LEBA Notes and supports this lobby letter from European Energy Trade Associations on the upcoming EU "Fit for 55" proposals for voting in Mid-May and to which are added EPP requests to limit access to the EU-ETS

We recall also that the ECB and the Potsdam Institute for Climate Impact Research comments on the role of "*Speculation*"– both noting that the debate quickly becomes existential… The ESMA report echoes conclusions from its preliminary assessment last November which found that speculative activity makes up only 4% of the EU ETS market. PDF ESMA final report; Emission allowances and associated derivatives; 28 March 2022.pdf

The ITRE vote a couple of weeks ago was 40 v 35, but ENVI holds the authority in the EP. This is the ITRE Report: PA_Legam (europa.eu) ENVI votes on 16/17 May.

Dossier	F/A	Dossier Title + *Dossier Comments*	Phase	Rapporteur	Shadow Rapporteur	Responsible
ENVI/9/06891	F*	Amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757	04	Liese Peter	Guteland Jytte - S&D Wiesner Emma - Renew Bloss Michael - Verts/ALE Lancini Danilo Oscar - ID Vondra Alexandr - ECR Modig Silvia - The Left	Kovacheva Nora Kaczmarek Michael Grgas Brus Katarina

Procedure Stars - Phase	Ref. Base & Contribution	Alias Trans. Letter	Ann. Date	Sess. DGlp/Xp *DGPres*	Legal base	Rules	F/A	Dossier	Dec. Type	Adopted	Amend.	Rapporteur	Appointed	Group	PE Documents	FdR	Exchange
2021/0211(COD) (***I) - (2.10)	COM(2021)0551	C9-0318/2021	13/09/21	06/06/22 *06/06/22*	TFEU192-p1	EP57	F*	ENVI/9/06891	R - Report	17/05/22 (P)	16/02/22	Liese Peter (RAP) - PPE	17/09/21	PPE	PE703.068v02-00 PR	1247697	22/03/22 (R)
															PE719.792v02-00 AM	1250922	10/02/22 (R)
															PE719.649v01-00 AM	1249630	09/09/21 (R)
															PE719.795v01-00 AM	1250437	
															PE719.648v01-00 AM	1249629	
															PE719.647v01-00 AM	1249628	
															PE704.676v01-00 AM	1247812	
															PE703.069v01-00 AM	1245924	
							A*	BUDG/9/07059	A - Opinion	20/04/22 (R)	10/02/22	Fernandes José Manuel (CRE) - PPE	25/11/21		PE700.653v02-00 AD	1254564	01/02/22 (R)
												Hayer Valérie (CRE) - Renew	25/11/21		PE700.653v01-00 PA	1244430	
															PE719.720v02-00 AM	1250025	
							A*	ITRE/9/06892	A - Opinion	20/04/22 (R)	02/02/22	Pekkarinen Mauri (RAO) - Renew	07/10/21	Renew	PE703.053v03-00 AD	1255562	26/01/22 (R)
															PE703.053v01-00 PA	1245816	
															PE704.837v02-00 AM	1249024	
															PE704.818v01-00 AM	1248460	
							A	DEVE/9/07609	A - Opinion	22/03/22 (R)	08/02/22	Comín i Oliveres Antoni (RAO) - NI	14/12/21	NI	PE704.668v02-00 AD	1252458	
															PE704.668v01-00 PA	1247776	
															PE704.915v01-00 AM	1249042	
							A	TRAN/9/06893	A - Opinion	28/04/22 (R)	18/02/22	Novakov Andrey (RAO) - PPE	29/10/21	PPE	PE704.649v03-00 AD	1255718	19/04/22 (R)
															PE704.649v01-00 PA	1247651	07/02/22 (R)
															PE729.990v01-00 AM	1252372	
															PE704.922v01-00 AM	1249064	

Joint associations call to safeguard diverse participation in the EU ETS ; *On 16-17 May, the ENVI Committee will vote on the revision of the EU Emissions Trading System (EU ETS).* Brussels, 9th May 2022

- On behalf of the undersigned business associations, representing all various types of participants in the EU ETS, **we contact you to express our concerns about the amendments proposing to limit participation in the EU ETS' markets to compliance entities and financial intermediaries purchasing allowances on their behalf. Specifically, we refer to amendments 1303, 1304, 1353, 1368, 1383,1394, 1395, 1396 and 1397.**

- We would like to call on you to support alternative measures to increase transparency and trust in the market for emission allowances and reject those amendments restricting market participation. Concretely, we ask you to support amendments 414, 914 and 915 to mandate the European Securities Markets Authority (ESMA) to regularly evaluate the market by developing a fact-based annual report on the transparency and integrity of the EU ETS.

