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The overview of the EUA price, unfortunately only visible for paid subscribers of emission letter

Emission News 11-2017

Practical Information for Emission Trading

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Source: ICE London

EU Council/Parliament agree: Up to 1.5 billion EUA will be deleted from the EU-ETS – Two allocation proced. for 4th trading period

The EU Parliament and the Council came to an agreement on behalf of the Trilog negotiations. In order to reduce the stock of EUA certificates, these will be transferred annually to the market stability reserve after 2019 where they may be deleted definitely under certain circumstances. Thus, the way is free for an essentially higher certificate price which is supposed among others to induce system operators of the EU emissions trade to modernization and efficiency increase as well as to a modification of the EU directive still within this year.

Moreover, Emissionshändler.com® describe in our **Emission News 11-2017** the current state of affairs as to data acquisition and application procedure for free allocation and what delays system operators may expect for such a process. Furthermore, the second part of the supplier markets' analysis in the German EU emission trade will be published which, according to estimation of Emissionshändler.com®, changed already in the course of introduction of MIFIDII.

Completion of the reformed EU Emission Trading is almost finalized

The efforts of the European Commission, of the Council, and the Parliament for the reformation of the European emission trading which started in 2016 are now achieving the decisive phase of nego-

tiations (Trilog). The whole process of design and planning of the necessary steps will come to an end at the end of the year 2017 and will be integrated into legal directives.

The reason for reformation were the overstocks of free emission certificates. These forced the European Commission to take steps in order to get a grip on them once and for all.

According to the general opinion the main reasons for the accumulation of at least 1.6 billion too many certificates are

- the certificates having been accumulated in the years of the financial and economic crisis between 2008 and 2010
- a massive import of certificates from other countries
- an increase of electricity production generated by renewable energies, not expected to this extent
- much progress in the improvement of energy efficiency.

That is why the volume of 1.6 billion complies with a complete annual budget for all European countries which would even increase considerably in the coming years if no corrective measures would be taken.

After the second meeting of the Trilog negotiators a compromise was achieved in the night of 09.11.2017 which determined the essential key points of a reformed emission trading which is the promotion of the essential aim of a further



reduction of CO₂ emissions until 2030 and an increase of the CO₂ price.

Generally, agreements were achieved on the following items.

in the course of the coming weeks.

The Market Stability Reserve (MSR)

A big part of the free EUA certificates will be lead to the once again modified market stability reserve respectively will be deleted definitely.

Furthermore, the MSR shall increase the commission's flexibility to take a stabilizing influence on the price, this by means of pragmatic increase or removal of emission rights to resp. from the market. On this way 1.5 billion emission rights could be taken from the market for example and could be lead to reserve.

The Benchmark Values

The Trilog agreed that these values shall be subject to a dynamic revision. For example, the actual values of the years are supposed to be taken as a basis which represents the Parliament's today's position. But an annual linear reduction of 0.2 up to 1.75% (always in accordance with the branch) for the first allocation period from 2020 until 2025 and a later adaption to further experience values for the second allocation period from 2026 until 2030 are also at issue.

Carbon Leakage

The Trilog principally agrees that a verification is necessary who is endangered by CL and who is not.

are waiting to be solved in this context which remain to be reduced to a common denominator on the occasion of agreements still to be settled. The following spreadsheet shows this in a characteristic manner:

Unfortunately this sheet is only visible for paid subscribers of emission letter

The Cross Sectoral Correction Factor CSCF

Originally this factor is a nuisance in contradiction to the system because it represents a super-ordinated adaptation of the allocation requests announced by the operators to politically prescribed total emission averages. Some system operators

even complained against the application of this factor in the third trading period.

The European Court of Justice (EuGH) partially accepted this complaint with its judgement of 28.04.2016.

Infobox

Extracts from the result of the negotiations of 09. November 2017 between the EU Council and the EU Parliament's leading negotiator

Purpose of the emission trade's reform is the removal of the EU-ETS main problem which is the collected overstocks of emission certificates which decrease the price and, as a consequence, fail to give sufficient incentives for investments in climate-friendly technologies.

