New regulation of the regulated markets for emissions trading

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In the wake of the Prada Report on the regulation of CO2 markets and the publication by the European Commission of the ‘Auctioning’ Regulation, the French Law on Banking and Financial Regulation introduced regulation of the regulated markets for CO2 allowance trading. For the AMF this has in practice meant the creation of Book VII of the General Regulation, on the organization and control of the emissions trading markets.

The ministerial order approving the new Book VII on the organization and control of the emissions trading markets was published in the Official Journal of the French Republic on 2 March 2011. The Book was drafted as a freestanding corpus of rules within the AMF’s General Regulation. The hybrid status of emission allowances, which in some respects resemble financial instruments and in others movable property, was the motivation for creating an ad hoc legal framework. The general outline is explained below.

Regulation of market operators managing regulated markets for emissions trading

Title II of Book VII regulates the activities of market operators managing regulated markets that admit greenhouse gas emission allowances to trading in their primary market (bidding on allowances - ‘auction’ compartment) and in their ‘secondary’ market. It refers in large part to the provisions of Book V of the General Regulation, applicable to regulated markets in financial instruments, but with the following specific features:

1. transactions are not currently cleared, but may be cleared in future;
2. the system for settlement and for delivery of the emission allowances has some special features compared with the settlement and delivery system for financial instruments. Consequently, Book VII refers to a “settlement system for the emission allowances” and does not refer to the settlement system for financial instruments concept in Article L. 330-1 of the Monetary and Financial Code;
3. Title II of Book VII applies not only to the secondary compartment but also to the auction compartment to the extent that this extension of scope is compatible with the provisions of the European Auctioning Regulation. So for example, the market operator will report to AMF not only on orders received and transactions executed, but also on bids (orders on the primary market) and allocations made following bidding.

Regulation of the activities of market members

Title III of Book VII sets out the obligations on market members, whether or not they are authorised as investment service providers (they may be large companies active in the emissions market) and whether they are acting on their own account or for their clients. The obligations on members dealing solely on their own account are elementary and few in number: they are required to act honestly, fairly and professionally, to comply with the market rules, to keep records of their activity, to control inside information and to introduce compliance procedures. On the other hand, some further obligations are placed on members that provide services to clients. They must ensure the primacy of their clients’ interests, manage conflicts of interest appropriately, provide adequate information to their clients, ensure client agreements are signed, and handle orders diligently and fairly.

For market members that are not investment service providers, these obligations apply as regards both spot trading of emission allowances and trading of derivatives where the underlying asset is an emission allowance.

As regards custody account keeping, the current system for emission allowances differs from the system for financial securities: the owner of the emission allowances is whoever holds an account in their name on the national register. In other words, when a service provider is keeping custody of allowances on behalf of a third party, it is the service provider and not the third party who is deemed to be the owner of the allowances. Consequently, Book VII requires that a member (individual) executing orders on behalf of clients must have at least one global account with the registrar specifically for recording the allowances and must take all possible measures, including internal organisational measures, to distinguish the emission allowances it holds on behalf of each of its clients. It must also draw its clients’ attention to the risks arising from a market member holding allowances and inform client that they may apply for an account in their own name.

Preventing market abuse

Title IV of Book VII should also allow better detection and prevention of market abuse relating to emission allowances. The content of its provisions is based not only on the rules laid down by the European Auctioning Regulation concerning bidding procedures for allowances on the primary market, but also on the content of the Market Abuse Directive (transposed in Book VI of the General Regulation).

Inside information is thus defined as information of a precise nature that has not been made public, relating directly or indirectly to one or more categories of emission allowances, and which, if it were made public, would be likely to have a significant effect on the prices of the relevant emission allowances or on the prices of emission allowance derivatives.

Rules limited to transactions linked to Bluenext

These rules only apply to transactions on Bluenext and to transactions directly linked to them. The alternative would have been to regulate all activities and services related to emission allowances. The AMF’s consultation on the draft of Book VII highlighted the advantages and disadvantages of both approaches. Limiting the rules solely to transactions on or linked to Bluenext obviously means that regulation is not harmonised across France’s regulated market for emission allowances and other execution venues (particularly over-the-counter). But applying regulation across a wider perimeter might have appeared excessive and could potentially have risked damaging the competitiveness of the French market. The AMF will therefore continue to push for a wider, more exhaustive regulatory framework for activities and services linked to the emissions markets at European level, which would enter into force simultaneously across the whole of Europe.

Read more

- Book VII of the AMF General Regulation

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