

EU ETS Reform and MSR Review








An analyst perspective

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The EU Climate Law and how it is affecting the EU ETS

| 2030 ambition | ETS vs ESR* emissions | Rebasing, early action |
|--|---|---|
| <p>55% net reduction Position represented by Commission and Council </p> <p>60% gross reduction Position by Parliament </p> <p>Trilogue negotiations to continue, 55% net target expected outcome </p> | <p>Current legislation 40% of overall 2030 emissions under ETS, 60% under ESR </p> <p>Impact Assessment** Split to be shifted towards 35/65, i.e. increased emission reduction burden on EU ETS </p> | <p>Rebasing New baseline for LRF, effectively one-off reduction of cap </p> <p>Early action Implementation in 2026 as default option, but early action (e.g. from 2024) could ease the transition </p> |
| 2030 headline target | | TP4 trajectory |

2030 cap

Determined after evaluation of 2030 ambition and ETS burden

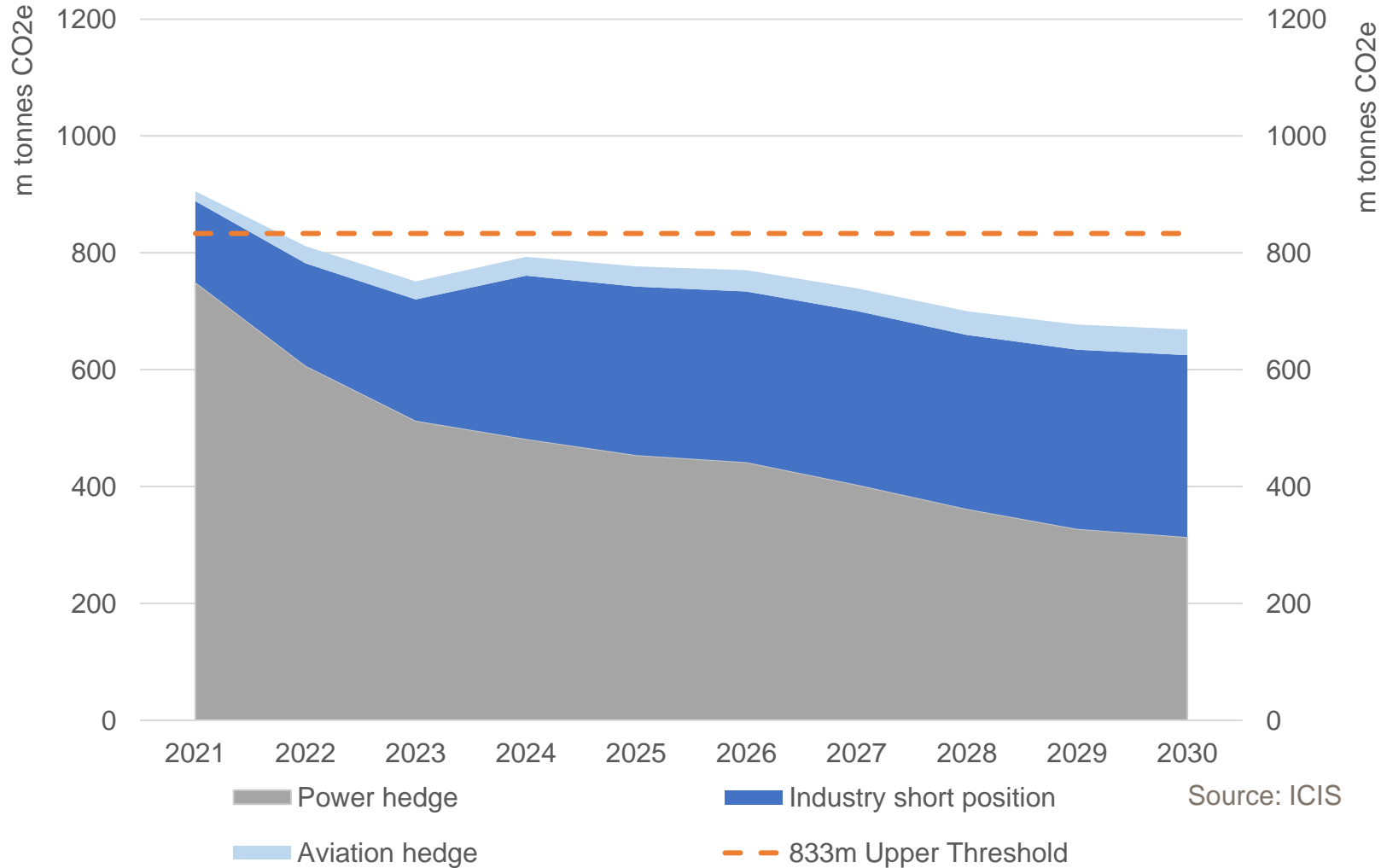
TP4 cap

To be determined once starting and end point are defined

* ESR = Effort Sharing Regulation, sectors not covered by EU ETS

** Published by the European Commission in September 2020

MSR threshold in the hedging context

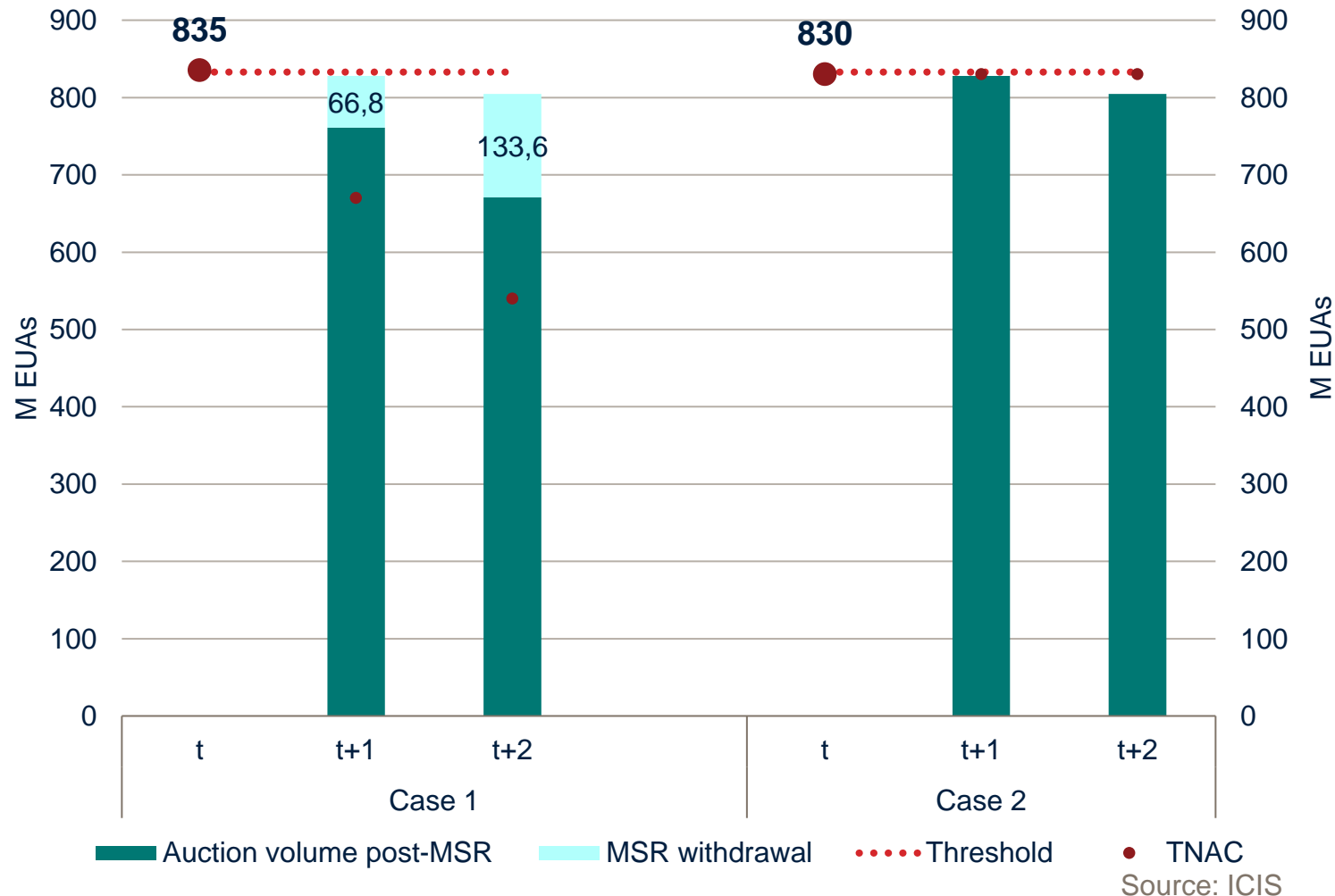


Some surplus is needed for market liquidity

- Upper threshold not in line with utility hedging
- Industry short position growing



