– Consultation Response –

# Integrating Greenhouse Gas Removals in the UK Emissions Trading Scheme

Brussels, 14 August 2024 | Europex, the association of European Energy Exchanges, welcomes the UK ETS Authority's consideration on including Greenhouse Gas Removals (GGRs) into the UK ETS framework. We believe that including carbon removals in the UK ETS supports maintaining healthy market conditions. However, the integration of carbon removals should not come at the expense of the integrity of the ETS market. Any link between carbon removals, their credits and the ETS should be established gradually and should not negatively impact the trust that has been created in the emission allowances market.

Moreover, we urge the UK Government to prioritise discussions on the linkage between the UK's and the EU's ETS, before implementing substantial design changes, such as the integration of carbon removals. The linkage of both systems would present a win-win solution for all parties involved, aiding liquidity, price discovery and the ability to attract abatement possibilities and investments in carbon removal solutions from across a larger area. Given the current similarities between the UK's and EU's regimes, there should be no two ETSs that are easier to link. Therefore, it is imperative for the UK Government to initiate negotiations with the EU as soon as practicable, before significant technical and design differences are implemented on either side, making the process more challenging.

### General on the principles (Q1)

Europex overall agrees with the Principles for Policy Design as identified by the Authority and believes they tie in with each other. This is notably true for the principle of maintaining market integrity, which presents an overarching aim, impacting all other principles and vice versa. Without environmental integrity, for example, market integrity would be seriously threatened. If trust in the market erodes, market participants may defer effective risk management and cost abatement practices.

As regulated exchanges, experienced in the operation of sound and robust carbon markets, we stress the centrality of market integrity within the consideration of any design option. Therefore, we outline four principles for market integrity to be considered, particularly related to pathways to integration of carbon removals into the UK ETS.

### GGR ETS market design principles (Q2, Q8, Q12, Q33)

1) The integration of carbon removals into the UK ETS should happen in a gradual manner, supported by transparent and predictable controls, preserving the integrity of existing markets.

   As the preservation of environmental and market integrity should be a central priority and following uncertainty over potential GGR unit supply at the start, cap Option 2 would be a pragmatic approach in the short term. In addition, rule-based quantitative and qualitative supply control parameters may be prudent on the road to a full integration and gradual price conversion between carbon removals and abatement costs. In the long run, price convergence through gradual integration of the GGR sector into the ETS can realize significant welfare gains.[1]

   However, in the short-term, a quantitative restriction (i.e., supply control mechanism explored in the consultation) could provide certainty that price formation happens efficiently yet in time leading to inter-system price convergence and full integration. In addition, an initial limit on the number of allowances that can be awarded to GGR operators would provide a demand signal for the GGR industry but would avoid destabilising the current ETS markets. While supporting Option 2, we suggest that the Authority further explores its own role in setting and enforcing rule-based controls. To preserve trust in the UK ETS market and guarantee market and environmental integrity, any GGR awarded should derive from a transparently set certification standard developed and/or authorised by the Authority. To this end, it might be prudent to commence with UK-based GGRs, and those authorised within any potential future linked ETSs.

2) Overlapping policies should be carefully assessed to avoid unintended impacts on market stability.

   Preserving market integrity and avoiding undue shocks requires the careful consideration of a broad range of policy measures that may influence the carbon market. Besides the effects of adjustments to the design and height of the cap, volume and price-based measures and their parameters (such as the CCM) and subsidy schemes and business models implemented in parallel to the carbon price should be carefully considered.

3) Take on board good practices from the existing ETS markets such as the maximisation of standardisation and transparency.

   In the interest of transparency and market integrity, it might be beneficial to differentiate GGR allowances from UKAs so that it is clear that the instruments represent two different outcomes; when a covered entity purchases a GGRA they are buying both a permit to emit one tonne of carbon dioxide *and* a removal. The market should carry out due price discovery and formation for this outcome in a separate yet linked market at the beginning. However, any such approach should be carefully assessed against the stability and liquidity of existing UKA markets.

[1] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4422845

In any case, we would however caution against far-going technology-specific differentiation in order to avoid market fragmentation and overly complex compliance structures. This way, the two markets would naturally and gradually converge in prices, during the long-term process of full integration – whilst allowing for differences at the start which adequately reflect abatement and technology costs, aiding efficient allocation of funds.

4) Predictability on the long-term integration pathway should be provided as soon as possible.

   Whilst we appreciate the use of an ex-post assessment after the first year(s) of GGR integration in order to amend any policy provisions, if necessary, we strongly recommend providing long-term regulatory certainty to the extent possible. Clarity on this long-term integration process would greatly benefit market participants to plan strategically, to anticipate and manage associated risks and manage investors' expectations. In addition, this would also support market stability and decrease risk premiums.

**About**

Europex is a not-for-profit association of European energy exchanges with 33 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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