HECLA
Emissions Management

December Special

December Special

With only a few weeks remaining until the starting gun fires, the inclusion of the maritime sector into the EU ETS is nearly upon us. Here we bring together a few excerpts from our previous weekly reports into a December Special report that looks at the implications and challenges the ETS will bring to shipping.

Topics include:

If you would like to find out about our research distributions, discuss EUA management/trading or arrange an online demonstration, please email team@hecla-em.com

End-to-end EU ETS Service Provider

Hecla Emissions Management AS is a 50/50 joint-venture established by Affinity (Shipping) LLP and the Wilhelmsen group.

founded 2023	ships managed +500	EUA exposure +1MM
clients +20	Hecla locations 2	client locations 12

E. team@hecla-em.com W. www.hecla-em.com T. +44 203 142 0179

EUA Market 27th Nov to 1st Dec

Prices collapsed for the third week running last week, falling to the lowest levels since October 2022. However, a bullish reversal on Friday could provide a glimmer of hope to those struggling with their long positions. The repositioning of options traders will be a key driver in the last trading days leading up to the options expiry on 13th December. Nearest strike prices on the Dec-23 put options are €70 – this strike also has the highest open interest after the unlikely looking €80 strike for a total put/call ratio of 0.88. The market is looking bearish…

Weekly (27/11 - 01/12)	
Open	€ 76.34
High	€ 76.50
Low	€ 70.44
Close	€ 72.45
Change	-5.4%

Forward Curve (04/12)	
Dec-23	€ 71.03
Dec-24	€ 74.11
Dec-25	€ 76.91
Dec-26	€ 80.06
Dec-27	€ 83.11

Technicals	
MACD	Negative
Bollinger %	8%
RSI	32.8
Volume	128.5k
Volume change	33%

EUA Front December 1Y Timeseries (€/tCO_2)

Opinion

Worldscale

Worldscale has released its much-anticipated system for including the EU ETS in its freight rate methodology for tankers trading on the spot market. The Worldscale system is a globally recognized method for pricing oil tanker freight rates. Tanker voyages are categorized into "Worldscale points," representing a percentage of a nominal rate. A benchmark route is assigned a Worldscale rate of 100 and other routes are assessed relative to this benchmark.

Until now, it was unclear how (if at all) Worldscale was going to include the EU ETS. Last week however, Worldscale released its methodology for scrutiny. EUAs will be calculated using a specified methodology, including factors such as miles per day, fuel consumption, emission factors, and port related considerations. Percentage factors are applied for EU to EU, EU to Non-EU, and Non-EU to Non-EU passages. Tapering for the phase-in is also included.

Different types of tankers are given fixed consumption figures and fixed daily EUAs for demurrage claims. Once the class of tanker is selected (which is based solely on size and not on age) then the only upfront variables involved are (i) sailing distance and (ii) number of EU port calls in the voyage.

This methodology has upsides. Firstly, charterers will be able to fix the exact cost of the voyage upfront when making the rest of their voyage calculations.

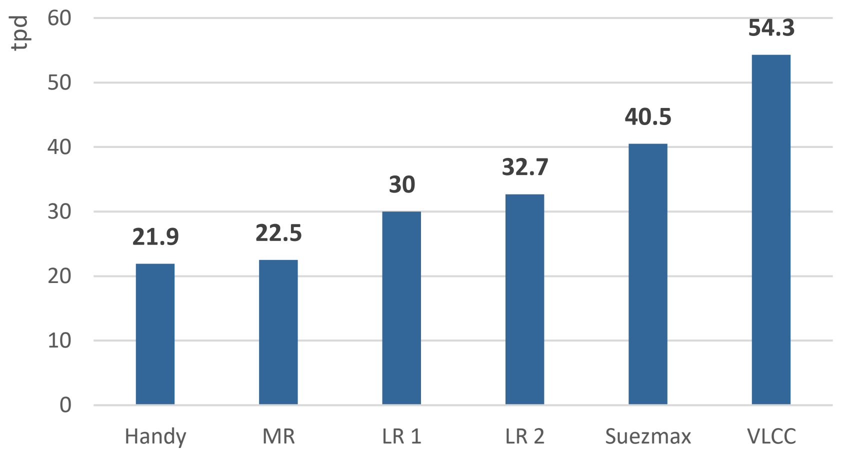
Secondly, the simplicity means that there is no requirement for extra calculators or tech – Worldscale will incorporate the methodology into their online login. There are, however, some clear drawbacks.