The yes/no issue – uncertainty with fixed thresholds



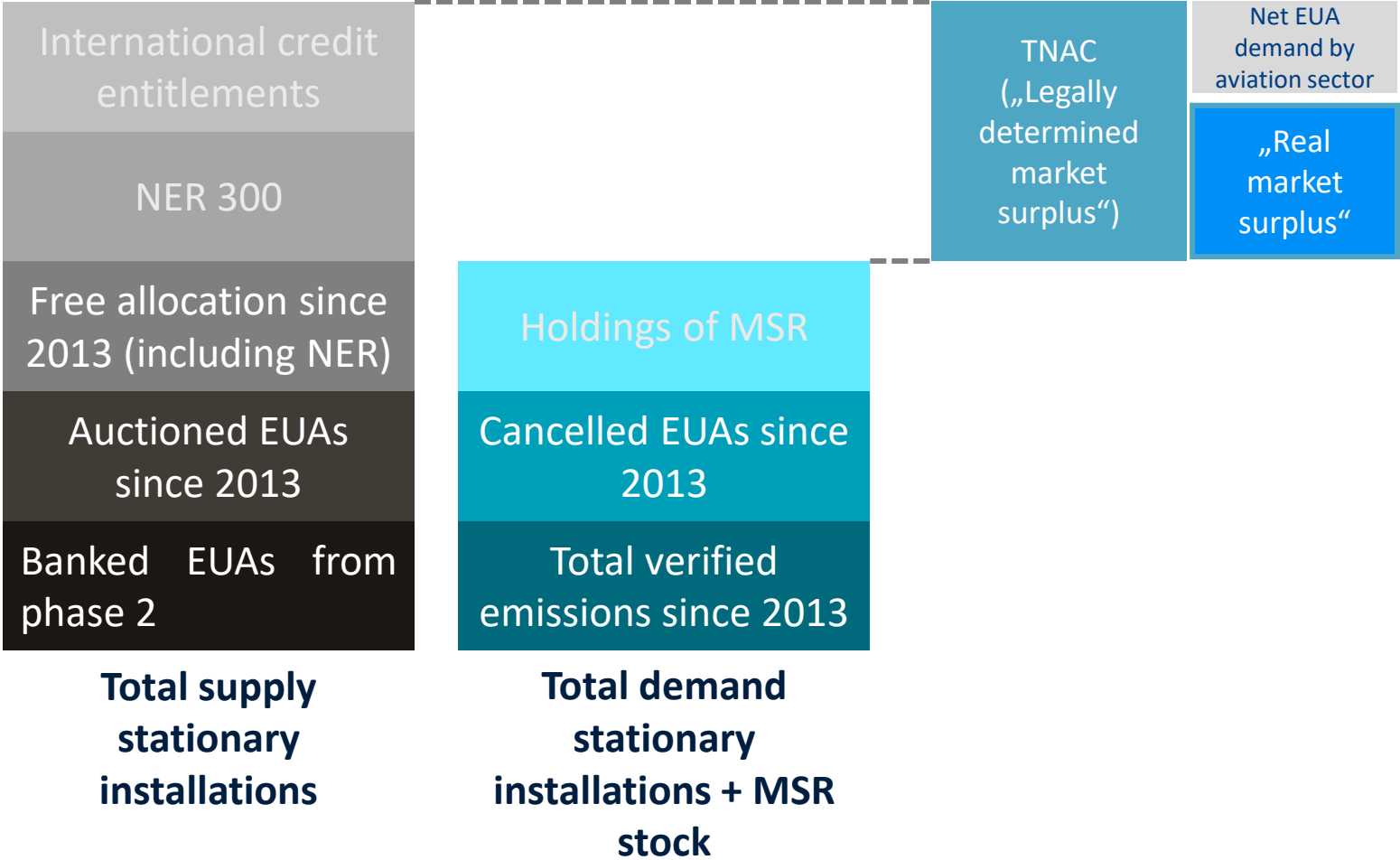
200m/100m

Minimum amount of allowances to be withdrawn with 24%/12%

Step function

Small changes to TNAC result in large changes of auction volume

TNAC calculation – aviation issue



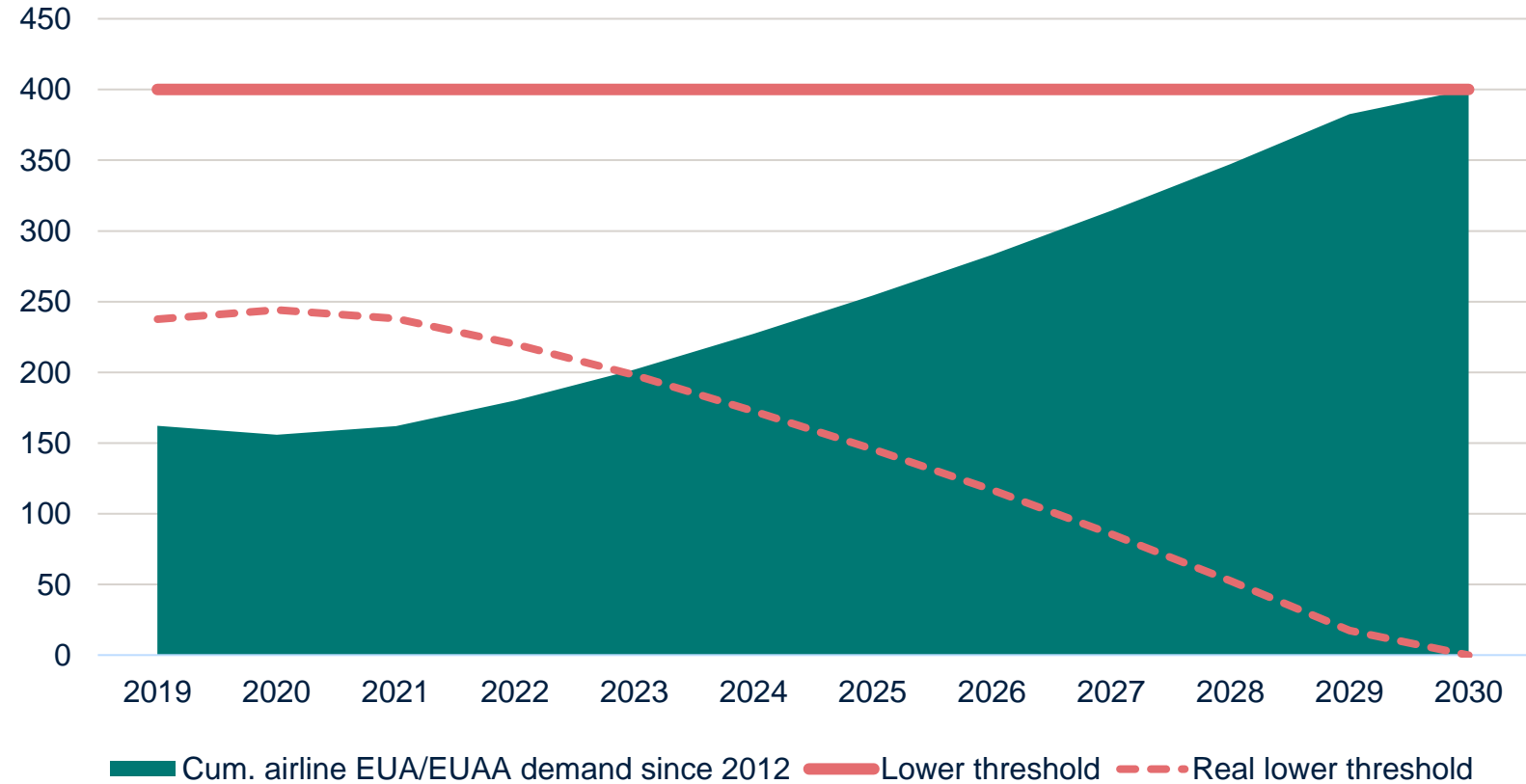
TNAC does not represent the real amount of circulating allowances

