

International Carbon Action Partnership Launching Ceremony

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Lisbon**

The Role of Carbon Markets

**Remarks by Caio Koch-Weser
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(Text may differ from actual delivery)

- Mr. Prime Minister, Mr President, Excellencies, Ladies and Gentlemen – Thank you for the invitation to participate in this important event.
- The financial industry as represented by INCIS (International Carbon Investors and Services), a group that promotes the development of emissions markets that are both environmentally sound and economically efficient, and of course my own institution Deutsche Bank, which is a member of INCIS, commends you on your new initiative.
- The International Carbon Action Partnership (ICAP) that is agreed today is a crucial step toward the creation of a global carbon market.
- This initiative is very timely indeed, as you can not only coordinate the design and implementation of carbon markets among ICAP members but you can also bring that common understanding to policymakers elsewhere.
- Broad-based understanding of the potential role of emissions trading in the fight against global warming is key as we move toward Bali and a post-Kyoto agreement.
- I would like to share with you today a market perspective on the lessons we have learnt from the European Trading System, how we see market developments going forward and the implications for a post-Kyoto agreement, and finally what steps will be needed to truly globalize the market.
- Let me also say that Deutsche Bank is a very active participant in the carbon market since our initial participating in the Prototype Carbon Fund of the World Bank in 2000. We have also engaged in substantive dialogue with the policy community in recent years, and look forward, of course to continue this dialogue including with ICAP.

Emissions Trading Experience

- To be sure: a trading system is the most efficient method of reducing emissions especially in cases in which there are challenging emission-reduction targets.

- The experience of phase I of the ETS in which allocations were larger than actual emissions, with the result of the carbon price falling toward zero has taught the market a great deal, and I would like to single out five main points in particular:
 1. Above all, it is critical to have reliable data on company emissions and political will to avoid setting inflated caps. In fact, policymakers should consider setting caps well outside the margin of error for emission projections to avoid over-allocation.
 2. Another important lesson is that markets need a sense of “permanence”, i.e. that a trading scheme is here to stay. Only then can we incentivise innovation and technological advances and allow longer-term planning for installations.
 3. Greater use of auctioning from the beginning of any trading scheme would be beneficial from both an economic and a political perspective.
 - Economically, auctioning allowances raises funds for the public purse and could allow governments, for example, to subsidise zero-carbon energy technologies and/or vulnerable energy consumers.
 - At the same time, political support is easier to achieve for a trading scheme when the higher prices it will inevitably lead to are seen to be flowing directly into environmentally beneficial policy objectives (rather than into the pockets of the shareholders of the companies in the scheme, as is the case with free allocation of allowances).
 4. Since markets rely on information for efficiency, it is vital that the companies covered by a trading scheme should be required to report on at least a quarterly basis (rather than an annual basis as is still the case with the ETS today), as this will make for a more orderly market and hence reduce price volatility.
 5. Finally, it is also crucial that the design of a market and the setting of caps is not politicised.
- This is still a new market but there has been an exponential increase in trading volumes. But it is also a market that is driven by policy and hence your support will be crucial for setting a framework that will allow this market to grow and reach the volumes many predict.
 - It is estimated that the value of the market will rise from \$30 billion in 2006 (with \$25 billion from ETS) to \$100 billion by 2010 and \$500-1,000 by 2020.
- Significant capital has been invested in emission-reduction projects in developing countries under Clean Development Mechanism (CDM) projects

which generate credits that can be used in part to comply with the EU ETS. Key CDM projects are under way in China, and India has the largest number of registered projects.

