China Emissions Trading and IFC

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Outline

- Why engage in China’s Emission Trading Scheme?
- What are we doing?
- Where does this lead for IFC?
- Key lessons so far
Why?

China will make or break the carbon market

**Challenge**

*The 800-pound gorilla*

- China, the biggest source of CO₂ emissions globally, accounts for more than 27% of the world’s emissions.
- In 2011, the National Development and Reform Commission, NDRC, announced that China would introduce use of emissions trading on a pilot basis in order to put a price on carbon.

**Chance**

*An important opportunity*

- ETS as an innovative market mechanism leveraging the “invisible hand” to utilise market forces to reduce growth in CO₂ emissions.
- China has established 7 ETS pilots to test the water with different focus and set the stage for private sector to play a big role in the pilots.

**Commitment**

*WBG and Climate Change*

- “At the World Bank, we are stepping up our mitigation and adaptation and disaster risk management work very, very aggressively … one of the most important things we have to focus on is getting prices right. We must find a way to set a stable price on carbon.”
  
  *President Jim Yong Kim, December 4, 2013.*
Snapshot: Growth of EU Carbon Market

Figure 2: Monthly EUA Trading Volumes 2005-2007

Figure 1: Evolution of EUA Prices 2005-2007

Annual allowance volumes 2008-11

Annual offset volumes 2008-11

Source: Point Carbon and Mission Climat of the French Caisse des Dépôts.

Source: World Bank
ETS pilots daily settlement prices during 2014

Snapshot: ETS pilots daily trading volumes and values during 2014

Challenges

- Futures not permitted
- Local emissions exchanges expected to lead pilots not acting as exchanges
- FIs do not have capacity and experience to provide services and products to clients
- No opportunities for intermediation by FIs
- Aggregation and risk management products not available

Opportunities

- Engage with CSRC and NDRC on futures and related products
- Leverage WBG carbon market engagement; offer global experiences and expertise
- Provide necessary knowledge and tools to FIs by leveraging platforms like CHUEE
- Pioneer carbon futures products with leading exchange
- Offer products like margin lines and carbon delivery guarantees
**National level: A top-down macro-level focus**

**IBRD-Partnership for Market Readiness (PMR)**

Design and preparation for a national ETS, including work on cap setting, allocation, MRV, mechanisms for price containment, market oversight and a legal framework.

Specific analytical work will be carried out on the inclusion of SOEs and the power sector.

A national ETS will be launched (target to launch 2016-2020).

**Pilot exchange level: A practical micro-level focus**

**IFC- Working with ETS Pilots**

Phase I will work with 1-2 exchanges to introduce non-spot trading products; build capacity within the exchanges.

Phase II, contingent on continued growth in the pilots (volume, participants), will focus on ensuring full FI/market participation.

All activities aimed at feeding into national market.
Phase I Plan:

1. Develop one China ETS platform with SZ exchange to be held quarterly.
2. Develop trading product:
   - By December 2014: Work with SZ exchange and 1-2 banks to develop 1-2 non-spot instruments for simulation;
   - January 2015-September 2015: Test products on SZ Exchange, lessons learned and deliver assessment report;
   - End 2015: Final assessment report to be provided to CSRC-NDRC research group on Study of China Future Products in Carbon Market.
3. Support IFC IS team to identify and structure new investment opportunities.
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<tr>
<th>Principles</th>
<th>Description</th>
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<td>Price stability</td>
<td>Prices do not jump but rather change in small movements - important for not having to mark-to-market continually.</td>
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<td>Liquidity</td>
<td>The contract has sufficient liquidity, i.e. a sufficient number of investors (buyers, sellers and brokers), to ensure a market with significant enough trading volume.</td>
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<td>Compliance buyers key</td>
<td>Contract buyers are dominated by participants who are taking steps to reduce the risk of an actual position, i.e. need to buy or sell the underlying asset, rather than those investors that seeking to profit from price movements.</td>
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<td>Risk mgmt</td>
<td>The contract is accompanied with proper risk management to control events of default (non-payment) and/or fraud.</td>
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<td>Support of regulators</td>
<td>Contracts have support of central regulators.</td>
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Program with Shenzhen Emissions Exchange (CEEX)

Phase I: Research and Development: June 2014-Dec. 2014

1a. Analysis

- EU ETS.
- Carbon trading products catalogue.
- Individual contract analysis.
- Contract selected for test.

1b. Awareness Raising & Capacity Building

- IFC China ETS Advisory Committee: NDRC, NCSC, China CDM Fund; CSRC, CBRC, China Futures Margin Monitoring Center; SPDB, IB; Petro-China International.
- Stakeholder forums.
- Two training events.
Program with Shenzhen Emissions Exchange (CEEX)

Phase II: Test and Evaluation: Jan. 2015-Sep. 2015

2a. Test Preparations
- IT-functionality
- Rule book
- Back-office functions
- Risk management framework and procedures
- Test manual

2b. Contract Test Execution

2c. Evaluation
- Test report, including possible recommendation to launch contract.
- Two forum / training events.
Where does this lead for IFC?

New Horizons

**FI Products**
- Non-spot or future instruments to hedge carbon risks
- CO2 risk assessment / CO2 asset management tools
- Tailored carbon delivery guarantee products

**Equity**
- Equity investments in current exchanges
- Co-set up Emissions/ Energy future exchanges with suitable partners in China

**Treasury**
- Develop new products and create market demonstration effects
- Engage directly in pilot trades and off-exchange transactions
- Carbon related bonds (China Nuclear Group Bonds and SPDB case)

**New Leads**
- FI funds and facilities to provide loan capital to climate-smart investments to meet companies' compliance needs
- Carbon funds to invest in projects that generate offsets which would be eligible for compliance under a Chinese ETS.
Summary

- Why engage in China’s Emission Trading Scheme?
  Cannot address climate change without China.
- What are we doing?
  Focused support to remove key barriers and overcome challenges recognised by the market.
- Where does this lead for IFC?
  Opportunities in a number of emerging areas where WB/IFC can establish a leadership position.
Thanks for your attention!

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