

## **5.4 What Are the Process and Requirements for Trading Compliance Instruments (Section 95921)?**

This section explains the regulatory requirements for how registered entities with holding accounts may transfer allowances and offset credits from their general holding account directly to other registered entities' general holding accounts. Transfers between registered entities result from transaction agreements between the parties that set out the terms for a trade. The term "transaction agreement" means an understanding among registered entities to transfer the control of an allowance or ARB offset credit from one entity to another, either immediately or at a later date. The entity required by the transaction agreement to transfer compliance instruments is referred to in the Regulation as the "source account." The entity that will receive the compliance instruments is the "destination account."

Not all secondary market transactions will result in a change of control of allowances. For example, transactions agreements may involve financial settlement terms as well as the transfer of compliance instruments. The Regulation is written so that a transfer request is filed only when the agreement requires physical delivery of the compliance instruments to a new owner (i.e., delivery of instruments from a "source account" to a "destination account").

### ***5.4.1 What Is a Transfer Request (Section 95921)?***

A transfer of allowances or offset credits from one registered entity to another can only be accomplished through a "transfer request" submitted by authorized account representatives in CITSS to the CITSS accounts administrator (as structured now, ARB is the CITSS accounts administrator, and actions taken by the accounts administrator are conducted in CITSS). A transfer request may only be submitted based on an existing transaction agreement. Section 95921(b) explains the information needed to complete a transfer request.

The transfer request page in CITSS provides a mechanism to submit many of the details contained in the underlying transaction agreement. For a detailed description of how to conduct transfers in CITSS, please see CITSS User Reference Version 5.0, at [http://www.arb.ca.gov/cc/capandtrade/markettrackingsystem/vers5\\_reference.pdf](http://www.arb.ca.gov/cc/capandtrade/markettrackingsystem/vers5_reference.pdf). Please note: CITSS terminology designed to implement the regulatory language may include slight variations in words. For example, "submit" is reflected as "propose." See the CITSS User Reference Version 5.0 for CITSS implementation terminology and how the regulatory requirements for the transfer of compliance instruments are implemented.

The account representative must enter some of the information described below into CITSS. CITSS will automatically complete some fields. For example, when an account representative logs into CITSS to submit a transfer request, CITSS will automatically place the account number for the source account and the name of the account representative into the transfer request. Also, when a second account representative for the source account approves the submission of the transfer request, CITSS will enter the name of that representative into the transfer request.

The remainder of this guidance explains regulatory requirements, and not necessarily the details of how these requirements are implemented through CITSS.

#### ***5.4.2 What Is the Process for Transferring Compliance Instruments Between Parties as Outlined in the Regulation? (Section 95921(a) and (b))***

The transfer request process requires actions by the account representatives of both the source and destination accounts. ARB chose this approach to give account holders greater security over transfers. The following steps outline the process for transferring compliance instruments in CITSS.

- Step 1:* The process is initiated by submitting a transfer request in CITSS by either a primary account representative (PAR) or an alternate account representative (AAR) for the source account entity submitting a transfer request to the CITSS account administrator. This action opens a three-day window during which the transfer request process must be completed. The three days starts at midnight Eastern Time (ET) the day the proposal is submitted in CITSS.
- Step 2:* A different account representative for the source account must confirm the transfer request within two (2) days of the initial submission of the transfer request.
- Step 3:* A PAR or an AAR for the destination account entity must confirm the transfer request to the CITSS accounts administrator within the time remaining of the three (3) day window that begins when the initial transfer request is submitted. By taking this action the destination account representative not only accepts the transfer but confirms that the information submitted in the transfer request is correct.
- Step 4:* If the Executive Officer makes a determination that the transfer request and the transaction for which the transfer request is submitted meets the regulatory requirements, the Executive Officer will instruct the accounts administrator to transfer the serial numbers of the compliance instruments purchased into the buyer's Holding Account or Exchange Clearing Holding

Account. As implemented through CITSS, the Executive Officer's determination and instructions are made directly in CITSS.

