

Article based on the “EU ETS & Cement – Enter the Phase IV” report published by CemBR in February 2022.

## ***Does the UK ETS differ from the EU ETS and how?***

### **Introduction to the UK ETS:**



The United Kingdom was part of the EU ETS scheme from its inception until the end of Phase III in 2020. At the end of the Brexit transition period, the UK left the EU and the EU ETS on 31st December 2020.

The UK ETS started on 1st January 2021 and is governed by The Greenhouse Gas Emissions Trading Scheme Order 2020. The UK government and the devolved administrations collectively constitute the UK ETS Authority.

Phase I of the UK scheme runs from 2021 to 2030. A 5% tighter cap for UK emissions was set compared to the country’s previously planned share in Phase IV of the EU ETS. The tighter cap aims to align the system with the government’s net zero emissions target by 2050. The number of allowances that can be created in each year is also capped with a declining cap between 2021 and 2030.

UK emissions auctions and secondary market trading take place at the Intercontinental Exchange (ICE). The first auction of UK ETS allowances was held on 19th May 2021. Unlike the EU ETS, the UK ETS has a transitional auction reserve price (ARP), which represents the minimum price for which allowances can be sold at auctions.

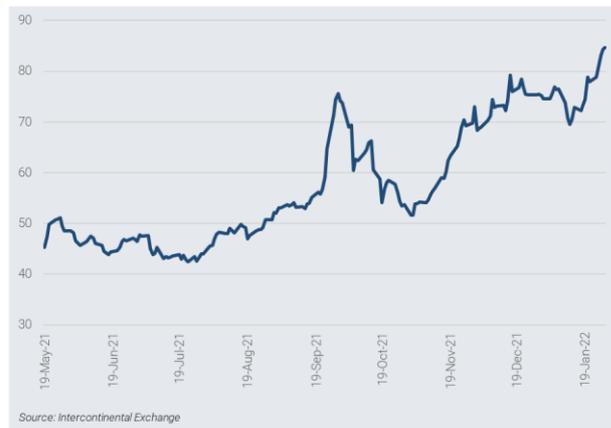
### **What has happened so far?**

Since launching in May 2021, futures prices of UK allowances generally increased from around GBP45/t to around GBP85/t at the end of January 2022. The lowest price in this period was around GBP42/t. Since launch, UK allowances have generally traded at a premium to EU allowances in common currency terms. For the period of December 2021 and January 2022, the average premium was around 8% to 9%.

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Some market participants attribute the higher UK prices to the smaller size of the market and lower liquidity. The fact that the UK ETS is new means that there is more demand for UK allowances, whereas the EU ETS has a surplus of permits from the previous phases.

FIGURE: UK ALLOWANCES (UKA) FUTURES PRICES (GBP/TONNES)



The UK ETS provides free allocation of carbon allowances. For the period 2021-2025 the approach used for the calculation of free allocations is the same as that used in Phase IV of the EU ETS to ensure continuity for businesses. The benchmark used for grey cement clinker is also the same for this period (693Kg CO<sub>2</sub>/t). In a

similar approach to the EU ETS, no cross-sectoral correction factor will be applied for the 2021-2025 period.

Companies subject to the scheme are required to submit an independently verified Activity Level Report (ALR) every year by the end of March. In 2021, the first year of the scheme’s implementation, the deadline was set on 30th June. If the ALR shows either an increase or a decrease of activity by more than 15% over the average activity levels of the previous two years, the free allocation allowance is recalculated with the same methodology as in the EU ETS. Starting in 2022, the annual free allocation for each installation will be published by the 28th of February and apply for that year.

#### Other arrangements:

The scheme includes a cost containment mechanism (CCM) which allows the authority to intervene if prices are elevated for a sustained period. For the first two years of its implementation, the UK ETS has lower price and time triggers than the EU ETS. In case the CCM is triggered, the authority has discretion on appropriate actions, which could include, for example, redistribution of allowances between current year’s auctions, bringing forward allowances from future years etc. Although the CCM was triggered in both December 2021 and January 2022, the ETS authority decided in both cases that the appropriate course of action was not to intervene in the market.

Within the Carbon Pricing sections of the UK-EU Trade and Cooperation agreement, reference is made to the commitment by both sides to explore options of linking their carbon pricing systems. However, there is no definite timetable or agreed framework currently for an eventual link.

#### UK cement sector:

The UK cement sector received around 5% fewer free allowances in 2021 over 2020. If the sector decided to operate at a level that there will be no need of further carbon purchases, its

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clinker utilisation rate would be around 68%. However, in the last two years (2019-2020), the industry operated at around 80% clinker utilisation rates. If this level of operation was maintained, the carbon cost of the industry in 2022 would be around £65 million (assuming carbon credit costs at January 2022 levels).

See full report for details on assumptions and analysis regarding both the EU ETS scheme members and the UK ETS. The report contains more than 150 pages and addresses 31 countries and 201 operational plants.

<https://cembrgroup.com/product/eu-ets-cement-enter-the-phase-iv/>

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