

IOSCO Consultation Report on Compliance Carbon Markets



EFET Consultation response - 10 February 2023

The European Federation of Energy Traders (EFET) appreciates the opportunity to comment on the IOSCO Consultation Report on Compliance Carbon Markets (CCMs).

We face rapidly accelerating climate change, where the scale of the effort required to mitigate the impact of man-made global warming is unprecedented. In these conditions, industry needs a strong price signal to incentivise a swift switch to carbon-free and, where this is difficult, to low-carbon technologies. By putting a price on carbon emissions, carbon markets offer this strong decarbonisation signal in the sectors that they cover. Therefore, **governments across the world should introduce without delay cap-and-trade schemes to ration emissions of carbon dioxide and other greenhouse gases by power generators and energy intensive industries.**

We appreciate that the Report shares this ambition and promotes the wide adoption of compliance markets. We also agree that orderly functioning, transparency, integrity and stability are key principles that should underpin well-functioning compliance markets and support the IOSCO recommendations aiming to assist jurisdictions in developing sound CCMs.

As a European association, our experience with carbon markets is limited to the EU Emissions Trading System (ETS), the linked to it Swiss ETS, and the UK ETS, and our answers to this consultation are based on that experience. These are well-developed markets, subject to robust oversight and comprehensive market integrity and transparency rules, and from our perspective, they can serve as a blueprint for the development of carbon markets elsewhere. The proper functioning of the EU ETS, for instance, was recently confirmed by the findings of a Report by the European Securities and Markets Authority (ESMA) from March 2022.

As such, the carbon markets in which we operate largely comply with the principles and recommendations presented in the Report, and we would support their application in other jurisdictions too. We would also encourage further efforts to link compatible, robust ETSS from jurisdictions with equally strong commitments to decarbonisation and comparable environmental and climate policies. Linking would bring valuable benefits as it would expand the liquidity pool and broaden the range of abatement options. One such exam where we would recommend prompt progress towards linking are the EU ETS and the UK ETS.

Consultation questions

Question 1: What are the benefits and risks of linking frameworks? How can these benefits be enhanced and these risks be mitigated?

Beyond the advantages of single schemes, linking compatible, aligned and harmonised carbon pricing systems could add further value by expanding the liquidity pool. Greater liquidity helps to reduce transaction costs, improves price discovery and ultimately, leads to greater market efficiency. We observed such positive developments with the linking of the EU ETS and the Swiss ETS, for instance.

Linking the EU ETS with the UK ETS would also have considerable benefits for the UK ETS which has suffered from low liquidity since its inception, and would certainly enrich the EU ETS too. We would recommend linking the UK and the EU ETSs as a matter of priority, as they are already fully compatible and harmonised (being part of the same system prior to Brexit). This would help to reach net zero targets faster and more cost-efficiently.

The linking of aligned and harmonised carbon markets could also help to reduce the risk of carbon leakage and avoid the need for carbon border adjustment mechanisms.

We do agree with the risks identified in the Report and those may be relevant in some circumstances, so a careful assessment would of course need to be carried out before linking takes place. Harmonisation of key design features is essential. Precautions against cybersecurity risks also need to be taken as breaches could undermine trust in the system.

Question 2: What should be the conditions underpinning a decision to link frameworks?

We agree with the conditions outlined in the Report. The schemes should be aligned in terms of scope and harmonised in terms of key design features. More broadly, the jurisdictions should have comparable commitments to decarbonisation, and environmental and climate policies.

Question 3: Do you agree these IOSCO principles are appropriate for carbon markets? Explain your response.

These principles are already largely applied in the markets where we operate (the EU/ EEA, Switzerland and the UK), so we would consider them appropriate.

Question 4: Are other IOSCO principles relevant for application to these markets?

We consider the list to be comprehensive.

Question 5: Do you agree the rules currently in place across key jurisdictions are helpful for scaling of carbon markets?

In our view, the EU/ EEA, Swiss and UK regulatory frameworks are robust and conducive to proper market functioning, and have helped to establish confidence in the carbon markets. We do not think that changes are needed.

Question 6: Are there any other aspects of compliance markets that could benefit from regulatory oversight?

In our view, the EU ETS, the linked to it Swiss ETS and the UK ETS – the carbon markets with which we have experience – are already subject to a comprehensive oversight framework and market integrity and transparency regime.

Question 7: Are the recommendations appropriate for the compliance markets?

Yes, we agree with the recommendations made by IOSCO in the Report and think that they would be useful in supporting new jurisdictions in developing CCMs.

Recommendation 1: Predictability and transparency in primary market decisions are crucial for managing risk.

Recommendation 2: Greater reliance on auctions over free allocation is to be preferred (and free allocation can even be phased out if alternative mechanisms to address the risk of carbon leakage are implemented), as free allocations could distort market functioning and disincentivise investment in emission reductions.

Recommendation 3: More frequent auctions could indeed allow for better price formation, bring more transparency and reduce price volatility.

Recommendation 4: Any intervention in a market stability mechanisms should be rule-based to allow for better predictability.

Recommendation 5: Non-compliance firms should be allowed to take part in primary markets, as this would facilitate market making, access to the markets, carbon financing, the provision of liquidity, and price formation mechanisms.

Recommendation 6: The Relevant authorities should define the legal nature of allowances in their jurisdiction.

Recommendation 7: Confidence in the execution of auction is indeed essential to the success of a CCM and mechanism to enhance scrutiny of auction performances, such as requiring auctions to be performed by regulated exchanges, are helpful.

Recommendation 8: Clear and robust frameworks for market supervision, integrity and transparency, as well as appropriate enforcement powers are an essential component of a well-functioning carbon market and can help to improve confidence in such markets.

Recommendation 9: Market infrastructures are the backbone of the carbon market and they need to be properly regulated and subject to ongoing supervision to ensure trading integrity.

Recommendation 10: As the consultation document highlights, bespoke derivatives contract will always be necessary for parts of the market as they cater for firms that have particular

hedging needs. However, contractual standardisation is also essential as it facilitates liquidity, exchange trading, and automation and operational efficiency.

Recommendation 11: Enhanced transparency in the form of public disclosures about aggregate positions and periodic public reporting derived from regulatory data could benefit confidence in carbon markets.

Recommendation 12: Clear lines of responsibility and cooperation among different authorities would certainly be beneficial and enhance efficiency.

Question 8: Are there any other aspects that the recommendations should address? If so, please state which ones and explain your reasoning

We consider the list of recommendations to be sufficiently comprehensive.