Entities engaged in a transaction will be in violation and may be subject to penalties if the above process is completed more than three days after the initial transfer request is submitted or if the initial submission of the transfer request is submitted more than three days after the expected termination date of the transaction agreement. That is, if a submitted transfer is not confirmed within two (2) days of the proposal or if the transfer is not confirmed by the receiving entity within three (3) days of the proposal being entered, the proposed transfer will expire in CITSS and no further action may be taken on that proposal. The transfer may be resubmitted under a new proposal.

There are three instances in which a transfer request confirmation by an account representative of the destination account is not required. Two instances are contained in section 95921(a)(2) of the regulation. The first includes transfers initiated by the Executive Officer. The second case involves an entity that wishes to transfer compliance instruments from its CITSS Holding Account to its Compliance Account. For these types of transfers, the transfer is completed once an account representative submits the transfer request and a different account representative approves the transfer request. The third instance involves transfers to or from an Exchange Clearing Holding Account (section 95921(d)(3)).

#### How is this process affected by the linkage of the California and Québec Programs?

Entities may buy, hold, and sell compliance instruments issued by either jurisdiction using the transfer process outlined above. However, since the parties to a transfer do not observe serial numbers of the compliance instruments they are transferring, they will not know the origin of compliance instruments transferred when conducting transfers on the secondary markets. Registered entities will not see any difference in the transfer process as the result of linkage. Parties to a transfer will know the project identification number and origin of any offset credits they are transferring.

#### How are different types of transaction agreements identified?

The account representative initiating a transfer between entities must first identify the type of transaction agreement for which the transfer request is submitted. The account representative will choose from three (3) categories of transaction agreements:

- Over-the-counter agreement for which delivery will take place no more than three days from the date the parties enter into the transaction agreement.

- Over-the-counter agreement for which delivery will take place more than three days from the date the parties enter into the transaction agreement, or that involves more than one delivery of compliance instruments over time, or that combines the delivery of compliance instruments with the sale of other products (a “bundled” agreement.)
- Exchange agreement through any contract arranged through an exchange or Board of Trade.

The account representative initiating the transfer must complete several other information fields for all three types of transfers from one entity’s holding account to another entity’s holding account. The representative must enter the quantity, vintage and type of compliance instruments to be transferred. The type of instrument will be either a specific vintage of allowances or offsets identified by project code. The representative must also identify the account number and Entity Reference Code number for the destination account.

The remaining information fields that must be completed are specific to the type of transaction agreement that results in the filing of the transfer request. (CITSS will then provide the account representative with a set of information fields that are specific to the type of agreement identified. Be aware that the order in which the fields are completed in CITSS may differ slightly from the order in the regulation.)

What transfer request information is specific to an over-the-counter agreement for which delivery will take place no more than three days from the date the parties entered into the transaction agreement?

This category covers transfers resulting from transaction agreements that contain the simplest terms, such as spot over-the-counter sales for immediate delivery.

Representatives must enter the date on which the two parties entered into the underlying transaction agreement and the date on which they expect the transaction agreement to terminate, if there is one. If the transfer of compliance instruments is the final term of the transaction agreement to be completed, then the date the transfer agreement is initiated should be entered as the termination date. If the agreement contains financial, contingency, or other terms to be completed after the transfer of compliance instruments is completed, then the expected termination date is the date the parties expect the final terms to be completed. If the transaction agreement does not specify a date for completing terms after the transfer process is completed, then the representative may enter the expected termination date as “not specified.”

Finally, the representative must enter a price for the compliance instruments in either U.S. or Canadian dollars. Please note that section 95921(b)(6) contains a list of

instances in which the account representative may enter a price of zero. These instances will be discussed in another section below.

What transfer request information is specific to an over-the-counter agreement for which delivery will take place more than three days from the date the parties entered into the transaction agreement, or that involves multiple transfers of compliance instruments over time, or incorporates compliance instrument requirements with other product sales or purchases?

This category covers transfers resulting from transaction agreements that contain more complicated terms than simple over-the-counter sales. These terms may involve multiple transfers of compliance instruments, purely financial arrangements, or the “bundling” of compliance instruments with the sales of other products or services. Consequently, the account representative will have a greater array of information fields to complete.

