

Transparency, anticorruption and accountability Webinar GIZ Mexico



Aspects of market regulation in the EU ETS

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Section V 3.3 – Economic Aspects of Emissions Trading, Monitoring, Evaluation

10.03.2021

Overview

- Market regulation – Aspects of implementation
- Excursion: Legal nature of emission allowances

Market regulation – Aspects of implementation

Market regulation – Aspects of implementation

Market oversight provisions shall prevent criminal activities and facilitate price discovery by:

- ✓ Increasing transparency
- ✓ Containing risk
- ✓ Providing liquidity
- ✓ Ensuring fair competition and a safe market environment
→ prevent manipulation, fraud and other market abuse

Trade off to handle by the regulator:

- **Market flexibility** to be efficient
and
- **vulnerability** to fraud and manipulation

Market regulation – Aspects of implementation

- A whole set of provisions related to financial market regulation applies in the EU ETS (e.g.):
 - Directive on Markets in Financial Instruments (MiFID II) and the supporting Regulation (MiFIR)
→ Secondary Market
 - Auctioning Regulation → Primary Market
 - Market Abuse Regulation (MAR)
 - Anti-Money Laundering Directive (AMLD)
- Implementation of provisions and requirements via national competent authorities (in Germany: BaFin; three-pillar-system)
- Coordination on European level via ESMA (European Securities and Markets Authority)

Market regulation – Aspects of implementation

- Set of powers allows national competent authorities to monitor the market and/or take remedial action, e.g.:
 - Imposing sanctions (→ issues related to market abuse)
 - Imposing multiple reporting and transparency requirements (→ trading venues and investment firms)
 - Reporting requirements include detailed data on transactions in emissions allowances or derivatives thereof (→ both exchange-based and OTC)
- Trading venues play an essential role in the analysis of data!

Legal Nature of Emission Allowances

Legal nature of emission allowances

- ETS Directive 2003/87/EC does not specify the legal nature of allowances
- EU ETS leaves the definition of the legal nature to the discretion of the Member States
 - Definitions vary across Member States
 - Germany: no specification on the legal nature of allowances; however, classified as „financial instrument“
- Study by the European Commission on the legal nature of allowances
 - Does the lack of a clearly defined and harmonised definition affect legal certainty and liquidity of the market?
 - Link to the study (196 pages), published in 2019: <https://op.europa.eu/en/publication-detail/-/publication/9d985256-a6a9-11e9-9d01-01aa75ed71a1/language-en>

Legal nature of emission allowances

- Study by the European Commission on the legal nature of allowances takes into account all relevant areas, specifically:
 - EU ETS legislation
 - Financial law
 - Tax law
 - Criminal law
 - Property law

- Main findings:
 - ✓ Concludes that a harmonised definition would **not** provide more legal certainty
 - ✓ **Nor** would it have an impact on liquidity of the carbon market
 - ✓ Stresses **importance of framework for market regulation**

Thank you for your attention!

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Security of the Registry: From IT-Architecture, Crime Prevention and Crime Detection

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10.03.2021

Overview

- ETS – registries, at risk of criminal attacks?
- 1st Pillar: IT-Security
- 2nd Pillar: Crime Prevention
 - Know-Your-Customer Checks
- 3rd Pillar: Crime Detection & Countermeasures
 - Cooperation with Law Enforcement, Transaction Monitoring and Countermeasures
 - Example: VAT-Fraud
- Sum Up and Conclusion

ETS registries, at risk of criminal attacks?

