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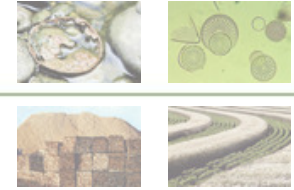
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# Carbon Market Oversight

Jonas Monast

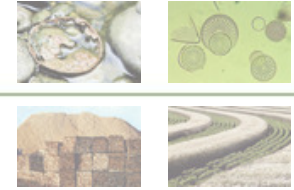
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- Financial markets typically evolve over time
- Regulatory changes often follow the development of new financial products or respond to failures in the market system
- Congress is creating the carbon market from scratch
- Purpose – achieve environmental objective in a cost-effective manner
- Opportunity to get it right at the outset
- Market should work for emitters and consumers

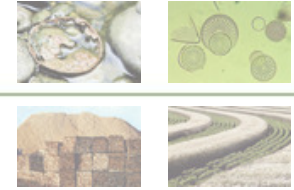




## Derivatives

- Tool for hedging risk
- Importance
  - Waxman-Markey
    - 38 year policy
    - 131 billion allowances over the life of the bill
    - Only 5 billion allowances issued in 1<sup>st</sup> year of trading
    - Derivatives provide options for long-term allowance price certainty



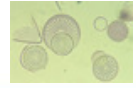


## High-profile market failures

- Petroleum futures
- Mortgage-backed securities
- Credit default swaps

Common theme: Largely unregulated markets



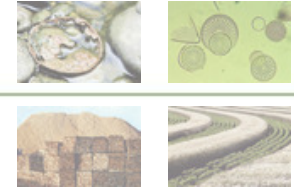


# Transparency

Tracking trading activity -- Who is trading, when, price changes

- Bids and offers
- Quotation systems
- Reporting
  - Registered exchange members
  - Brokers
- Benefits
  - Allows effective market monitoring
  - Reduces volatility

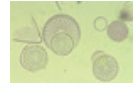




## Counterparty Risk

- Standard practice for exchanges
- Ensures that parties are creditworthy
- Limits risk
  - Members required to post a certain amount of margin to cover the maximum expected one-day loss
  - If the value of the positions held by a clearing member goes down, the member must make a payment
  - Payment must be made by early the next morning, before the market opens for trading

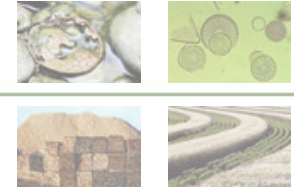




# Manipulation/Excessive Speculation

- Definitions
  - *Manipulation* – Direct attempt to affect prices
  - *Excessive speculation* – excessive risk that drives price volatility
- Best practices
  - Position limits
  - Margin requirements
  - Market monitoring
  - Enforcement





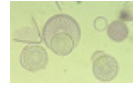
## Other issues that may affect trading activity

- Ability of emitters to abate emissions
- Number of allowances/offset credits in the marketplace
- Accounting rules





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Nicholas School of the Environment and Earth Sciences • Duke University



[www.nicholas.duke.edu/institute](http://www.nicholas.duke.edu/institute)

[Jonas.Monast@duke.edu](mailto:Jonas.Monast@duke.edu)

