E3G

BACC BUSINESS ADVISERS ON CLIMATE & COMPETITIVENESS

Unpacking the EU ETS review proposal

Implications for industrial frontrunners, competitiveness and climate

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Introduction

Purpose and scope of the webinar

- Analytical discussion rather than a comprehensive technical walkthrough.
- Focus on ambition, carbon leakage and investment support.
- Read the proposal through the lens of industrial business cases and climate delivery.

CONTENT

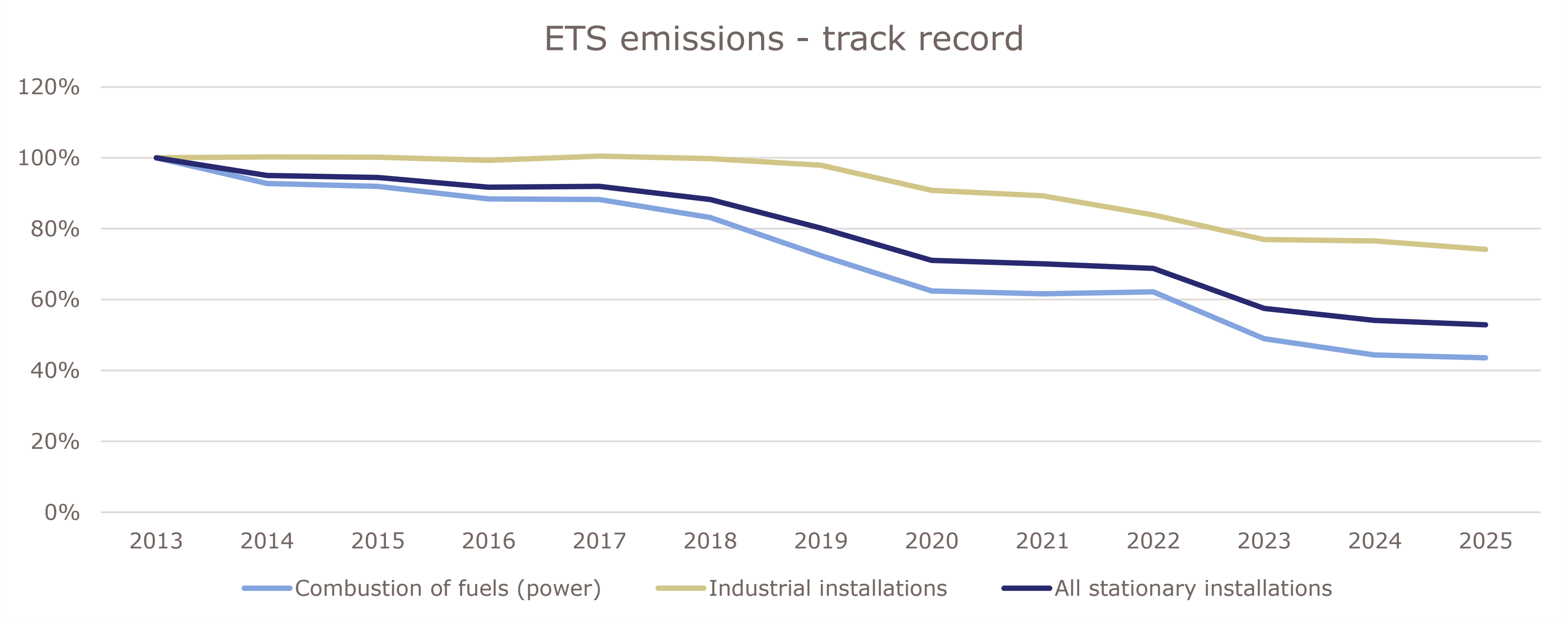
- Ambition, flexibilities & MSR
- Carbon leakage protection
- Revenue use and funding instruments
- Conclusion and discussion

What this webinar does not cover:

