RFA RENEWABLE FUELS ASSOCIATION

What Role Did Speculation Play in the March 2013 RIN Price Spike?

The Renewable Fuel Standard (RFS) requires refiners and importers ("obligated parties") to blend specified amounts of renewable fuels with gasoline and diesel each year. Obligated parties demonstrate that they have met or exceeded their annual RFS blending requirements by submitting RINs (Renewable Identification Numbers). In essence, RINs are serial numbers assigned to every gallon of renewable fuel. When a refiner or blender purchases a gallon of renewable fuel, they also receive the RIN. When that gallon of renewable fuel is blended with gasoline or diesel fuel and placed into commerce, the obligated party separates the RIN from the gallon. The RIN can then be submitted to EPA to demonstrate compliance, banked for compliance with next year's RFS requirements, or sold to other regulated parties on the open market. Thus, if obligated parties blend more renewable fuel than is required by the RFS, they are in a position to sell surplus RINs to other market participants. Because obligated partied have generally used more ethanol than required by the RFS in previous years, a massive bank of RINs has been accumulated. EPA recently estimated the stock of surplus RINs at 2.6 billion.

In finalizing the RFS1 regulation in 2007, EPA opted to open the RIN trading market to third parties who are neither renewable fuel producers nor obligated parties under the RFS. The Agency argued that doing so would enhance liquidity in the RIN market. EPA responded to concerns about the potential impacts of speculation on RIN prices by arguing that "…by expanding the number of parties that can hold RINs, we minimize the potential for any one party to exercise market power, and thus we do not believe that such activity on the part of speculators is likely to substantively affect the availability of RINs or their price."[1] As a result, EPA's list of regulated parties shows a significant number of third-party firms who likely trade RINs, but do not typically trade the underlying physical renewable fuel products.[2]

From the beginning of the RFS2 program until February 2013, RINs typically traded in the $0.02-0.04 range (Figure 1). However, in the fall of 2012, RIN prices rose to the $0.05-0.08 range and remained there until mid-January 2013. This was expected, as the 2012 drought had reduced corn supplies and ethanol production had fallen by ~10%. By the end of January, RIN prices had risen to $0.28. Prices fluctuated between $0.25 and $0.29 until February 20, when the price jumped to $0.34. Prices rose further to $0.44 by February 25. Then, in the nine trading days between February 26 and March 8, RIN prices inexplicably spiked to $1.05. Prices peaked at $1.055 on March 11, and have since retreated to the $0.60-0.70 range.

The sudden surge in RIN prices has provided fodder for oil companies who wish to repeal the RFS. They argue that the E10 "blend wall" prevents them from using physical gallons of renewable fuels to meet 2013 RFS requirements, and they suggest the cost of RINs will be passed on to consumers in the form of higher gas prices. Indeed, the oil industry suggested higher RIN prices were a factor in this spring's higher gas prices, <u>despite the fact that retail gas prices spiked long before RIN prices increased, and gas prices fell while RIN prices were rising</u> (Figure 2). The spike in RIN prices has also caused many to

[1] EPA Summary and Analysis of Comments. EPA420-R-07-006, April 2007. Note that Magellan, Shell/Motiva, Sutherland Asbill Brennan (representing petroleum product importers, blenders, and traders), and the Independent Fuel Terminal Operators Association were among stakeholders supporting the inclusion of non-obligated third parties in the RIN trading market.
[2] See EPA "Part 80: Fuels Program Registered Company/Facility ID List." Available here: http://www.epa.gov/otaq/fuels/reporting/programsregistration.htm

question the functionality and transparency of the RIN market. Market participants and observers have suggested speculative buying by non-obligated parties was a factor in the RIN price spike. For example:

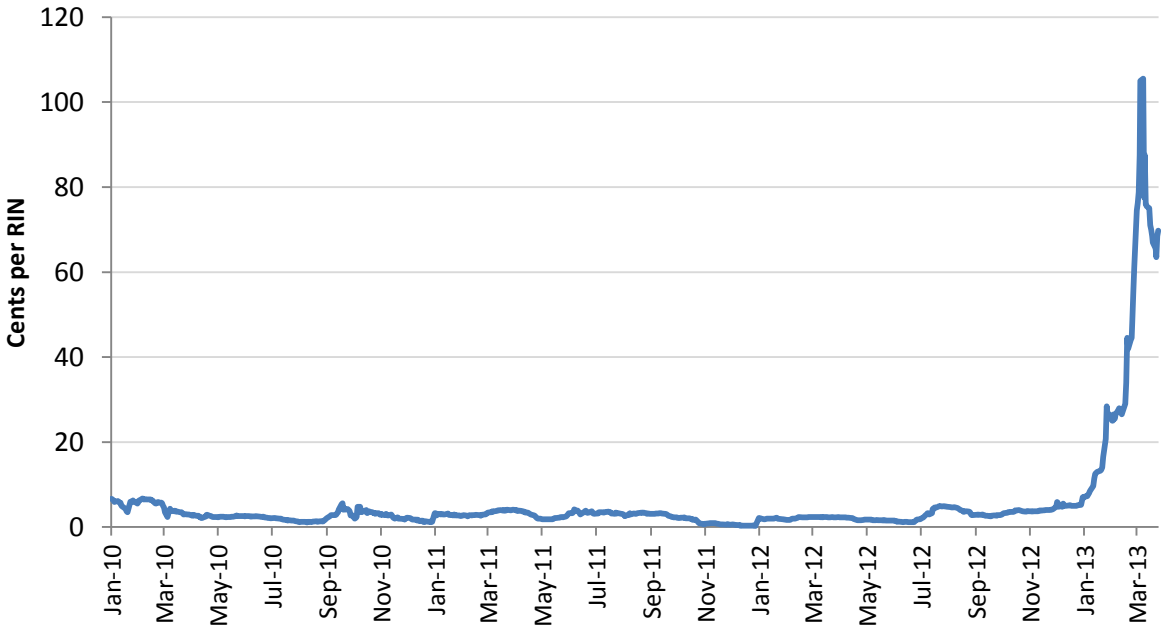
- "*The notion that commodity brokers, hedge funds, and other non-obligated parties are participating in this market, and using it as a casino, defies both logic and the intent of the Renewable Fuels Standard (RFS).*"-- Mike Jennings, CEO of oil refiner HollyFrontier[3]

