Carbon Market Dynamics
Overview of the Actors & Strategies

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1. C Market Dynamics: Factors driving the C Price
2. Carbon Trading: Some basic concepts
3. Carbon Market Actors and their Strategies

Disclaimer: the following set of slides relies heavily on a presentation delivered by Dominik Glock, FutureCamp GmbH, Munich, at the ICAP-PMI Training Montenegro on 10 May 2023
Carbon Market Dynamics
Which factors drive the development of the carbon price in an ETS?

Give your answer at mentimeter: head to menti.com and enter the voting code 6796 0963 or follow the QR link below:
Dynamics of the (EU) ETS price

- Commodity prices (oil, gas, coal)
- Weather
- ETS surplus, banking
- C price stabilisation
- Climate policy ambition
- Companion policies
- Linking, offsets
- GDP growth
- Clean tech innovation
- Exogenous (climate) policy

**Short-run effects**

**Longer-term effects**
Basic Concepts of Carbon Trading
Carbon trading: basic concepts

**Trading Products**
- EUA/aEUA
- CHU/CHUA
- UKA
- CER/ERU
- Swap
- Options

**Delivery Times**
- Spot
- Forward

**Trading Venues**
- Exchanges
- OTC (Over the Counter)

**Point of Sale**
- Primary market
- Secondary market
### Exchange trading: Pro‘s and Con‘s

<table>
<thead>
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<th>Pro‘s:</th>
<th>Con‘s:</th>
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<tbody>
<tr>
<td>High security</td>
<td>High entry barriers</td>
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<tr>
<td>Anonymous trading</td>
<td>High entry costs</td>
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<tr>
<td>High price transparency</td>
<td>Minimum lot sizes</td>
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<td>Fast and secure procurement</td>
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<td>Low variable costs</td>
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# Types of OTC Trading

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<th>Direct bilateral</th>
<th>Via intermediary</th>
<th>Via broker</th>
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<tbody>
<tr>
<td>• Direct trade between firms</td>
<td>• Intermediary (counterparty) is a professional trader – trading as a service for clients</td>
<td>• Brokers collect bids and offers</td>
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<td>• (often between firms that already have a business relationship)</td>
<td>• Typical intermediary traders: Banks, large utilities, consultancies</td>
<td>• Once there is a match, broker exchanges contact details of the counterparties</td>
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<td>• Counterparty risk remains</td>
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<td>• Brokers get a brokerage fee from each counterparty</td>
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<td>• Deal itself is conducted as a bilateral deal</td>
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Actors and their Strategies
Typical Market Actors in an ETS

- Service Providers
- Utilities
- Financial Sector
- Industrial Companies
Carbon Market Actors & Strategies: Some takeaways

- Not all ETS have fully developed carbon markets with sophisticated trading. The EU ETS is the oldest, most sophisticated and most liquid.

- C market participants chose the strategy that works best for them. Trading off efforts for a sophisticated trading strategy vs benefits for the firm.

- Few (large) players pursue a sophisticated trading strategy.

- These few players may still account for a large proportion of overall trading.

- Liquid market will likely require participation of non-compliance traders.
Thanks! Any more Questions?

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Market strategy of utilities (in the EU ETS)

Large Utilities
- Trade on a regular, frequent basis (daily, weekly)
- Hedge their power/heat sales and/or fuel purchases (futures)
- Usually have their own trading departments / use outsourced trading platforms with other utilities
- Use all venues and trade types

SME Utilities
- Often use spot contracts and trade less regularly
- Usually only have only 1-2 persons responsible for carbon trading
- Use intermediaries to access different venues (service provider, financials, other utilities)
Industrial Companies (in the EU ETS)

- Still relatively well endowed with free allocation (carbon leakage)
- Usually would trade on a quarterly or yearly basis (compliance trading), some moved to monthly trades
- Trade mostly via intermediaries
- Only few big players have direct access to exchanges, auctions

- Until 2016 mostly passive trading strategies (esp. SMEs). Since then, clear tendency towards active trading strategies
- Increasing importance of C trading due to shortage of certificates, significantly rising prices since 2017
- Increased importance of EU ETS at management level and in overall corporate strategy
Financial Sector (in the EU ETS)

- Provide liquidity for covered entities (more counterparties, lower bid-offer spreads)
- Facilitate trading by acting as intermediaries
- Use all trading venues (auctions, exchanges, OTC)

- Many banks withdrew from carbon business in 2013 (poor market outlook, reputational issues)
- Comeback in 2018 – following tighter financial market regulation (EU allowances as financial instruments under MiFID)
Service Providers (in the EU ETS)

**Consultancies**
- Often offer carbon trading as ancillary service for their clients
- Usually trade small volumes

**Brokers**
- Simply bring together buyers and sellers
- Usually do not trade on their own account

**Trading Companies**
- Usually also active in other commodities
- Take small margins
- Joint ventures, e.g. trading companies of utilities
- Mainly trade on behalf of their clients