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Implementation of the funding mechanisms in the EU ETS

State of play

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Agenda

1. Overview of the funding mechanisms
2. Reflections on stakeholder sentiment analysis
3. Reflections on Member State decisions

ERCST & CEEP work: overview

- **Paper published in 2018**: discussing what was known at that point, and highlighting issues to be addressed during the implementation phase.
- **Five workshops organised**: Brussels, Bucharest, Prague, Sofia and Warsaw
- **Survey**: representatives of Member States + representatives of 70 companies and associations
- **Follow-up interviews** and correspondence with Member States
- **Draft paper presented today** – published in the coming weeks

Funding mechanisms: introduction

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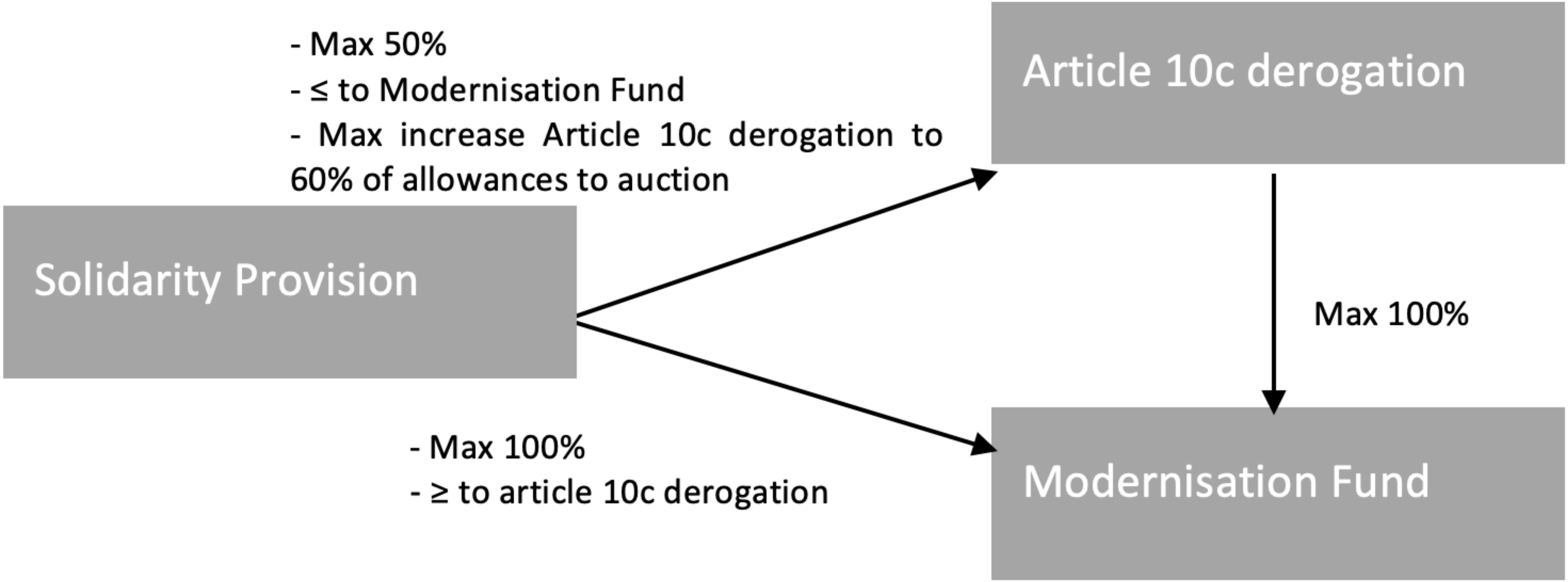
- Four funding mechanisms for the 4th Phase of the EU ETS
    - Update of two existing mechanisms
        - Solidarity Provision
        - Article 10c Derogation
    - Introduction of two new mechanisms
        - Innovation Fund (successor of NER 300)
        - Modernisation Fund

Funding mechanisms: overview

Funding Mechanism	Estimated amount of allowances (million)	Estimated value over phase 4 (in € million) - €25/EUA
Solidarity Provision	798	€ 19 950
Article 10c Derogation	648	€ 16 200
Modernisation Fund	310	€ 7 750
Innovation Fund	450	€ 11 250
TOTAL	**2 206**	**€ 55 150**