The most obvious is that if a given tanker burns more than the Worldscale standard tanker (see graph top right) then the owner will always receive fewer EUAs than are required for compliance. At the end of the voyage, the owner will always have to dip back into the market to purchase the balance of EUAs they did not collect from the charterer.

In fact, even if a given tanker burns less than the Worldscale anticipated amount, an extra degree of accounting is required to allocate the over-estimated EUAs to vessel voyages.

One point that the methodology does not prescribe is the settlement of EUAs. This means that either the charterer will purchase the EUAs and transfer them to the owner or the owner will purchase the EUAs and include the sum into freight. Worldscale will not be involved in the settlement and each party is free to negotiate how settlement will occur.

Daily Fuel Consumptions for Worldscale EUA Calculator



We are yet to see how the wider market will react to this methodology. From our initial discussions, it has obviously gone down well with owners of younger, more efficient tonnage and less well with owners of the opposite.

While for time-charters post-voyage validation is of course advised, a pre-voyage estimate that gains currency in spot tanker markets could raise questions over the value of post-voyage emissions verification tools. With the calendar not far from seeing laycans into next year, we will keep you updated on whether the market is trying out pre-voyage estimates of post-voyage validations. Most likely, however, it will be a bit of both.

Daily Tanker Costs

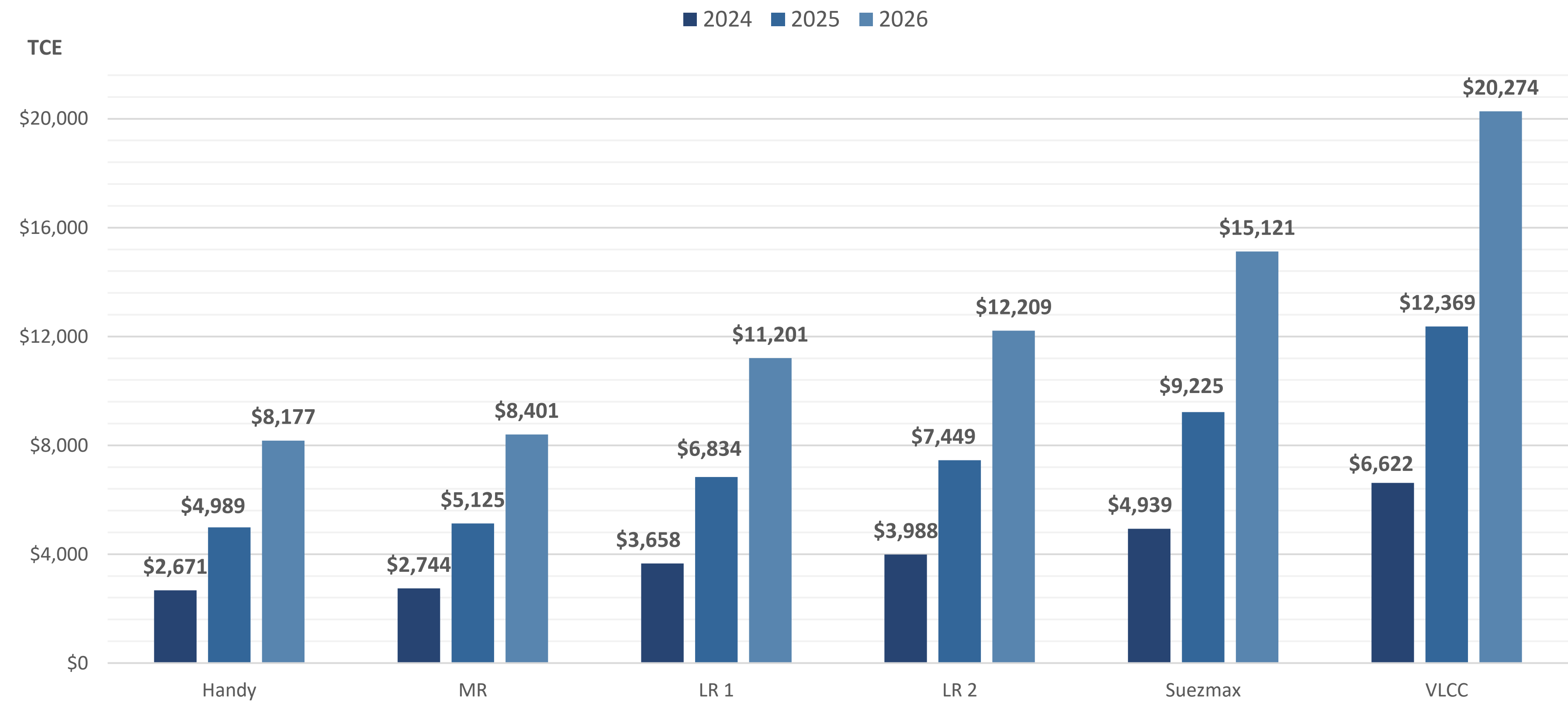
Assumptions

Intra-EU sailing (i.e., divide by two for inbound/outbound sailing)

Worldscale consumption figures

Average analysts forecast for EUA price (€89, 2024; €95, 2025; €109, 2026) – see page 7.

EUR to USD = 1.1



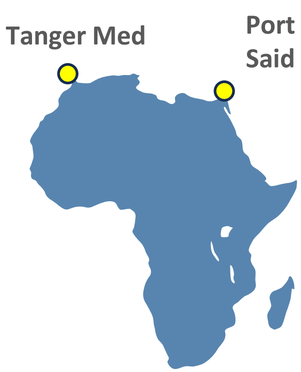
E. team@hecla-em.com W. www.hecla-em.com T. +44 203 142 0179

Opinion

Transshipment Hubs