- Aviation
- Maritime shipping
- Waste incineration
- CCU

The EU ETS – a brief recap

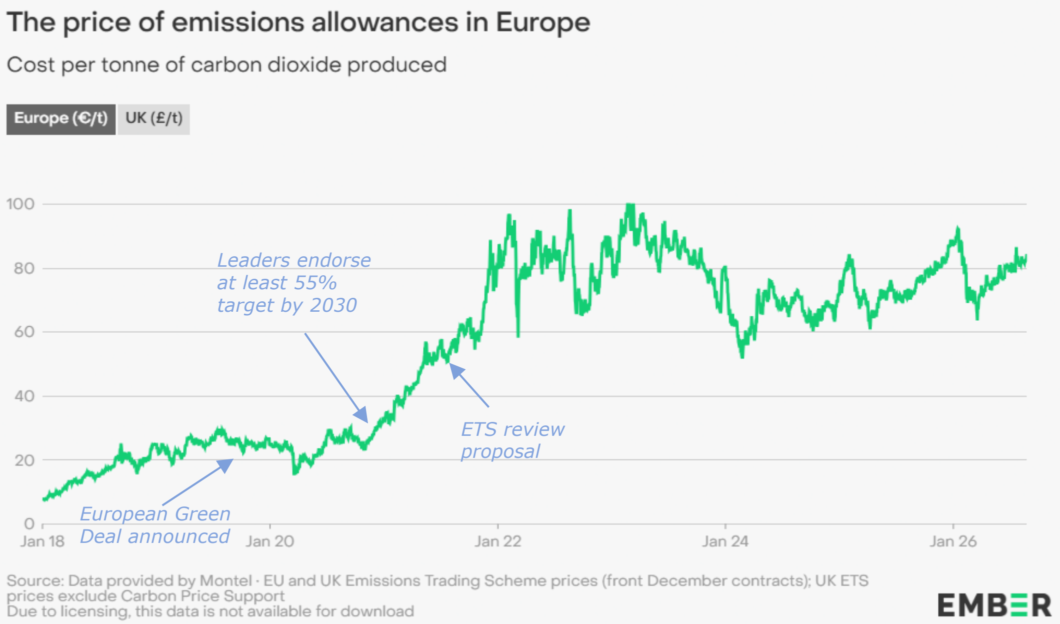
ETS EMISSIONS HAVE FALLEN BY NEARLY 50% SINCE 2013, BUT MUCH FASTER IN THE POWER SECTOR