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- In its report1 commissioned by the European Commission, ESMA concluded that *"the data analysis has not unearthed any major abnormality or fundamental issue in the functioning of the EU carbon market from a financial supervisory perspective"*. ESMA, as well as the European Central Bank2, demonstrate that recent carbon price increases and volatility seem to stem from EU policy changes and economic developments such as the increase of global gas prices.
    - *1 'Final Report – Emission allowances and associated derivatives'. Published 28 March 2022.*
    - *2 'The role of speculation during the recent increase in EU emissions allowance prices'. Published as part of the ECB Economic Bulletin, Issue 3/2022.*
- Imposing restrictions on who may participate would significantly weaken the market for emission allowances, putting at risk the EU's ability to meet its more ambitious climate goals most cost-efficiently. This is because such restrictions would undermine the ability of many companies to manage their risks related to fluctuations in the price of emission allowances, regardless of whether those are compliance entities or other entities exposed to this price risk. Specifically:
    - First, compliance entities are naturally on the 'demand' side of the market and use long-term contracts to manage the price risk of the emission allowances they have to purchase to fulfil their compliance obligation. For this, they need companies who want to conclude such a contract with them and thereby take the opposite 'supply' side of the transaction. These can for example be financial companies or other energy companies with trading and hedging capabilities. If such companies are no longer allowed to participate in the market for emission allowances, it will leave compliance entities unable to protect themselves against price and liquidity risks and hence will hinder them in the efficient execution of their long-term decarbonisation strategies.
    - Second, restrictions on participation will reduce liquidity in both the long-term markets and in the auctions, resulting in increased price volatility and potentially auctions failing to sell all allowances. This may disrupt the regular, predictable supply of allowances and auction revenues.
    - Third, limiting the transfer of allowances to 'regulated entities' as proposed in AM 1303 & 1353 would hinder the common practice of delivering emission allowances via organisations such as clearing houses or brokers ultimately hampering the market's well-functioning.

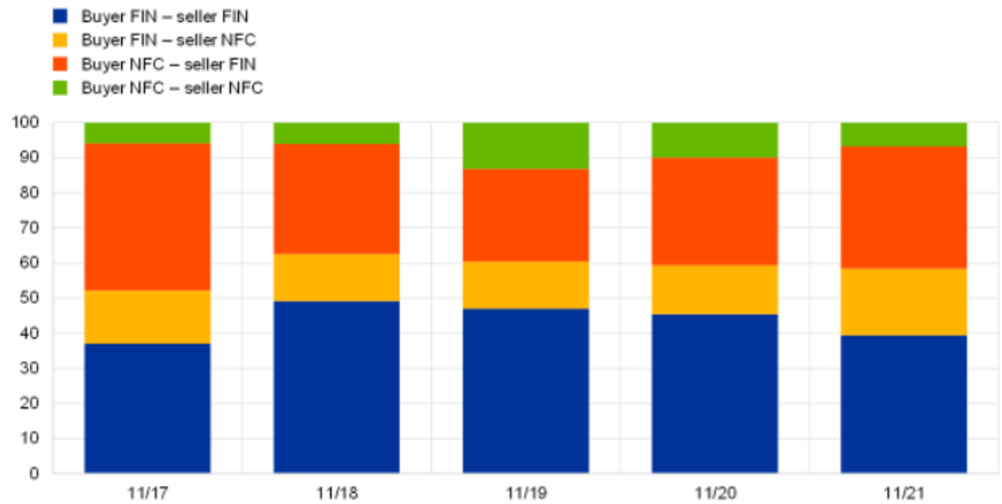
ECB Comments & Charts: *A speculation index confirms that, while speculation appears to have increased slightly since early 2019, it seems to remain limited and well below the levels seen during earlier phases of the ETS. A proxy for the level of speculation in the ETS market can be constructed by comparing the overall volume traded with the volume of open positions for all entities.*