Politics The European Commission has included Tanger Med and Port Said, two pivotal transshipment hubs, in the EU ETS. The proposal of including neighbouring ports into the EU ETS is designed to reduce the risk of evasive port calls. Now the Commission has published a note that provides more details on the initial proposal. In order to be identified as a neighbouring transshipment port, and therefore excluded from the definition of 'port of call' stops:

1. The port must be located outside the Union but less than 300 nautical miles from a port under the jurisdiction of a Member State.
2. The port's share of transshipment of containers must exceed 65% of the total container traffic of that port during the most recent twelve-month period.
3. If the third country has applied measures equivalent to the EU ETS then it will be counted as a 'port of call' stop.



The third point, about equivalent measures in third countries effectively working as a veto to the EU's demands, is salient. It displays, in no uncertain terms, the EU's ambition that third countries develop their own Emissions Trading Schemes.

According to this idea, if a third country does not apply their own ETS to their emissions, then the EU sees itself at liberty to tax them instead. It is important to bear in mind that in the Maritime ETS regulation itself, there is a provision to revisit the 50% charges on inbound and outbound voyages if by 2028 other countries have not come forward with their own ETS to collect the other 50%.

New Surrender Deadline

Following the EU's adoption of the new Fit for 55 Regulation, the wider carbon market has been analysing the effect of the compliance deadline moving from April to September for the 2024 period.

Historically, the EUA futures have evolved around several key contracts: December and March. The December futures have always been most liquid as the power industry, the main compliance buyers, would typically link their hedging to an annual cycle, but as active trading of EUAs became more widespread, more liquidity settled on the March contract allowing trading desks to take physical delivery of their futures positions ahead of the surrendering deadline on 30th April. This activity led to a seasonal increase in EUA prices ahead of the expiry of these two contracts: traders with short positions would need to buy back futures and so the price would get squeezed higher close to expiry.