Representatives must enter the date on which the two parties entered into the underlying transaction agreement and the date on which they expect the transaction agreement to terminate. If the transfer of compliance instruments is the final term of the transaction agreement to be completed, then the date the transfer agreement is initiated should be entered as the termination date. If the agreement contains financial, contingency, or other terms to be completed after the transfer of compliance instruments is completed, then the expected termination date is the date the parties expect the final terms to be completed. If the transaction agreement does not specify a date for completing terms after the transfer process is completed, then the representative may enter the expected termination date as “not specified.”

ARB created this category of transfer request to cover transfer agreements which may contain terms beyond a single transfer of compliance instruments. The account representative will have to identify whether the transaction agreement:

- Provides for further compliance instrument transfers after the current transfer request is completed; and/or
- Provides for transfers of other products.

ARB also created this category of transfer request to cover transfer agreements which may not specify price as a fixed unit price. If price is specified as a fixed unit price, the representative must enter the price for the compliance instruments in either U.S. or Canadian dollars. Alternatively, if the transaction agreement sets the price as the sum of a cost base plus a margin, the account representative must enter the cost base and the margin on a per unit basis. For example, a transaction agreement could set the base cost equal to some published price, such as the settlement price at a particular auction or the closing price reported by an exchange for some trading date. The

margin, sometimes referred to as a “premium,” is usually a fixed amount per unit. If the transaction agreement has a pricing mechanism that does not match the fixed or base-plus-margin formats, the account representative would manually enter the pricing formula into the transfer request.

Please note that section 95921(b)(6) contains a list of instances in which the account representative may enter a price of zero. These instances will be discussed in another section below.

#### What transfer request information is specific to an exchange agreement?

The account representative initiating the transfer request must identify the exchange on which the transaction is conducted as well as the contract description code assigned by the exchange to the contract. CITSS will include a menu identifying exchanges and contract codes. If the exchange or contract code is not included on the menu, the representative must manually enter them.

The account representative must then enter the date of close of trading for the contract as well as the price at the time of close of trading. For trades on the Intercontinental Exchange, the member clearing entities provide all fields to the parties to the trade.

#### Are there instances where a price need not be reported?

Section 95921(b) requires entities to report the price of the compliance instruments being transferred, but there are exceptions to this requirement. Representatives may enter a price of zero if their proposed transfer fits one of these exceptions.

Representatives would enter a zero price and indicate that their proposed transfer is:

- Between entities with a direct corporate association;
- From an entity’s holding account to its compliance account;
- From a publicly-owned utility to an entity or a Joint Powers Authority operating a generation facility as a joint venture with the utility;
- From a publicly-owned utility to a federal power authority to cover emissions associated with imported power;
- From an electric distribution utility to an entity operating a generation facility under a tolling agreement or other long-term power purchase agreement that does not specify a price or cost basis for the sale of the compliance instruments alone;
- The result of a transaction agreement requiring production of an ARB-issued offset or transition of an early action credit to an ARB-issued offset, and the agreement does not specify a price for the ARB-issued offset;

- From a transaction agreement that incorporates compliance instrument requirements with other product sales or purchases, and does not specify a price or cost basis for the sale of the compliance instruments alone; or,
- From a publicly-owned utility to an entity (including a Joint Powers Authority of which that utility is a member, or an operating agent acting on behalf of such a Joint Powers Authority) operating a generation facility from which the utility obtains electricity.

#### Why are there exceptions from the requirement to report a price?

ARB staff expects that most transaction agreements will involve a specific price for compliance instruments being transferred. Contracts that specify an aggregate payment or a basis for payment for compliance instruments transferred will yield either a price or an average value, which can be entered into the CITSS transfer request. ARB is aware that some contracts may result in transfers of compliance instruments without an explicit price. For example, contracts between electric generators and utilities may make utilities responsible for supplying the compliance instruments for power they purchase under contract. There will be no price available for this transfer because the generator does not make a payment to the utility for the compliance instruments. In this case, the utility may enter zero as ARB will already have the price for the utility's purchase of the compliance instruments, from the transfer request that initially placed the instruments in the utility's account. Other cases include contracts in which compliance instruments are transferred along with or in return for bundles of goods and services, with no basis for calculating payment for the compliance instruments. ARB will allow parties to these types of contracts to enter a price of zero rather than impute a value based on the bundles of goods and services involved.