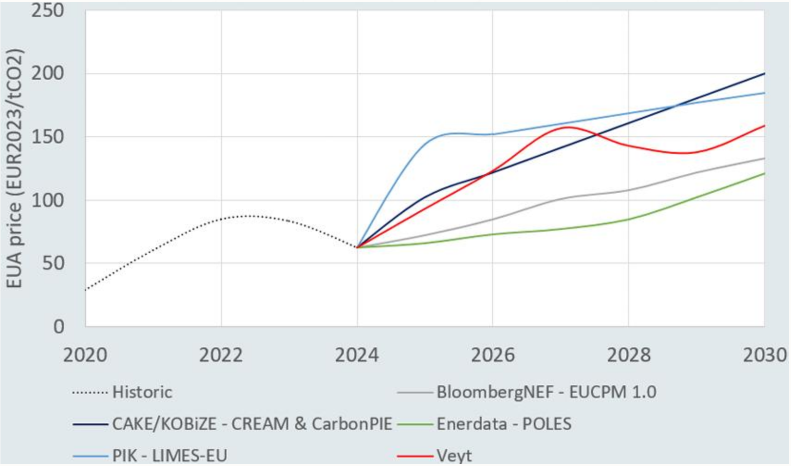


Source: E3G based on EEA data

The EU ETS – a brief recap

THE FIT FOR 55 ETS REFORM SIGNIFICANTLY INCREASED AMBITION AND EFFECTIVE & ANTICIPATED CO2 PRICES

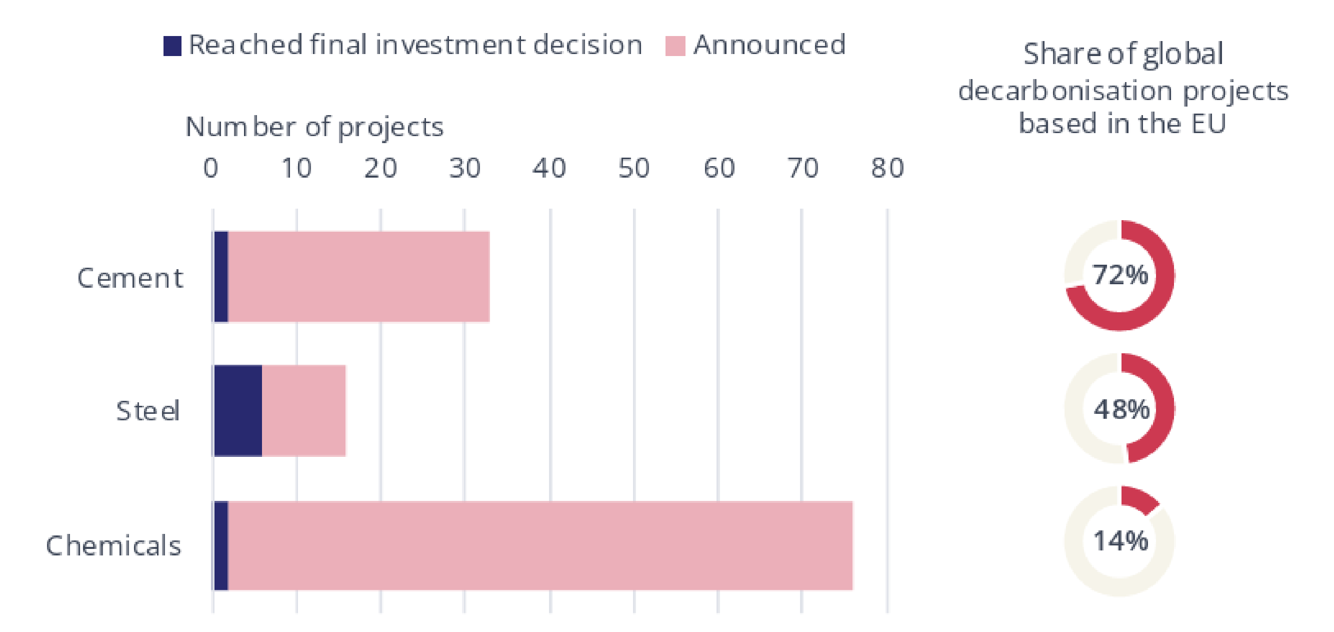




Source: Ariadne project

The EU ETS – a brief recap

SIGNIFICANT INVESTMENTS MADE OR ANNOUNCED IN EUROPE ON THE BACK OF THIS

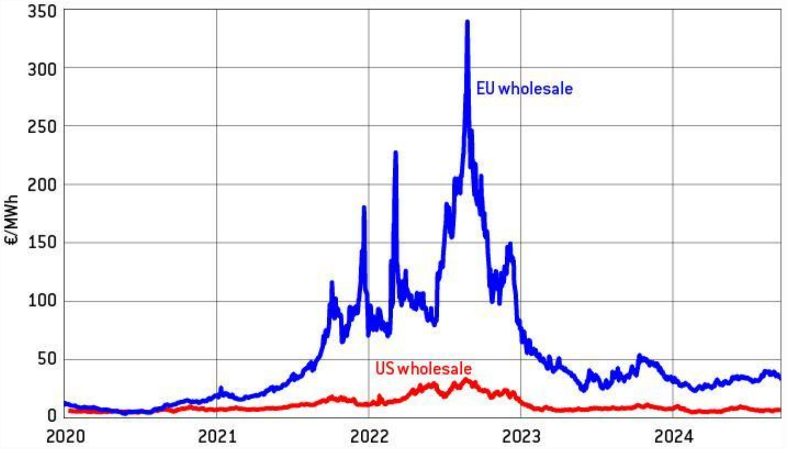


Source: E3G based on Mission Possible Partnership project tracker (2025)

The EU ETS – a brief recap

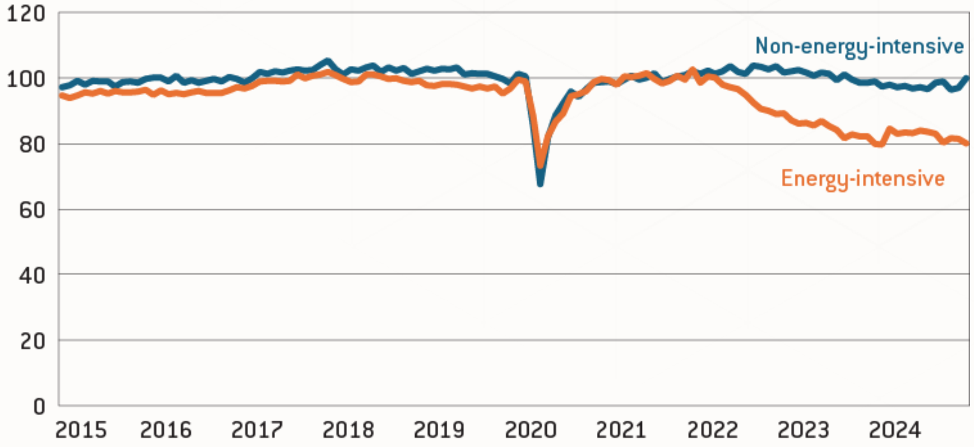
ENERGY CRISIS, TRADE PRESSURE AND DECLINE IN INDUSTRIAL PRODUCTION PUTS POLITICAL PRESSURE ON THE ETS

