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Sustainable Architecture for Finance in Europe (https://safe-frankfurt.de/)

SAFE Finance Blog

The SAFE Regulatory Radar in October

10/30/2019

German climate policy framework, EU sustainable finance regulation and new rules for clearing counterparties after Brexit: a selection of financial regulatory developments from this month

At the end of each month, the SAFE Regulatory Radar highlights a selection of important news and developments on financial regulation at national and EU level.

German climate policy framework approved: Carbon pricing and monitoring procedure

On 9 October, the German Federal Government has formally adopted the climate policy framework presented after the Climate Cabinet (https://www.bundesregierung.de/breg-de/aktuelles/bundesregierung-packt-klimaschutz-an-1592188) ("Klimakabinett") meeting on 20 September 2019. It is supposed to realign national efforts in cutting greenhouse gas emissions with the internationally agreed long-term reduction targets. The package consists of two acts: The Climate Action Programme 2030 (https://www.bundesregierung.de/breg-en/issues/climate-action/klimaschutzprogramm-2030-1674080) ("Klimaschutzprogramm 2030") and the Climate Action Law ("Bundes-Klimaschutzgesetz (https://www.bmu.de/gesetz/entwurf-eines-gesetzes-zur-einfuehrung-eines-bundes-klimaschutzgesetzes-und-zur-aenderung-weiterer-vor/)").

The Climate Action Programme 2030 implements a variety of sectoral measures. Above all, it extends carbon pricing to transport and buildings.

While the European Emissions Trading System (EU-ETS (https://ec.europa.eu/clima/policies/ets_en)) limits the total amount of CO_2 emitted by the energy sector and industry, the Effort Sharing (https://ec.europa.eu/clima/policies/effort/regulation_en) regulation adopted in May 2018 requires member states to cut emissions in sectors that fall outside the scope of EU regulation, including transport, buildings, and agriculture.

A national trading system (nEHS) will put a price on burning motor fuels (e.g., petrol and diesel) and fossil fuels in heating appliances (heating oil, liquid petroleum gas, and natural gas). Generally, emissions trading allows prices to readjust according to market demand without sacrificing the quantity goal. In 2021, the carbon price will be fixed at 10 Euro per ton CO_2. After having charged 20 Euro in 2022, the carbon price will be successively increased by 5 Euro per year. A fixed price path does not deliver the desired guidance effect. Therefore, allowances that are not covered by the non-EU-ETS emissions budget assigned to Germany must be bought from other member states. By 2026, emission allowances will be issued in auctions and overspending will no longer be feasible. There will be a temporary price corridor of 35 to 60 Euro per ton. Consequently, 2026 will be the first year in which the market will form the price.

So far, 26 countries (https://carbonpricingdashboard.worldbank.org/) worldwide have formally adopted a carbon pricing mechanism. For example, the Swedish carbon tax (https://www.government.se/government-policy/taxes-and-tariffs/swedens-carbon-tax/) covers all non-EU-ETS sectors and currently amounts to 114 Euro per ton CO_2. Switzerland imposes a tax of 84 Euro per ton CO_2 on fossil fuels in heating appliances and electricity production.

To gain widespread acceptance of carbon pricing, governments use revenues derived from the issuance of new emission allowances either to finance additional climate change mitigation policies or to compensate citizens for the rising cost of living. For example, in Switzerland, carbon tax revenues are spent on a buildings renovation program and citizens are partially compensated with lowered social security and health insurance contributions.

In Germany, the market-led carbon price will successively replace fixed components in the electricity price such as the shared contribution of the German Renewable Energies Act (EEG) and power grid fees. Tax-deductible commuting expenses for employees are increased temporarily to make up for insufficient transport infrastructure in rural areas. Finally, the German transfer system will compensate welfare recipients (e.g., "Wohngeld") for higher heating expenses.

