



SUSTAINABLE MARKET SOLUTIONS FOR GLOBAL ENVIRONMENTAL PROBLEMS

EU ETS

World Bank February 15, 2005

Andrei Marcu
President

International Emissions Trading Association



Description of EU ETS



European ETS - Scope

Creation of a large, competitive, cost effective Market

- Encompassing more than 25 Countries
 - 15 EU members states
 - + 10 accession countries
 - + possibility to link with Kyoto parties
- 4'000 – 10'000 installation from 4 activities
 - Energy activities
 - Production and processing of ferrous metals
 - Mineral industry
 - Production of paper, board and pulp from timber



European ETS – Permits and Allowances

Permits:

- Site-specific
- Set monitoring and reporting obligations (EU Guideline)
- Set obligation to hold allowances matching emissions each calendar year
- Non-transferable

Allowances:

- Issued by Member States
- Entitlement to emit a ton of CO₂ (e)
- Held in the national registry system
- Tradable

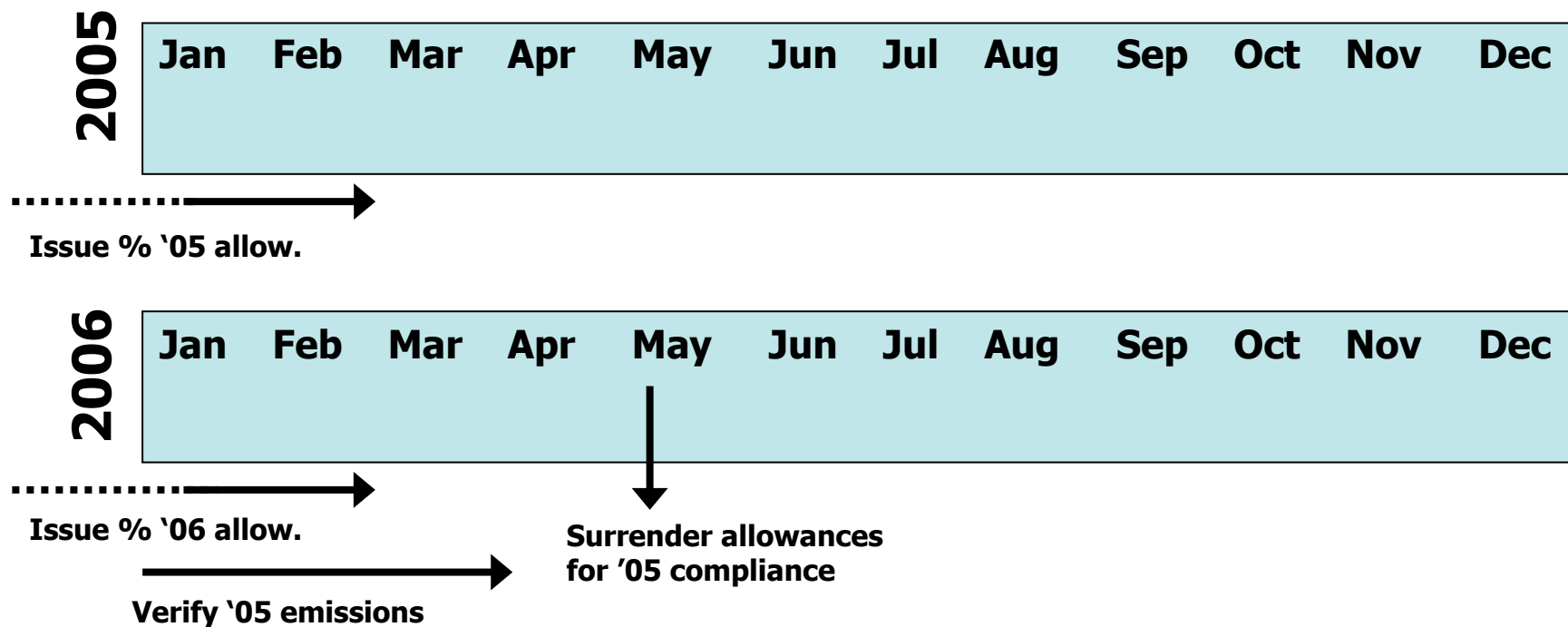


European ETS - Allocation, Compliance, Linking

- Allocation
 - Member State sets quantity, timing, percentage
 - Approved by EC – to comply with provisions
 - 2005-7: at least 95% free
 - post 2007: at least 90% free
- Compliance
 - Annual
 - Potential for banking & borrowing
 - Penalty (40 € - 100 €)
- Linking Directive



