



Practical Guidance for Korean ETS Participants:
Insights from EU ETS Policies from a Financial Intermediary

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Overview

- ETS Perspectives from a financial intermediary
- Critical policies for a well-functioning ETS
- Adaptive strategy including adjustment to ETS future directions



Perspectives of a financial participant in ETS

Involvement in Market

- **Typical roles of financial counterparty**
 - Trading OTC and on Exchange
 - Providing execution services to clients
- **Ability to trade on financial and physical basis**
- **Provider of liquidity**
 - Complete confidentiality and anonymity
 - Optimize execution price
 - Primary Participant in ETS Auction
- **Pricing across markets and products**
 - Marketing more structured products such as repos, options and commodity linked notes
 - Willingness to assume significant risk positions
 - Provide customized hedging services

Services in EU ETS

- **Auction Services**
 - Accepting indirect bids and helping clients acquire large volume of EUA at a lower price
- **Transaction services**
 - Carbon Repos
 - EUA-CER Swap
 - Options
 - CER Origination and Portfolio Management
- **Cross-commodity trading services**
 - Combine ability to trade gas, power, coal, oil and weather to provide consolidated risk management for ETS participants
- **Structured financial solutions**
 - Combine ability in offering solution for many areas of energy and non-energy risk management, including fixed income, strategic, credit, foreign exchange.



Critical policies for an ETS

- Emissions allowances and caps
 - Quantity, fungibility, allocation method, covered sectors, banking and borrowing rules, fines for non-compliance, gradient for reductions
- Monitoring, reporting, and verification rules
 - Compliance cycle of annual procedures, role of independent accredited verifiers, reporting templates
- Registry rules
 - Account set up, transaction log, IT safeguards for system integrity, annual reconciliation of allowances and verified emissions
- Market oversight practices
 - Procedures for preventing market abuse, transparency, communication to market participants
- Eligibility of other carbon instruments
 - Quantitative limits, qualitative restrictions, one-way/two-way linkage to other ETS



Importance of an adaptive strategy as ETS evolves

- EUA price should be determined by its marginal cost of abatement, which in EU ETS is utilities switching fuels from coal to gas. The problem is that EU ETS is “long” due to extended EU recession. Carbon price can therefore be significantly below marginal cost of abatement.
- Currently EU Council, Parliament and Commission are discussing a “back-loading” proposal which might temporarily remove 900 Mt from auctions during 2013-2015 and return them during 2019-2020.
- Separately, EU ETS is exploring options to implement long-term structural changes that would permanently remove material volumes of surplus EUA.
- Simultaneously, EU is negotiating closer linkage with Australia ETS.
- Finally, some indications of future directions provided in EU paper outlining a framework for integrating climate, energy security, and competitiveness objectives.



For more information

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