- Allowances and certificates are:
 - Fungible assets
 - Digital assets
 - Relatively highly priced
- Low logistical costs
 - Relatively easy access
 - Relatively easy transport
- Attractive for certain kind of illegal activities
- Phishing, data theft and other digital crimes
- High-profile crimes
- Risk of some crimes can differ depending on the ETS-system



INTERPOL

ENVIRONMENTAL CRIME PROGRAMME

Guide to Carbon Trading Crime



June 2013

Source: <https://www.interpol.int/content/download/5172/file/Guide%20to%20Carbon%20Trading%20Crime.pdf>

1st Pillar: IT-Security

- IT-measures
 - 2-factor authentication for login, transactions and other processes
 - Username + Password + SMS challenge 3x3 or Token Application
 - Hardware token in use for national administrator
 - E-mail notifications
- Regulatory measures
 - 4-eye-principle
 - Transaction delay of 24 to 48 hours



Source: DEHSt (2012): Establishing an ECAS Access and creating a User ID in order to apply for Aircraft Operator Holding Accounts in the Area of the Union Registry administered by Germany

2nd Pillar: Know-Your-Customer Checks

Central Goals:

Identity Checks and Legitimacy Checks
Increased Deterrence
Risk-Level of accounts

Checks for Account Holders

Checks for Representatives

Proof of Registration
(Commercial Registry)

Background Information on
company, owners, acting
management

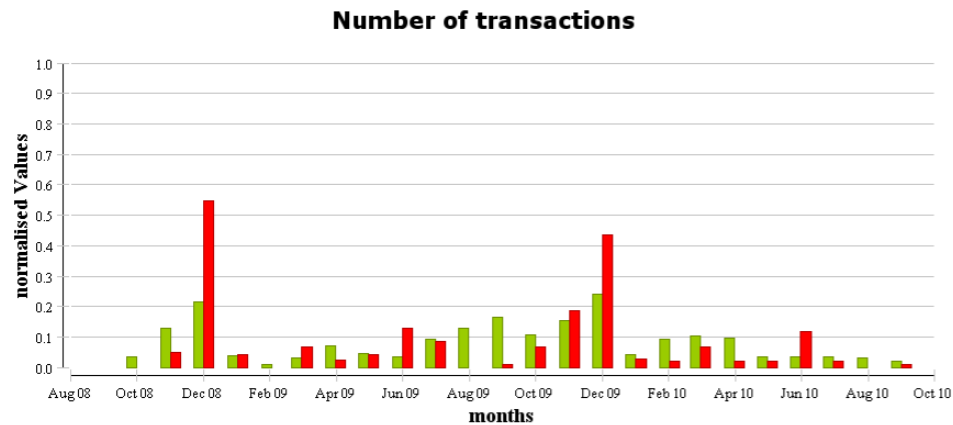
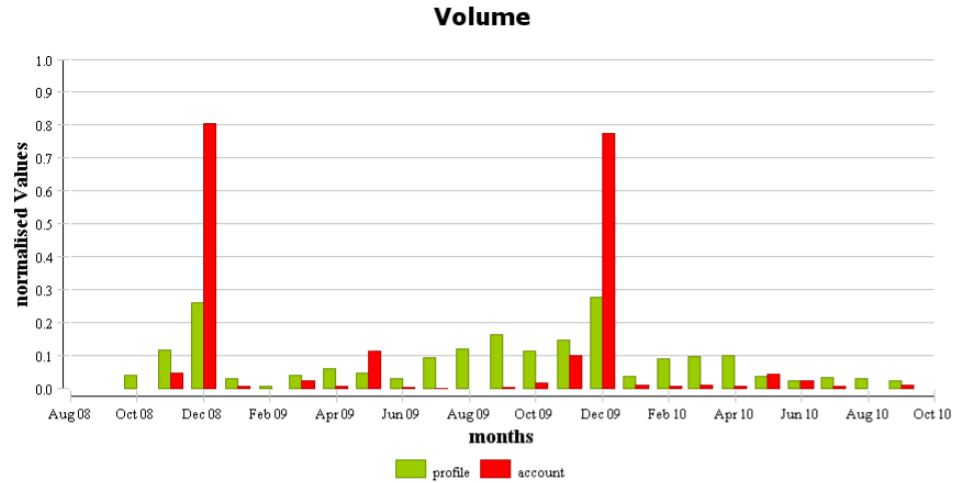
Proof of identity (Passport)
Proof of Residence
Criminal Record

