PREPARING THE REVIEW OF THE MARKET STABILITY RESERVE

9th of October 2019, Mihai MLADIN

The European Roundtable on Climate Change and Sustainable Transition (ERCST) organised a meeting on the 8th of October at its headquarters in Brussels where industries representatives gathered to express their concerns and brainstorm on the Market Stability Reserve (MRS). The MRS is the key measure to enhance the resilience of the system towards external shocks, such as an economic crisis for instance, by reducing the oversupply of allowances from the market. In this sense, MRS is not designed to cash in shocks, but to keep ETS on track. The MSR is already operational and its first review is due in 2021, when a decision will be made whether its functioning parameters will be changed or not. The focus of the discussions was on the expected economic impact of MRS on the EU ETS market balance in Phase 4 (2021-2030) and how companies can better position and protect themselves. An ERCST position paper on MRS is due to appear on 18 November 2019.

During Phase 4, without taking into consideration MSR, but only the Linear Reduction Curve (LRS), of 2.2 % annually, the total amount of allowances during 2021-2030 will be 15.780.048.000 certificates. From this amount, 57% must be auctioned and 43% are to be allocated for free. From the 57% however, 2 % is kept under the Modernisation Fund and 3% is kept as a free allocation buffer for meant for certain corrections. In this way, GHG emissions by 2030 are expected to be reduced by 43% compared to their 2005 level, in line with the European Union commitments and the Paris Agreement. The exact amount of allowances under the MRS is not known yet, but certain speculation can be made, by looking at market demand and compliance demand. Two academics, Dr. QUENTIN from London School of Economics (LSE) and Dr. TROTIGNON from Paris Dauphine University presented their statistical model and prediction. In the period 2019-2024 the percentage of allowance under the MSR is expected to be around 24% from the total number of allowances. Their model revealed that after 30% reserve, the prices follow a rocketing trajectory producing shocks in the market. Commenters on the research findings said that the transaction prices can reach between euro 50 to 80 per allowance towards the end of Phase 4. ERCST believes that MRS will have no impact on reference amount available under Article 10c Derogations from the ETS Directive (estimated at 965 million allowances).

After 2021 about eight billion allowances will be auctioned. Companies can either auction certificates or get rid of their polluting facilities. In this sense close monitoring and transparency is needed to make a clear difference in between compliance investors and financial-speculative investors. Carbon leakages and carbon leakages techniques has also to be followed and tackled down. "*Stability of prices in the context of ETS does not mean a froze over price but rather predictable prices*", Daniele AGNOSTINI, Head of Low Carbon and European Energy Policies at Enel, declared, along with "*we know that markets are not perfect and we need to decide what we can fix and what we can tolerate".*

The conclusion of the event was that MRS may reduce appetite for investors, however, the opposite scenario has to be envisioned, as well, when the price of allowances goes up. In the latter case, a decision must be made, if the price is to be paid by industry or by consumers. A series of open question were launched for further thoughts: How do we define market balance and market imbalance, if we need new indicators for competitiveness, and whether the TNAC (Total Number of Allowances in Circulation) is a good indicator of MSR performance.