European ETS – Banking and borrowing





Linking Directive

- CDM credits accepted independent of the KP
- No nukes
- No LULUCF
- Hydro – WC on Large Dams
- Review as part of the 2006 review
- Amount of CER per installation to be determined by each MS



How can CERs and ERUs be used in the ETS?

- EU ETS and Linking directive
 - Under the EU ETS each installation is required to surrender a number of allowances corresponding to their verified emission volume for each calendar year
 - In the event that an installation has insufficient allowances for compliance, the shortage can be covered by:
 - Purchasing additional allowance from the market
 - Surrendering a specified number of CERs and, from 2008, ERUs from its operator's holding account (article 21 [2] EU Registry legislation)
 - Surrendering of CERs and ERUs are subject to specified preconditions



Preconditions for surrendering CERs

- Starting 2005 CERs can be used for compliance
 - Up to a percentage of the allocation to each installation - specified by its Member State (additional criteria under Annex III of the Directive)
- CERs are not converted into EU allowances – but entered directly into the surrendered allowance table
- UNFCCC ITL required for the transfer of CERs into an EU registry (?)



Preconditions for surrendering ERUs

- Kyoto Protocol enter into force is required for establishing the Supervisory Board responsible for the approving of JI projects;
- ERUs are not converted into EU allowances – but entered directly into the surrendered allowance table;
- UNFCCC ITL required for the transfer of CERs into an EU registry (?)



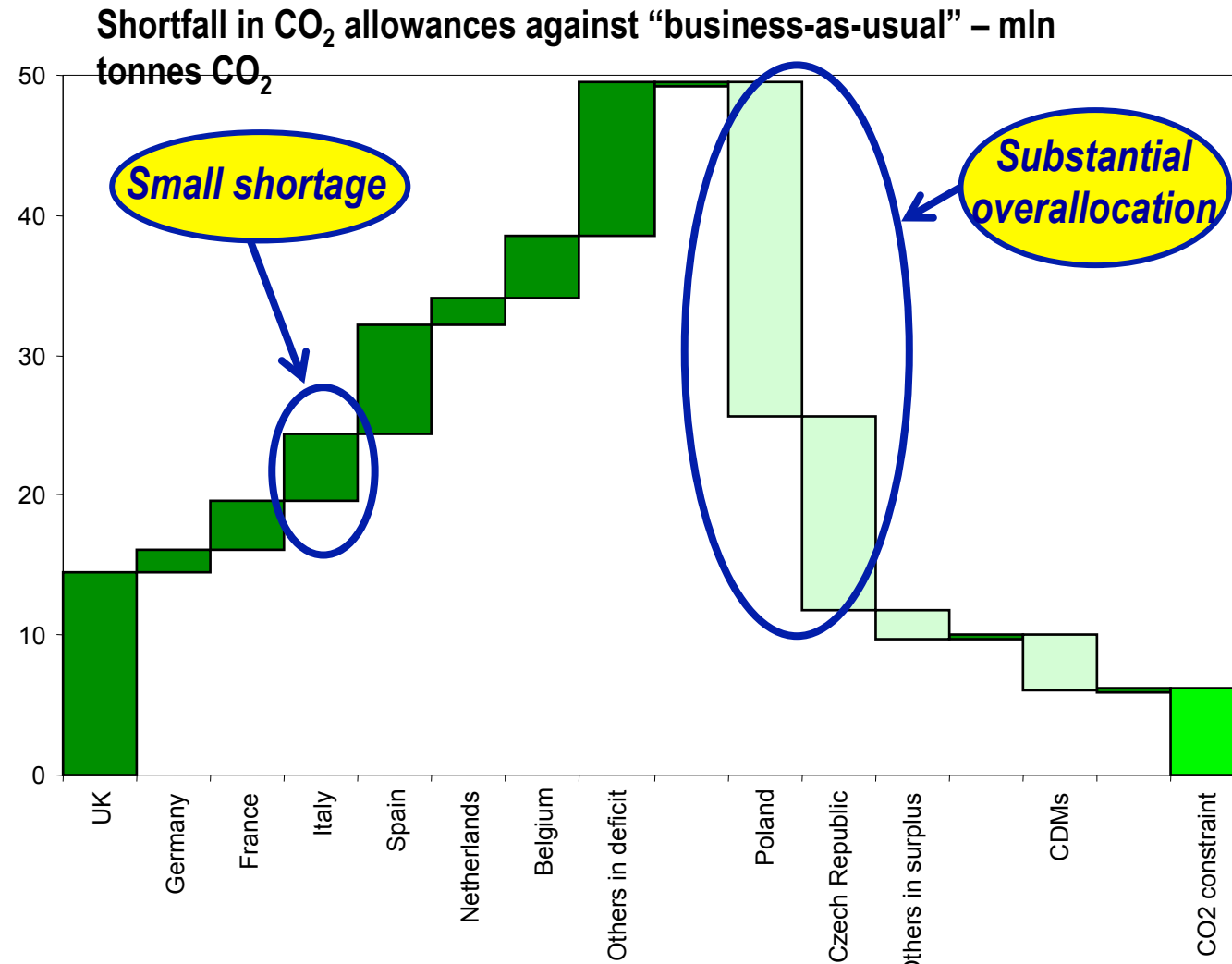
Will Europe be CO₂-constrained?