3rd Pillar: Cooperation, Transaction Monitoring and Countermeasures

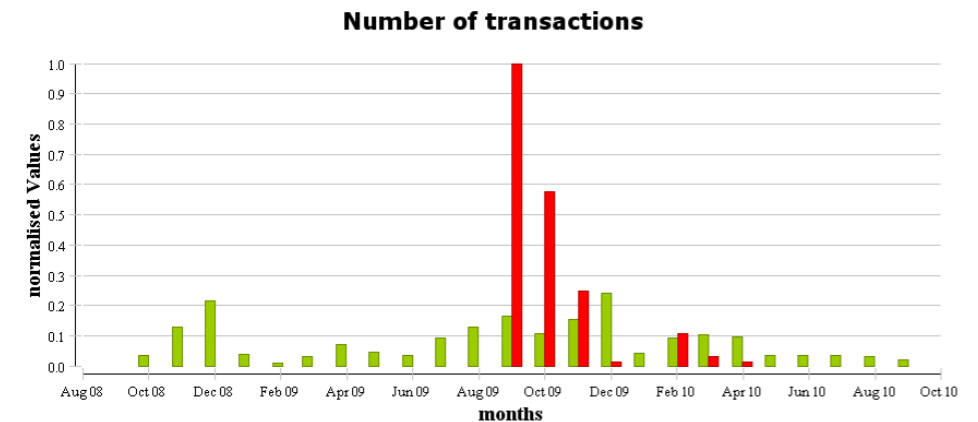
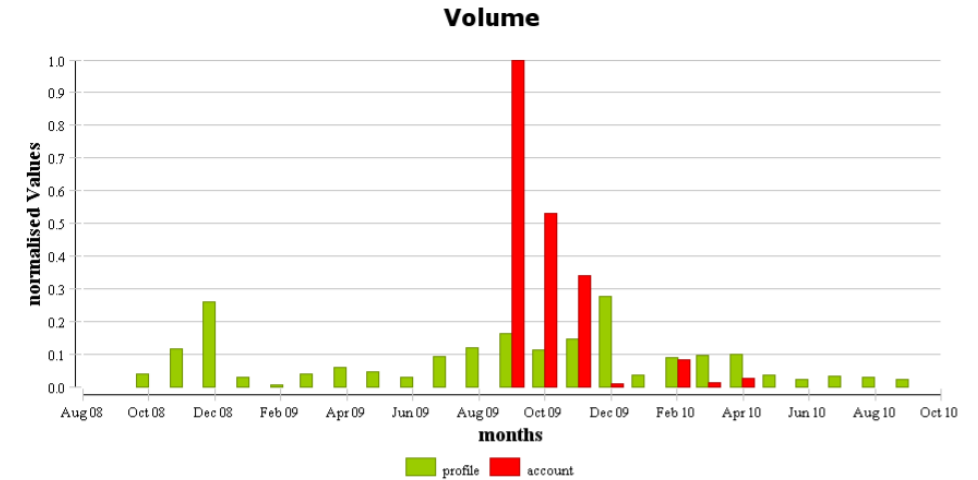
- IT-Security and KYC are necessary but not sufficient
- Regular Exchange with Law-Enforcement and other regulatory bodies
- Monitoring of the registry on a continuous basis
- Regulatory basis for countermeasures
 - Suspension of users
 - Blocking of accounts
 - Suspension of the entire registry

Suspicious Transaction

„Normal“ Trading



VAT Fraud Trading



Conclusion

- ETS-Registries hold a lot of easily transportable and accessible assets
- Always expect a certain level of criminal risks
- Strongest and most necessary pillars: Thorough IT-Security and KYC
- Must be complemented by further measures
 - Exchange with law-enforcement
 - Regular Monitoring of Registry
 - Regulatory measures to maintain security

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Ensuring Integrity in Monitoring and Reporting

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Section V 3.3 - Economic Aspects of Emissions Trading, Monitoring, Evaluation

10.03.2021

Overview

- Why is a Monitoring Plan so Important?
- How to Ensure the Data Quality of Emission Reports From large Emitters?

