California Air Resource Board

Potential Amendments to the Regulations Governing Greenhouse Gas Emissions and Market-Based Compliance Mechanisms

Discussion Draft Issued January 31, 2014

Comments of Morgan Stanley Capital Group Inc.

Morgan Stanley Capital Group Inc. (MSCG) appreciates the opportunity to submit these comments on proposed changes to the Cap-and-Trade regulation, issued for discussion on January 31, 2014. These comments address only the incremental changes from the proposal reviewed by the Air Resources Board at its meeting on October 25, 2013. Comments previously made on proposed changes in that version, as a general matter, still represent the views of MSCG, except where the incremental changes of 1/31 are responsive to, or otherwise change the relevance of those prior comments. For any follow-up communication, please contact Steve Huhman at (914) 225-1592, or via e-mail at [Steven.Huhman@morganstanley.com](mailto:Steven.Huhman@morganstanley.com).

1. With regard to the new defined term, “Expected Termination Date”, MSCG finds confusing the interaction of this new term with the term “Termination Date”. We appreciate ARB’s efforts to better define and clarify reporting requirements, and to create reporting requirements that better match commercial practices, and we presume that ARB’s revision is in this spirit. However, it is unclear how an “expected” termination date differs from a simple Termination Date. Typically, we would think that the “expected” termination date is the contractual termination date. Is the new term intended to describe a situation where no termination date is contractually specified, and the ARB desires the submitter to estimate such a date? Some additional clarification of the underlying intent behind two so nearly identical terms, without an obvious distinction of when each applies, would be appreciated.
2. MSCG appreciates ARB’s responsiveness to prior comments about the overreach of requirements for registration of an organization’s employees who have knowledge of Allowance transactions and related information, as described in Section 95830(C)(1)(I). The revised language appears to have substantially eliminated the need to register people with casual or incidental knowledge of such transactions. This is a major improvement. Some concern remains, however, with regard to the term “review”. Does ARB intend this to mean any person who simply is authorized to “look at”, the various holding, compliance, etc. accounts? Or is “review” in this context intended to capture someone who “reviews” a transaction in the sense of approving it for execution? MSCG reiterates its concern about the administrative burden imposed by requiring registration of more personnel than absolutely necessary, and advocates that the individuals deemed “necessary” should only be those authorized to transact in the relevant accounts. To the extent ARB is not willing to so restrict registration requirements, we would urge ARB to only include those who “review” transactions in the sense of having some approval or decision making authority over transactions, and not include those who merely “see” transactions or data. Last but not least, whatever ARB decides, we request that the intent behind “review” be clarified.
3. In Section 95912(d)(4)(E), covering requirements to maintain auction participation eligibility, ARB proposes to require “an attestation disclosing the existence and status of any ongoing investigation or an investigation that has occurred within the last ten years with respect to any alleged violation of any rule, regulation, or law associated with any commodity, securities or financial market…”. MSCG appreciates that ARB has a legitimate interest in monitoring the reputation and trustworthiness of participants in its markets. It is, however, commonplace for market participants like MSCG to be subject to a variety of investigations (both formal and informal), data requests, settlement discussions and the like. This is due to both the large number of regulatory bodies with oversight over our various business areas, and the multitude of complex regulations in force. Moreover, such investigations may not necessarily be (and often may never become) public. The breadth of the proposed requirement, however, creates administrative burdens that we do not believe are commensurate with the risk posed to ARB markets. For that reason, MSCG suggests that the requirement be revised to require disclosures of only those matters that are matters of public record, or if not previously disclosed, those matters where the agency initiating the matter has not expressly required MSCG to maintain the confidence of the matter. This approach is consistent with other requests typically promulgated by sponsors of Requests for Proposals in many markets.
4. With regard to Section 95921(a)(3), the proposed new language establishing a violation and authorizing penalties for transactions not completed after three days from submittal of a transfer request is puzzling. First, once a transfer request is submitted, it is ARB that controls when it takes place, not the parties to the transaction. So, in what circumstances could a transfer not take place, except ARB’s failure to perform? And in that circumstance, why would it be equitable to find parties who submitted the request to be in violation and subject to a penalty? The only situation MSCG can conceive is one where a transfer request is submitted by one party (presumably the source account holder), but the recipient account counterparty fails to confirm. If this is indeed the case, the proposed “violation and penalty” remedy seems to be disproportionate to the offense. If violations and penalties are to be assessed for failure to confirm, which party would be deemed the violator - - source or recipient? It is not clear why failure to confirm should result in anything other than ARB simply refusing to execute the transfer. In conclusion, MSCG urges ARB to clarify what sort of problem(s) this section is attempting to address, and unless it becomes clearer that such problem(s) creates a significant burden or disruption, that it not hold out the possibility of a violation and penalty sanction.
5. MSCG greatly appreciates and strongly supports the proposed language in Section 95920(f)(1)(B), General Prohibitions on Trading, which makes it clear that a contract for future delivery of allowances will not be viewed as constituting the prohibited act of holding compliance instruments in one’s account for another entity.