EUROPEAN COURT OF AUDITORS

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Press Release
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EU Emissions Trading System – framework for protecting market integrity and implementation of ETS need further improvements – say EU Auditors

A report published today by the European Court of Auditors (ECA) finds that the Commission and Member States did not adequately manage all aspects of the EU Emissions Trading System (EU ETS), which is a main element of the EU climate and energy package. While the auditors noted continuous improvements introduced at the initiative of the Commission to protect the integrity of the EU ETS as a market-based mechanism, some issues still had to be addressed to further improve market integrity. The system also suffered from significant weaknesses in implementation in phase II (2008-2012). The report recommends improvements to market regulation and oversight so as to increase investor confidence and leverage the EU ETS as a tool of environmental policy.

"The EU ETS is the cornerstone of the EU's climate policy. It has been progressively improved since its introduction ten years ago. But still more could be done in a number of areas, such as controls on the opening of ETS accounts, the monitoring of transactions, market supervision and the verification of emission levels at installations. Our recommendations can help the Commission and Member States improve market integrity and implementation of the system, making it a stronger tool for achieving climate change targets by 2020 and beyond," ***commented Kevin Cardiff, the ECA Member responsible for the report.*** *"Given the considerable financial stakes involved in the multi-billion euro carbon market, previous security incidents, and the goal of promoting real action to reduce greenhouse gas emissions, improvements are needed to the framework for protecting market integrity, and the system as a whole needs to be better implemented."*

The current reform of the ETS (introduction of a "*market stability reserve*") and related debate focus on its effectiveness and on how to deal with the surplus stock of allowances, which was not in the scope of this report.

Our audit shows that attention has to be given to market integrity and implementation so that the EU can be more confident that this flagship policy is fully equipped to deliver on emission reductions and low carbon technologies. The auditors found that the Commission's and Member States' management of certain aspects of the EU ETS, particularly during phase II, was not entirely adequate. There were problems with the framework for protecting the market in allowances, and also problems with the actual implementation of the system.

Concerning the framework, even after the inclusion of the market in ETS allowances in the scope of the European Directives for financial instruments and market regulation, some issues remain in relation to compliance traders, bilateral over-the-counter spot trading and smaller market participants. No oversight of the emissions market has been established at EU level and cooperation involving national regulators and Commission was found to be insufficient, which could imply that distortions and anomalies with potentially serious effects are not appropriately managed. The auditors noted a need for a clearer legal definition of emission allowances and the creation and protection of security interests in allowances, which could help the market to function more effectively. Further progress is also needed regarding the high-risk Union registry for processing fundamental ETS data: in particular tighter controls over account opening and improved monitoring of transactions. Nevertheless, the report acknowledges that there has been a marked reduction in reported incidents in recent years.

The auditors detected important weaknesses in Member States' and the Commission's implementation of the system. In particular, systems for monitoring and reporting on emissions were insufficiently implemented and harmonised in phase II, with gaps in the Commission's guidance and monitoring of Member States, as well as a lack of transparency in its assessment of national allocation plans. Some Member States did not provide all the required reports on the

The purpose of this press release is to give the main messages of the special report adopted by the European Court of Auditors.
The full report is at www.eca.europa.eu

ECA Press
Damijan Fišer - Press Officer
12, rue Alcide De Gasperi - L-1615 Luxembourg
T: (+352) 4398 45410 M: (+352) 621 55 22 24
E: press@eca.europa.eu @EUAuditorsECA Youtube: EUAuditorsECA eca.europa.eu

operation of the system, and the Commission did not publish the required annual implementation report, while the impact of consultation and coordination fora between the Commission and Member States was limited due to the low level of participation by the latter.

The Commission had a limited role in ensuring the harmonisation of key controls in the Member States' implementation of the system. The auditors were unable to assess the effectiveness of the diverse sanction systems due to a lack of consolidated information at Member State and EU level, and warn that divergent practices between the Member States concerning the rules for surrendering international project credits could potentially affect the level playing field for operators.

Notes to editors

ECA special reports are published throughout the year, presenting the findings of selected audits of specific EU budgetary areas or management topics. This Special Report (6/2015), entitled "**The integrity and implementation of the EU ETS**", assesses whether the ETS was managed adequately by the European Commission and Member States.

Introduced in 2005 and currently in phase III of implementation, the EU ETS is both the EU's flagship policy to combat climate change and the world's largest cap-and-trade system for greenhouse gas (GHG) emissions. A steadily-reducing cap has been placed on overall emissions from high-emitting industry sectors. The cap restricts emissions of more than 11 000 energy-intensive installations across the EU, covering around half of GHG emissions. These installations receive emission allowances or buy them at auction, and can also trade allowances as needed.

The Commission's long-term roadmap for GHG emissions aims at a reduction of 80 % by 2050. The Council has agreed on the 2030 objectives of a climate and energy policy framework and endorsed a binding EU target of at least a 40 % domestic reduction in greenhouse gases by 2030 compared to 1990. The EU ETS will continue to play a central role in achieving these objectives. Furthermore, the Council and Parliament have recently reached agreement on the introduction of a market stability reserve to address the problem of surplus allowances overhanging the market and putting downward pressure on market prices.

The auditors examined whether an appropriate framework was established to protect the integrity of the system as a market-based mechanism. They also looked at the actual implementation of the EU ETS in phase II (2008-2012), so that lessons can be learned for the future development of this policy. The auditors checked how the Commission guided Member States' implementation efforts and whether it fulfilled its own obligations. Evidence was obtained from seven Member States selected by volume and types of emissions (Germany, France, Italy, Poland, UK, Greece and Spain). At Member State level, the audit focused on the allocation and surrendering of allowances, systems for the monitoring, reporting and verification of emissions, and sanctions.

Recommendations

The EU auditors recommend as follows:

- the Commission should address remaining issues in emissions market regulation and oversight in order to further improve market integrity;
- the legal status of allowances should be further clarified in order to contribute to stability and confidence;
- certain aspects of the systems for processing fundamental EU ETS information (the Union registry and related procedures) should be further improved;
- the control framework at the level of the Member States should be better applied so as to ensure that the weaknesses identified are taken into account for the implementation of phase III of the EU ETS (2013-2020);
- during phase III, the level of guidance and information about the implementation of the EU ETS should be improved;
- the implementation of sanctions in relation to the EU ETS should be made more transparent. Up-to-date and accurate information should be available at Member State and EU level on the implementation and results of penalty procedures, and the Commission should better monitor enforcement practices across the EU as well as the consistent application of national penalties.

These recommendations have been accepted by the Commission and will be followed up. The full text of the recommendations is available in the special report, together with the Commission's replies.