

Paris EUROPLACE

« Carbon and Climate Finance: the New Deal »
Challenges and upcoming reforms

Energy and CO₂ Paris EUROPLACE working
group – « Commission Energie et CO₂ »

Paris EUROPLACE Financial forum

July 7, 2010

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PLAN

1. Energy and CO₂ working group
2. EU Current Carbon Markets Landscape
3. Challenges and upcoming reforms

Paris EUROPLACE and Climate Change

- Energy and CO₂ working group was set up in January 2010 as part of the Committee of financial Law of Paris EUROPLACE (« Comité de Droit Financier ») chaired by Michel Prada.
- The « Comité de Droit Financier » of Paris EUROPLACE participates actively to pending reforms with the relevant authorities and also take initiatives in submitting proposals (Haut Comité de Place).
- Paris EUROPLACE has been active in the field of climate change with the existing « Climate and Financial innovations working group » chaired by Pierre Ducret, Head of Banking services at CDC.

PARIS EUROPLACE ENERGY AND CO₂ WORKING GROUP

Activity : Participate to the definition of the legal, accounting and tax treatment of products and transactions relating the Energy and CO₂ sectors and of regulations aiming at a better functioning of the French markets.

Members include experts, authorities and players in the Energy and CO₂ markets;

- Financial institutions (Powernext, BlueNext, NYSE Euronext....)
- Law Firms (CMS Bureau Francis Lefebvre, De Pardieu, Brocas, Maffei, JeantetAssociés, Freshfields, Norton Rose, August&Debouzy, Clifford Chance....)
- Representatives of companies/groups covered by EU-ETS (CDC, CDC Climat, ORBEO, EDF-GDF, SUEZ, TOTAL, VEOLIA, AIR LIQUIDE....)
- Relevant regulation bodies and trade associations (AMF, ACP, CRE, ANC, AMAFI, AFG...);
- Representatives of the French relevant authorities (MINEFI, MEEDDM, Banque de France....).

EU Carbon / CO₂ Markets current Landscape:

- Growing and well functioning market:
 - Since 2005, transactions volumes multiplied by 20;
 - Notional value of EU transactions: €66 billion (2009):
 - Allowances derivatives count for 85% of the transactions;
 - Development of more complex carbon instruments.
- The major trading venues are London for derivatives (ECX) and Paris (BlueNext) for the spot market.

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- The derivative market is partly regulated
 - If traded through an organized trading platform (Mifid; MAD / FSA-ECX)
- Otherwise: spot market and some derivatives are not regulated and not supervised
- Risk prevention and protection of investors necessary to foster the development of the markets (access to the markets; better transparency; trading infrastructure...) command a tailor made legal frame

CHALLENGES

- From free allocation to Auctions in 2013;
- New EU-ETS players such as Airlines;
- Ensure environmental efficiency of the markets;
 - Regulation framework
 - Harmonization within the EU (avoidance of arbitrages);

CHALLENGES – A FRENCH INITIATIVE

- « The Regulation of CO₂ Market » discussion paper
Task force chaired by Michel Prada.
- French initiative with an EU purpose
 - Adoption of an EU Regulation Framework
 - Harmonized legal, accounting and tax treatment of allowances and credits;
 - Market functioning and organization rules (access; players; infrastructure and transparency)
 - Oversight of the CO₂ market

CHALLENGES AND UPCOMING WORK and Paris EUROPLACE

- The Energy and CO₂ working group concentrated on the Legal treatment of the allowance in France as a contribution to the work of the « Prada task force »

- And in light of the Prada discussion paper, three main issues will be addressed in September through sub working groups:
 - Legal/Accounting/Tax treatment of allowance and credits
 - Access to the markets (players, regulations and oversight)
 - Development of Carbon investment vehicles (UCITS etc..) in France

PARIS EUROPLACE ENERGY AND CO2 WORKING GROUP (1/4)

1. Legal, Accounting and Tax treatment of allowances and credits: Sub-working group.

1. At stake

- Sufficient liquidity and stability of the « price signal » offered by the market:
 - Harmonization; simplicity and neutrality;
 - For all carbon products (allowances and credits).

2. Legal Treatment. Should an allowance be regarded as an intangible/movable good, financial instrument, administrative authorization?

- Allowance directive: no definition
- Question mainly for SPOT markets
 - On derivative markets: financial instrument:
 - Conflicting view within the EU and even in France (movable/intangible good vs emission authorizations)

PARIS EUROPLACE ENERGY AND CO2 WORKING GROUP (2/4)

3. Prada DP recommends a «suis generis harmonized legal regime within the broader context of the development of similar environmental instrument » : transferable administrative authorization
 - Hybrid nature between trading « goods » and administrative authorization
 - with the borrowing/extension and necessary adaptation of existing relevant existing regulations.
 - Question to be addressed by the sub-working group from a practical angle.
4. Questions to explore in order to solve current problems and meet objectives:
 - **Financing of the purchases / Pledge:** critical issue for 2013 (auctions).
 - Practical problems to solve for 2013 for a satisfactory pledge for financial institutions and players (how to limit transferability; how to action the pledge in case of bankruptcy; how to spot pledged allowances in the register etc.)
 - Market functioning
 - Compensation and other aspects
 - Opening French existing funds to carbon instrument
 - Movable good approach necessary