- Comparison of NAPs versus “business-as-usual”
 - Basis is submitted NAPs

Small shortage in old EU 15 ...

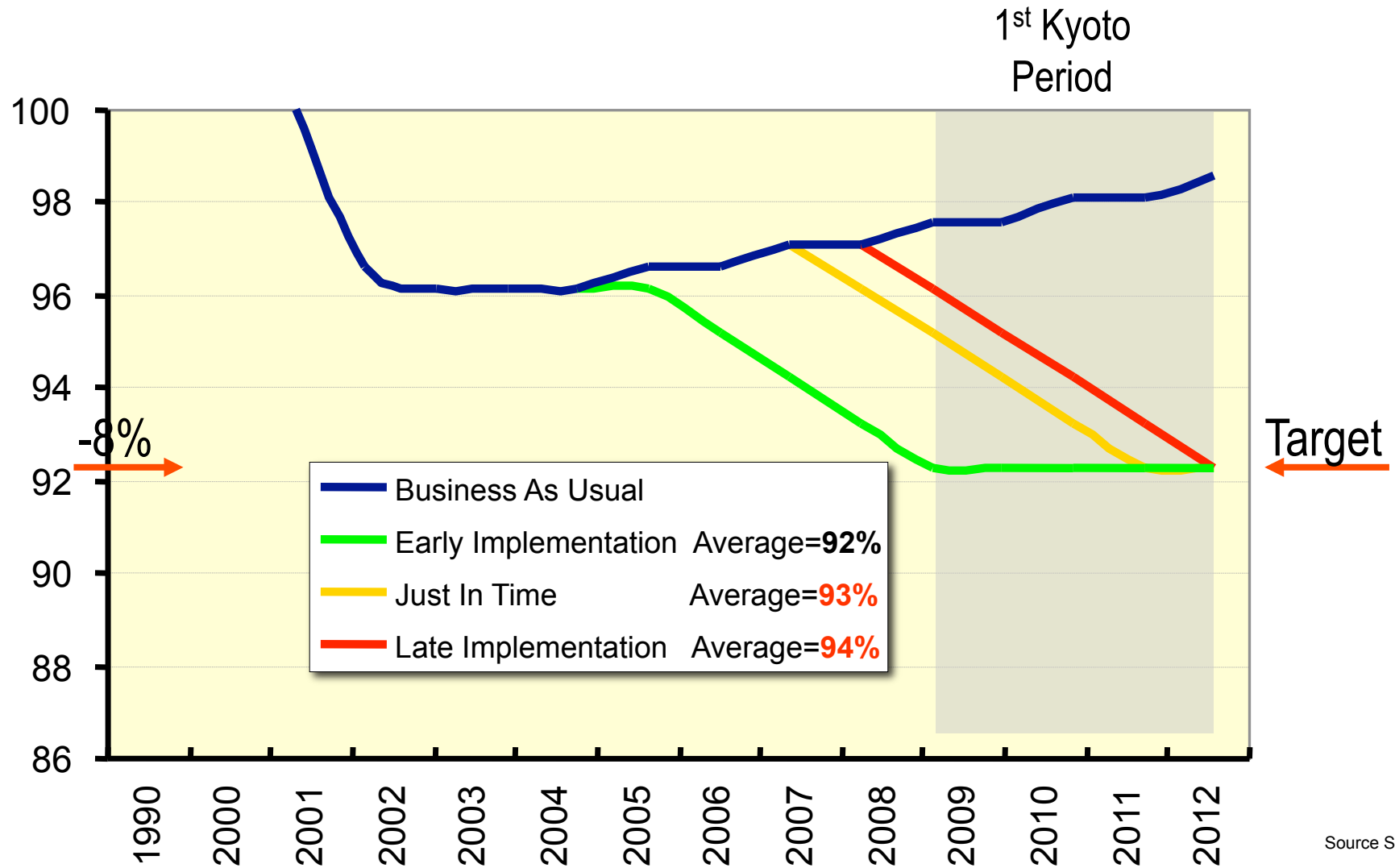
... plus plenty of “hot air” ...