Funding mechanisms: interlinkages



Solidarity provision

- **10% of the total quantity of allowances** to be auctioned from 2021 onwards are distributed among eligible Member States for ”the purpose of solidarity, growth and interconnections within the Union”.
- **Eligibility**: Member States with a domestic product per capita at market prices equal to or below 90% of the Union average in 2013.
- **Quantity:** ≈ 798 million EUAs
- **Timeline:**
  - Member States to decide by September 30 how to use the flexibility mechanism

Article 10c derogation

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- **Transitional free allocation** *may be given* to installations for electricity generation: modernise, diversify and transform the energy sector
- **Eligibility**: Member States with a domestic product per capita at market prices below 60% of the Union average in 2013
- **Quantity:**
  - Up to 40% of specific MS allowances to be auctioned over phase 4 ≈648 million EUAs
  - After flexibility: up to 60% of specific MS allowances to be auctioned ≈798 million EUAs
- **Timeline:**
  - Member States to decide by June 30 on use of Article 10c
  - Member States to decide by September 30 how to use the flexibility mechanism

Article 10c derogation

- Some notable changes compared to phase 3:
  - Croatia and Slovakia are now eligible to make use of Article 10c, while Cyprus and Malta are not anymore;
  - While over phase 3 Article 10c Derogation was often used for the modernisation of coal plants, this seems no longer possible in phase 4.
  - Only up to 70% of the investment costs may be supported, provided that the remainder is privately financed.
  - A ‘phase-out obligation’ was introduced/ when an investment leads to additional electricity generation capacity, a corresponding amount of capacity with a higher emission intensity has to be decommissioned.

Article 10c derogation

Option 1: projects above €12.5 million

Competitive bidding process

Option 2: projects below €12.5 million

Selection based on objective and transparent criteria by the MS.

Projects financed up to 70% of the investment costs (remaining costs privately financed)

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Modernisation Fund

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- **Support investments** proposed by Member States, aimed at modernising energy systems and improve energy efficiency
- **Eligibility**: Member States with a domestic product per capita at market prices below 60% of the Union average in 2013
- **Quantity:**
  - Default: 2% of total number of allowances ≈ 310 million EUAs
  - Free allocation buffer not used: up to 2.5% of total number of allowances ≈ 387.5 million EUAs
  - If full flexibility used: ≈1 685 million EUAs

Member State	Percentage of Modernisation Fund	Millions of EUAs
Bulgaria	5,84 %	18.10
Croatia	3,14 %	9.73
Czech Republic	15,59 %	49.33
Estonia	2,78 %	8.62
Hungary	7,12 %	22.07
Latvia	1,44 %	4.46
Lithuania	2,57 %	7.79
Poland	43,41 %	134.14
Romania	11,98 %	37.14
Slovakia	6,13 %	19.00
TOTAL	**100%**	**310**

Modernisation Fund

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- **Timeline:**
  - Member States to decide by September 30 how to use the flexibility mechanism
  - Implementing act to be adopted later this year / beginning 2020.
  - Investment Committee is expected to be established by the second quarter of 2020, with the aim of having its first meeting in the third quarter of 2020.