Why is a Monitoring Plan (MP) so Important?

Why is a Monitoring Plan so Important?

Monitoring Plan - **how** the general monitoring and reporting **provisions** laid down in the Monitoring and Reporting Regulation (MRR) **will be applied in an individual installation**.

- The approved MP **supports the operator** in structuring the monitoring of emissions and is predetermining quality of AER
 - $AER = MP + \text{Figures/Data monitored}$
 - The better the MP the better the Annual Emissions Report (AER).
- The approved MP **binds the operator** to the described monitoring methods
 - legal certainty, i.e. conformity with the approved MP guarantees compliance
- The approved MP is the **starting point for all verification activities** carried out by 3rd party verifiers
 - MP should be as clear as possible to support verification + hence, approval by CAs should be done carefully

Content of a Monitoring Plan (I)

MP describes all relevant data and monitoring methods for the installation:

- Installation **boundaries** (description, flow chart).
- Technical **processes** of the installation (combustion, production of chemicals, ...).
- List of all **source streams**, i.e.
 - all fuels in case of combustion installations or
 - all carbon containing input and output streams for chemical installations.
- **For each** source stream the **expected emissions** amount has to be declared.

Content of a Monitoring Plan (II)

For each source stream the operator has to describe **how** the amount and the relevant calculation factors are **estimated**:

- **Source stream amount:**
 - Measuring devices inclusive quality control and uncertainty assessment
 - Conservative estimations
- **Calculation Factors (net calorific value, emissions factor, biomass content,...):**
 - Sampling plan, analyses frequency, applied standards for analyses, accreditation of laboratories
 - Usage of standard factors
- **The legal requirements based upon the amount of installations emissions: the more GHG are emitted, the higher are the requirements.**


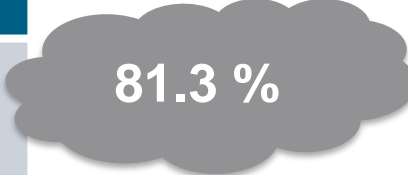


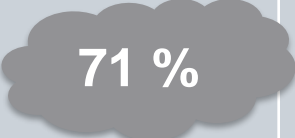
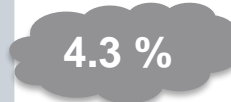


Experience of DEHSt with first approval of MPs

Approximately **1.900 installations** in Germany:

- In around **50 % of all MPs** the operator was asked
 - to correct mistakes in the MP or
 - to give more information (necessary evidences or clarifications).
- **Many MPs had to be corrected by the operator** more than one time.
- Many administrative orders of the MPs **contain collateral clauses**.
- ✓ **The quality of the MP defines the quality of the emissions report!**

How to Ensure the data quality of Emission Reports From large Emitters?

EU ETS in Germany: Scope in „Numbers“

Installation category	Number of installations in Germany	Total annual emissions per year
Category C (>500 kt CO ₂ -eq/yr)	136  7 %	343.2 million t CO ₂ -eq  81.3 %
Category B (>50 kt CO ₂ -eq/yr)	409  22 %	60.8 million t CO ₂ -eq  14.4 %
Category A (≤ 50 kt CO ₂ -eq/yr)	1325  71 %	18.3 million t CO ₂ -eq  4.3 %
of which are low emitters < 25 kt CO ₂ -eq/yr	1052  56 %	8.6 million t CO ₂ -eq  2 %

total: **1870**

422.3 million t CO₂-eq

Major Source Streams:
 > 5,000 t CO₂-eq/yr or
 > 10% of CO₂-eq/yr
 → min. 100,000 t CO₂-eq/yr

Ensuring MRV Compliance

Control of operators by DEHSt based on **written procedures**

Validation & Approval of MP: Desktop check

- In accordance with EU Monitoring and Reporting Regulation
- Focusing on monitoring methods (measuring, sampling, analysing incl. QA/QC)
- Completeness if possible
- Less important: internal procedures
- If needed: approval under conditions & clauses