The following rules will be transposed to a modified EU directive until the end of 2017:

- The overstocks of EUA shall be minimized twice faster than planned so far. With the beginning of the year 2019, 24% of the overstock will be transferred from the market to the market stability reserve MSR. A calculative presentation shows that probably already in 2021 or 2022 the overstock will have been diminished to such an extent that a considerably higher EUA price would be the consequence.*
- The certificates stored in the MSR, however, could return to the market with the beginning of 2023. But as this backflow is not supposed to reduce the price, it has been agreed to delete up to 1.5 billion EUA of the MSR.*
- A decision was made that in case of a facilities' shutdown in the EU the national authority shall be entitled to remove the corresponding certificates from the market and delete them. They will no longer be at the disposal of other states.*
- Furthermore, a free allocation for shall continue to exist. The allocation must not surpass the present however. All benchmarks will be adapted annually to the technological progress.*
- The electricity sector shall continue to purchase all certificates.*
- A new innovation funds (3 per cent of the EU budget) shall be left at the disposal of all member states. It is destined for innovative projects in the area of renewable energies, separation and storing as well as avoidance of CO₂.*
- A modernising fund (2.5 per cent of the EU budget) are left at the disposal of poorer European states. Facilities shall be supported by this fund as far as these produce less than 450 g CO₂ per kilowatt hour. Coal-fired power stations shall be excluded from this support. An exception will exclusively be made for*



According to this judgement no modification will take place retroactively on the allocations guaranteed but a newly calculated factor needs to be applied for probable new allocations in the relevant cases with the beginning of 2018. The general appliance of such a factor, however, was never theme of doubts.

Due to the difficulties with the acceptance of this factor a way shall be found for the fourth trading period which avoids the appliance of such a factor. There is consensus on it in the Trilog negotiations.

The Innovation Fund

A decision has been made already that such a fund will be raised. A financing volume of approx. 10 billion Euros is provided for it. These means shall be used for the aim of innovative projects. Aim is the promotion of innovative projects (investments in technologies and infrastructure) in the industries of the member states. It will be open for all member states.

The coal threshold

This value is a political issue because it can become a criterion for the promotion of new projects. The European Parliament plans to prescribe a threshold for the power generation of 450 g CO₂/kWh. Projects with a higher CO₂ exhaust would then no longer be worth to be supported. As a result, coal-fired power plants with a today's technology would no longer be supported because the CO₂ exhaust of coal power plants and brown coal power stations without cogeneration amounts to 949 g CO₂ per kWh resp. 1153 g CO₂ per kWh.

Even in case of using exhaust heat for the heating of apartments the CO₂ emissions of coal power plants and brown coal power stations would decrease to 622 g CO₂ per kWh resp. 729 g CO₂ per kWh of electricity and would consequently no longer be worth to be supported either.

The small emitter rules

Germany presently does not apply this rule for any plant so far because it is not attractive for the operators. The essential reason are

Thus, this rule shall be

abolished, according to a proposal on behalf of DEHSt and instead

- a cancelling of the Opt-Out rule is supposed to be realized
- a facilitation for small emitters for the monitoring is supposed to be created
- emergency generators and emergency flares via cumulation rules from the ETS appliance area are supposed to be removed generally which in Germany is already practised almost everywhere

The national data collection and the following application procedure

A decision has been made which prescribes that the national governments are requested to submit until 30.09.2018 from their data treasury those of the measurement period between 2013 and 2017 to the commission.

The system operators shall become active after April/May 2019 when they will be requested to apply for free allocation. In this context it is expected generally that

latest trading period.

he DEHSt, however, proposes a considerable simplification of the calculation rules for changed allocations for new installations or capacity modifications. But an agreement on it in the frame of Europe has not been made yet.

Two temporarily different application procedures and more reporting

The application procedure for the new trading period shall be realized twice which means once in the year 2019 for the period between 2021-2025 and probably in the year 2024 for the period 2026-2030. In so far two separated allocation procedures within the trading period will be applied for which also different reference periods shall play a role.

Furthermore, the annual reporting about the notifications of the company will include a more detailed query (e.g. forwarding of residual gases, heat import/export, emissions of the allocated elements) the system operators concerned will be obliged to deal with.

It is not yet sure if a new data collection system „DEV 2030“ is supposed to be created, enabling the use of these data for allocation appliances.

