

Report Part Title: LOSING OUR ADVANTAGE: THE CITY OF LONDON IN DECLINE

Report Title: UP IN SMOKE

Report Subtitle: HOW THE EU'S FALTERING CLIMATE POLICY IS UNDERMINING THE CITY OF LONDON

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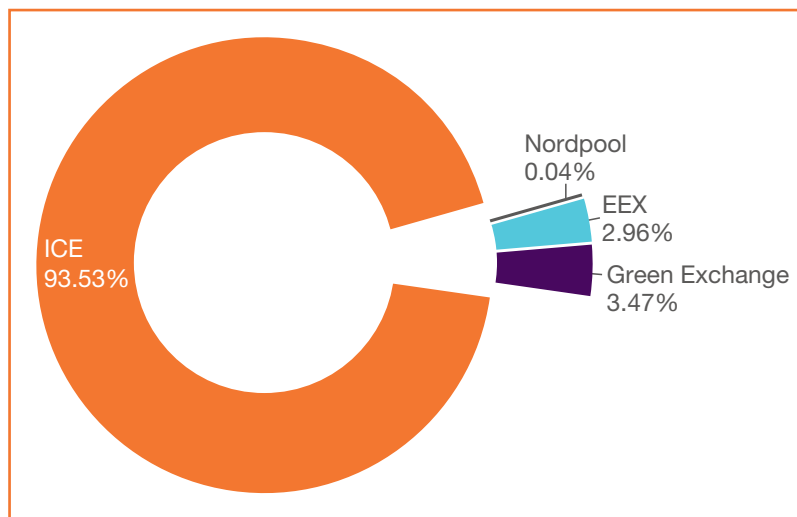
## 4. LOSING OUR ADVANTAGE: THE CITY OF LONDON IN DECLINE

The establishment of the EU ETS in 2005 was heralded as a significant opportunity for the City of London. Many of those opportunities have been fulfilled and more present themselves in the plethora of new carbon-pricing regimes being set up worldwide, as described in chapter 2. Problems within the ETS, however, pose a serious risk to the predominance of the City as the home of carbon finance and a number of jobs have already been lost. This chapter examines these opportunities and risks.

In 2006, the City of London Corporation published an early analysis of the interaction between emissions trading and the ‘substantial financial rewards’ that it could offer the City of London (CEAG 2006). The report set out the ‘prospects for London to become the leading international provider of emissions market services to the mushrooming industry’. It outlined that London had captured many ‘first mover advantages by the early implementation of the UK ETS in 2002 and by the vigorous promotion of the EU ETS’.

Many of these predictions have turned out to be accurate. In 2006, the European Climate Exchange (ECX) – based in London – dealt with more than twice the volume of emissions trades than its nearest competitor. In September 2013, the London-based Intercontinental Exchange (ICE), the ECX’s successor, had 93.5 per cent of the market and traded 27 times the volume of its closest competitor, as figure 4.1 shows (ICE 2013).

**Figure 4.1**  
Market share of active carbon exchanges



Source: ICE 2013

Total annual volumes of emissions contracts have increased every year, with volumes in 2012 nearly 100 times greater than in 2005 (ibid). In September 2012, the average daily volume of European Union Allowances (EUAs) on the ICE was 27.7 million, compared with approximately 350 million during 2005 in total (ibid, CEAG 2006). As one speaker said at an IPPR roundtable discussion in September 2013 hosted by the City of London Corporation:

**‘London is the centre of carbon futures. Its position in the carbon markets is pretty stable, nowhere else is close.’**

Global developments in carbon-pricing regimes also provide an opportunity for the City of London. Although the world is unlikely to see a global carbon market of the kind envisioned in the run-up to the UNFCCC talks in Copenhagen in 2009 (Lazarowicz 2009),

there are instances of existing and emerging carbon market regimes linking up. For example, the European Commission and Australia announced in 2012 a pathway to link the EU ETS and Australian Emissions Trading Scheme (EC 2012a). The two-way link will commence no later than July 2018, with Australian businesses allowed to use EUA to help meet liabilities under the Australian scheme from July 2015. Although the new Australian prime minister, Tony Abbott, would like to repeal the Australian scheme, this is not possible without support from the Labor Party in the Australian Senate, which is not forthcoming. Meanwhile, the European Commission is negotiating with Switzerland to link the EU and Swiss schemes.

These new international linkages mean that there will be more liquidity within the EU ETS and therefore more potential business for the City of London. As countries introduce carbon-pricing regimes, there are opportunities for the City to provide expertise to governments and regulated firms in designing and complying with monitoring, reporting and verification systems and to help establish exchanges.

Alongside these positive developments, the EUA price has collapsed, as documented in the previous chapter. The instability surrounding the ETS and the resulting crisis in demand for traded units through the CDM has jeopardised jobs in a number of banks and financial institutions, as summarised in table 4.1.

**Table 4.1**  
Developments in financial  
service institutions

Institution	Development
Barclays	Sold its carbon trading business to Tricon, a Swedish carbon trading company.
Camco Clean Energy	Scaled back its UK staffing.
Deutsche Bank	Closed its global carbon trading operations.
EcoSecurities	Laid off 85 per cent of its staff, many of whom were UK-based.
JP Morgan	Scaled back its environmental markets team.
Morgan Stanley	Closed its full-time carbon desk, now covered only part-time.
Nedbank	Scaled back its operation.
Sindicatum	Closed its London operations aside from one lawyer; moved everyone else to Singapore.
TFS Green	Scaled back its operation.
UBS	Closed its climate change advisory practice.