Utility contracts which transfer allowances to generators may take the form of forward contracts, which do not fall under the prohibition against beneficial holdings as described in Section 5.7.1 of this chapter of the guidance. Allowances held in a utility's holding account count against the holding limit, but the utility can meet its forward contract commitments within the holding limit by:

- Using staggered transfer dates for different contracts;
- Using forward procurement contracts with delivery dates close to the date the utility must make a transfer; or
- Transferring allowances for its own compliance to its compliance account.

What other documentation must parties to a transfer provide to ARB?

Pursuant to section 95921(b), upon request by the Executive Officer the entities that are party to a transfer will be required to provide documentation about the transaction to ARB.

**5.4.3 How Is a Deficient Transfer Request Remedied? (Section 95921(i))?**

A transfer request may be deemed deficient before the transfer is recorded into CITSS or after the transfer is recorded by the accounts administrator. In both instances, the deficiency must be remedied, but the process differs in the two cases.

If the accounts administrator observes a deficiency in a transfer request before the transfer is recorded into CITSS, the accounts administrator will notify both entities and ARB's Executive Officer. However, only the entity responsible for the deficiency will be notified of the nature of the problem and correction needed. The entities can resubmit the request with the deficiency corrected, but this must occur within the three (3) day window that started with the initial transfer request submission. If the deficiency cannot be corrected within the three (3) day window, the entities may withdraw the request or submit a new transfer request in place of the initial deficient request. However, failure to complete the transfer request within the initial three day limit is a violation, and penalties as mentioned in Section 95921(a)(3) may apply.

If the accounts administrator finds a deficiency in a transfer request after the transfer is recorded into CITSS, the accounts administrator will notify both entities and ARB's Executive Officer. Again, only the entity responsible for the deficiency will be notified of the nature of the problem and correction needed. The entities have five (5) business days following notification from the accounts administrator to correct the deficiency. If the entities fail to correct the deficiency within that time, the Executive Officer may direct the accounts administrator to reverse the transfer.

**5.4.4 What Are the Requirements for Exchange Clearing Holding Account Transfers? (Section 95921(d))?**

Transfers to an Exchange Clearing Holding Account occur to complete trades on an exchange that uses a central clearing entity. The clearing entity, referred to in CITSS as an Exchange Clearing Service Provider, must take temporary possession of the compliance instruments being traded. When the terms of sale on the exchange are completed, the clearing entity transfers control of the instruments to the buyer. In this transfer process, the seller enters a transfer request specifying the Exchange Clearing Service Provider as the destination. The Exchange Clearing Service Provider will then file a second transfer request to move control of the instruments to the buyer.

Trades on exchanges that do not have a central clearing entity taking temporary control of the instruments, such as the Intercontinental Exchange (ICE), are accomplished by a simple transfer between the buyer and seller. The information requirements for both types of transfers are explained above in Section 5.4.2. The exchange's clearing entity will generally provide the required information to the parties to the transfer.

Compliance instruments can be transferred for clearing purposes to voluntarily associated entities through Exchange Clearing Holding Accounts. In this case, a transfer request should list the Exchange Clearing Holding Account as the destination account. All compliance instruments received by an Exchange Clearing Holding Account must be transferred to one or more destination accounts within five (5) days of receipt. Unlike the transfer request process in Section 95921(a), a transfer to or from an Exchange Clearing Holding Account does not require confirmation by an account representative of the destination account. Also, unlike Section 95921(a), a request to transfer compliance instruments from an Exchange Clearing Holding Account does not require confirmation by a second account representative of the source account

***5.4.5. What Are the Transaction Record Requirements for Entities with Exchange Clearing Holding Accounts? (Section 95921(h))***

Entities with Exchange Clearing Holding Accounts are required to provide transaction records to ARB within 10 calendar days of a request from the Executive Officer. In addition, transaction records with the data required in 95921(b)—specifically, Holding Account numbers for the source and destination accounts—must be kept for 10 years. Holders of Exchange Clearing Holding Accounts are required to include the information contained in section 95921(b)(5) in transfer requests, as they handle exchange transfers.