It follows, therefore, that this seasonality will shift with the change in the compliance calendar. August futures will become the new March if patterns persist, and we could see a more active Summer for carbon desks. Furthermore, the prevalence of December EUA futures may well come under pressure as the calendar becomes more spaced out and traders look to hold their futures positions longer than year end until the following August. The new regulations will also trigger a change in the distribution of free allocations. In previous years these were given out in Q1, contributing to the general volatility in March.

From 2024 free allowances will be received in June which will alter the way in which those in receipt will look to trade those positions and the price implications. All in all, the EUA market is heading for a substantial restructure. Whilst Hecla believes that most shipping companies will be focused on the accurate collection and transfer of physical EUAs to be compliant (particularly in 2024 and 2025) as opposed to investing in the controls and systems necessary for futures access, those shipping companies with a higher risk appetite will not be able to rely on the tried and tested price seasonality of years gone by.

Opinion

Compliance Entities

The European Commission has issued a new regulation (C(2023) 7831 final) outlining rules for the administration of shipping companies within the EU ETS. There are three options for managing the practical aspects of compliance related to the EU MRV and EU ETS.

1. The owner takes the responsibility. The registered owner establishes a monitoring system, develops a monitoring plan and submits it to the Administering Authority (AA).
2. The owner delegates practical monitoring to the ISM Company. The registered owner retains responsibility, but delegates practical monitoring to the ISM company.
3. The owner delegates responsibility to ISM Manager. The registered owner delegates the compliance responsibility to the ISM manager with a document signifying the delegation of responsibilities.

The regulation prompts several thoughts. Firstly, owners can no longer afford to sit back and expect the technical mangers to create the processes required for managing the EU ETS. While technical managers can still become the compliance entity, this arrangement must be agreed by both parties in writing and then the requisite paperwork sent to the administering authority.

Secondly, the relationship between the MRV and the EU ETS is still unclear. If the owner takes responsibility for the EU ETS in its entirety, then the owner must also take on the responsibility of the MRV. However, there may still be allowance for the ISM code holder to maintain the “practical” parts of the MRV if the owner is then the entity which submits the reports to Thetis. It is not clear whether the ISM code holder will be able to submit the reports to Thetis on behalf of the owner if the owner is now responsible for the MRV.

Lastly, the new regulation highlights the importance of shipowners having access to trading accounts. While it is useful for the technical manager’s role to be cleared up somewhat, it should not distract from the fact that owner should not rely on the technical manager for *commercial* management of EUAs.

Dry Bulk FFAs / EUAs

Not to be left out of the regulation shake up, The Baltic Exchange today announced that panelists for C2 and C7 capesize routes would be required to include EU ETS costs from 1st January 2024, but in doing so have highlighted a potential difference in approach between dry bulk and tankers.

The C2 and C7 routes cover iron ore and coal shipments from South America to Europe and have been central to the speculation of how the dry bulk market will deal with carbon pricing in its key benchmarks. Although the exact impact of this move – and the ability of the market to accurately gauge the real EUA cost - is central to dry bulk capesize market participants and FFA traders, the wider implication of the move is more interesting to the rest of the industry.

In their consultation paper earlier this year, the Baltic noted that market participants believe that Shipowners would end up pricing the carbon cost into spot freight rates and then buying EUAs themselves. This move on the C2 and C7 would seem to uphold that, but it would be in contradiction to the direction taken recently by Worldscale for spot tanker markets.