The intuition behind such a proxy is that speculative behaviour leads to an increase in the volume traded but, since speculative positions tend to be closed quickly, not to an equivalent increase in the volume of open positions. A speculation index, calculated as weekly trading volume over the open interest at the end of any given week, currently suggests that speculation may have gradually been increasing over the last two years. However, it remains largely below the levels seen at the creation of the ETS market and during phase 2

EU ETS market structure

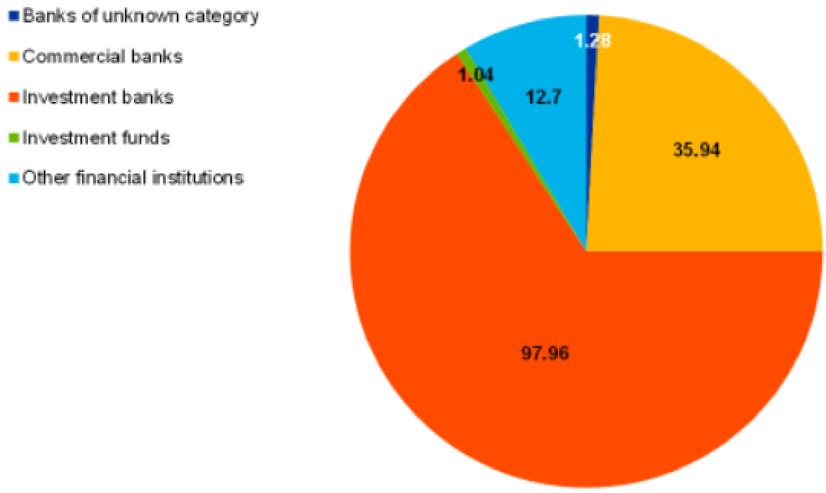
a) Development of open positions by entity

(percentages)

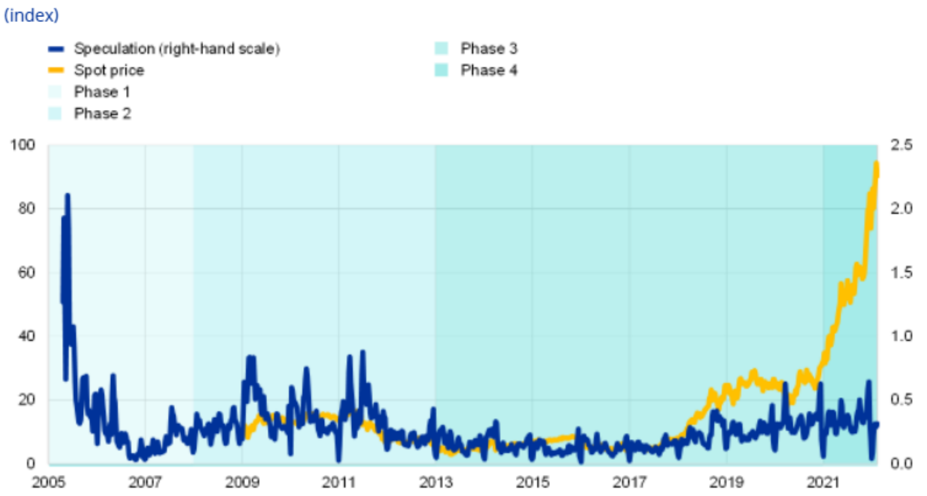


b) Shares of open positions by financial subsector

(percentages)



Speculation in the EU ETS futures market



Reforms to the EU Emissions Trading System designed to limit trading by financial entities could reduce liquidity and make it more expensive for compliance entities to hedge for the future, market experts say.

