Brexit and the EU emissions trading system

Following an amendment voted by the European Parliament, the Commission has drafted a regulation in preparation for the possibility that the United Kingdom leaves the EU without any agreement concerning its continued participation in the EU emissions trading system (ETS).

Effects of Brexit on the EU ETS

The decision of the United Kingdom (UK) to leave the EU will have an impact on the EU emissions trading system (ETS) in which the UK participates. If the UK should leave the EU with no agreement on its continued participation in the EU ETS, emission allowances created in the UK would remain valid throughout the EU, while the obligation of UK operators to surrender allowances for their emissions would lapse. Due to the EU-wide nature of the EU ETS, the origin of allowances is not known to market participants. Allowances for verified emissions in the year 2018 must be surrendered by 30 April 2019, whereas the UK's EU membership will cease on 29 March 2019 (unless extended by unanimous agreement), meaning that UK operators would not have to surrender allowances for their 2018 emissions. Such a situation would undermine the environmental integrity of the EU ETS by further increasing the existing surplus of allowances.

Parliament's initiative

In order to address this risk, the European Parliament voted on 13 September 2017, on the legislative proposal for the inclusion of aviation in the EU ETS, to add a provision that would prevent aviation operators and other operators in the EU ETS from using allowances that are issued from 1 January 2018 onwards by a Member State whose obligations are to lapse. On 18 October, Council and Parliament reached agreement in trilogue on the aviation ETS file, including the addition of the safeguard measure introduced by Parliament.

Proposed Commission regulation

To implement the agreed safeguard measures, the Commission has drafted a Commission regulation that would require EU allowances created from 1 January 2018 to be identified by a country code, if they are issued by a Member State in respect of which there are obligations for aviation operators and other operators lapsing. Allowances that have such a country code may not be surrendered for compliance with the EU ETS. This would apply to all allowances, whether auctioned, allocated for free, or issued in exchange for international credits. The proposed regulation can be adopted by the Commission once it has received a positive opinion from the EU Climate Change Committee, unless opposed by Parliament or Council. The Commission underlines that the proposed safeguard measures are without prejudice to any future agreement with the UK that may enable UK entities to enforce compliance obligations under the EU ETS for the years 2018 and 2019.

Reaction of the British government

The UK government proposed on 6 November to bring forward the compliance deadline so that UK operators would have to surrender allowances for their 2018 emissions before the UK's scheduled EU exit. In this case, the compliance obligations would not be lapsing. This move is part of wider efforts by the UK to pursue emission reductions, and possibly even remain in the EU ETS until the end of the third trading period in 2020.

Impact on carbon markets

According to carbon market analysts, the measure proposed by the Commission could lead to a fragmented market for EU allowances, with UK allowances trading at a discount to allowances issued by other Member States. Forward trading contracts would also be affected and become more complex. Emissions exchanges would have to adapt their contract definitions. Other impacts might be increased volatility, uncertainty about compliance obligations, lost auction revenue for the UK, and a temporary closure of the EU ETS registry.

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