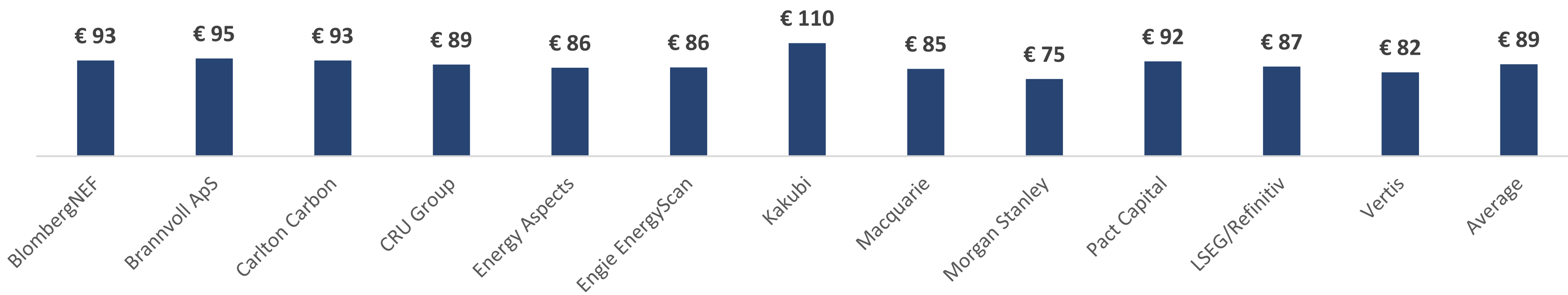
In response to their position as pricing arbiters in the spot tanker market, Worldscale released a methodology (reported on by Hecla in Week 44) whereby spot tanker owners and charterers would have a benchmark EUA volume for a number of different routes, thus making it easier for charterers to buy a set volume for transfer to the shipowner.

Although criticised by some market participants, if adopted the Worldscale approach would set a different course for tankers compared to the dry bulk market when it comes to EU ETS.

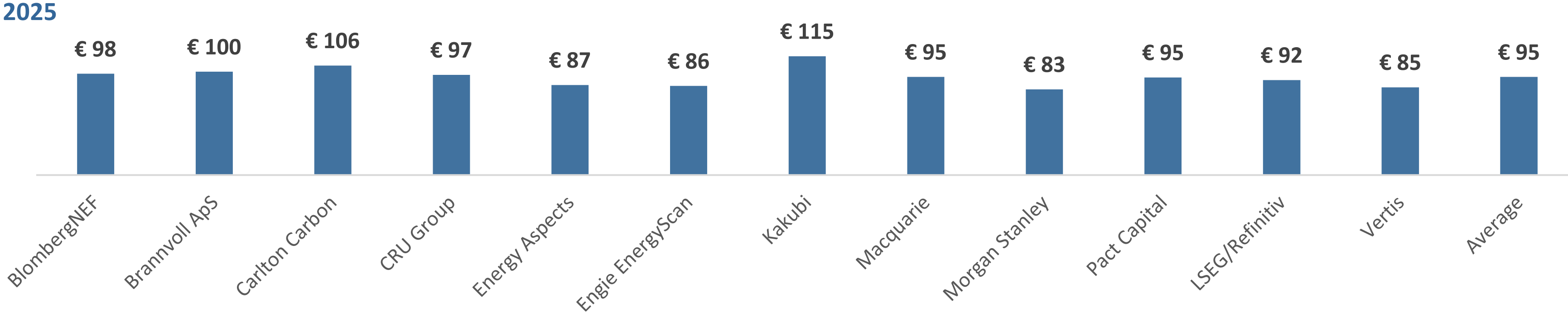
As voyages begin to be fixed that could hang into the 2024 compliance period, the debate will no doubt speed up and heat up with money on the line.