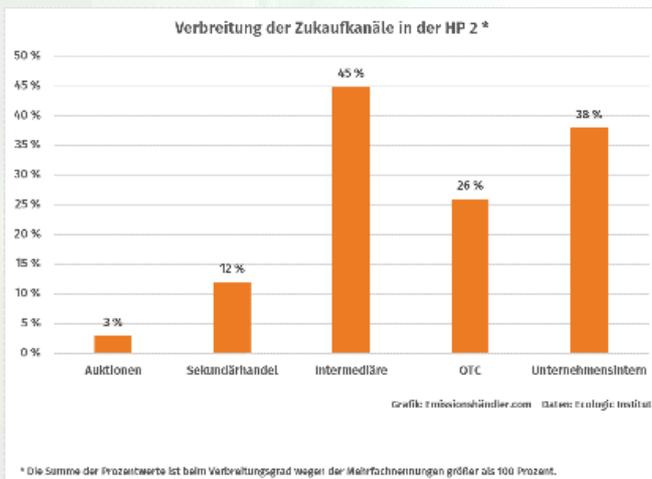


The following report includes the second part of the article “The change of the supplier market for emission permits in Germany”. It is a continuation of the Emission News 10-2017.

Financial and temporal expenditures of Emission trading

In order to consider financial and temporal expenditure of operators participating in emission trading, the following text shall describe in detail only that system operators’ group which is engaged in dealing via Intermedia means.

According to general opinion, not only the OTC trade is concerned by these intermediary means but also secondary trading. It is incomprehensible that the DEHSt present the trading forms OTC and secondary trading as equivalent. This statement has been a subject of the former Emission News 10-2017.



DEHSt presentation of inlet sewers distribution



Emissionshändler.com® Presentation of inlet sewers distribution

Cost expenditures in Emission Trading

If we now evaluate the survey having been ordered by DEHSt regarding the cost for additional emission allowances via the intermedia channel, these are below 10,000 Euros per year for the biggest part of small and medium-sized enterprises. Only larger enterprises purchasing additional allowances also at the stock exchange, the value amounted up to 20,000 Euros.

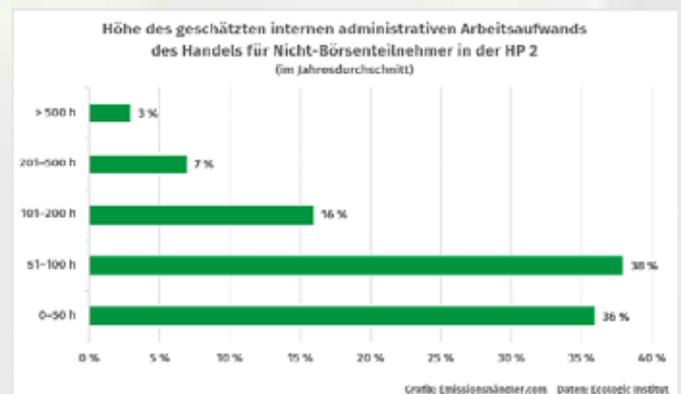
As the inquired cost also included internal administrative expenditure for the trade’s organisation, it is hardly possible to differentiate the cost for fee and external expenditures as there are verification of reports on one hand and the time needed for the preparation of or other activities around the register account on the other hand.

It can be said in any case that some exchange participants the emission trading’s overall burden mark of 100,000 Euros per year although probable fees and payments for clearing banks were not even included in this amount.

Time expenditures in the Emission Trading

If we now consider the time spent for emission trading, the DEHStin survey reveals surprising figures.

According to the study, a big part of the non-exchange buyers is occupied up to 100 hours per year with the purchase of emissions certificates. If it is known that the very biggest part of the KMU uses to buy certificates not more than once in a year – if anyway – it turns out to be clear that the polling company Ecologic Institute put the term “trade” in the survey on the same level with “emission trading” in the sense of EU-ETS.



Time expenditure of KMU for „emission trading“



That is why it turns out to be clear that the definition of an emission certificate provider in the MIFID II is not meeting the needs with an additional provision for the emission trading in general is meant. This is an extremely improper definition which is certainly not favourable for the data's quality.

If a glance is thrown on the last DEHSt survey's summarizing evaluation of 2013 having been published in January 2014, it will be of interest in how far these results will change in the inquiry data having been made in summer 2017 and which shall be published in the beginning of 2018. This also under the aspect that the intermedia market seems to pass through a significant change by means of the MIFID II having been announced for 4 years.

The formation process of the MIFID II influenced the supplier market

The long-standing process of the MIFIDII development and its probable consequences on the structure of the emission certificates' providers being admitted then lead to ways being taken by various potential providers within the last years.

