

The Carbon Markets and Investors Association (CMIA) welcomes the European Commission (EC)'s efforts to maintain the environmental integrity of offsets for use within the EU ETS.

The CMIA promotes efficient market mechanisms to tackle climate change, at all times seeking to ensure the environmental integrity of such mechanisms. In order to attract investors and thus be a functional tool in the fight against climate change, market mechanisms need to be built upon the principles of **environmental integrity, predictability, certainty, continuity and consistency**.

The EU ETS, CDM and JI, being market mechanisms, based on using these principles to deliver real, additional and verifiable emission reductions, have the CMIA's full support. The CDM additionally contributes to sustainable development worldwide.

Furthermore, the CMIA recognises the EC's desire to incentivise more investment into Least Developed Countries (LDCs) in particular into renewable energy and energy efficiency projects. Investment choices made within the CDM are, however, based on project and country related risks and, as such, CDM geographical balance will not be achieved solely by introducing qualitative restrictions (QR) for CERs/EURs as currently intended by the EC.

Finally the market experience of qualitative restrictions on CERs from large hydro projects is that they create new asset classes, fragmenting the market, which in turn adversely affects liquidity and the determination of a fair price. The CER market is already characterised by low liquidity and we would ask the EC to keep these factors in mind when proposing new regulations.

In addition to the guiding principles we identify above, we include below some critical practical considerations based on our member companies' involvement as market participants:

1. Operationalising Qualitative Restrictions

We would like to offer the following suggestions to the EC to aid them in effectively operationalising Environmental Qualitative Restrictions (EQR).

- i. Establishing the criteria for implementing EQR before starting the comitology process for determining EQR.
- ii. Highlighting and explaining any shift from EQR to QR (i.e. restrictions applied for other reasons than environmental integrity).
- iii. Demonstrating the exhaustion of the pursuit of alternative multilateral measures.
- iv. Defining a clear beginning, middle and end to the comitology process, with the end scheduled as soon as is practicably possible before the onset of Phase III of the EU ETS, in order to avoid making regulation on ad hoc basis.
- v. Providing sufficient notice to the market before any EQR/QR apply.
 - o Investments in emissions reductions projects have long lead times, to maintain confidence and secure new investment will require more than the minimum 6 month notice period established under the ETS directive.

- i. Refraining from applying any new EQR/QR to credits surrendered until 30 April 2013 to enable entities covered within the EU ETS to fulfil their compliance obligations for Phase II, as these obligations should be only subject to EQR/QR defined before the start of Phase II.
 - o Making credits surrendered for Phase II compliance subject to new EQR/QR would be a clear retroactive application of rules, from investors' and market perspective.
- i. Applying the cut-off between those CERs that are subject to EQR/QR and those that are not should be on the basis of the compliance period in which the reduction took place, as reflected in the CER serial number.
 - o To do otherwise, will require a registry system being put in place that can distinguish between CP1 CERs issued pre 2013 and those issued post 2012, which with the current versions of the ITL and CITL registries is impossible.
 - o The CER serial number does not include the issuance date, rather the compliance period for which it was issued. Thus in the absence of a workable proposal to resolve this issue the cut-off between those CERs that are subject to EQR/QR and those that are not should be based on the compliance period in which the reduction took place physically.
- i. To the extent operators are allowed by Member States to use CERs/ERUs for compliance the exchange of Phase II CERs and ERUs (from JI projects determined before the end of 2012) against Phase III EUAs until 31 March 2015 should also not be subject to EQR/QR.
 - o From a market perspective this distinction will be feasible as
 - CERs not subject to EQR/QR will be identifiable by the CP1 identifier;
 - the issuance delay of CERs at the EB level is taken into account;
 - minimum certainty for investors over investments that have already been made is provided;
 - applying EQR/QR only to CERs generated in Phase III will avoid distorting compliance strategies and enhanced swapping activities in the transition period to Phase III.

2. Transparent, predictable process - publicising the rationale for restrictions beyond environmental integrity

The CMIA would like to underline its willingness to engage in a dialogue with the EC in order to share its membership's views and expertise.

Using QR for e.g. political leverage, regulating the profitability of projects, controlling the price of carbon or other reasons than maintaining the integrity of the EU ETS, are, from a market perspective, regulatory measures, which will sap investors' confidence in the EU ETS, the CDM and future climate change mechanisms.

CMIA's members note that an important means of ensuring predictability, certainty, continuity and consistency is to engage in a transparent legislative process, including the ability for participants to comment on specific legislative proposals and on an accompanying regulatory impact assessment before such proposals are finalised.

To date, stakeholders have been invited to comment on the concept of restrictions, via email to a website, without providing a specific timeline.

From previous discussions, we understand that there will be a chance for stakeholders to comment on the text of a specific set of proposals. We would ask that if such consultations

are not going ahead that this be made public via the DG CLIMA website, with an outline of any alternative process.

Maintaining investors' appetite for CDM projects or future bilateral mechanisms will require that EQR and QR are determined through **predictable transparent** processes such as is detailed above.

3. Environmental Integrity

As the CDM is part of a multilateral process, ideally, environmental integrity issues should be resolved at this level via the CDM Executive Board (EB) and guidance to the EB from the Conference Of the Parties (COP). In both these fora the EC and Member States are represented and have committed to a multilateral process. Only if these avenues have been demonstrably exhausted should unilateral options be pursued.

4. The compliance status of projects should be immediately clear

Implementation of EQR should not require a second assessment process for projects generating CERs/ERUs for eligibility in the EU ETS. EQR/QR compliance should not be based upon complying with an extra layer of requirements but based upon the pre defined attributes of a given project.

5. Enforceability in a post-2012 environment:

An automated registry system for filtering compliant CERs at the point of delivery to a counterparty needs to be implemented to avoid EQR/QR spawning a multitude of lawsuits. The example of 'recycled CERs' has shown how important it is to be able to check all held assets for their EU ETS eligibility immediately (i.e. upon delivery).

Finally, CMIA would like to repeat that it welcomes the chance to work with the EC on the design of incentive schemes to channel additional investment to desired CDM projects in LDCs, something that EQR/QR in isolation will not achieve.

Miles Austin
Director, CMIA
miles.austin@cmia.net