Real surplus

Real market surplus is about 160m lower in 2019 compared to TNAC calculation, growing to >400m by 2030

Source: ICIS

Lower Threshold – aviation issue



Source: ICIS

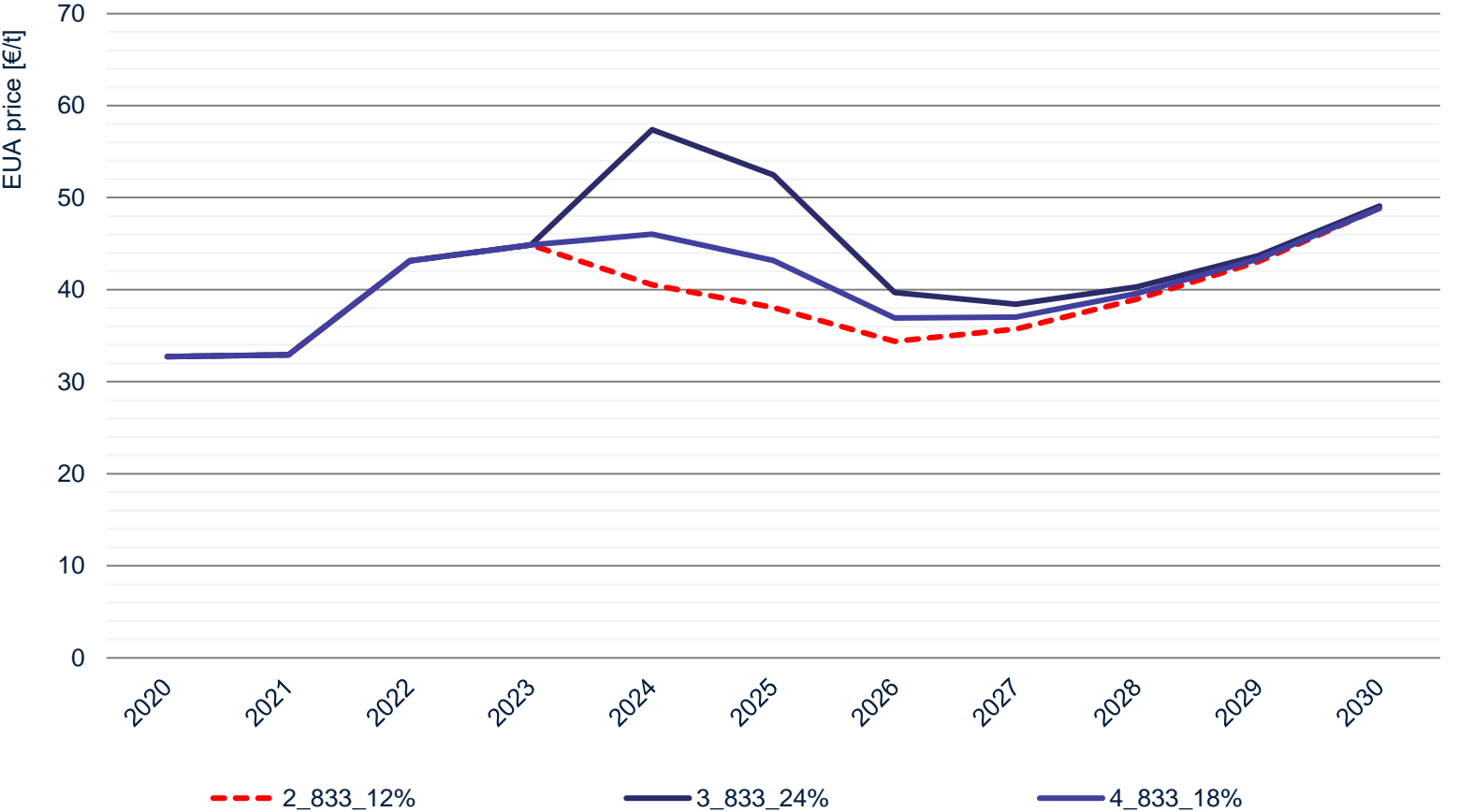
Real lower threshold significantly below 400m