... equals negligible CO₂-constraint





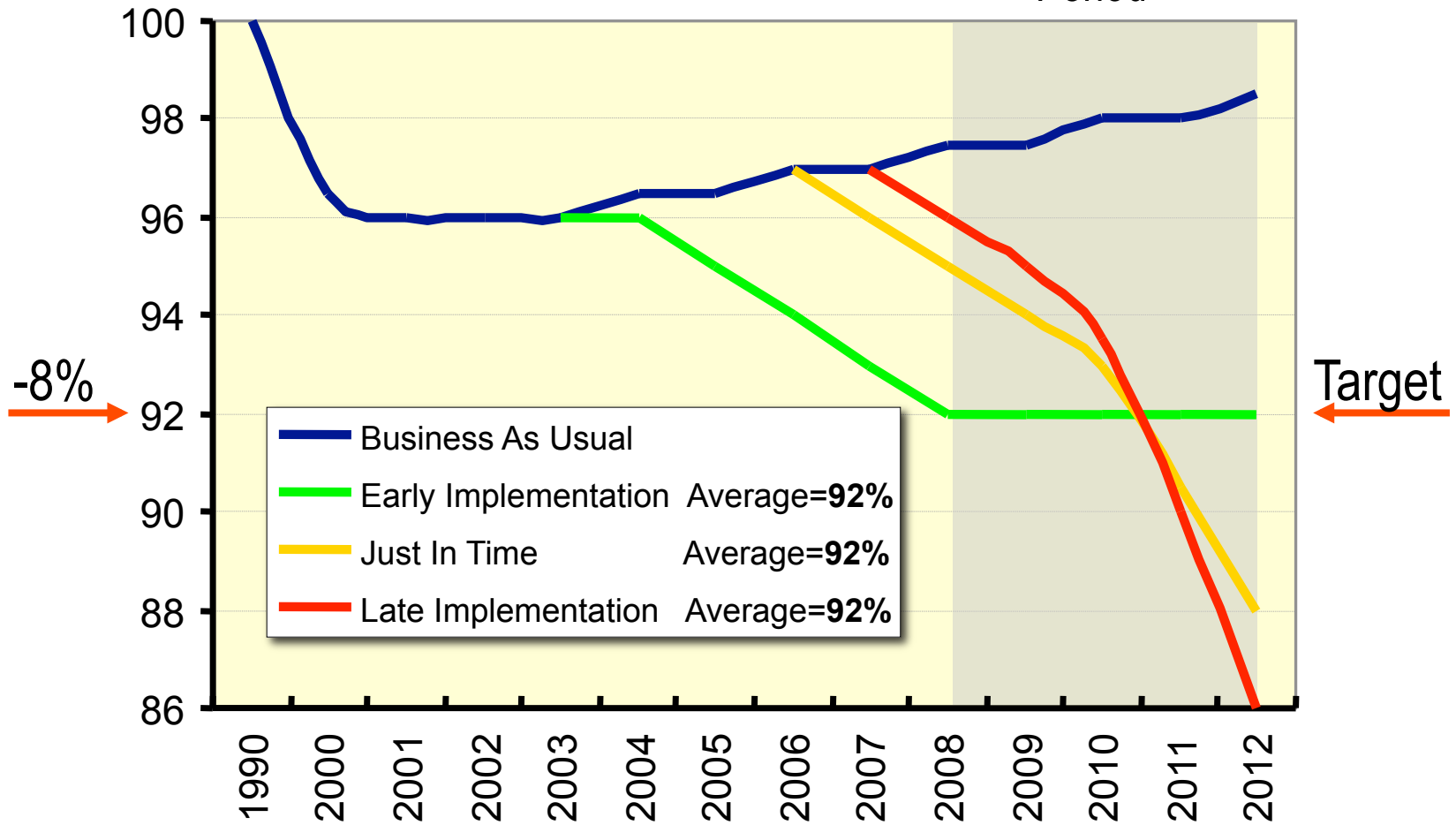
Meeting the EU Target (I)