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Modernisation Fund

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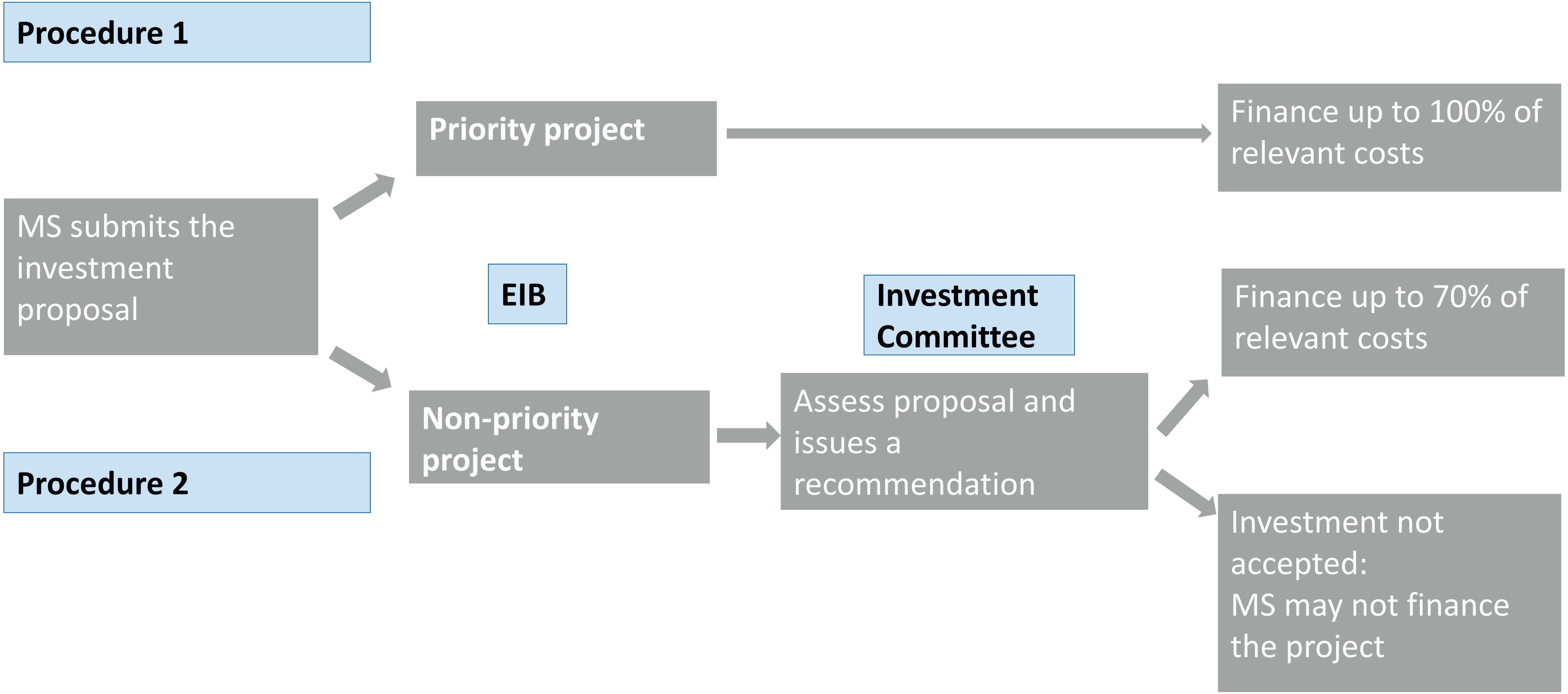
- Modernisation Fund operates under the **responsibility of the eligible Member States**.
- MS is required to send any proposal for funding to the European Investment Bank and the investment committee. The EIB is tasked with assessing whether a proposed project is a priority project or not.
- **Priority area**: generation and use of electricity from renewable sources, the improvement of energy efficiency, except energy efficiency relating to energy generation using solid fossil fuels, energy storage and the modernisation of energy networks, including district heating pipelines, grids for electricity transmission and the increase of interconnections between Member States, as well as to support a just transition in carbon-dependent regions in the beneficiary Member States. Investments in energy efficiency in transport, buildings, agriculture, and waste.
- **Non-priority area**: projects 'consistent with the Union's 2030 climate and energy policy framework and the long-term objectives as expressed in the Paris Agreement'. **No investments can be made in energy generation facilities that use solid fossil fuels**, with the exception of efficient and sustainable district heating in Member States with a GDP per capita at market prices below 30 % of the Union average in 2013 – Romania and Bulgaria.

Modernisation Fund



Modernisation Fund

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Key unknowns likely to be determined in the Implementing Act:

- what information Member States are required to submit to the Investment Committee and the EIB when proposing projects?
- provisions for the election of non-eligible Member State representatives to the Investment Committee.
- provisions outlining the decision-making procedures by the EIB and the Investment Committee.
- provisions on how and when allowances are to be monetised by the EIB.
- provisions to ensure transparency, including reporting requirements for the Member States, the EIB as well as the Investment Committee.
- provisions on how to ensure that the 70-30 proportion between priority and non-priority projects is respected.
- provisions for recovery rules.