Chances are really low that MSR outtake is ever triggered



Market impact

Withdrawal rate has an impact



Source: ICIS

ICIS Insight Paper European carbon market to shift gears

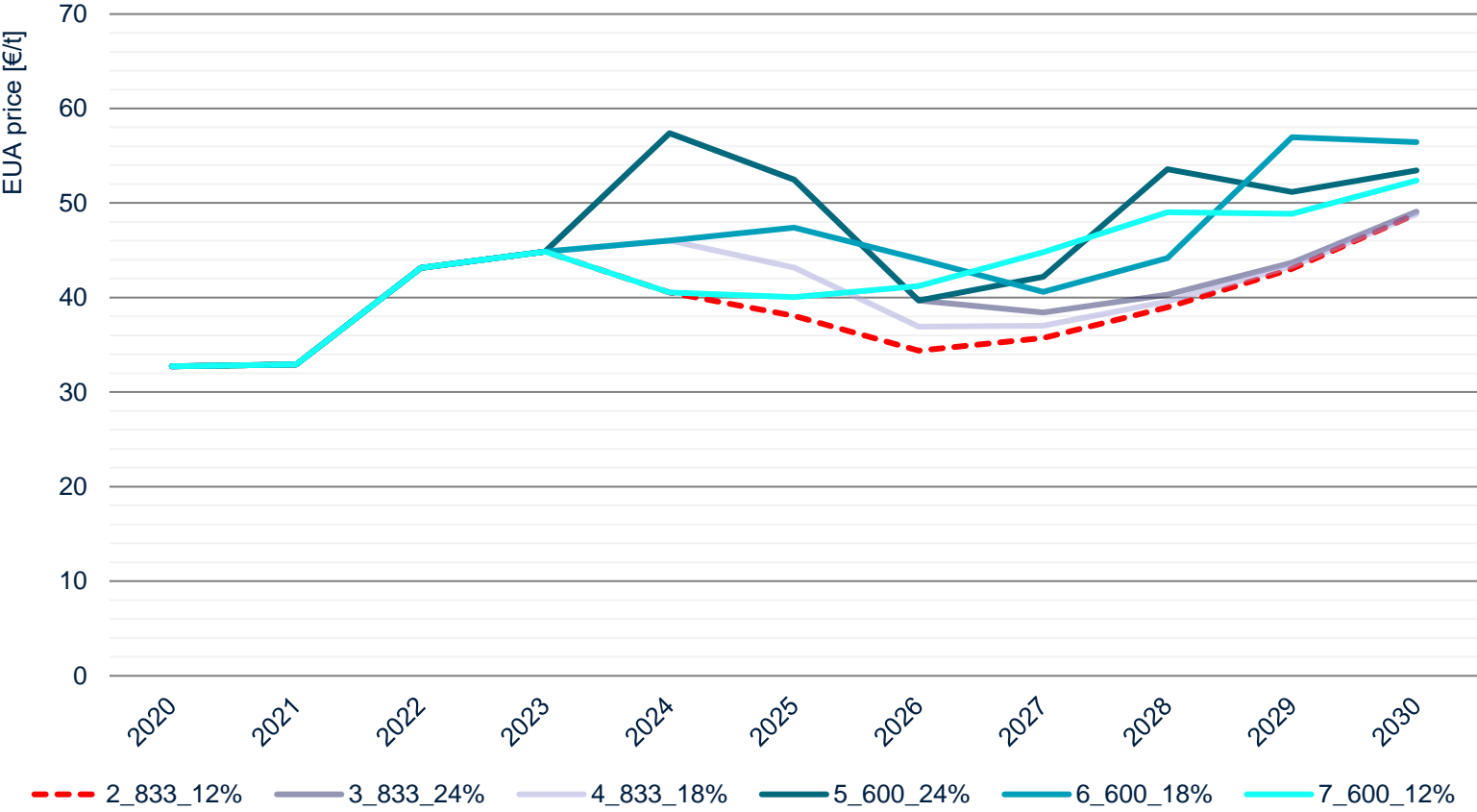
Featuring 26 scenarios for the MSR
review and various cap trajectories.

Available on [icis.com](https://www.icis.com) to download.