Meeting the EU Target (II)

1st Kyoto
Period



Shell slides



Emission reduction projects take time . . .

- Major projects can take 3-4+ years due to;
 - Capital allocation and approval process
 - Planning approval, stakeholder engagement etc.
 - Construction lead times
 - Alignment with facility shutdown schedule*
 - Even minor projects can take up to 4 years due to;
 - Alignment with the facility shutdown schedule*
- * A refinery will have a major shutdown every 3-4 years. On average, expect a lead-time of 2+ years for a minor project



European Union

- Unsolved Implementation Issues
 - Registries
 - Transfers of project allowances in to ETS
 - Transferring of EUAs out (non-surrendered)
 - Company Trading Authorisation
 - FSA (Financial Regulation)
 - VAT (actually solved!)
 - Accounting
 - Contracts
 - Liquidity



EU ETS – Current Issues

- **European Commission:**
 - Currently making decisions on approving final set of NAPs
 - Kyoto targets now very likely for 2nd Phase
- **Administrative**
 - Company Trading Authorisation
 - Contracts – IETA, ISDA, EFET
 - VAT treatment of allowances –guidance emerging
 - Trading Authorisation – covers “Investment activities”. In UK FSA “guidance” suggests some trade types (derivatives) may need authorisation, may be different in other MS depending on classification of allowance
 - Accounting for allowances on the balance sheet (IFRIC)



Brokers and Exchanges

- Currently over-brokered, fractured market (10 brokers!)
- Point Carbon's non-cleared exchange
- Many exchanges planned: EEX, ECX, AAX, PowerNext, Nordpool etc.
- Credit enhancement of limited value to main players
- In the beginning exchanges will cause a fractured market to become more so
- Allowance trading will end up split between brokers and exchanges (as other commodity markets are)
- In the end liquidity will concentrate in 4 brokers and 1 or 2 exchanges

