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24 April 2012

Antony Bedford
Markets Infrastructure and Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Mr Bedford

Response to CP12/6 - Regulating Bidding for Emissions Allowances under Phase Three of the EU Emissions Trading Scheme

The members of the Commodities Working Group of the Global Financial Markets Association (GFMA)¹ welcome the opportunity to provide comments to The Financial Services Authority (FSA) on this Consultation Paper (CP). Our members are keen to maintain an active dialogue with the FSA throughout the process of consultation, and would therefore like to offer some constructive comments that we hope will serve as part of that ongoing dialogue.

We are supportive of the EU Emissions Trading Scheme (ETS) and welcome Phase III as an important step towards increasing the efficiency of allocating emission allowances. Rather than answering each of the questions raised in the CP, we would like to highlight two points in relation to the resultant two tier regulatory approach.

We appreciate that the FSA has proposed a regulatory framework working within the parameters set by the EU Commission Auction Regulation (CAR)² which distinguishes between 'MiFID bidding business' and 'non MiFID bidding business' (the latter being categorised by the FSA as '*Auction regulation business*') resulting in the following groupings:

- **MiFID bidding business:** investment firms and credit institutions authorised under the Markets in Financial Instruments Directive (MiFID) or the Banking Consolidation Directive (2006/48/EC) will be regulated as they are for other MiFID business where they bid, on behalf of their clients, on 5 day futures, given these are classed as financial instruments under MiFID; and

¹The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

² EU Commission Auction Regulation 1031/2010 of 12 November 2010 as amended by EU Commission Regulation 1210/2011 of 23 November 2011.

- **Auction regulation business:** the following firms will be subject to conduct of business rules set out in CAR and additionally, FSA rules relating to prudential, financial crime and approved persons measures:
 - Investment firms and credit institutions authorised under MiFID or Banking Consolidation Directive where they bid on 2 day spot auction products on behalf of their clients; and
 - Firms exempt from MiFID under Art 2(1)(i) ('exempt firms') where they bid on 5 day futures or 2 day spot auction products on their own account or on behalf of clients of their main business.

We welcome the approach whereby all firms, whether or not exempt from MiFID, will be subject to FSA authorization and regulation if they wish to bid in emission allowance auctions. However, we note that this dual approach will also result in the following outcomes:

- Investment firms and credit institutions which wish to undertake bidding in both 2 day spot and 5 day futures auction products on behalf of clients will be subject to two regulatory regimes; and
- Exempt firms will be subject to a different and lighter regime than investment firms and credit institutions for the activity of bidding in emission auctions in relation to 5 day futures auction products on behalf of clients.

Firstly, it is important that investment firms and credit institutions are not disadvantaged by having to operate within two regimes and therefore compliance with the higher MiFID level regime should be deemed compliance with any CAR specific regime.

As the FSA will be aware, the second outcome above is relevant to the current wider discussion regarding the regulatory treatment of commodity firms, both globally and at EU level. Specifically, there has been a series of comments directed towards commodity market issues and particularly entities which conduct the same or analogous activities as financial institutions, being subject to regulation of a similar standard to that which applies to such financial institutions.

Recently, for example, we have seen the introduction of a market abuse regime tailored to the wholesale energy markets in the EU³. At , a global level, IOSCO⁴ consulted on the appropriate regulatory oversight for oil price reporting agencies in the light of the fact that their services have a significant impact on oil markets and that some of their activities are comparable with those of financial institutions. GFMA is supportive of these initiatives, believing, as a matter of principle, that where firms undertake the same activities, they should be subject to consistent oversight and standards.

³ Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency (REMIT).

⁴ CR04/12 Functioning and Oversight of Oil Price Reporting Agencies, Report of the Technical Committee of IOSCO, March 2012.

The exemption for commodity firms under Art 2(1)(i) is part of the current MiFID II review with consideration being given to narrowing this exemption to create a more level playing field where all entities conducting the same activities should be subject to the same regulation. While GFMA has supported removing emission allowances *per se* from the ambit of MiFID on the basis that the proper scope of MiFID is financial products (therefore including 5 day emission allowance futures) and not underlying commodities (therefore excluding 2 day spot emission allowances), we believe it is appropriate to also implement at all levels equivalent standards where firms undertake analogous activities. We recognize that the FSA must operate within the parameters of CAR. However, we note, as does the FSA, the CAR permits as a condition of authorisation under CAR, that the national authority may require *'any other measures deemed necessary having regard to the nature of the bidding services being offered and the level of sophistication of the clients in question'*.

As noted above, we welcome the consideration the FSA has given already to applying additional measures however believe that it should go further. We believe that the following two examples which would occur under the current proposals highlight where exempt firms bidding on 5 day futures would be, inappropriately, subject to a lighter regulatory regime:

- Firms undertaking Auction regulation business have the option to opt-in to client assets and money rules. However, given the rationale for permitting this opt-in is for firms to be able to apply harmonised rules where they undertake other MiFID business, it is unlikely that exempt firms would make use of this option; and
- A person approved to perform a governing function for an exempt firm will not be required to be authorised separately for the customer function in relation to acting as a bidder's representative. This is a different approach to other investment activity where the governing function does not subsume the customer function i.e. two separate approvals are required.

We are strongly of the view that where firms undertake the same bidding activity on behalf of their clients in relation to 5 day futures auction products, the FSA should apply commensurate measures.

The members of the Commodities Working Group welcome the opportunity to respond to CP12/6 and look forward to developing an ongoing dialogue with the FSA on these and other issues of importance to the emissions market.

Yours sincerely



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