IIGCC
Institutional Investors Group on Climate Change

IIGCC Statement on EU ETS Reform

Statement by the Institutional Investors Group on Climate Change (IIGCC)

The scientific evidence on manmade climate change is clear. Yet despite global efforts to control emissions, global CO_2 concentrations are still rising, with an increase of more than 5% in 2010 – unprecedented in the past two decades[1]. Concentrations of greenhouse gases in the atmosphere are now close to the level at which serious climate change is likely[2], and we are already witnessing an increasing number of natural catastrophes, with increasing economic losses[3]. However, private sector capital is currently not being deployed in low carbon solutions at a rate that is fast enough in order to avoid unmanageable risks of climate change.

The Institutional Investors Group on Climate Change (IIGCC), representing around 80 investors, with EUR7.5trillion in assets, is concerned about the potential for climate change to have major negative impacts on the economic systems in which we operate in and, in turn, on the assets in which we invest. We believe that clear, credible and long-term domestic and international policy frameworks are needed in order to shift the balance in favour of low-carbon investment opportunities, allowing private sector investment at the scale required.

The EU Emissions Trading Scheme is a landmark piece of legislation that introduced a price on greenhouse gas emissions for the first time. We have supported the implementation of carbon markets because we believe that a market mechanism placing a price on carbon emissions can help to drive emission reductions by catalysing innovation and driving investment in low carbon solutions.[4]

The determination of the quantity of permits within a trading scheme is technically and politically complex, yet it is the most important part of the trading scheme. The allocation for Phase III of the EU Emissions Trading Scheme was set in line with the EU's 2020 objective of a 20% cut in greenhouse gas emissions. However, since the decision on EU emission allowance allocations was set, economic circumstances have changed considerably, with the drop in economic activity driving a reduction in energy demand. The oversupply of permits has been further aggravated by significant increases in the issuance of CERs and ERUs, a trend which is expected to continue during the course of 2012.[5] Alongside this, achievements in energy efficiency have also contributed to demand reductions, and we can expect the Energy Efficiency Directive, if implemented, to accelerate this trend.

1 See for example, **http://www.pbl.nl/sites/default/files/cms/publicaties/CO2%20Mondiaal_%20webdef_19sept.pdf**

2 See for example, **http://www.esrl.noaa.gov/gmd/ccgg/trends/global.html#global** for CO2 concentration data, and **http://www.pik-potsdam.de/news/press-releases/files/synthesis-report-web.pdf** and **http://unfccc.int/resource/docs/2011/cop17/eng/09a01.pdf** for thresholds.

3 See for example, **http://www.munichre.com/app_pages/www/@res/pdf/media_relations/press_releases/2012/2012_01_04_munich_re_natural-catastrophes-2011_en.pdf**

4 See for example the IIGCC's 2009 statement, *Toward an effective global carbon market*. **http://www.iigcc.org/__data/assets/pdf_file/0011/461/IIGCCCarbonMarkets.pdf**

5 CERs = Certified Emission Reduction unit, a carbon credit issued under the Clean Development Mechanism. ERU = Emission Reduction Unit, a carbon credit issued under the Joint Implementation mechanism. Both can be used in the EU Emissions Trading Scheme within certain limits.

Carbon analysts forecast that the accumulated oversupply in the EU ETS will amount to between 1.4 – 2 billion tonnes of CO_2 and that without further action this will persist during the entire Phase III of the ETS. As a result, the price of EUAs has fallen dramatically to the current range of EUR6-8 per tonne, with CER prices lower still. Given the current level of gas and coal prices, the carbon price is not even high enough to support a switch from coal to gas.

The EU ETS was expected to send a robust price signal to drive investment in both energy infrastructure and energy efficiency. As long-term investors we are concerned that such low prices fail to produce a strong enough signal to enhance the economic viability of energy efficiency, renewable energy and other low-carbon energy sources, as cost-effectively as possible. The consequence of not having adequate scarcity in the market significantly increases the risk that the EU will become 'locked in' to a higher-carbon trajectory, which will make the emissions reductions necessary beyond 2020 more costly and difficult to achieve, with the ultimate effect of undermining long-term economic growth and company performance.

IIGCC's Recommendations

Whilst in general IIGCC members are wary of interference in the operation of markets, in the case of the EU ETS we believe that we face an exceptional situation, where changing economic and policy circumstances warrant a recalibration of the system.

1. **One way to do this would be through a change in the overall level of ambition of the EU's 2020 emissions target, with a commensurate change in the EU ETS allocations.**

2. **Given the urgency of the problem, we also support immediate action to define and implement, as soon as possible, a one off set-aside of EUAs in order to remove the oversupply from the system.**

3. **We urge policymakers to develop pre-agreed adequate review process mechanisms to cope with unforeseen economic circumstances in future.**

In addition to well-functioning carbon markets, governments will need to provide additional measures to encourage an effective response to the climate challenge and design policy packages to maintain coherence over time where policies interact strongly. It will be necessary to complement carbon markets with a range of market-based mechanisms and regulation, including for example the elimination of fossil fuel subsidies, government support schemes such as feed-in tariffs, and product standards and codes to increase energy efficiency.

In order to mitigate climate change risks, we therefore believe it is imperative that decisive action is taken soon and, given the visibility of Europe's pioneering work establishing the ETS, we call on Europe to show leadership in ensuring that the ETS is managed so as to ensure its success.

IIGCC Membership April 2012

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AP1 (First Swedish National Pension Fund)
AP2 (Second Swedish National Pension Fund)
AP3 (Third Swedish National Pension Fund)
AP4 (Fourth Swedish National Pension Fund)
APG Asset Management
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Aviva Investors
Baptist Union of Great Britain
BBC Pension Trust
Bedfordshire Pension Fund
BlackRock
BMS World Mission
BNP Paribas Investment Partners
BT Pension Scheme
CB Richard Ellis
CCLA Investment Management
Central Finance Board of the Methodist Church
CF Partners (UK) LLP
Church Commissioners for England
Church of Sweden
Climate Change Capital
Co-operative Asset Management
Corporation of London Pension Fund
Dragon Capital Group Ltd.
Earth Capital Partners
Environment Agency Pension Fund
Environmental Technologies Fund
Ethos Foundation
F&C Management Ltd
Five Oceans Asset Management
Generation Investment Management LLP
Greater Manchester Pension Fund
Grosvenor Fund Management
Henderson Global Investors
Hermes
HgCapital
HSBC Investments
Hudson Clean Energy Partners
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Kleinwort Benson Investors
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London Borough of Newham Pension Fund
London Pensions Fund Authority
Low Carbon Investors Pte Ltd
Merseyside Pension Fund
Mercer Global Investments Europe Limited
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