



Economic Implications of Regulation in the Carbon Market

Project

Duration

Oct 2015 - Aug 2019

In the last few years, regulation of European financial markets has evolved – primarily through the adoption of the second EU Markets in Financial Instruments Directive (MiFID II) and further EU Directives and Regulations, including those on market abuse and money laundering. While the carbon market is not their primary target, these new developments nonetheless have an impact on the European trade of emissions allowances within the framework of the EU Emissions Trading System (EU ETS). In the context of this project, Ecologic Institute and its partners, FutureCamp and Professor Weber of the University of Zürich, investigates how the regulation of the financial market has developed recently, how these changes influence market access for actors in the carbon market and how the behavior of plant operators may change – or have changed already – in reaction to the new legal guidelines.

The analysis follows three steps:

1. The first step is comprised of a stocktaking and systematic description of recent developments in the regulation of the European financial market. This process will identify which market regulation and oversight requirements relevant to the carbon market have changed in the last few years, as well as foreseeable changes still to come. The assessment will also take note of which carbon market actors are impacted by the changing regulations and what the resulting responsibilities are.
2. The second step categorizes, describes and compares the various trading platforms in the EU carbon market with regard to their significance. This includes a stocktake and categorization of the different actors active on each platform and the services they offer. In doing so, the analysis should lead to a better understanding of the significance of the new financial market regulations for carbon market operators, intermediaries and their customers, and highlight possible consequences for their business operations. The investigation will be augmented with a survey distributed to market participants, which will seek to ascertain their level of knowledge concerning recent developments in financial market regulation and whether they are planning to adjust their operations accordingly, or have already done so.
3. In a third step, the project will analyze in depth the trading strategies and market access channels of plant operators covered by the EU ETS, concentrating specifically on purchase or sale of allowances. A representative survey will help describe the actual trading behavior of the plant operators, the channels they use to access the carbon markets, and the strengths and weaknesses of the different access channels as perceived by the operators.

With these three analytical steps the project will help answer overarching questions about

the significance, purpose and impact of financial market regulation in the context of the European carbon market.

- Are developments in the legal framework for regulation in financial markets well suited to help meet the regulatory goals of the carbon market?
- To what extent are the general objectives of financial market regulation applicable to the carbon market? To what extent, are the changed framework conditions in the financial market appropriate to tackle the unique challenges pertaining to regulation and oversight of the carbon market?
- How should the desired impacts of the financial market regulation adjustments be evaluated regarding undesired side effects (i.e. transaction costs, administrative burden etc.)? Is there a risk that the new financial market regulations will overshoot their initial objective and negatively affect liquidity and balanced market power in the carbon market when essential actors back out of the EU ETS to avoid the additional regulatory burden? How can this risk be evaluated and can it be avoided with the appropriate adjustments and measures?

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