The thresholds make the difference



Source: ICIS

600m

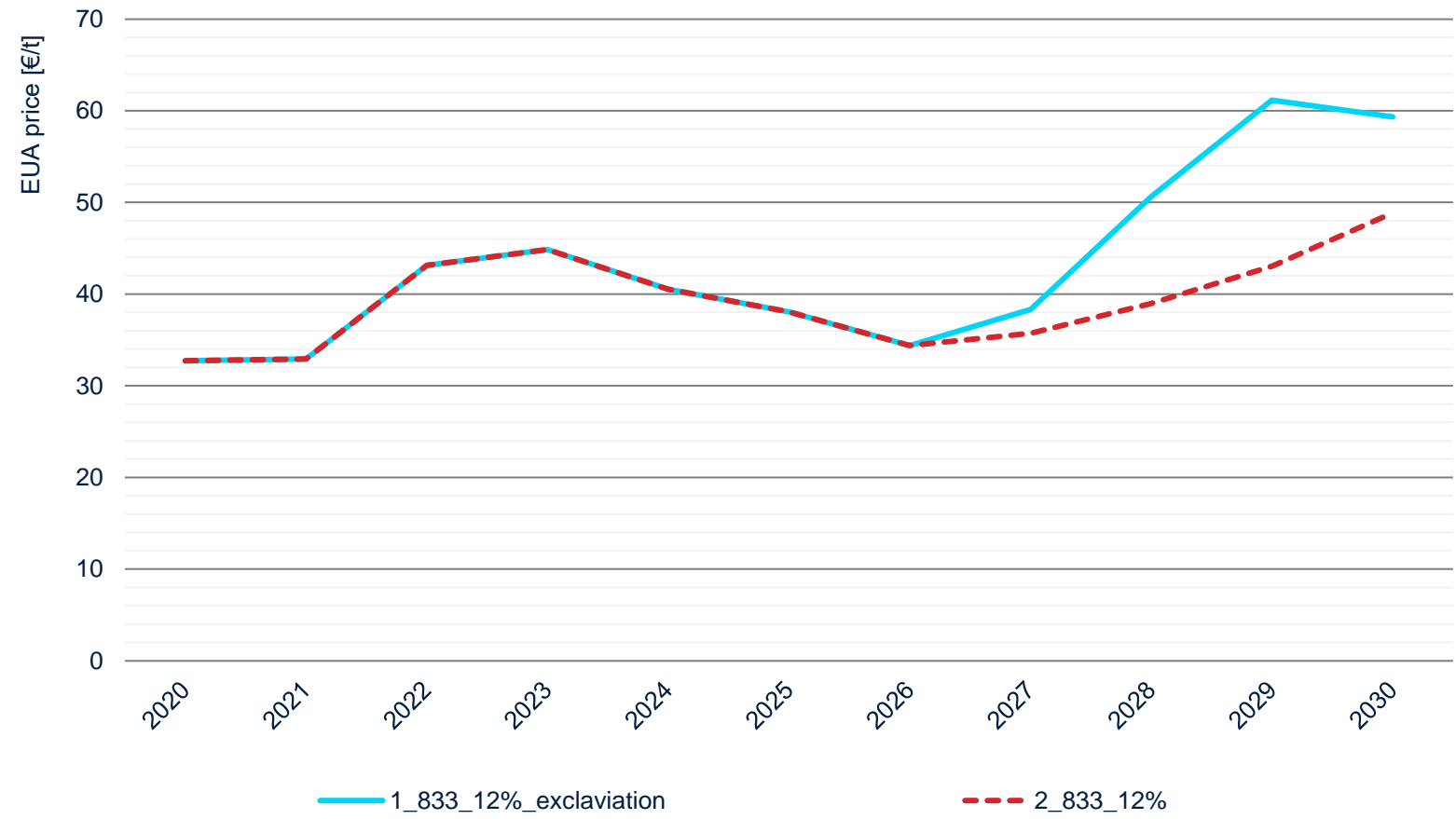
Lower thresholds cause the MSR being triggered during additional years

24%

Could cause the MSR to reach the upper threshold earlier than other scenarios



Ignoring aviation demand is bullish



Source: ICIS

8

Years of MSR withdrawal not accounting for aviation demand

5

Years of MSR withdrawal including aviation in TNAC

Rebasing – scenarios



| Scenario | Taking effect in | Rebasing start year* | Rebasing (TP4) | LRF after taking effect |
|---------------------------|------------------|----------------------|----------------|-------------------------|
| EC proposal (No rebasing) | 2026 | 114m | - | 5.2% |
| Medium rebasing | 2026 | 198m | 212m | 4.2% |
| High rebasing | 2026 | 398m | 709m | 2.0% |
| Early rebasing | 2024 | 198m | 722m | 3.5% |
| Early LRF | 2024 | 94m | 355m | 4.3% |

Source: ICIS

830 Mt

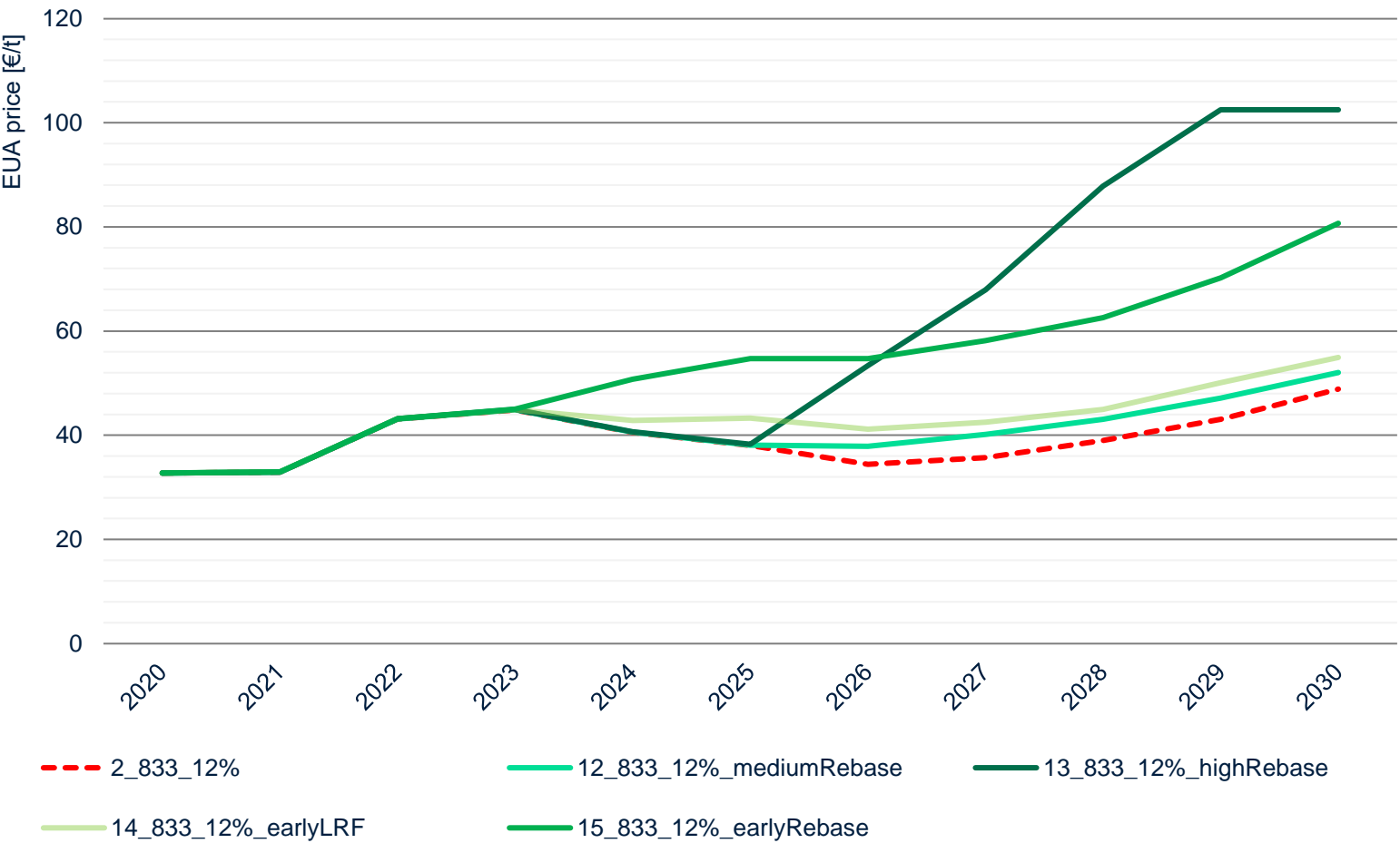
2030 cap in all scenarios.
Equivalent to -55% net target,
35/65 ETS vs. ESR split, excl.
UK installations, current scope