Innovation Fund

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- Successor of NER300
- Support innovation in low-carbon technologies and processes
- **Eligibility**: projects in all Member States
- **Quantity:**
  - At least 450m EUAs
  - to be increased by unspent NER300 funds and up to 50m allowances if the free allocation buffer is not fully used
- **Timeline:**
  - Commission delegated regulation adopted on February 26, 2019
  - First call for proposals likely in June 2020

Innovation Fund: some takeaways

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- **Flexible funding**
  - Up to 60% of relevant costs
  - Both up-front and ex-ante
  - Project development support possible
  - Compatible with other types of support
- **Call for proposals**:
  - Determine specific assessment methodology;
  - Determine eligible projects/sectors;
  - Any additional criteria aimed at achieving a geographically balanced distribution
- **Commission has direct governance** – but delegated to implementing body?
- **Role of Member States limited**

Reflections on stakeholder sentiment analysis

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- Stakeholder expectations are high

Table 3: Survey question – 'Which statement best describes the expected impact of the new funding instruments on the low-carbon investment decisions of your company?'

They will be a trigger for new investment decisions	They will have a supportive role in making investment decisions	They will only have a minor influence on investment decisions
35%	55%	10%

Reflections on stakeholder sentiment analysis

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- Types of project companies want to apply for funding with?

Table 4: Survey question – 'for which type of projects might your company apply for funding under the respective funds?'.

Article 10c Derogation	Modernisation Fund	Innovation Fund
Efficient co-generation (47%)	PV (50%)	Low-carbon technologies and processes (79%)
Carbon capture and storage/use (47%)	Onshore wind (42%)	Innovative renewable energy and energy storage (58%)
Smart grids and electricity storage (33%)	Renovation of distribution grids (42%)	Carbon capture and storage/use (48%)
	Efficient co-generation (33%)	
	Carbon capture and storage/use (33%)	

Reflections on stakeholder sentiment analysis

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- Overall, Modernisation Fund preferred over 10c Derogation
  - More companies eligible for funding
  - Up to 100% of relevant costs covered
  - No phase-out obligation
- Highlighted the need for flexible investment schedules – innovation fund finance rules were welcomed
- Several uncertainties were highlighted:
  - Eligibility of certain types of projects (e.g. what qualifies as a non-priority project)
  - Making decisions without all the legislation being in place (Modernisation Fund?)
  - Impact of the revision of the state aid guidelines?
  - Impact of the functioning of the Market Stability Reserve?