Future Framework: What is Needed and How to Get There

- The Kyoto protocol has led to action on various fronts, and perhaps most importantly it has propelled the European Trading Scheme and the creation of the largest carbon market.
- The EU Commission has been setting the standard and wants to be a leader in renewables and clean coal technologies that employ carbon capture and storage (CCS)
 - The commitment to cut GHG emissions by 20 percent by 2020 is significant and provides a longer-term orientation for market participants
 - The tight target will lead to an increase in the price of carbon which is key to making CCS viable. For CCS to be an option, we need a price of about EUR35-40/tCO₂ compared with a price of a little over EUR 20 today.
 - Given the amount of fossil fuels available especially in China, it is crucial that we find a way that makes fossil-based but clean technologies economically feasible.
- Other countries should follow the EU in setting ambitious long-term emission reduction targets beyond the expiration date of Kyoto in 2012.
- Clear commitments are especially needed from the largest emitters, in particularly the United States, China, and India. For the US, the commitment should be in form of a binding limit. China and India should at least aspire to a firm target.
- Countries outside the EU should move at the very least in order to prevent their companies from falling behind when it comes to technological innovation and leadership.
- This also applies to Japan where the business community still firmly opposes the cap and trade scheme many in the Japanese government would like to see implemented. ICAP could become an important vehicle of support for Japanese authorities whose leadership in the effort toward a Kyoto successor will be of crucial importance as it assumes chairmanship of the G7/8 in January of 2008.
- Such actions will help setting the proper price signal today reflecting future tighter limits and bring about the technological progress needed globally over the medium-term.

- Investing in clean technologies, renewables and other climate change–related products is taking off. Investors will be looking for “winners,” i.e. companies that are innovators in the climate change space. Hence, pro-active, innovative companies are likely to be rewarded.
- In any event, given the relative size of the ETS market today and the long-term targets set by the EU, the price of carbon in the ETS will in fact be the driver for prices elsewhere

Linking Markets and the Political Process toward a post-Kyoto Agreement

- Linking of the tight cap and trade regimes in Europe and the US would send a powerful political signal to China and India that countries that have historically contributed the most to the generation of green house gases are taking a lead toward resolving the problem.
- At the same time, such an approach will make it easier for the largest emitters of today and tomorrow to join the effort. The preparedness of Chinese steel producers to join the new global CO₂ monitoring scheme by the International Iron and Steel Institute is a strong indication of the new champions’ willingness to assume shared responsibilities.
- Whether commitments will be expressed in absolute or relative (per capita) terms will at the end be a political decision but in the first instance the commitment as such must be made.
- For markets it is encouraging to see true progress in the United States, especially in California and other Western States and Canadian provinces that form WCI (Western Climate Initiative) and the Eastern States that form RGGI (Regional Greenhouse Gas Initiative).
- These trading schemes should be extended to the federal level. Markets will certainly follow closely as the Liebermann/Warner bill is moved through the U.S. Congress.
- It is imperative that the various trading schemes that exist or are in the process of being set up are sufficiently similar to allow efficient linking and the emergence of a global price for carbon. Hence, I can only underscore the significance of the declaration being signed today among governments and public authorities.
- Let me also just say a few words on what markets expect from a Kyoto successor. It should:
 - Cover the period to 2020, longer than the initial 5 years which seems to be too short for countries to meet targets, but not too long in order to avoid procrastination.
 - Maintain most of the definitions and terminologies of the current agreement

- Preserve flexible mechanisms such as CDM and JI and consider combining them into one framework with shared methodology and oversight to avoid duplication
- CERs/ERUs are currently bankable between phase 1 (2008-12) and phase 2 (2013-2020) up to a limit of 2.5 percent each country's Assigned Amounts. This limit should be removed and unlimited banking considered.

Conclusions

- Emissions trading remains relatively underutilised and could become a major tool for economic and environmental transformation.
- The world economy will benefit from inter-linked markets trading the same underlying commodity on the same terms.
- A unique tradable carbon product will provide greater liquidity and will give investors confidence that the market is here to stay.
- The EU has understood the crucial link between the carbon price and technological innovation and the US in particular should be concerned of not falling behind.
- Enhancing the understanding of the carbon markets and the benefits of market-linking amongst policymakers will set the basis for a global carbon market. And we again applaud you on your initiative.
- The financial industry stands ready to lend support to your important endeavour.