722m

Early rebasing can have same
cumulative effect on TP4 as
high rebasing, but more
distributed

* Reduction compared to previous year

Rebasing sets the direction (833/400m)



Source: ICIS



Early

Changes to MSR parameters in 2024 result in price drop in most scenarios except Early rebasing

MSR

Minor role in case of earlier target impact

Key takeaways



- Current MSR parameters ensure market remains tight until 2023
- MSR settings remain particularly important for mid-phase 4
 - Thresholds set the number of outtakes and continuity
 - Withdrawal rate a second-layer criterion
- Important considerations:
 - Timing of cap trajectory change sets tone
 - Early rebasing provides steady market framework
 - Role the MSR should play in ambitious 2030 framework

Thank you!



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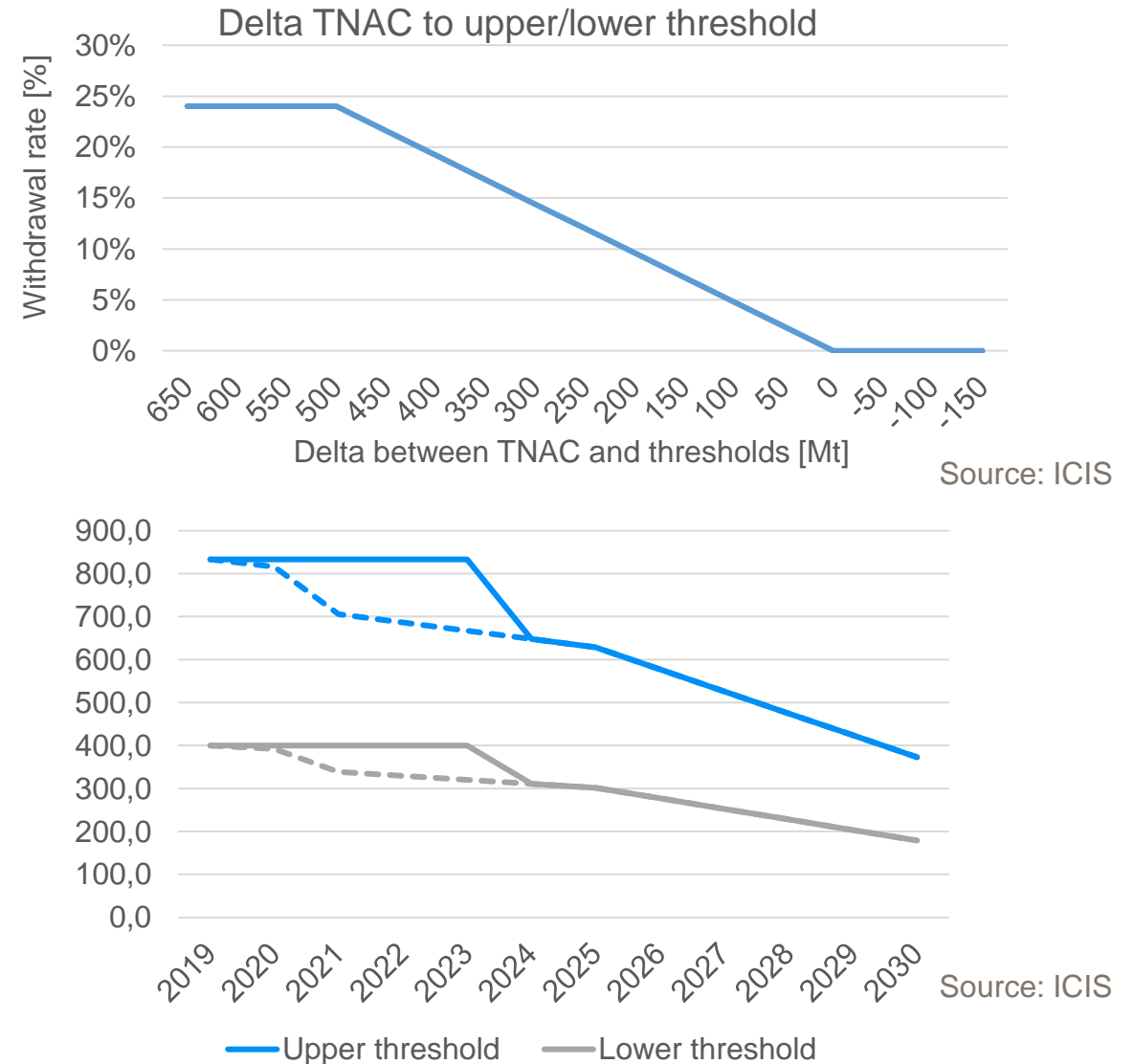