Source: Barclays Capital, IETA Annual Forum, Nov 4 2004



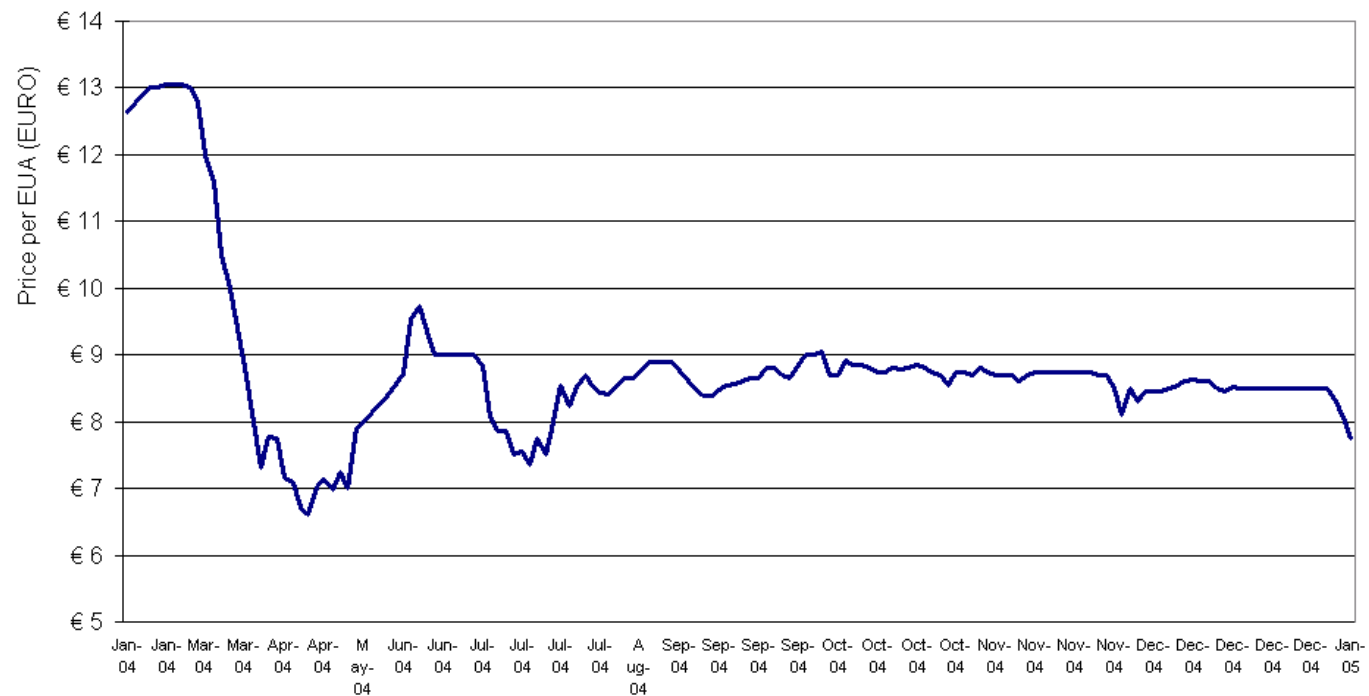
EU ETS – The Market

- Market characterised by forward trades of 10,000 – 25,000 allowances (larger trades reported)
 - Traded contracts for 1 Dec 05, 1 Dec 06 and 1 Dec 07 Delivery
 - Credit and contract major issues with forward trades
 - Current EUA prices ONLY for large companies with contracts agreed and credit approved – difficulties for small
- Reasonable activity in trades of EU allowances.
 - Over 9 million allowances have traded for all delivery years
 - Over 70% for 2005 Delivery
 - Recent Price range €7.70-8.00 per allowance.
- Market liquidity growing
 - Early market susceptible to sudden price changes
 - Market stabilised over the last month as depth has increased
 - Development of spot market (end Feb 05 when allowances allocated) will ease credit and contract issues



Reported EU Allowance Price – UPDATE THIS

EU Allowance Price Curve (2005 Delivery)





Why have prices fallen in 2005?

- Many reasons suggested
 - Mild winter in Europe
 - Scandanavian rain filling hydro reservoirs
 - Increase of 19.8 MtCO₂ in UK allocation
 - Move from trading on politics to fundamentals
 - Market Makers playing an increasing role
- But note
 - Market still thin and concentrated in UK, Germany, Netherlands