EU wholesale gas prices compared to the US



Source: Bruegel

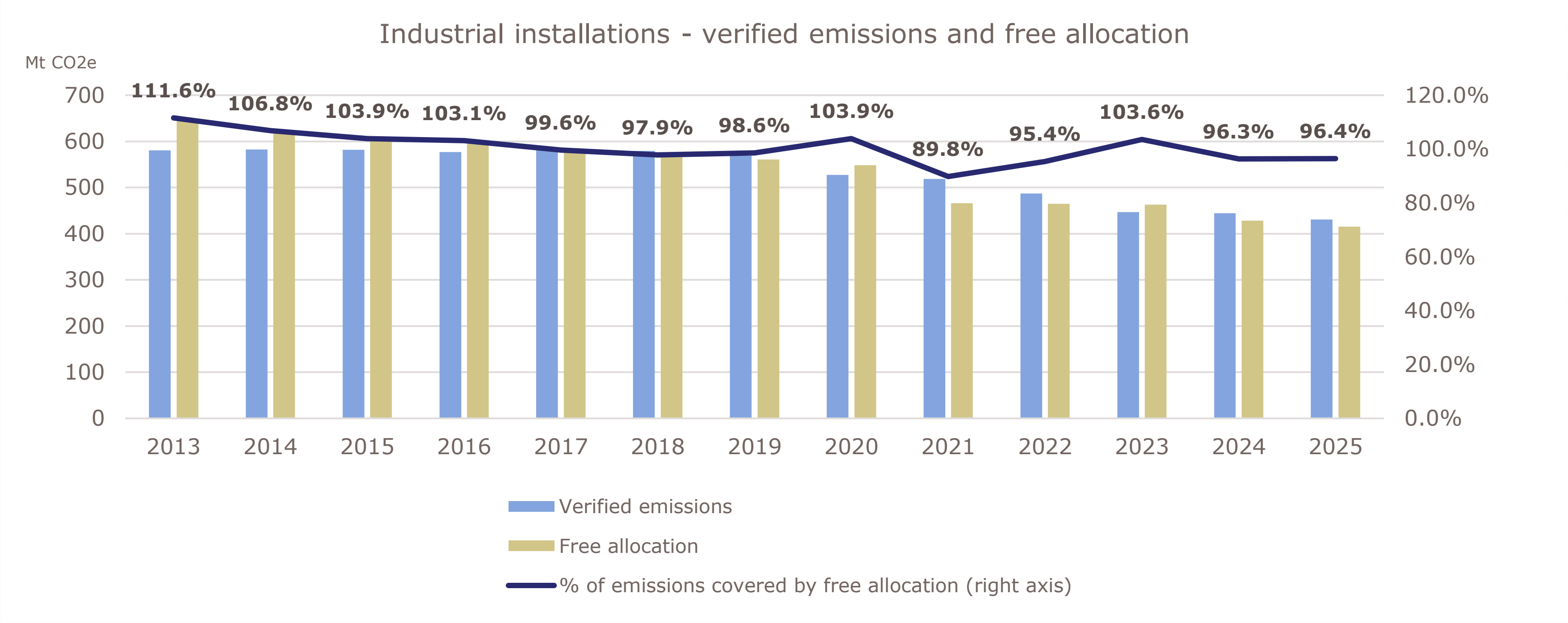
Indexed EU industrial output, energy-intensive and non-energy-intensive sectors