Backup

ICIS proposal for a self-adjusting mechanism

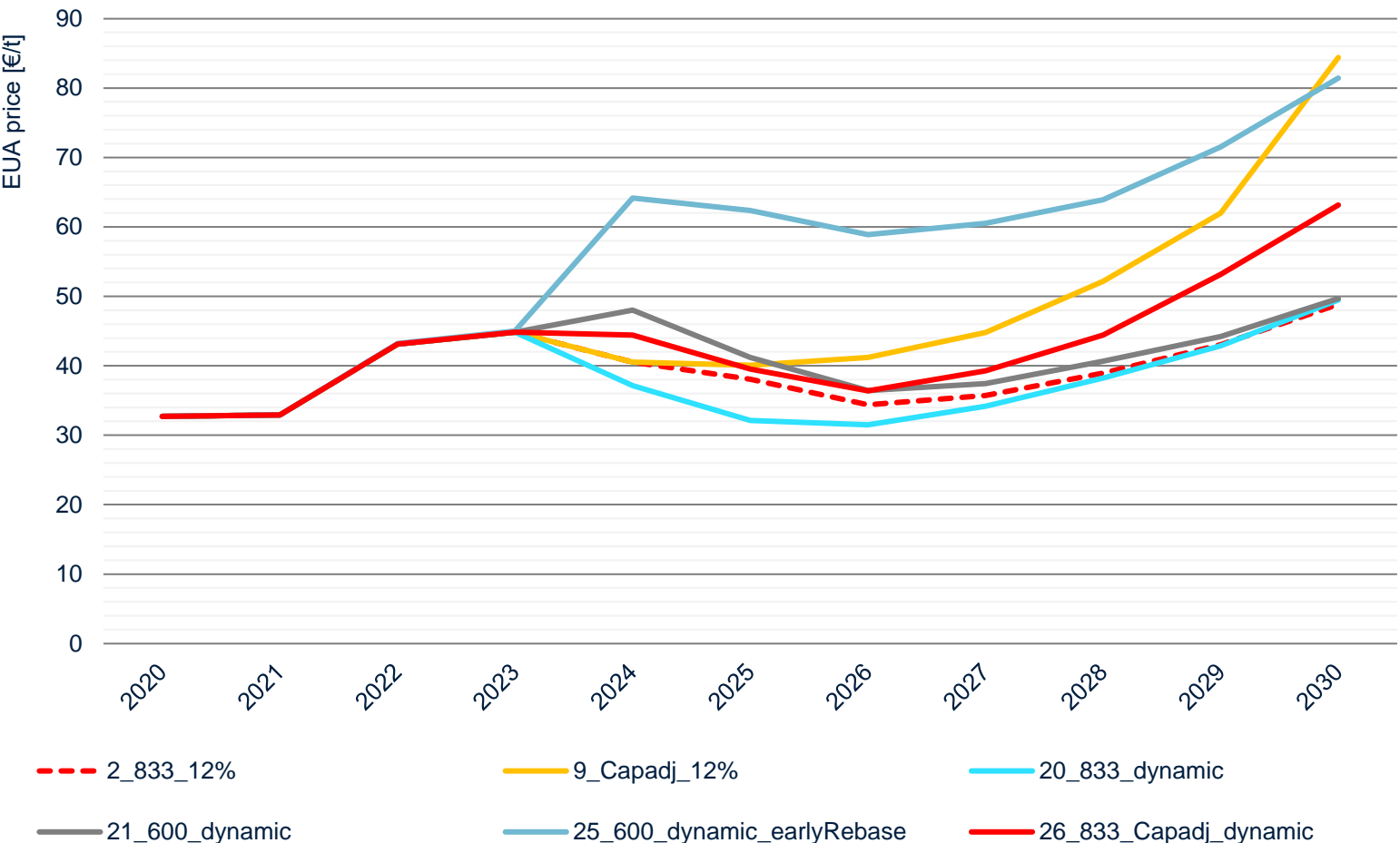


- Self-adjusting withdrawal rate depending on market tightness
 - withdrawal rate independent from an active regulatory decision
 - convert the mechanism into a self-adjusting instrument
 - Decision whether to also apply to the lower threshold
- Declining thresholds as function of cap
 - Counter the static nature of the thresholds
 - Use a historic threshold ratio to cap
 - Base it on the actual cap trajectory (accounting for scope extension, rebasing etc)





Dynamic element continuously triggers MSR



Source: ICIS

10

Cap-adjusted thresholds trigger the MSR during all years in TP4

Dynamic

Cap-based setting ensures accounting for decarbonising economy