

Unallocated allowances in the EUETS – How should they be treated in the Market Stability Reserve proposal?

In previous discussions surrounding the Market Stability Reserve (MSR), most of the focus was on the start date and the treatment of the backloaded allowances. However, the recent vote in the European Parliament's Environment Committee proposes to also place the unallocated allowances into the reserve.

It is important to highlight that IETA members largely welcome the proposal to introduce a reserve in the EU ETS, and believe the measure improves the EU ETS by increasing its supply flexibility. In light of the expected 2billion+ surplus in the EUETS by 2020¹, addressing this imbalance is necessary as well-functioning emissions trading systems need to be driven by the principle of scarcity.

Reform of the EU ETS can help the system work more efficiently; nevertheless there is a **concern about the volatility that would result from the release of the unallocated allowances from the New Entrants Reserve and from closures of installations**. There is no justification to further increase the number of allowances in circulation beyond the MSR thresholds, especially since most of that volume will be automatically moved into the MSR a year later.

The lack of clarity on the exact volume of unallocated allowances reduces market participants' confidence in the EU ETS, especially if there are no clearly-defined rules about how they should be treated at the end of the Phase. We note that according to the European Commission's estimates² more than 410 million allowances from the New Entrants reserve have still not been allocated or reserved, and a larger amount is expected not to be allocated by the end of Phase 3 due to closures of installations.

Analysts' estimates vary on the amount of unallocated allowances by 2020 – but these look to be substantial amounts, whose return on the market would have consequences in terms of supply-demand balance

Estimated volumes of unallocated allowances due to return to market in 2020	
Bloomberg New Energy Finance	690 million EUAs
ThomsonReuters Point Carbon	376 million EUAs
ICIS Tschach Solutions	671 million EUAs ³
Ecofys	500-900 million EUAs ⁴
Sandbag	754 million EUAs ⁵

¹ <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014SC0017&from=EN>

² http://ec.europa.eu/clima/policies/ets/cap/allocation/docs/status_table_ner_en.pdf

³ <http://data.consilium.europa.eu/doc/document/CM-1851-2015-INIT/en/pdf>

⁴ <http://www.ecofys.com/files/files/ecofys-2015-working-paper-leftover-allowances-phase-3-eu-ets.pdf>

⁵ http://www.sandbag.org.uk/site_media/pdfs/reports/Avoiding_the_Avalanche.pdf



There are two main concerns in case the treatment of unallocated allowances is not addressed in the Market Stability Reserve (MSR) proposal:

- **Oversupply** - The intent of the MSR proposal is to deal with oversupply. Returning allowances directly to the market will work against this stated aim.
- **Volatility** - The lack of certainty on the exact volumes to return to market causes unpredictability, with consequent volatility, and undermines the role of the MSR to stabilise the market.

There is consensus in IETA that unallocated allowances from the New Entrants Reserve and the allowances not handed out to installations due to closures be placed directly into the Market Stability Reserve. The proposed formula in the European Commission's proposal to smoothen auction volumes over Phases, would not be sufficient to address the oversupply in the market. It would be helpful to minimise the impact of additional allowances being added to the auction volumes at the end of Phase 3, but it would simply add those auction volumes over the next couple of years; thereby increasing directly the supply.

We recognise there are ongoing discussions concerning the potential use of unallocated allowances. **There may be some merit in some of these considerations but they should form part of the negotiations on the upcoming legislative proposal on the EU ETS revision.** As a result these unallocated allowances should not be placed in the reserve in an undefined way, as some of them were originally due to be handed out for free. Hence, they should be earmarked pending any further consideration in case of any future decisions to use these allowances.

Market participants need a predictable outcome from the MSR discussions that clarifies how unallocated allowances will be treated at the end of Phase 3. In order to be consistent with our reasoning on the backloaded allowances not returning to market at a time when the market is oversupplied, IETA recommends that these unallocated volumes not be added to the auction volumes at the end of Phase 3 since the market is forecast to remain oversupplied well into Phase 4.

IETA encourages greater transparency on the quantity of unallocated allowances. Specifically, IETA supports annual publication of the amount of allowances either not handed out for free due to installation closure or partial cessation or allocated allowances from the New Entrants' Reserve. Such annual data publication must be at the same time as verified emissions and allocation data are released.