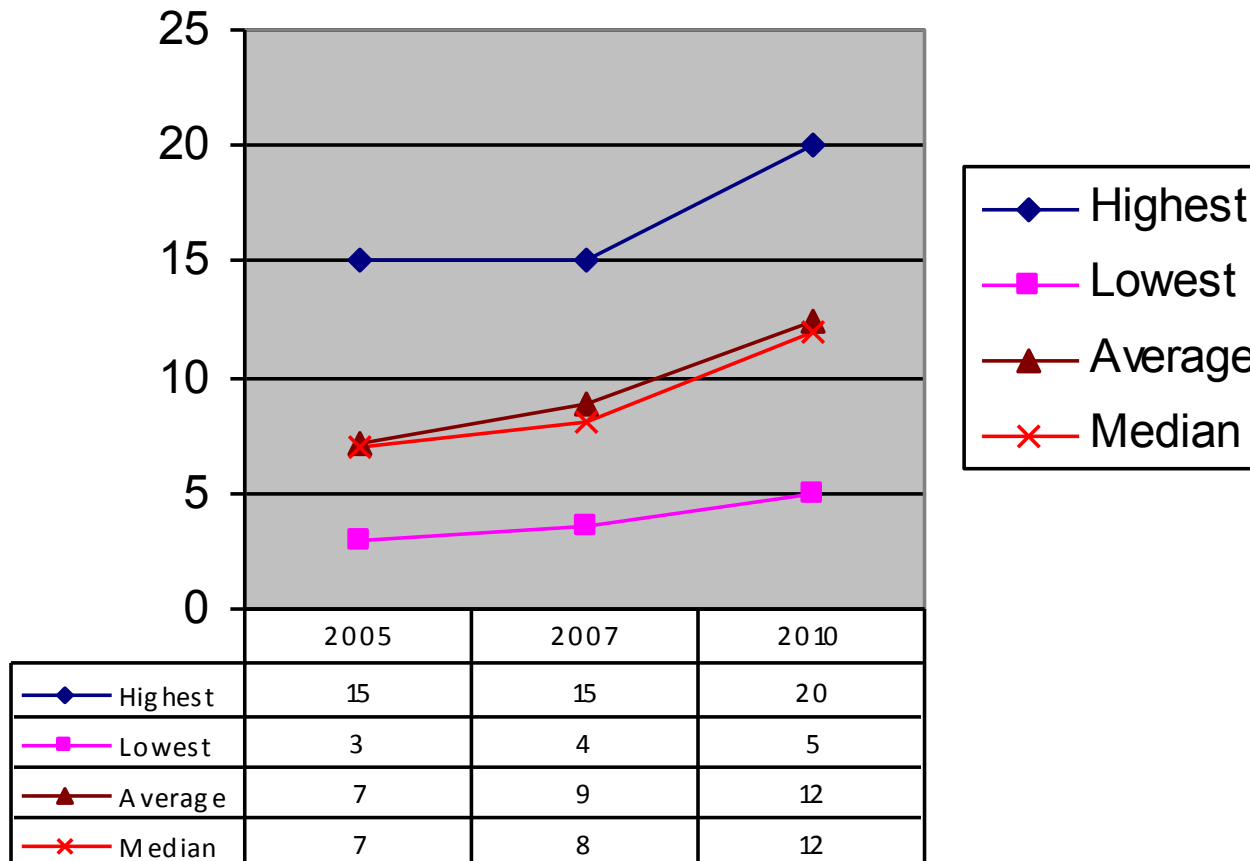


Current Prices (Correct at 7 Jan 05) UPDATE??

Commodity Type	Vintage Year	Price range (Offer) per tonne CO2e
Kyoto Compliance Tools		
CDM - CERs	2000 - 2012	EUR 4.50 - 6.50
JI - ERUs	2008 - 2012	EUR 4.00 - 6.00
Commodity Type	Vintage Year	Bid / Offer per allowance
National Compliance Tools		
UK allowances - Bid / Offer	2004	GBP 3.50 / 3.80
EU allowances - Bid / Offer	2005 Delivery	EUR 7.60 / 7.80
EU allowances - Bid / Offer	2006 Delivery	EUR 7.60 / 8.10
EU allowances - Bid / Offer	2007 Delivery	EUR 7.70 / 8.20

