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CARBON MARKET BUSINESS BRIEF

UK

UK ETS AT A GLANCE

Years in operation	Phase I: 2021-30 Phase II: 2031 – TBD
Overall cap & trajectory	The cap will initially be set at 5% less than the UK's notional share of the EU ETS cap (for Phase 4). This equates to around 156 million allowances in 2021. This initial cap will be reduced annually by 4.2 million allowances.
Target(s)	-21% by 2020 and -43% by 2030, compared to 2005 emissions
Emissions Reduced to date	The UK's GHG emissions have reduced by over 44% since 1990, facilitated in large part by the existence of an emissions trading system. GHG Emissions from installations covered by the EU ETS – which included the UK at this time – decreased by 9.1% in 2019 compared to 2018.
Sectors covered	• Power and heat generation • Industrial processes (eg oil refineries, coke ovens, iron and steel plants) • Cement manufacturing • Glass • Lime • Bricks • Ceramics • Pulp • Paper and board • Aviation • CCS networks • Petrochemicals • Ammonia • Non-ferrous metals • Gypsum • Aluminum • Nitric, adipic and glyoxylic acids
GHGs covered	CO_2, N_2O, PFCs
# of covered entities	Approximately 1,000 installations
Allocation method	Auctioning is the default method, with varying levels of free allocation to industrial sectors based on harmonised rules. The initial approach to free allocation (including benchmarks) will closely resemble the EU's approach for Phase 4 for the EU ETS. There will be 58 million free allowances made available in 2021.
Trading rules	N/A
Use of offsets and linking	The use of international credits for compliance is not currently permitted.

Other features	Allowances can be banked indefinitely, meaning any historic vintage can be used for future compliance. It is also possible to borrow allowances from one year into the future if this is within a trading phase. It is not possible to borrow allowances between trading phases. The UK ETS will have an auction reserve price (price floor) of £22, which establishes a minimum price for which allowances can be sold at auction. A Cost Containment Mechanism will provide a process for addressing significant extended price spikes in the market. This will have lower price and time triggers over the first two years of operation than the EU ETS equivalent.
Penalties for non-compliance	Failure to comply with obligations under the UK ETS will lead to significant civil penalties being applied.
Use of revenues	Unlike the EU, UK ETS revenue is not ringfenced for climate and energy purposes.

MAJOR DEVELOPMENTS

After a public consultation in 2019/20, the UK Government published detailed proposals for the UK ETS in June 2020. At this time, the Government's official position was that its post-Brexit carbon pricing regime would either be a UK ETS or carbon emissions tax. Media sources claimed that the Treasury was pushing strongly for a tax.

This was complicated by ongoing negotiations on the future relationship between the EU and UK. The possibility of linking the EU ETS to a new UK ETS was thought to be part of these negotiations, but no linkage was agreed by the time of the final Trade and Cooperation Agreement (TCA) on Christmas Eve 2020. The UK Government's official decision in favour of a new UK ETS was announced as part of the publication of the long-awaited Energy White Paper in December 2020.

The final text of the TCA committed both sides to 'cooperation' on carbon pricing, and 'serious consideration' to the possibility of linking the EU ETS and UK ETS. Linkage remains possible from a technical perspective given that both jurisdictions have Net-Zero/Climate Neutrality by 2050 targets, and because the design of the UK ETS is almost identical to the EU ETS. However, political will is needed to link two different emissions trading systems. Although calls for linkage have been made by many observers, the two jurisdictions had not initiated negotiations by the time this briefing was published.

The first auction under the UK ETS will take place on 19 May through the Intercontinental Exchange. Until this point, no market will exist for UK operators, and the price that this auction might drive is unknown. The Government has implemented a number of mechanisms to support prices, such as a floor price of £22, and a cost containment mechanism to lessen the risk of price spikes. However, no mechanism currently exists to deal with oversupply of allowances to the market. The Government has agreed to consult separately on the option of introduce a Supply Adjustment Mechanism, similar to the EU's. It is likely that such a mechanism would be required for linkage to the EU ETS. A UK registry is expected to be ready by Q2 2021.

An initial review of the UK ETS will be conducted in 2023 and 2028 respectively to assess whole system performance. These reviews are aligned with EU ETS Phase 4 reviews, and will be done in consultation with the UK's Committee on Climate Change.

USEFUL LINKS

ICAP ETS Map
The Greenhouse Gas Emissions Trading Scheme Order 2020

REFERENCES

Carbon Market Report 2020 European Commission (2020)
2019 UK greenhouse gas emissions: summary (publishing.service.gov.uk) BEIS (2020)
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