- The warnings come after a narrow majority of the European Parliament's industry committee (ITRE) voted 40 to 35 in favour of an amendment seeking to restrict participation in the EU ETS to "installations, aviation and maritime operators with compliance obligations to cover their emissions", and "financial intermediaries purchasing allowances on account of these entities (but not on their own account)."
- The vote, held on 20 April, forms part of the ITRE committee's opinion on the European Commission's proposal to reform the EU ETS, a key part of the EU's ambitious "Fit for 55" package of legislative proposals. These aim to pave Europe's way to reducing greenhouse gas emissions by 55% by 2030 compared to 1990 levels.
- The ETS, made up of a primary market of allowances (EUA) and a secondary market of derivatives based on allowances, is the cornerstone of the EU's climate policy. It sets a cap on the total amount of CO_2 that can be emitted by energy-intensive companies each year, and this cap declines over time. Companies buy these allowances and trade them in the market to fulfill their annual needs.
- Companies that reduce their emissions below the target level—for example by switching to cleaner fuels—can sell those excess allowances. The goal is to create economic incentives for companies to reduce their emissions, with market dynamics of supply and demand determining the price of EUAs.

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- While most EUAs are held and traded by companies that need them to comply with the ETS, banks, brokers and investment firms also participate in the market to take positions and facilitate trading between counterparties.
- "For markets to function well, financial institutions or 'speculators' are needed to take the opposing positions to hedgers to allow the hedgers to reduce their risk exposure," said Jostein Kristensen, a partner at consultancy Oxera and author of [a recent report] that provides an economic assessment of the EU ETS.
- "This is even more the case in the carbon market, where there is generally only one supplier of emissions allowances—the government—while there are many natural buyers whose emissions are covered by the EU ETS that often seek to hedge their carbon price risk," he added.
- "By opening up trading opportunities to a broader, more diverse group of market participants, the carbon market has become more resilient and better at providing risk-management solutions to companies."

ETS revamp

- The ETS draft proposed by the Commission includes proposals to tighten the ETS by reducing the allowable amount of emissions, as well as a gradual phase-out of free CO2 allowances. It is currently being debated by both the EU Parliament and the member states in the EU Council.
- Each institution has the right to propose its own changes and the final shape of the law will be ironed out in talks later this year that will also involve the Commission.
- The amendment to limit trading by financial entities was tabled in February by Polish MEP Jerzy Buzek (EPP), who sits on the ITRE committee, in the hope that capping financial participants "could lead to a decrease or even an end to price speculation in the EU ETS."
- "This is to prevent speculation raising the price of CO2 emission allowances, which in the end always affects the wallets of citizens," Buzek said.
- However, some market experts disagree. According to Lawson Steele, the former head of carbon and utilities research at Berenberg who speaks widely on the topic, curbing speculators would be "really bad news for the EU".
- "The liquidity and price discovery they provide is both important and significant," Steele tells MarketVoice. "Mechanisms such as Article 29a [in the current ETS rules] are in place to stop the price rising too quickly, and this is what [lawmakers] should focus on," he said.
- How significant the impact of ITRE's vote will be is unclear. Although ITRE is involved in the EU ETS negotiations as an associated committee—and its opinion should be taken into account—it is the environment committee (ENVI) that is the lead committee tasked with steering the EU ETS reform proposal through the European Parliament.
- ENVI has appointed Buzek's EPP colleague Peter Liese (EPP, Germany) as rapporteur who, to date, has proposed more moderate measures. These

include the release of extra emissions allowances if the ETS sees protracted high prices—an amendment to Article 29a of the current ETS rules—and for the European Securities and Market Authority to regularly monitor trading behaviour and the integrity of the market.
- Under Liese's draft proposals, the Commission would release 100 million CO2 allowances into the market from its market stability reserve if, for more than six months, the average allowance price is more than two times the average price in the two preceding years.
- ENVI is scheduled to vote on parliament's negotiating position on the ETS reforms on 16-17 May, after which the full European Parliament will hold a ballot on the final amendments in the first week of June. The Council of heads of state will likely announce its opinion at the end of June with tripartite negotiations among the three EU institutions beginning in September.
- Although non-binding, the ITRE vote brings into sharp focus the perennial debate among policymakers—often within the same parliamentary group—over the impact of speculators in commodity markets.