Source: Bruegel

The EU ETS – a brief recap

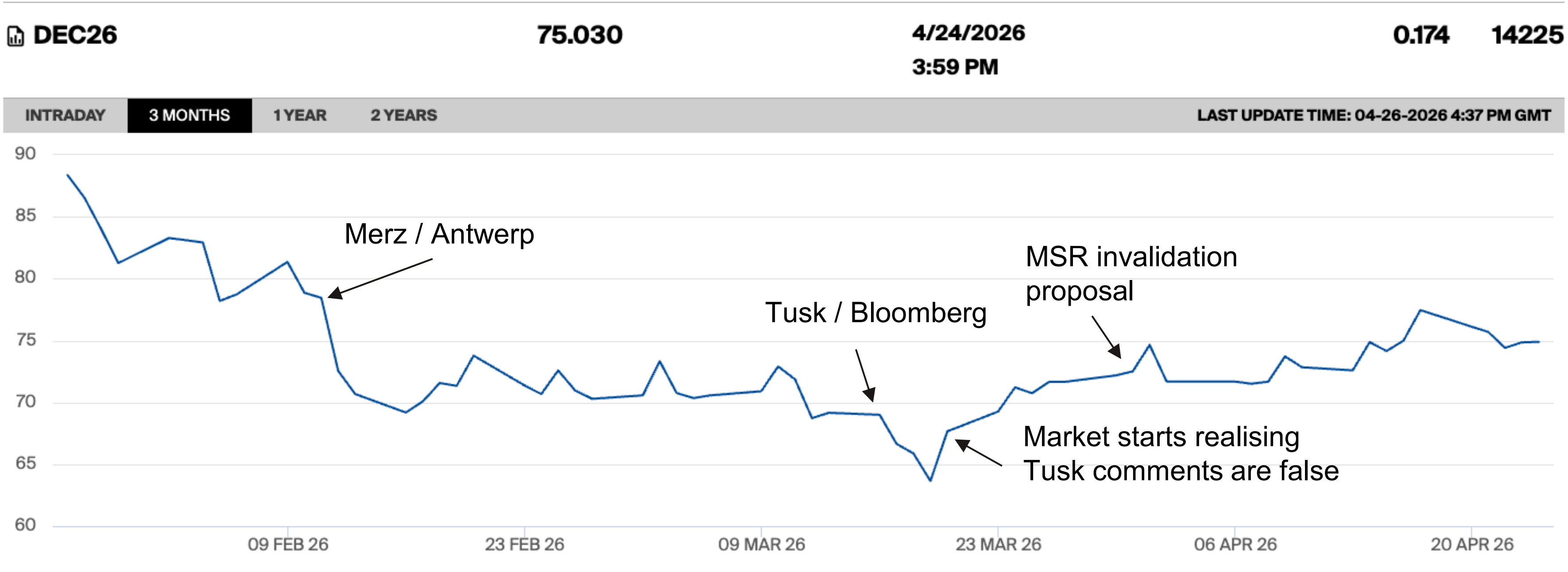
FREE ALLOCATION CONTINUES TO COVER THE VAST MAJORITY OF INDUSTRIAL EMISSIONS



Source: E3G based on EEA data

The EU ETS – a brief recap

INCREASED POLITICISATION OF THE ETS LEADS TO PRICE UNCERTAINTY



Source: ICE Index, EUA futures

How to read the ETS proposal

- The Commission's balancing act: **providing more space for industry, increase investment support and achieve 2040 targets**.

- Inevitably results in some tensions:
  - The proposal technically preserves the integrity of the EU ETS cap and 2040 target, but with some major risks and uncertainties.
  - Several measures strengthen the investment architecture while others weaken the market signal.

- **Core question: how do the proposed changes impact the (long-term) investment signal?**