Legal, Accounting and Tax treatment issues (3/4)

- **Harmonized and neutral accounting treatment for allowance and credits** (spot; derivative).
 - Current French accounting treatment considered as satisfactory to some extent but remains to be revised for 2013 and completed (avis 2004-C of CNC and recommendation 2009-R-02)
 - Difference of treatments in Europe for groups: reporting issues
 - Burden and cost associated with the post 2013 accounting treatment.
 - IFRS (IFRC 3 interpretation rules repealed in June 2005 as impacting P&L); IASB exposure draft expected in 2010/2011: treatment to the responsibility of « producer » (« assujetti »)
 - IAS 39 for derivatives
 - Participation of the sub-working group to the upcoming ANC (French Accounting regulatory body) reform project :
 - Current rules to be adapted to auctioning – ANC will focus on Financials stand alone and consolidated basis reforms with an emphasis on allowance and credits trading (toward financial instrument treatment);
 - Derivatives rules to be adopted: toward commodities derivatives treatment.

Legal, Accounting and Tax treatment issues (4/4)

- **Tax treatment (VAT)**
 - EU directive (2010/23/EU) of 16 March 2010 on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain services susceptible to fraud
 - Temporary possibility for MS to apply reverse charge mechanism (ie VAT on the sale is dealt with by purchaser) until 30 June 2015
 - France:
 - application of a de facto zero rate (ie no VAT-able transaction with no related limitation of the recovery rights of the parties).
 - Financial intermediaries are exempt on their fees unless they elect for taxation: Competitiveness issue with the UK to be addressed.
 - Spain; UK; the Netherlands: exemption or reverse charge mechanism.

ACCESS TO THE MARKET (1/3)

2. Access to the markets by players, regulations and oversight sub-working groups / « Groupe conditions d'accès et de surveillance du marché et encadrement des intervenants »

- Current situation / Registry : directive 2003/87/CE and regulations 2216/2004 and 916/20073
 - Any individuals or entity may open an account in any registry with an ID;
- At stake:
 - Control / money laundering / protection
 - Upcoming EU regulation to be effective on 01.01.2012 on access to registries:
 - **Access rules** to be strengthened (registry holder may ask that no other account be opened on other registries or/and that at least one authorized person be resident in the registry country; list of requested documentation to be finalized)
 - **Better control**: registry holder could reject an application or freeze/close an account; exchange of information with other EU relevant authorities
 - Anti-Fraud rules applicable as soon as the regulation is published (before 2012)

ACCESS TO THE MARKET (2/3)

- Up to the MS to define the anti abuse rules and the registry holder rights and procedures:
 - Combination with existing regulations; how to fall within the scope of domestic AML regulations? Issue of the individuals and entities not involved in carbon or finance business : recommendations should be issued in September by a working group including DGT and MEDEM
- Auctions (draft of EU regulation)(Primary market)
 - Auctioning single platform unless MS decide to set up its own platform until 2016 (exception backed by the UK, Germany, Poland, Spain). Likely to be adopted « as is ».
 - The draft defines the conditions to access the primary market as of 2013 (mainly to producers « assujettis » and regulated players)
- Prada DP:
 - Secondary and primary markets: Prada discussion paper recommends an authorization for not regulated yet players depending their status (« producers »; transaction on one's own benefit « pour compte propre »; related parties –group- transactions)
- At stake:
 - No discriminations rules for « assujettis » preventing them from full access
 - Same set of rules whether players act on their behalf or as intermediaries (« compte propre ») (« compte de tiers »)
 - Emitters /« Assujettis » : issue of the access to all platforms (passport)
 - Bluenext : scope of members
 - No rules on Secondary market;
 - Protection of individual investor;
 - Intermediaries : same conditions than the ones applicable on other markets

ACCESS TO THE MARKET (3/3)

- Right balance between free access and protection of the market and its players
 - Access to market rules should differentiate between players and rules should be consistent by type of players.
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- Upcoming regulation of the spot market in France.
 - Germany extended Midif rules on regulated markets.
 - Extending rules on derivative markets (Prada DP recommendation). To be defined.
 - DGT currently works on proposals

 - The Sub-Working Group will participate actively to the coming reforms and be keen to promote a proportionate approach in light of the risks addressed and to differentiate rules depending the players.

French market: toward Carbon vehicles (1/2)

- UCITS « OPCVM » cannot invest into allowance or credits for more than 10% of their assets with the exception of contractual funds (« fonds contractuels »)
- At stake: competitionners
 - Creation of carbon funds for qualified investors (Luxembourg; Netherlands...)
 - Extending existing funds offered to public to carbon instruments
 - Creation of a carbon index
 - Friendly and competitive regulatory and tax regimes
- The free access principle requires the market to offer carbon investment vehicles and ... preferably in France.

French market: toward Carbon vehicles (2/2)

- French authorities also work on this issue – proposals also made for micro-credit

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