Ensuring MRV Compliance

Control of operators by DEHSt based on written procedures

- **Review of AER and VR** based on **written procedures** incl. **priorities setting** if necessary incl. administrative offense procedure
 - Some automated checks, centralised analyses of AER data to provide a pre-filtering of error messages, inter alia plausibility of emission factors, carbon contents, net calorific values
 - Cross checks with historical data and production data
 - **Requests for information** (with and without suspicion of mistakes)
 - Hearing, administrative offense procedure, correction of reported data, claim for additional number of allowances, sanctions

Additional Quality Assurance Measure

On-Site Inspection (about 10 per year):

Purpose: Compliant monitoring and reporting

- evaluation of aspects not (easily) verifiable at desktop inspection,
- clarification of issues/suspicion in an efficient way,
- increasing quality pressure on operators

Participants:

Operator, DEHSt,

optional: regional CA, verifier,
consultants



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General rules to prevent corruption

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What do we mean by corruption?

- **In the legal sense:** abuse of a position of trust in a delegated function
- **Transparency International** defines corruption as the misuse of entrusted power for private gain
- Corrupt behavior **in a broader sense:** not acting in an ethically or morally irreproachable manner, violating an applicable code of conduct, established and known principles and values
- Corruption as a **criminal phenomenon:** violation of criminal laws in Germany (bribery and corruption, granting and accepting advantages and other criminal offenses)

Understanding of values

- **Common understanding of values**, what constitutes conduct with integrity
- In the entire federal administration and in the German economy, corruption prevention has a **high priority** and is **not specific theme of the administration of the EU ETS in Germany**
- **General goals in Germany**
 - a) avoid of **loss of confidence in the integrity and legality** of governmental administrative actions
 - b) not only to consistently pursue any cases of suspected corruption that may arise, but also to **effectively counteract** any corruption **with** the help of **preventive measures**

Main measures to prevent corruption

- **Clear and recognizable attitude of top management to the topic** of anti-corruption ("**tone from the top**"): role model function and part of the professional management task
- **Documentation of this attitude in the organization**: publication of guidelines, circulars, code of conduct, regular training (sensitization) of employees
- **Systematic analysis and evaluation** of the organization's areas of responsibility with regard to organization-related risks: *Where are **areas particularly susceptible to corruption**?*
- **Institutional-organizational safeguarding of prevention**: central corruption officer independent of directives in every federal authority in Germany (also in the German Environment Agency) and decentralized contact persons in all specialized units (German Emissions Trading authority)

Enforcement of general rules by implementing of risk-minimizing/securing measures in the organization

- **Establish transparency** of technical decisions (through the individual hierarchical levels)
- **Transparency of delegation structures:** Who makes which decision?
- Establish clear decision-making authority and **define scope for decision-making for employees**
- **Avoidance** of possible conflicts of interests/ separation of functions
- **so-called 4 - eyes principle** and (in areas particularly at risk of corruption) strive for **personnel rotation** in the performance of tasks (approx. 5 years)
- Constant dialog between superiors and employees

Organizational risk minimizing/securing measures

- Establishment of an **anti-corruption oriented organizational culture**, which is not concerned with every conceivable misconduct of employees but with the **avoidance of systematic misconduct**
- In the case of any misconduct: Clarification of the facts, review and, if necessary, exclusion of sources of error
- Cooperation with other internal control functions (e.g., legal department/ internal audit).
- **Example of a rule for employees:**
“Work in such a way that your work can be checked at any time. For your own protection, the way you work should also be transparent and comprehensible. Since you will usually leave your job again at some point (transfer of new tasks, relocation) or be absent for a short time (illness, vacation), your work processes should be so transparent that a successor or substitute can familiarize himself/herself with them at any time.”
- For this reason the databases must always be maintained on a daily basis by the responsible employees.

ANNEX: Anti-Corruption Code of Conduct



Thank you for your attention!

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