Dansk Aktionærforening

CESR
Committee of European Securities
Regulators
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CESR/CEBS Call for Evidence on Commodities
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Danish Shareholders Association (Dansk Aktionærforening) wants to bring up a case in relation to possible market failures.

Case:

The market for EUA and CER emission quota's was established by the EU to create a platform whereby end-users could trade emission rights across borders within the EU. The contracts are quoted as futures and cleared on trading platform s such as Nordpool (EUA and CER) and European Climate Exchange (EUA). The contracts resemble the futures within commodities with the delivery mechanism al/o wing physical delivery of the underlying contract (the European Climate Exchange allows financial delivery on contracts while Nordpool only allows physical delivery). So good so far.

The difference between C02 emission rights and commodities is however the amount of underlying assets that exist. The definition of C02 emission rights is governed by the Kyoto agreement within Europe. There is an ultimate number of quota's and this number will be tightening in the future once the market moves from Phase II to Phase III. The risk of the system is therefore related to the existence of underlying assets for delivery - opposed to normal commodities with a natural and thereby unlimited supply in the near- and middle-term.

If the market for C02 balloons - the amount of outstanding derivative contracts will grow rapidly (which is being experienced) - resulting in a far greater number of financial contracts than the pool of underlying assets (emission rights) that can be delivered at expiry. The EUA and CER system could potential/y result in an asymmetric dispersion if the sum of market contracts with physical delivery exceeds the amount of underlying emissions and the market participants that are 'long' in the market - all require physical delivery at the maturity of derivative contracts.

This can be exemplified:

- The sum of quota's is Y
- The sum of financial contracts is W = Y x N
- When N < 1 or N = 1 is it possible to deliver, because the market participants wants delivery of a number of quotas smaller than or equal to the existing number of quotas. But what will happen if N > 1, i.e. the market participants require delivery of W contracts, a number larger than Y, the number of quotas in the underlying market?

Kind Regards

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