL
- Consolidated registry: only States accounts (for the Kyoto eligibility)
- Union Registry (UR):
  - Other accounts will be transferred to the UR;
  - All units (EUAs, AEUAs, CERs and ERUs) will be transferable within the UR and controlled by the EUTL;
  - Only CERs and ERUs will be additionally controlled by ITL (EUAs and AEUAs will not be checked by ITL).

Source: Registry Regulation 2010 & 2011, Clifford Chance
Increased security

- Wider access to confidential information held in the Union Registry will be given to competent national authorities: **Europol will get a permanent ready-only access to the database**;
- National administrators may **freeze allowances** and accounts in case of suspicion of fraud for 2 weeks;
- **Strengthened KYC** checks for account holders and their representatives (criminal record).

- Two-factor authentication (similar to the use of a token in online banking)
- Double validation (**4-eyes principle**) with out-of-band confirmation (e.g. SMS) of transactions
- All transfers **delayed (26h), except for transfer to a trusted accounts**
- Allowances will be fully **fungible**, which means that an allowance can be substituted by any other allowance, if there were a legal claim;
- Buyers in **good faith will acquire full entitlement to purchased allowances**;
- **Non-display of the serial number of allowances**: they will be visible only to registry administrators

- Introduction of a **trusted accounts list**;
- New account categories, including holding accounts and trading accounts. Trading accounts will offer more flexibility to transfer allowances than holding accounts.
What products for trading?
Phase 3 EUAs feeding the market

- **NER 300**: 300M EUA to finance CCS and renewable energy projects (futures or forward)
  - Sales via exchanges or banks
  - Continuous trading or auctions
  - First sale should take place before the end of the year

- **Early auctions** (spot)
  - 120Mt to be auctioned in 2012 (all MS)
  - No visibility on the tender process for the selection of platforms

- **Regular phase 3 auctions** (spot)
  - Joint Procurement Agreement for the central platform and the auction monitor agreed on in September
  - Tenders should be launched late 2011/ early 2012
  - First auctions on the “final” platform should start in January 2013.
CERs: 2010 marked the lowest investments in primary CDM since 2005…

- Lack of post 2012 regulatory clarity
- Integrity issues and qualitative restrictions

Source: State and Trends 2010 - World Bank
… but there are signals for post 2012 developments

- CER issuances have accelerated over the past 12 months: 300Mt supplied from October 2010 to this year, the highest 12-month total (Bloomberg)
  - The mechanics of the CDM seem to have improved since Cancun (appeal body, start of crediting from the date of project submission instead of the date of registration, reduce the length of the completeness check process…)

- Post 2012 funds: almost $2.8 billion are invested in funds for post 2012 purchases, not only in LDCs (Point Carbon).

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Conclusion

Still important regulatory uncertainties but Europe is moving forward and the climate policy is “under construction”.

Important challenges to come:

- Unified legal framework
- Migration on the Union Registry and implementation of security measures
- Ex post adjustment debate
- Selection and cohabitation of auction platforms
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