

EFET welcomes ESMA Preliminary Report on the functioning of the EU carbon market

EFET welcomes the *Preliminary Report* on the functioning of the EU carbon market issued by the European Securities and Markets Authority (ESMA) on 15 November and developed in the context of the current high energy prices. We are pleased to see that the market in EU emission allowances (EUAs) and EUA derivatives is developing according to expectations and that regulators have not identified any issues with the current market design or any signs of market manipulation.

The EU ETS is the cornerstone of Europe's climate policy and a mechanism that has demonstrated its ability to deliver on decarbonisation objectives. Moreover, it is the most cost-efficient mechanism for reaching carbon neutrality by 2050. To incentivise the necessary switch to low carbon and carbon-free alternatives, however, the price formation in the primary and secondary markets for emission allowances needs to send a strong carbon abatement signal.

Liquid markets where many buying and selling interests meet ensure that transaction costs are reduced, trades are executed quickly, and the price is set where supply and demand meet. In the EUAs market non-financial counterparties are there to buy emission allowances for compliance reasons and use emission allowance futures to hedge price risks related to their compliance obligations. Financial counterparties, on the other hand, do not have compliance obligations, but act as intermediaries especially for smaller non-financial counterparties and are an important source of liquidity.

We face rapidly accelerating climate change, where the scale of the effort required to mitigate the impact of man-made global warming is unprecedented. Industry, therefore, needs a strong price signal to incentivise a swift switch to carbon-free and, where this is difficult, to low-carbon technologies. By putting a price on carbon emissions, the EU ETS offers this strong decarbonisation signal in the sectors that it covers.

EFET, therefore, would caution against interfering with the EU carbon market beyond the ongoing work by the Commission on revising the EU ETS Directive and strengthening the Market Stability Reserve. In that regard, we call for:

- Reinforcing the role of the EU ETS as a key driver for decarbonising the EU economy;
- Creating a pathway for a gradual expansion of the EU ETS;
- Ensuring the MSR review forms part of a comprehensive EU ETS revision;
- Ensuring coherence between the EU ETS and the overlapping instruments and policies introduced both at EU and at national level; and
- Putting in place a CBAM linked to the EU ETS.

We look forward to the forthcoming in-depth analysis and remain available, should regulators wish to address any questions or concerns to the energy trading community, which we represent. For more information, please contact Nataliya at press@efet.org