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**COMMISSION STAFF WORKING DOCUMENT**

**Document accompanying the**

**Commission Regulation on the timing, administration and other aspects of auctioning of  
greenhouse gas emission allowances pursuant to Article 10(4) of Directive 2003/87/EC**

**Executive summary of the impact assessment**

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### **Commission Regulation on the timing, administration and other aspects of auctioning of greenhouse gas emission allowances pursuant to Article 10(4) of Directive 2003/87/EC**

#### **Executive summary of the impact assessment**

##### *Legal basis, principles, objectives and stakeholder consultation*

As from the third trading period starting in 2013, all EU allowances (EUAs) not allocated free of charge must be auctioned. This implies a major change: currently some 4% of the allowances under the cap are auctioned, but as from the third trading period (2013-2020), the share of allowances will increase to at least 50%. For 2013, this implies auctioning at least about 1 billion EUAs. In addition, some 30 million EU Aviation Allowances (EUAAAs) will be auctioned. Auction revenues will belong to the Member State responsible for the relevant allowances as laid down in Article 10(2) of the revised ETS Directive.

Articles 3d(3) and 10(4) of the revised ETS Directive mandate the Commission to adopt a Regulation to ensure that auctions respect the overarching principles of openness, harmonisation, transparency, and non-discrimination. The Directive complements these principles by the objectives of simplicity, fairness, predictability, cost effectiveness and efficiency. Fairness implies: full, fair and equitable access for small and medium-sized enterprises covered by the EU ETS and small emitters; and mitigation of risks of market abuse (i.e. insider dealing and market manipulation). Efficiency refers both to the efficiency of the auctions as to the efficiency of the EU ETS itself, i.e. auctions must strengthen the carbon price signal so as to allow abatement of greenhouse gas emissions at least cost.

The Impact Assessment builds on an extensive written stakeholder consultation and several stakeholders meetings. See for further information the Commission's auctioning website, [http://ec.europa.eu/environment/climat/emission/auctioning\\_en.htm](http://ec.europa.eu/environment/climat/emission/auctioning_en.htm).

##### *First key issue: auctioning spot and/or futures*

Spot auctions refer to auctions resulting in (near) immediate payment and delivery. Futures auctions refer to auctions of allowances with payment and delivery deferred e.g. several months or years after the auction date. Efficient auctions will result in a clearing price that will be close to the carbon price in the secondary market and the price of futures is typically somewhat above the spot price, reflecting in particular the cost of carry. Futures are used in particular by electricity generators for hedging carbon price risk when selling output in advance of actual delivery. Auctioning spot, however, has the following advantages over auctioning futures:

- Auctioning futures increases complexity and restricts access as it inevitably involves a clearing house and a system of cash margining. In particular SMEs covered by the ETS and small emitters would have greater difficulty to participate.
- Auctioning futures has a much greater impact on the secondary market as the choice of the auctioning exchange 'locks in' the trade in the auctioned product until it matures.
- Auctioning futures does not add liquidity in the spot market until the maturity date.

- Auctioning futures requires a single specification of the product to be auctioned, but different participants have different preferences. In addition, traders typically wish to buy an EUA future and a fuel future in a single transaction (a 'spread'), which is incompatible with buying futures in an auction. Public authorities should not interfere in such matters, but rather rely on the secondary market.
- In futures auctions, demand will be more concentrated, thereby increasing the risk of market abuse.
- Auctioning futures can be very costly for the Member States as they will have to wait for full payment until maturity and may have to pay initial and variation margin in cash on top.

Financial players on the carbon market can be expected to supply the required volumes of forwards and futures in a competitive manner. Auctioning an adequate volume at early spot auctions will facilitate such trading, as it helps to avoid excessive open positions.

For early auctions, awaiting the development of the single registry, futures may have to be auctioned.

*Second key issue: auctioning through (an) exchange(s), primary participants or (a) third party service provider(s)?*

There are three options as regards the institutions to carry out the auctions. The first option is a *primary participants' model*, where a limited number of 'primary participants', i.e. financial institutions, are exclusively mandated to participate directly in the auctions and which assume the administrative and operational burden of carrying out the pre-registration checks, and credit risk management vis-à-vis indirect bidders. The second option is to select (an) exchange(s) to carry out the auctions. The third option is to select a *third party service provider*.