- *"You can tell people are buying RINs, hoarding RINs, keeping RINs, not selling RINs - they think prices are going higher, and when you get into a squeeze, how high is the price?"*-- Valero Energy CEO Bill Klesse[4]

Unfortunately, it is impossible for the public to know what factors led to the unusual spike in RIN prices in mid-March. Information regarding RIN prices, the daily or weekly volume of RIN transactions, the identity of parties buying and selling RINs, and other key information is not available to the public. Only EPA has visibility on this information, and the RIN market remains entirely opaque to the public. Further, daily RIN prices are reported by energy trade publications such as OPIS, Argus Media, and Platts. The methodology used by these publications for reporting RIN prices isn't always clear, and it unknown what volume of trades is represented by the daily quoted price.

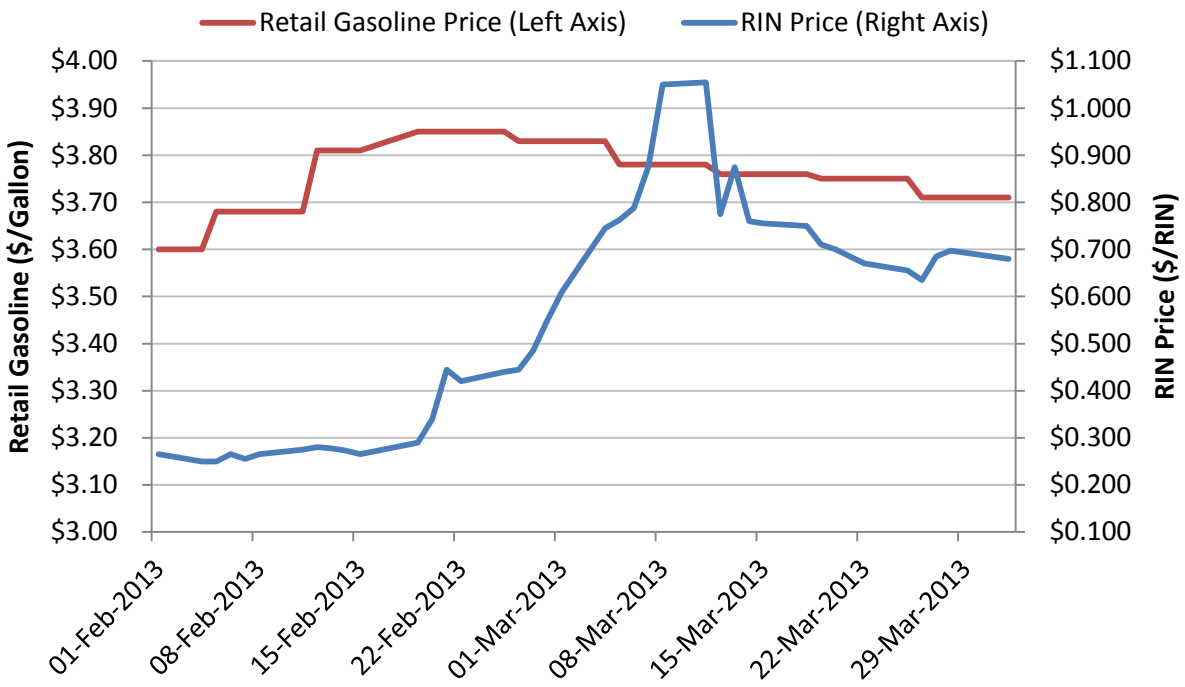
Due to the total lack of transparency in the RIN market, further investigation into the factors behind the recent RIN price spike is justified. Additionally, EPA should immediately consider measures that can be taken to provide greater transparency in the RIN market.

FIGURE 1. DAILY PRICE FOR CORN ETHANOL RIN



[3] See http://www.reuters.com/article/2013/03/19/hollyfrontier-rins-ceo-idUSL1N0CB53K20130319
[4] Ibid.

FIGURE 2. RETAIL GAS PRICES AND RIN PRICES



Source: Figure 1: OPIS and Argus; Figure 2: EIA and OPIS.