Ambition, flexibilities & MSR

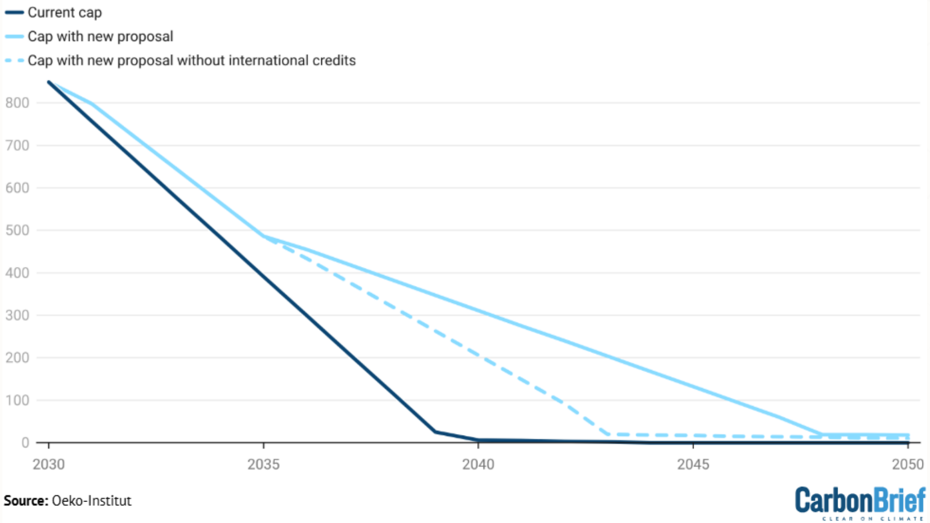
The post-2030 emissions trajectory

MORE FLEXIBILITY, LESS CERTAINTY

- Declining LRF presented as consistent with the 2040 target.
- Proposal before 2031: no change to the Linear Reduction Factor.
- From 2031: LRF drops from 4.4% to 3.7%, then 1.7% from 2036 if international credits materialise (OR 2.7% - if they do not).
- **Core question**: Were early movers expecting the LRF to continue at 4.4% beyond 2031?
  - Seems so, e.g. group of early mover steelmakers with > EUR 10 bln in FIDs.

Emissions would drop more slowly in the EU carbon market under new proposals

Different trajectories for emissions cap reductions in the EU Emissions Trading System over 2030-2050, (MtCO2e)



Source: Oeko-Institut

Flexibilities: international credits

- **Proposal**: Up to 260 million allowances set aside;
- the 1.7% LRF is predicated on this exact number of 'cost-effective' credits materializing until the 2033 report.
- **Our assessment:**
  - Weakens the carbon price and revenues; redirects ETS resources abroad mid-transition.
  - Cost-effectiveness is a criterion; implies that credits must undercut the EUA price - cheapness test dressed up as a quality test.
  - Integrity assessment: by whom, and how?
  - Binary design: 1.7% or 2.7% - no treatment of partial availability; 2033 decision rests on delivery years later.
  - Understandable EU wants to operationalise Article 6 of PA - why not reserve this for EU sectors without ETS, e.g. agriculture?

Flexibilities: permanent carbon removals

- **Proposal**:
  - Cap increased by 250m allowances to finance the purchase of an equivalent volume of domestic BioCCS and DACCS removals;
  - Why: Carbon removals needed for part of industrial net-zero, e.g. balancing residual emissions in the chemicals sector.
  - Safeguards: central purchasing, cancellation of acquired units, payment on delivery.
  - Risk: 2034 review opens the door to considering nature-based and potentially less-permanent removals in future.

- **Our assessment:**
  - 250 Mt extra emissions space is offset against expected removals – but full 1:1 delivery is not guaranteed.
  - No fallback if removals underdeliver – unlike for international credits.

The Market Stability Reserve (I)

- **Stated objective**: adapt the MSR to a shrinking market, improve predictability and maintain sufficient liquidity.

- **Proposal:**
  - **Intake rate:** 24% → 12% from 2028
  - **Thresholds & release volumes:**
    - Lower buffer introduced, mirroring the logic of the upper buffer
    - Thresholds, buffers and volumes decline 4% annually from 2029
  - **TNAC calculation:** adjusted for historic aviation demand
  - **Separate proposal:** end automatic MSR invalidation

The Market Stability Reserve (II)

- **The MSR is currently still doing heavy lifting**: ~270m allowances were invalidated in January 2026, and ~190m will be placed in the reserve between September 2026 – August 2027

- **Accumulation of new surplusses are likely according to analyts**. One analysis suggests the combined Commission proposals for the MSR could leave a 2040 allowance surplus equivalent to 5.6× annual ETS emissions *(Sandbag, August 2026)*

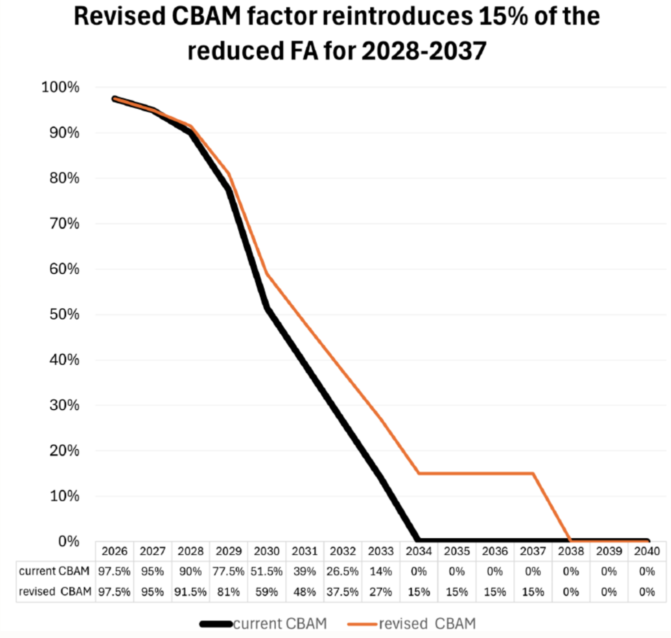
- **Our assessment:**
  - Dynamic thresholds and smoother releases are sensible – but sufficiently dynamic?
  - But lower intake + ending invalidation compounded by a slower trajectory and other flexibilities will weaken scarcity and investment signals, and could lead to accumulation of new suprluses in the market according to some analyses *(e.g. Sandbag, Öko-Institut, Climact)*