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The Climate Action Law enshrines the commitment to reach greenhouse gas neutrality by 2050 in law and complements an automatic adjustment procedure that holds policymakers accountable. The now permanent Climate Cabinet has received the mandate to reassess the efficiency and effectiveness of the mitigation policies adopted in the Climate Action Programme 2030 on an annual basis. The Climate Action Law assigns linear emissions reduction paths to each sector. If the sectoral targets are not achieved, the minister in charge will be required to submit an action plan within three months that brings the relevant sector on track. An independent body called “Expertenrat für Klimafragen” will formally record cases of non-compliance but has no authority to issue directives. This is said to speed up the realignment of sectoral measures with the emissions reduction to be achieved. The Climate Cabinet has the final say over the measures to be taken.

As a next step, the bundle must be passed by both the German Parliament and the Federal Council.

Sustainable Finance: ongoing work on taxonomy and risks assessment in the EU

According to a European Council position (https://www.consilium.europa.eu/en/press/press-releases/2019/09/25/sustainable-finance-council-agrees-position-on-a-unified-eu-classification-system/), published on 23 September 2019, a unified EU classification system (taxonomy) should be established by the end of 2021 and applicable by the end of 2022. Therefore, the European Commission has to define “technical screening criteria” for each relevant economic sector as well as quantitative and qualitative thresholds which must be met by the economic activity.

In the context of the implementation of the final elements of the Basel III reforms (https://eba.europa.eu/regulation-and-policy/implementing-basel-iii-europe), the European Commission has launched a public consultation (https://ec.europa.eu/info/files/2019-basel-3-consultation-document_en)that covers i.e. sustainability issues. In particular, the Commission asks which measures could be taken to incorporate ESG (environmental, social and governance) risks into prudential regulation. Legislative proposals introducing the final Basel III implementations are expected by mid-2020.

Capital Markets Union: New rules for clearing counterparties following Brexit

On 15 October 2019, the European Council adopted revised rules for clearing counterparties (CCPs) (https://www.consilium.europa.eu/en/press/press-releases/2019/10/15/capital-markets-union-council-adopts-new-clearing-house-rules/) in the single market, taking particular account of the impact of Brexit on the financial system in Europe. After Brexit, three CCPs based in the UK will become third-country (non-EU) CCPs. The new law explains how EU and third-country CCPs will be supervised.

To provide services in the EU, a third-country CCP has to be recognized by the European Securities and Markets Authority (ESMA). Regulation of the European Parliament and the Council amends the European Market Infrastructure Regulation (EMIR (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32012R0648)). The regulation foresees an establishment of a permanent ESMA committee. The CCP Supervisory Committee will get a mandate to supervise both EU and third-country CCPs. It will be composed of competent authorities of member states with an authorized CCP and independent members.

The legal act introduces a new, two-tier system for recognition of third-country CCPs including additional risk-based considerations. This will allow ESMA to deny or suspend the recognition. The regulation distinguishes third-country CCPs into two categories of systemically important and non-systemically important CCPs. The systemic importance will be defined by specific criteria based on the size, nature, membership structure and complexity of the CCP’s business. Systemically important CCPs (Tier 2-CCPs) would be subject to stricter rules. For instance, they will have to comply with the additional requirements set by EU national central banks as well as to provide ESMA with all relevant information and to enable on-site inspections.

The amendments are aimed to strengthen the supervision of CCPs by taking into account the growing size, complexity and cross-border dimension of clearing in the Capital Markets Union and to provide legal certainty regarding how firms based outside the EU will be able to operate in the single market. The new framework provides ESMA with wide discretion regarding third-country CCPs.

The regulation will be published in the Official Journal of the European Union on 12 December 2019 and will enter into force 20 days later.

Current public consultations

- European Commission: Public consultation on the **report pursuant to Article 54 of the Benchmark Regulation (https://ec.europa.eu/info/law/better-regulation/initiatives/finance-2019-benchmark-review_en)**. The deadline is Friday, 6 December 2019.

- European Commission: Public consultation on the **capital requirements to international standards (https://ec.europa.eu/info/law/better-regulation/initiatives/finance-2019-basel-3/public-consultation_en)**(prudential requirements and market discipline). The deadline is Friday, 3 January 2020.

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