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Banking on carbon assets

A new regulatory environment for greenhouse gas emissions could hold good news for banks.

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For the foreseeable future, the global financial-services sector will be wrestling with the grim realities of credit losses, deleveraging, and challenges to traditional business models. With dramatic industry restructuring already underway and a clear need for players to concentrate on the here and now, it would be easy to lose sight of a nascent but significant long-term opportunity: facilitating carbon trading.

By placing a value on greenhouse gas emissions, regulators have created a new asset class—carbon allowances. The European Union, for instance, issues allowances to companies in the industrial and energy sectors, stipulating that companies can emit capped levels of carbon emissions during the year. Enterprises that overshoot their allowances can buy supplementary ones from companies that have a surplus. China is discussing plans for a similar scheme, and the United States may introduce one soon as well.

Many banks, including Barclays, Merrill Lynch, and Deutsche Bank, already profit from trade in this new asset class, which had a market value of about €65 billion in 2007. By participating in those transactions, banks earned around €500 million in revenues last year. Trading volume could grow to €2 trillion by 2020—more than double the size of the global commodities derivatives market in 2007. By helping to transform today's assortment of mainly OTC deals into tomorrow's global commodity, banks could gain revenues of €3 billion to €5 billion.

These figures, a mere drop in the bucket compared with the losses many banks currently face, are almost half of the annual trading revenues realized in 2006 by banks across all commodities. Firms hoping to participate in these new markets have a critical role to play today in the creation of universal standards for market transparency, product specifications, and contract terms; the provisioning of liquidity; and the development of regulation to encourage large-scale trading by blue-chip companies.

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James Twining is an associate principal in McKinsey's London office.

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