Carbon leakage protection

The carbon leakage package

IN A NUTSHELL:

- Free allocation continued for at 100% benchmark value throughout 2030s for non-CBAM sectors
- Free allocation phaseout for CBAM sectors delayed to 2038. CBAM sectors will get 15% more free allocation 2028-2037 than originally planned and a more gradual decline before.
- Conditionality introduced: decarbonisation plans, investment matching the allocation's value.
- Indirect costs compensation largely kept as is. 25% national revenue cap – some member states give a lot more.



	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
current CBAM	97.5%	95%	90%	77.5%	51.5%	39%	26.5%	14%	0%	0%	0%	0%	0%	0%	0%
revised CBAM	97.5%	95%	91.5%	81%	59%	48%	37.5%	27%	15%	15%	15%	15%	0%	0%	0%

Source: European Commission

Free allocation benchmarks

Period	Benchmark change	What it means
2026–2030	**Product benchmarks**	No further change from the June 2026 update
2026–2030	**Heat & fuel fallback benchmarks**	Relaxed to provide **~80m additional free allowances,** using the remaining free allocation buffer without triggering the CSCF.
2031 onwards	**All benchmarks**	Maximum annual tightening falls **2.5%** → **2.0%**; minimum stays 0.3%. Free-allocation buffer rises **3%** → **4%**
2031 onwards	**Fallback benchmarks**	Move towards additional **sector-specific heat/fuel benchmarks**; details set later

Our assessment

- **Overall, the proposal leans towards giving more free allocation,** weakening incentives and reducing resources for investment.
- **Introducing additional product-specific benchmarks makes sense** to account for sectoral differences
- **Missed opportunity for broader carbon-leakage reform:** eligibility & methodology – differentiating more according to leakage risk and transition potential

Free allocation conditionality: Design

Proposal:

- From 2031, most recipients need a board-endorsed Invest in EU decarbonisation plan worth 80% of the allocation. 20% based on actual delivered emission reductions.
- 80% on plan approval; 20% on delivered investment and significant emission reductions.
- Relocation outside the EU triggers reimbursement (only the 20%).
- *Exempt*: installations with IF, Booster or IDB projects (80% released on award, 20% on start of construction or first disbursement), top 10% performers, zero/low-carbon and small installations.

Free allocation conditionality: Assessment

- **Our assessment:** Makes sense – devil in the details
  - COM's impact assessment: historical free allocation slowed innovation in heavy industry.
  - Balance to strike: genuine leakage protection and stronger incentives to innovate.
  - Conditionality at installation level – against creative destruction theory.
    - One derogation (Art 10a – 3d) - ‘joint decarbonisation investment agreement'
  - Specifics of Invest in EU plans part of delegated regulation - let's be pragmatic --> where the real strength will lie.
  - Assessment should sit with independent third parties, not MS.

