European Union Emissions Trading Scheme

INCUBEX

Cap & Trade

The EU ETS was launched in 2005 in order to help tackle climate change. It sets a Europe-wide annual cap on CO2 emissions which reduces each year. From 2005-2019 the reduction goal was approximately 1.5%. In 2020 the reduction was set at 1.74%, and from 2021 onward it is set at 2.2%. Companies under the programme may trade allowances known as EUAs, each equivalent to 1 tonne of CO2, setting a price per tonne for carbon.

EUA Auctions

EEX hosts primary EUA auctions on behalf of EU member states as well as a liquid secondary market including spot, futures and options contracts on EEX.

Market Players

- Energy sector
- Industrial sector
- Utility companies
- Financials: banks, trading houses, hedgefunds, trading firms
- Aviation sector

Four Phases:

Phase I: 2005-07 – pilot phase

Phase II: 2007-12 – cap lowered by 6.5%

Phase III: 2013-20 – cap lowered by 20% (already achieved)

Phase IV: 2021-30 – aim to increase pace of emissions cuts to 43% compared to 1990

Historical Price Chart - Best Performing Asset Class in 2018

From January 2018 the price of EUAs has increased 4-fold. There also has been substantial growth in the number of trading participants exponentially increasing as more financial players have got involved and the Market Stability Reserve (MSR) began to take effect. The substantial dip in March 2020 follows the global trend across all markets as a result of the coronavirus pandemic, reaching lows not seen since June 2018.

Facts

- 1 EUA is a certificate to emit 1 tonne of CO_2 or CO_2 equivalent
- Total annual cap is approximately 1.6bn EUAs
- The EU ETS covers approximately 11,000 energy intensive installations in the 28 EU Member states plus Iceland, Liechtenstein and Norway
- Sectors included: Energy intensive sectors including oil refineries, steel works and iron production, aluminium, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals
- The EU ETS covers approximately 40% of the carbon footprint in Europe
- Ultimate aim is to reduce GHG emissions by 80-95% by 2050 compared to 1990
- Total emissions have been declining by 45mt per year during Phase 3 (between 2017 and 2018, emissions decreased almost twice as fast as the cap)

Supporting Prices: Backloading and Market Stability Reserve (MSR)

Backloading was the first step to tackle the large surplus – it delayed the supply of EUAs into the market in the short term by postponing some auctions.

The MSR supports prices by removing surplus EUAs from the market. Beginning on 1st January 2019, it reduces new supply by cancelling government auctions, until the calculated surplus falls below a specified threshold.

The Union Registry and The EU Transaction Log

The Union registry is an electronic accounting system that ensures the accurate accounting of EU allowances issued under the EU ETS and international credits.

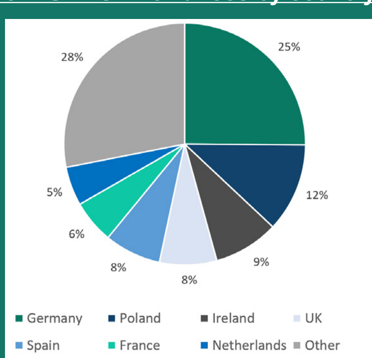
EU Aviation Allowances

EUAAs – Airlines flying into or out of Europe may comply with the EU ETS using EU Aviation Allowances (EUAAs) or EUAs.

CORSIA - Carbon Offsetting and Reduction Scheme for International Aviation

- Global market based measure to offset aviation emissions growth
- Phase I: 2021-2027 - Voluntary 85% coverage
- Phase II: 2027 – Mandatory ~99.5% coverage

Share of EU ETS Allowances by country (2018)



Primary and Secondary Market

During Phase III of the scheme (2012-2020), 57% of the total amount of allowance will be auctioned, while the remaining allowances are available for targeted free allocation to industry.

2018's secondary market volume exceeded 13 billion tonnes as either spot, futures or options contracts.

Other ETS Schemes

A number of cap and trade systems are in place or being developed worldwide, including North America (they have regional based ETS such as CCA and RGGI), Switzerland, New Zealand, South Korea, China, and

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