Reflections on Member State decisions

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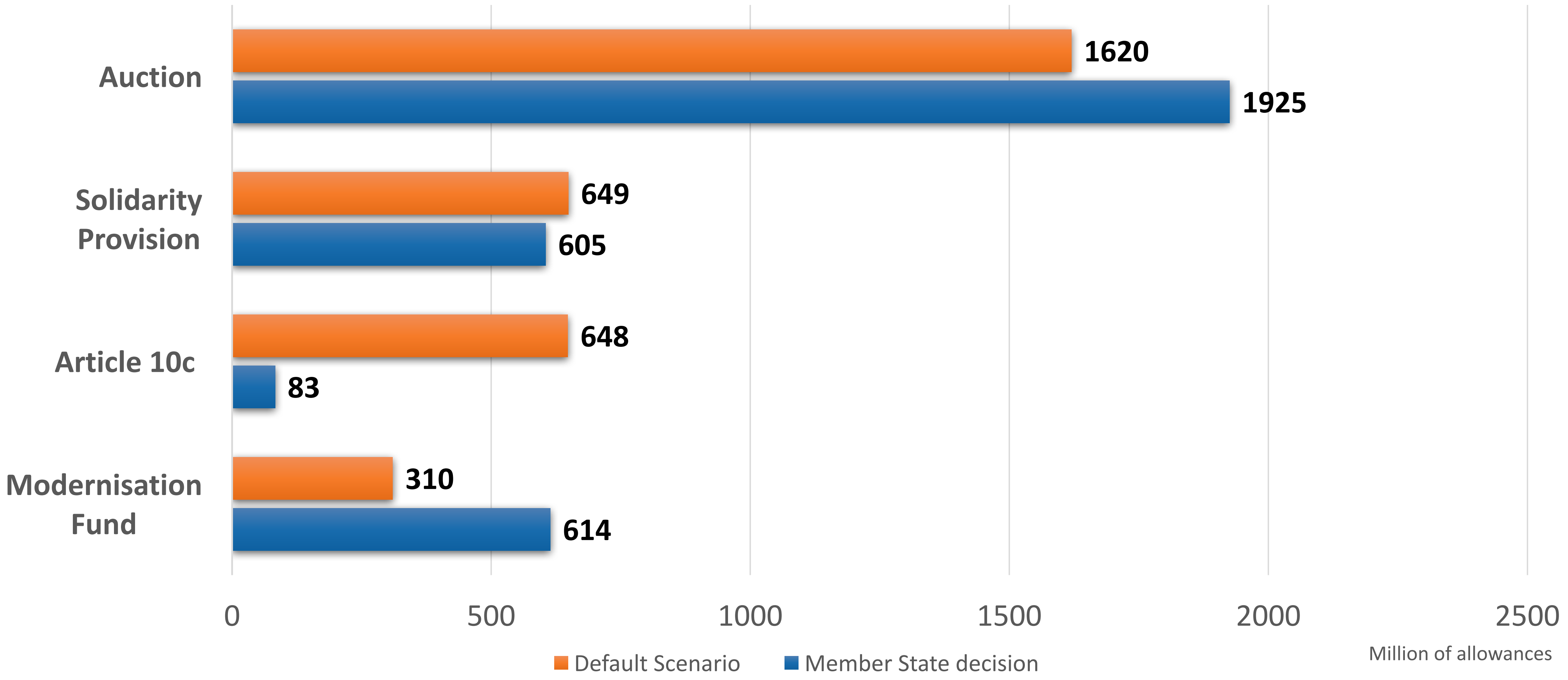
Member State	Use Article 10c during phase 4? *To what extent?*	Transfer solidarity allowances to Article 10c Derogation?	Transfer 10c allowances to the Modernisation Fund? *How many?*	Transfer solidarity allowances to the Modernisation Fund? *How many?*
Bulgaria	Yes *40% of allowances to be auctioned*	No	No	No
Croatia	Yes *20% of allowances to be auctioned*	No	Yes *50% of 10c allowances*	Likely not *To be decided*
Czech Republic	No	No	Yes *100% of 10c allowances*	Yes *50% of solidarity provision allowances*
Estonia	No	No	No	No
Hungary	Yes *40% of allowances to be auctioned*	No	No	No

Reflections on Member State decisions

Member State	Use Article 10c during phase 4? *To what extent?*	Transfer solidarity allowances to Article 10c Derogation?	Transfer 10c allowances to the Modernisation Fund? *How many?*	Transfer solidarity allowances to the Modernisation Fund? *How many?*
Latvia	No	No	*To be decided*	*To be decided*
Lithuania	No	No	Yes *100% of Article 10c allowances*	No
Poland	No	No	No	No
Romania	Yes *Only small-scale projects for a total value of €112 million*	No	Yes *All but €112 million used for small-scale projects*	No
Slovakia	No	No	Yes *75% of Article 10c allowances*	No

Reflections on Member State decisions



Reflections on Member State decisions

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- Reasons to not use Article 10c vary:
  - Latvia and Lithuania: already low-carbon power production system
  - Czech Republic: avoid unnecessary administrative costs of managing two mechanisms
  - Poland: deemed to be an inefficient tool
- Reasons to use Article 10c:
  - Hungary: Independent choice of projects without engagement of other actors
- Flexibility mechanism serves its purpose: Member States is able to pool resources according to their priorities and national circumstances
- Article 10c allowances are viewed and treated differently from Solidarity provision allowances

Reflections on Member State decisions

- How auctioning revenues are used also influences Member State decisions
- Focus will be on priority area projects
- Following Member States decisions, the overall amount of Article 10c + Modernisation Fund allowances decreases by about 260 million
  - This does not necessarily mean that the overall investments for climate and energy purposes will decrease – e.g. the Polish government is planning to use the revenues of its 10c allowances to establish a new national fund.

Conclusions and recommendations

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- **Stakeholder involvement** is necessary and beneficial, and should be ensured going forward in the implementation process
- **Flexibility is important**
  - Modernisation Fund preferred over Article 10c derogation
  - Flexibility mechanism
  - Flexible investment schedules
- **Transparency** should be a key element in the design and use of all funding mechanisms
- An increase of the EU 2030 climate target should not result in a decrease in resources available for the funding mechanisms due to the decreasing cap – ideally, they should even be increased.