EUA Price Forecast – Industry Poll

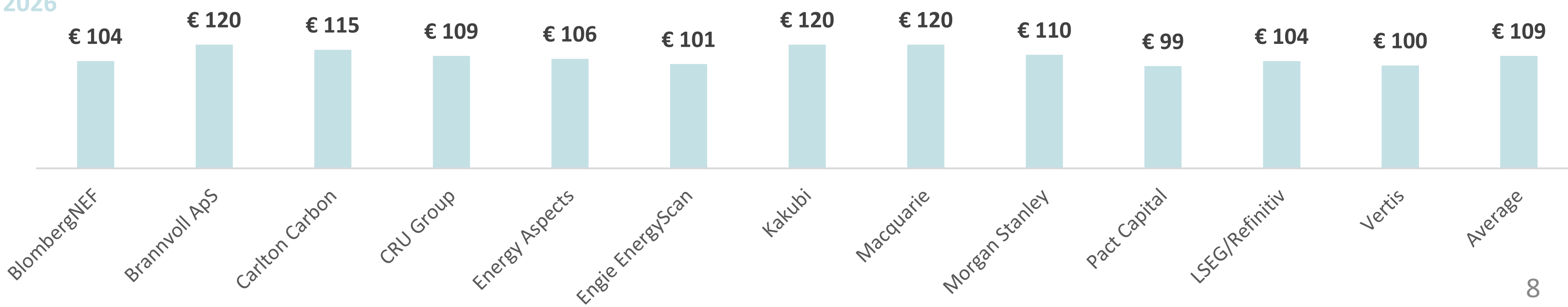
2024



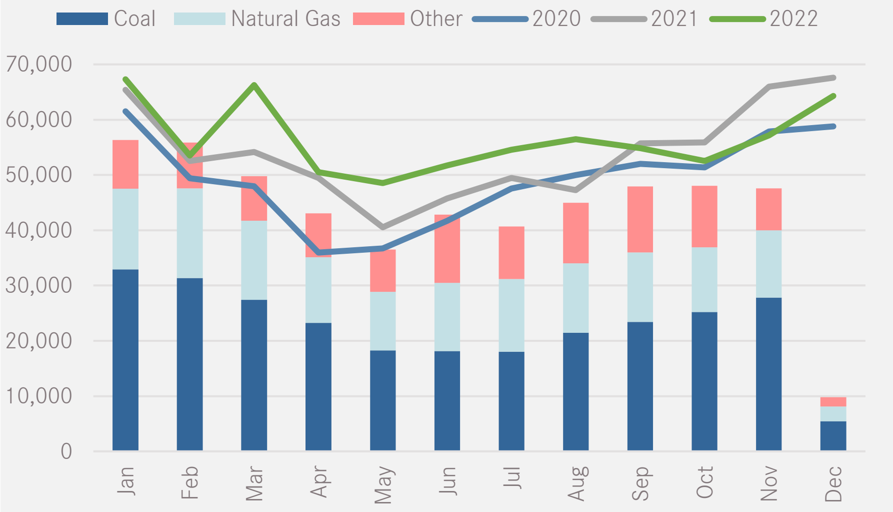
2025



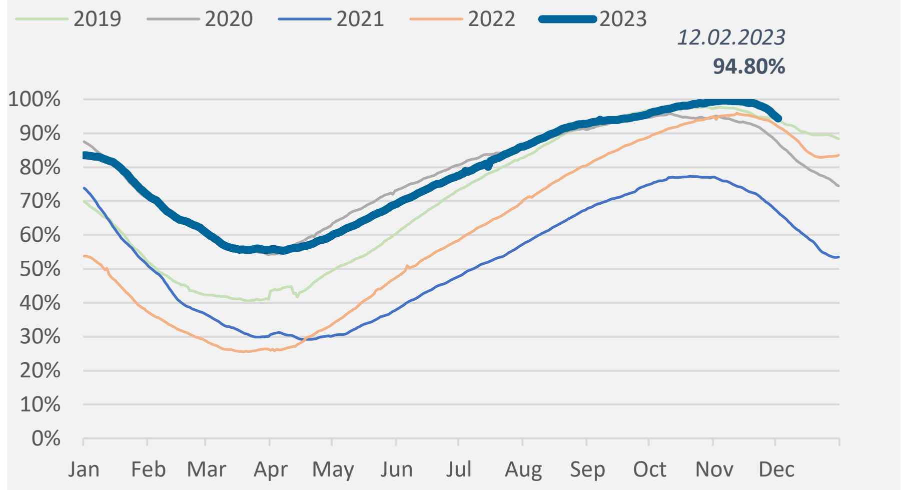
2026



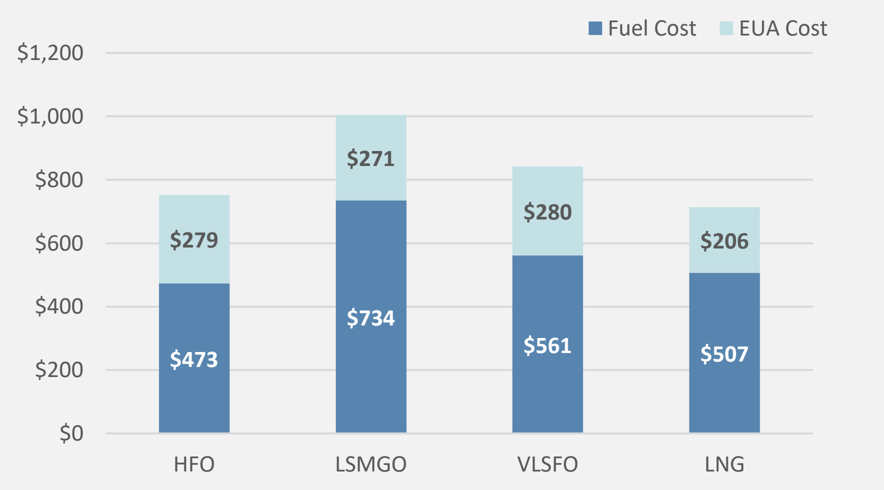
EU Monthly CO_2 Emissions Mix ($ktCO_2$)



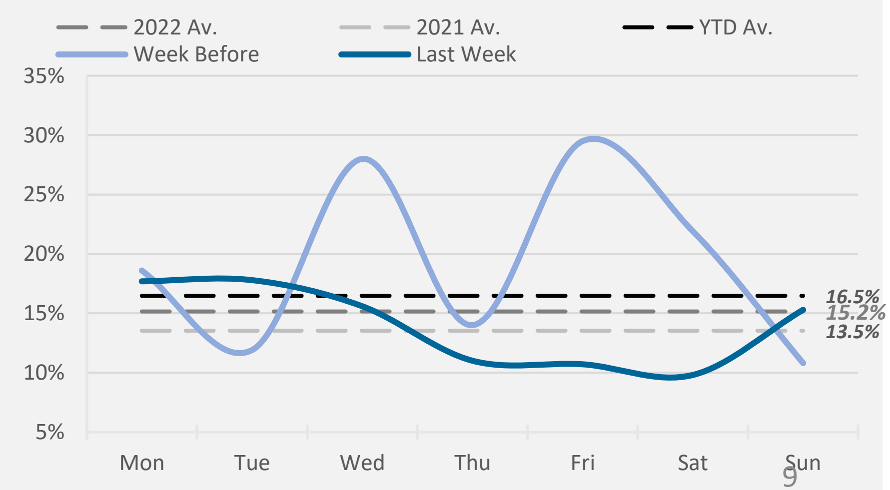
EU Gas Storage Levels (AGSI)



Bunkers Plus Carbon, Basis Rotterdam (USD/HFO-equivalent ton)



Share Of Wind Energy In European Electricity Demand (Percent Of Total)



E. team@hecla-em.com W. www.hecla-em.com T. +44 203 142 0179

Service Offering

Hecla Emissions Management has been created to assist clients with all the compliance obligations associated with managing the EU ETS.

Hecla centralises the ETS value chain within one workflow and allows the customer oversight through its digital platform.

Registry Establishment
Streamlined process for creating trading registries and/or custody arrangements

Data Integration
Visualisation of ETS applicable emissions with input from verifiers

Carbon Market Advisory
Provision of commercial advice on EUAs

EUA Procurement
Direct access to buy and sell allowances

Registry Management
Back-office services including transfers to owners

Compliance Management
Assisting DOC with surrendering requirements

Weekly Report Contacts

Hugo Wilson
E. hugo.wilson@hecla-em.com

Benjamin Gibson
E. benjamin.gibson@hecla-em.com

Malcolm Hollingworth
E. malcolm.hollingworth@hecla-em.com