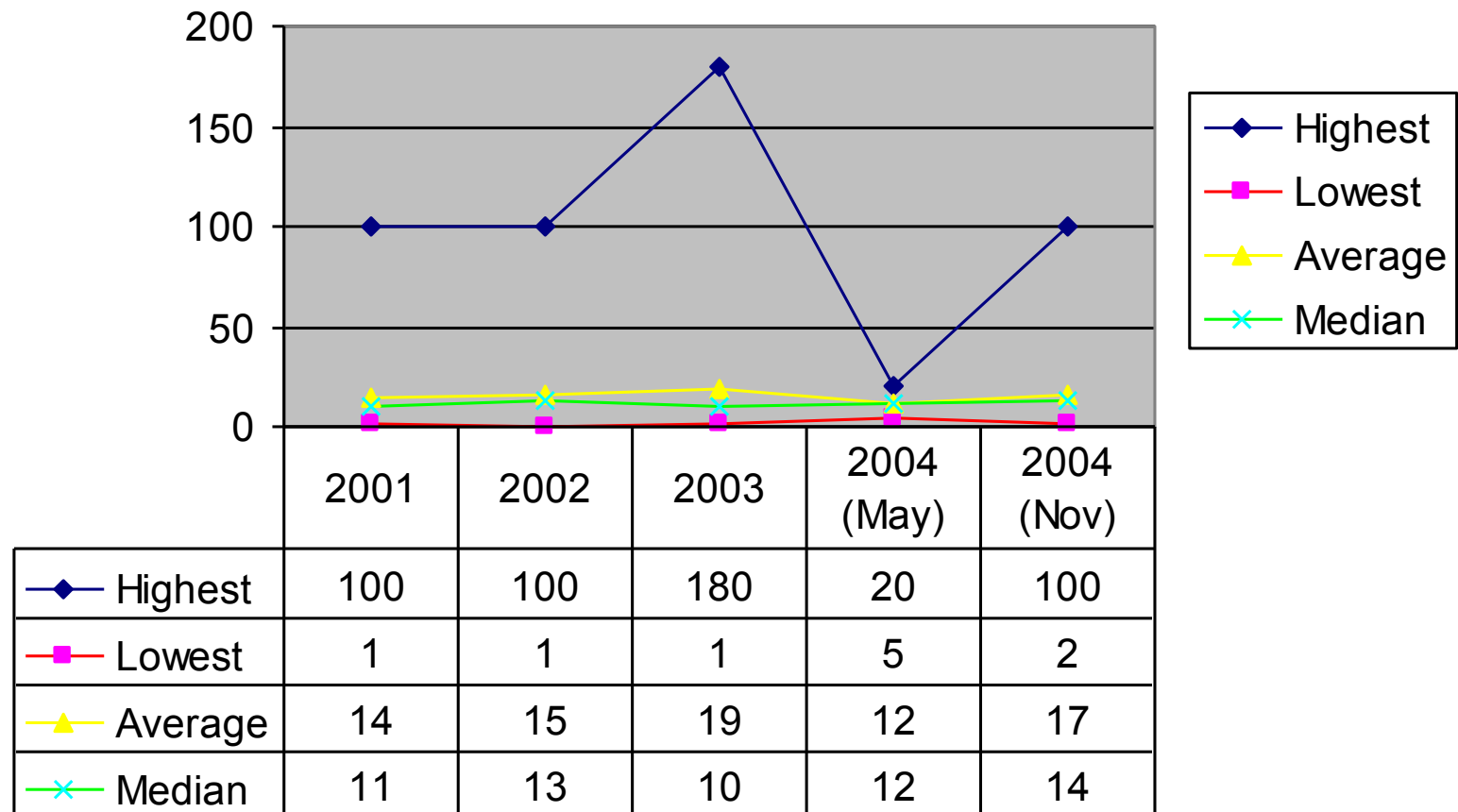


What will be the price of a AAU/EU Allowance (€)





What will be the price of a AAU/EU Allowance in 2010 (€) – views since 2001





SUSTAINABLE MARKET SOLUTIONS FOR GLOBAL ENVIRONMENTAL PROBLEMS

For more information

International Emissions Trading Association

www.ieta.org

Andrei Marcu – President

marcu@ieta.org