Divided opinion

- Energy costs are a hot-button issue, particularly since the 2018 "gilet jaunes" protests in France. In recent months tension has intensified among policymakers as carbon prices have reached new highs around the same time as energy bills have skyrocketed.
- In February, EUAs leapt to a record high of €98.49 per tonne of CO2 after increasing by almost 150% in 2021. Analysts such as Steele say the CO2 price needs to be higher than €100 euros per tonne to make cleaner fuels and technology competitive with polluting alternatives.
- But rising CO2 costs have stoked political tensions and prompted several European member states, particularly Poland and Spain, to call for the Commission to intervene in the EU ETS and exclude financial entities. They blame trading activity and "excessive speculation" by financial players for the spiralling CO2 prices.
- For Poland, a country that relies on coal for more than 70% of its power, cushioning the impact of higher energy prices on consumers has become a top political priority.
- Market regulators, economists and carbon analysts, however, say the price of carbon has risen mainly because of fundamentals, not speculation, with speculative positions currently too small to be statistically significant.
- In particular, they point to gas price rises, which have encouraged electricity producers to switch from gas to coal-fired power generation thereby increasing the demand for EUAs, as well as the EU's climate policy reforms.

ESMA report

- One such regulator is ESMA, which began investigating trading behaviours in the EU ETS at the behest of the Commission late last year following concerns about excessive speculation. In March, ESMA published its final report which found no major problems in the functioning of the market, although ESMA did recommend the possible implementation of position limits for derivatives.
- The report echoes conclusions from its preliminary assessment last November which found that speculative activity makes up only 4% of the EU ETS market.
- According to the ESMA report, non-financial entities (CO_2-emitting companies) mainly held long positions in carbon derivatives for hedging purposes. Short positions are mainly held by banks and investment firms, providing liquidity and carbon financing. Positions by investment funds remain limited, the report finds, adding that the evolutions of carbon prices and volatility are in line with market fundamentals.
- Speaking on a webinar organised by Euractiv on 27 April about possible impacts of excessive speculation, Fabrizio Planta, the head of ESMA's markets and data reporting department, reiterated the findings of the report, saying there were no major abnormal issues with the ETS market.
- "Any measure to limit the presence of financial firms in other countries has had a negative effect in the past. Studies have clarified this in places like China and South Korea," Planta said.
- "Our conversations with compliance entities—energy companies—show they are generally happy with how the market is functioning," Planta said, adding that limiting the presence of financial firms was "not a solution."
- Economists at the European Central Bank have also weighed into the debate with a short report published in April that echoes the view of ESMA. The report says that the sharp rise in CO_2 prices since the beginning of 2021 has been driven in large part by a mix of higher gas prices, colder weather causing energy demands to rise, shrinking allowance supply and the adoption of the Fit for 55 climate and energy package.
- As such, and citing ESMA's work, it said "tangible evidence of a strong increase in speculative activity related to potential changes in market structure appears scarce."

Crucial role

- As the all-important ENVI vote draws nearer, market participants are keen to point out the benefits of financial institutions participating in the EU ETS.
- "The more participants you have, the better the price discovery will be, and this is important," said Steele. "If we're trying to reduce our emissions by 2030 then we need the carbon price to be a signal that it is financially viable for companies to invest in other processes to reduce carbon emissions."
- In a co-signed letter to the Commission in February, ten trade associations, including FIA, The International Emissions Trading Association, Eurelectric and the European Federation of Energy Traders, among others, said the ETS market

consists of a wide variety of participants – each of which has a critical role in the efficient functioning of the market and reaching Europe's decarbonisation targets.
- "Restricting the participation of financial and non-financial actors would run the risk of weakening the market. It would make it more expensive and complex for compliance entities to hedge for the future and plan for investments into low carbon alternatives. It would reduce the ability of this group to access the market via financials and it would cut liquidity, driving up transaction costs and uncertainty for all participants," the letter says.
- "The result of lower liquidity would be increased volatility and would significantly reduce the economic relevance of long-term price signals."
- As the ENVI vote approaches, financial industry groups and associations of compliance entities are working on advocacy efforts to push back on the amendment proposal and demonstrate the impact of missing liquidity on their real-world business.