After the MIFIDII will come into force on 03.01.2018, it can be assumed that a number of strategies existed how a potential provider was able to position himself in the years 2013 and 2014 in order to keep this position unchanged after the MIFIDII will enter into force.

- a) Previous providers in the role of a broker and trading house could decide if they apply for a bank license and are willing to submit the control of their business to the BAFIN
- b) Dealers and consultants with permanent or occasional activities could decide in how far they can respectively may continue their trading activities without a bank license
- c) Banks could decide if they continue to stay in business with the MIFIDII or if they prefer dealing emission certificates exclusively with the big operators
- d) Banks could decide if they were willing to remain in the market with emission certificates anyway or if they prefer getting off for quite some time before the MIFIDII.
- e) Stock exchanges like EEX took over increasingly auctions of EUA certificates, disappeared from the market (Bluenext, Climex-New Values),

concentrated themselves on the futures trading (ICE) or brought a

If we now consider the result of different provider groups and the ways they took, it can easily be recognised in autumn 2017 and shortly before entering into force of MIFIDII in January that according to the opinion of Emissionshändler.com® in fact some noteworthy changes did show up.

Brokers and Dealers

Most the time the group of trading houses and brokers mentioned before under a) used to invest high volumes of money and time in order to position themselves as trading and broker house with a bank license. In their position they were able to face almost without any competitors the system operators of the

will most probably not dispose of a bank license. This strategy, however, was not successful because due to comfortable exemption clauses, MIFIDII does not prescribe this any longer.

As a consequence of this recognition and the consciousness not being competitive any longer, some broker houses in Europe closed their CO2 section already or disappeared completely from the market.

Dealers and consultants

The group of individual dealers and consultants with permanent or occasional dealing activity mentioned earlier under b) had in fact in some cases the possibility to decide for a future dealing activity with a bank license but they hardly did respectively weren't willing nor able to care for the corresponding financial means and the administrative expenditures to perform the change to a "banking house".

When it became clear that the operating their business model, certainly most providers of this group decided to stay in business.

Banks and other financial institutes

It seems that a large number of bank group members mentioned earlier under c+d) decided either to cease their KMU business regarding



emission certificates completely or to keep it going with regular customers exclusively if otherwise another profitable business relation with the customer would be endangered. The high administrative expenditure banks around MIFIDII, MIFIR & Co. are forced to pursue is worth being negotiated only in case of big trading volumes of 200 to 500,000 tons per year which KMU normally don't achieve.

From the view of banks still other reasons than MIFIDII exist not to show up as emission certificates providers – Consequently, the number of corresponding providers decreased accordingly.

Stock exchanges and auction platforms

The group of the relevant stock exchanges mentioned earlier under e) reduced within the last years to the ICE London and the EEX in Leipzig, accompanied by the fact that also the spot market disappeared, existing formerly within the 2. HP. This is another reason why the perspectives of a stock exchange trading for KMU emission certificates make hardly any more sense. Not only the expense is much too intense, also the cost and pitfalls of the clearing banks' contracts being interposed make this business concept completely unattractive

Conclusion

The supplier market for the CO2 emission trading changed since 2013 and the discussion about MIFIDII beginning at that time. Broker houses and financial service providers recognised that not only the golden times of are gone (the system operators' exchange contingents are exhausted). Neither will the effect appear with the beginning of 2018 that the MIFIDII will destroy the small dealers' and consultants' business model. Consequently, appropriate brokers will partially address themselves to other business models respectively will leave the CO2 market. At the same time the increase of trading activities at the stock exchange will essentially fail to appear, even

if Auction-Only and further facilitations are meant to ease the access to this inlet sewer. The financial burdens and administrative hurdles are simply too high, especially those created by clearing banks.

So, at least the KMU of the emission trading – may rely on the fact that free dealers and consultants of the Intermediate group will provide the market with emission allowances reliably and, above all, cost-efficiently. This is important because

, due to the MIFIDII rules which they are obliged to respect.

Probably such trends are already recognisable in the new DEHSt survey which will be published in 2018. It remains to be hoped that the quality of the new survey's statements will be a little bit higher because terminologies will have experienced a better definition.

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All price curves shown here are based on data from the ICE London, generated from a Reuters information system.

Our offer

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