



## Practicalities of Trading - procedures and requirements

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## Outline of the Presentation

- Overall process description
- Actions for market participants
  - Preparations for emissions trading
  - Preparation of trading strategy
  - Market analyses
  - Steps of deal-making
- Lessons learned
- Summary of the presentation

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## Overall process description

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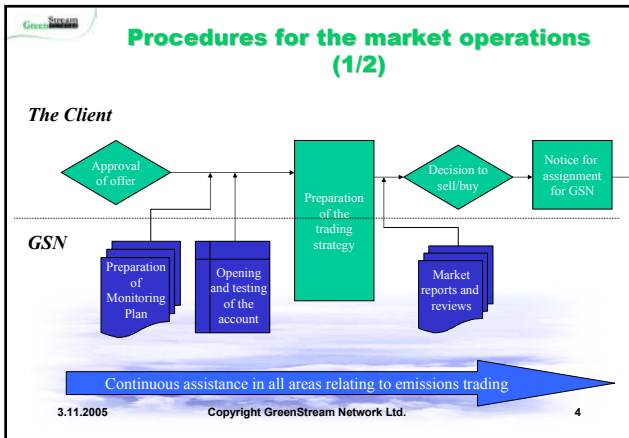
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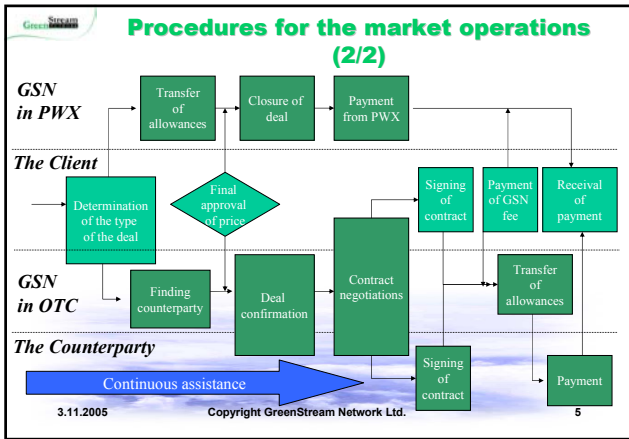
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**Preparations for emissions trading**

- Decisions about company-level responsibilities.
- Preparation of a Monitoring Plan.
- Opening of an allowance account and testing of it.
- Quality check of data collection system at facility.
- Ensuring of availability of market information.
- Implementation of the reporting structures.



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**Preparation of trading strategy**

- **Strategy is about answering questions:**
  - Should the strategy be passive or active?
  - Is the interest only in compliance or is the volume of income a topic?
  - Should the company free the money tied in the allowances?
  - Which share of the company's emissions can be predicted accurately and can thus be taken into the strategy as a fact?
  - ...and further
- **The trading strategy is also a risk management strategy**
  - Price risk
  - Volume risk
  - Trading-related risks
  - and so on...
- **Also not doing anything is some sort of strategy!**



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**Market analyses**

- **For success the key issue is to sell/buy at the right time.**
- **For analysing the markets one has to follow several factors:**
  - Allowance market prices
  - Other commodity markets
  - Weather patters
  - Climate and energy politics
  - Market players' actions
  - ... and other factors
- **Different companies have different needs; the analyses can be done weekly, monthly or quarterly.**
- **The need of information is based on the chosen strategy.**



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**Steps of deal-making: bilateral deals**

1. Contracting an intermediary (optionally).
2. Finding a counterparty candidate (intermediary).
3. Credits checks.
4. Agreement of price and volume (via taped telephone lines).
5. Sending of confirmation letters.
6. Bilateral agreement with the counterparty.
7. Delivery of the product (immediately or 1.12.2005/2006/2007).
8. Payment from buyer to seller.



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**Model contracts in bilateral markets**

	Confirmation OTC Physically Settled EUEA Transaction	IETA Emissions Trading Master Agreement	EFET Allowance Appendix
Nature	Annex to ISDA	Independent	Annex to EFET
Commodity	EUA & others	EUA & others	EUA
Netting	All	EUA	EUA or electricity
Underdelivery replacement cost	Replacement cost	Contract price + price difference + additional costs	Market price + additional costs
Excess Emissions Penalty	Can be included	Can be included	Included
Change in rules	Settlement Disruption Event	Negotiations	Negotiations, financial treshold
Force Majeure	ITL included	ITL not included	ITL included
Liability	Consequential or indirect loss	Like ISDA except for death or injury due to negligence or fraud	Like ISDA except gross negligence, fraud or intentional default

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**Steps of deal-making: exchanges (case Powernext Carbon)**

- Contacting an intermediary (optionally).
- Transfer of allowances to French account.
- Agreement of price and volume with the intermediary.
- Accepting the deal at PWX.
- The clearing bank CDC removes the allowances from the allowance account.
- The clearing bank CDC moves the payment to the seller's (intermediary's) account in France.
- Payment is transferred from France to the seller's account by CDC.



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## Lessons learned

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## Lessons Learned

- The selection of the counterparty must be done carefully.
- Deal confirmation must be done properly.
- The price can move fast; do not tie yourself into a specific price.
- Small volumes must be aggregated or sold via exchanges.
- Reserve enough time for making the bilateral contract. Read the contract text carefully.
- Use external advisors whenever needed; building in-house knowledge to cover all the required issues takes a long time.
- Even small trades bring lots of information; it is better to act sooner than later!



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## Option of externalisation

- Externalisation frees company's own resources for the core business.
- Externalisation reduces costs.
- Some activities require special know-how; externalisation brings in larger resources.
- Utilisation of external resources together with company's own experts ensures usually the best results.
- The coverage of services offered by third parties vary and the comparison of prices is not always easy.



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 **Summary of the presentation**

- Preparation for emissions trading requires several actions.
- Trading strategy is a tailor-made rulebook for trading and risk management.
- Market analyses must be good enough to fulfill the specific needs of the company.
- The steps of deal-making must be planned upfront.
- The deal-making requires careful activities; the monetary value of the deals is high.
- Exchanges are usually the easiest way to proceed.
- Externalisation of activities is possible. Challenge is to find the right balance between the quality of services and price.



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