The option of a third party service provider is more costly and has higher risk of inefficiencies and failure than the other two options, as it does not make use of existing infrastructure. The primary participants' model has the disadvantage that the large majority of bidders will have to bid indirectly, thereby revealing their trading strategy to the primary participant. This is a major concern, in particular for the electricity sector. Moreover, encouraging indirect bidding may come at a cost. Auctioning through an exchange does not raise similar concerns and may bring further advantage of established experience with market abuse supervision. For these reasons, the best option is the exchange-based model.

*Third key issue: what number of auction processes?*

Three different approaches have been identified. The first consists in *centralisation*, where auctions are conducted on behalf of all Member State through a single EU-wide auction process along a predetermined calendar and set of rules. The second is a *coordinated approach* consisting of a limited number of auction processes set up by Member States either individually or jointly. In this approach, each Member State can auction the allowances it is responsible for through one auction process or more. The third is a *hybrid approach*, where auctions would be held at common time slots, while a number of individual exchanges or debt management offices (DMOs) would be responsible for collecting bids, while a common auctioneer would determine the clearing price on the basis of all bids received. Collateral, payment and delivery would be managed by the individual exchanges/DMOs.

The following impacts must be taken into account:

- The centralised approach is most cost-efficient. Under the coordinated approach costs of developing and maintaining auction platforms would multiply and participants would have to pre-register with multiple platforms or be satisfied with access to only a limited share of the auctions. For the sake of comparison, it may be noted that the total value of allowances to be auctioned will be much smaller than the value of government bonds auctioned by a single debt management office in each individual larger Member States.
- A centralised approach is the simplest and most transparent approach. For bidders, there is only one auctioning system to get acquainted with.
- Non-discrimination is easiest to ensure under a centralised approach. Any auction platform has to have a detailed rulebook and under the coordinated approach these rules could hide infringements of the principle of non-discrimination.
- Under the coordinated approach, participation will be spread over different auctioneers, thereby increasing the risk of market abuse.
- Establishing an auction calendar with an optimal frequency is most straightforward under the central and hybrid approach. It is more complex, and politically much more sensitive under the coordinated approach, in particular as auction slots may not be perceived as equally attractive.
- The hybrid approach would have the least impact on competition in the secondary market. However, when auctioning spot, neither the coordinated nor the centralised approach are expected to have a significant negative impact on competition.
- The centralised approach is more easily understood and will (further) strengthen the reputation of the EU ETS, thereby encouraging the use of cap-and-trade systems around the globe. Absence of a centralised auctioning system can be expected to complicate potential future negotiations on linking the EU ETS to other emissions trading systems currently under development.

For these reasons, a centralised approach is the most appropriate model for EUA auctions in the third trading period.

#### *Other issues addressed in the Impact Assessment*

The Auction Regulation should furthermore provide for:

- Weekly auctions and a procedure for determining the 2011 and 2012 volumes to be auctioned after the adoption of the Regulation, taking into account information still to become available;
- Solid know-your-customer checks with respect to categories of participants which are pre-defined as to ensure access to any potential participant that has a legitimate interest to trade;
- Protection against credit risk and assurance of auction integrity by potential involvement of a clearing house and/or exclusion or penalty provisions for defaulting bidders, whilst ensuring adequate openness, including for SMEs covered by the EU ETS and small emitters;
- Mitigation of risk of market abuse by means of auction design, frequency, liquidity, auction monitoring and periodic review. In addition, tied bids would be cleared randomly and imposing a maximum bid-size will be retained as an option if the need and effectiveness would be demonstrated.

The auctioning of EUAAs would follow the same format, albeit at a lower frequency.

### *Monitoring and evaluation*

Adoption of the Regulation is to be followed by the tender procedures to select and appoint a central auction platform and a single auction monitor. The Regulation, the tender procedures and the appointment contracts should contain appropriate provisions for monitoring and evaluation.

At any time, the Commission may make proposals to improve or adjust the rules as deemed appropriate. The Commission will monitor the functioning of the European carbon market (including the auctions) pursuant to Article 10(5) of the revised ETS Directive.