As well as a 'push' from the instability caused by the continued uncertainty surrounding the ETS, there are a number of 'pull' factors from other markets. As one senior banker outlined at IPPR's roundtable discussion:

**'Most activity is now in the new markets – China, California, Australia etcetera. Europe [is] very slow now. There is some residual demand for services related to the ETS but there is far more in the new markets.'**

The City of London has often benefited from being in a timezone that meant it could link the close of the Asian trading day with the start of the day in New York. This benefit appears to be disappearing in relation to carbon trading, as most of the new activity is taking place in Asia. Financial centres like Sydney and Singapore are better positioned, and a number of banks have set up a presence in those countries rather than carrying out activities from London.

Another City figure contrasted what was taking place in the far east with the debacle in Europe:

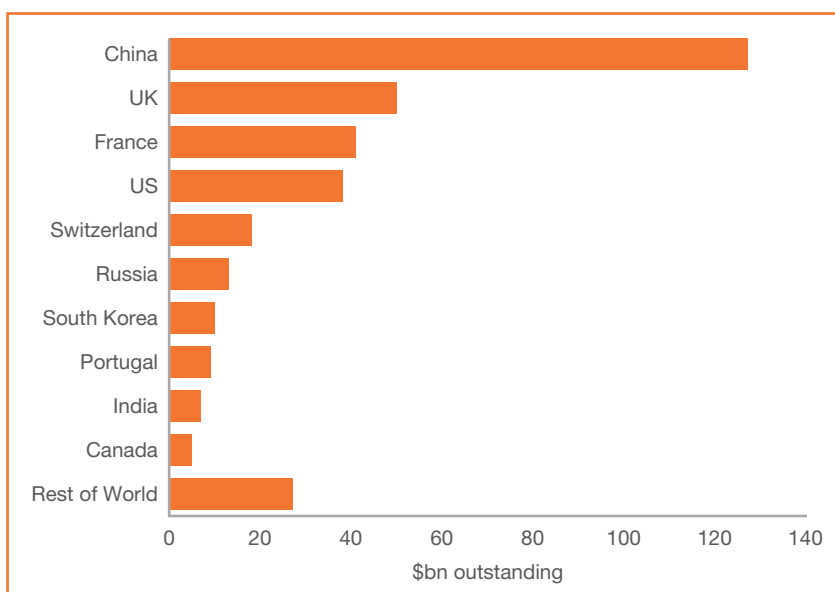
**‘Structural reform has to be seen as enduring and stable and free of policy and regulatory interference. If there is a lack confidence that that can be delivered then major questions are going to be asked about the ETS, especially against the backdrop of what is happening elsewhere, such as China.’**

A third speaker widened the discussion to put concerns about ETS reform in the context of the question about whether the UK should leave the European Union or hold a referendum on that question:

**‘In the event that we were to withdraw from the EU, it may threaten the future of the ETS itself because the UK government has been very supportive, so that is a concern.’**

Alongside these concerns about the impact of the impasse over the ETS on the City of London, there was some optimism that although carbon trading may not provide the number of domestic jobs once envisaged, there were other opportunities to deploy new products. For example, HSBC has revealed that there was a 25 per cent increase in the issuance of new climate-themed bonds from 2011 to 2012 (Climate Bonds 2013). Climate-themed bonds outstanding in 2013 total \$346 billion – predominantly for transport projects (\$263 billion) but also for energy (\$41 billion) and finance (\$32 billion). Although China is the country with the largest issuance, the UK is in second place with \$50 billion, as figure 4.2 shows. The US is fourth, with \$38 billion.

**Figure 4.2**  
Top 10 countries for  
climate-themed bond  
issuance



Source: Climate Bonds 2013

At IPPR’s roundtable, one individual saw a clear role for the City in the years leading up to the crucial 2015 UNFCCC conference meeting in Paris.

He characterised this as ‘frameworks, principles and solutions’:

**‘In terms of frameworks there’s probably a role in the regulatory side of things to encourage more dissolution from companies. Make things easier for companies in terms of what companies need to be disclosing. What is a material risk disclosure when it comes to climate change.**

**‘On principles – examples are from the [United Nations Environment Programme] Principles for Responsible Investment and Principles for Sustainable Insurance.**

**‘The easiest one for the city is solutions. Helping new companies go public on AIM<sup>17</sup> or whether its green bonds, or new instruments that help to mobilise private capital, that’s an area for the city to shine.’**

Climate risk and resilience was also mentioned as a crucial way of expanding the role of the City of London beyond carbon markets. Recent research has shown that three-quarters of businesses do not have a formal climate resilience strategy in place, so this has the potential to be a major growth area (Nichols 2013).

Although the City of London has been hit by the wider problems with the EU ETS and the resulting collapse of activity, there is a major opportunity in the broader business of carbon risk and resilience. However, for this opportunity to be realised by the City it is crucial that structural reforms to the ETS are enacted and that political obstacles are directly addressed. The next chapter sets out a number of proposals for how the scheme could be improved.

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17 Although it has been argued that in practice it would not be a tax because it would not actually set a fixed price for allowances (Tindale 2012).