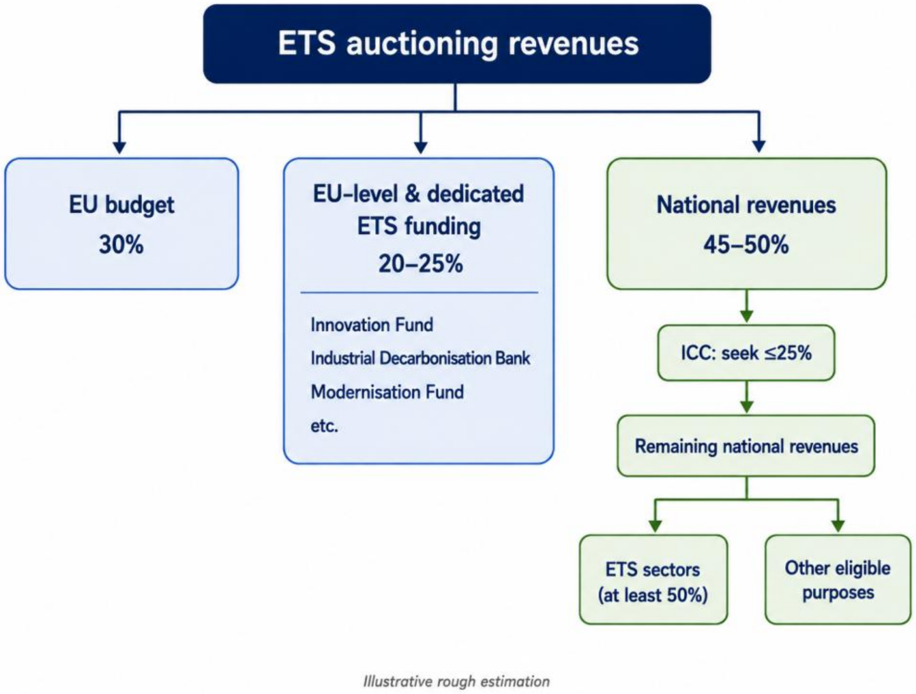
Revenue use & funding instruments

Funding and investment

OVERVIEW

- **Proposal:**
  - More and better-targeted investment support, especially for industry
  - Relatively larger common EU funding pots

- **But:**
  - 30% to the EU budget
  - Additionality question around national revenue use



Investment Booster and Industrial Decarbonisation Bank

Proposal:

- Innovation Fund: 200 mln post-2031 (+50 mln from FA buffer), much smaller as scaleup funding moves to Booster/IDB.
- Investment Booster frontloads support pre-2030, first in, first-served. Phase I of IDB. 400 mln allowances.
- IDB phase II: from 2031, competitive bidding and CCfDs, funding linked to delivery. Another 400 mln allowances.
- **Our assessment:**
  - Finally ex-post output-based support enters the scene.
  - Not explicitly open to early movers (only in recital 42)
  - Should completion bond for startups be financed by EU instrument?

Solidarity & Modernisation Funds

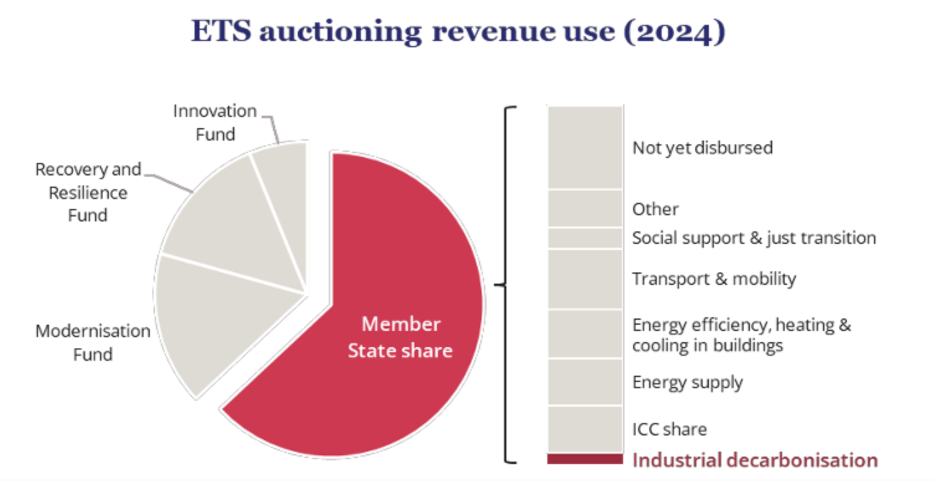
- **Proposal:**
  - 10% solidarity redistribution retained for lower-income Member States.
  - Modernisation Fund extended to 2040, with 2% of the ETS cap dedicated to it.
    - Additional 0.5% of the ETS cap reserved for these countries through the IDB.
    - Stronger focus on industrial decarbonisation and energy-system modernisation, with tighter safeguards on spending.
      - No fossil fuels
      - 95% of spending to go to priority investments.

- **Our assessment:**
  - Broadly positive: solidarity is preserved and strengthened, with more targeted support for industrial decarbonisation in lower-income Member States.

National ETS revenues

MORE TARGETED, NOT MORE MONEY

- **Today:** Member States already *have* to use 100% of ETS revenues — or an equivalent amount — for climate and energy purposes.
  - *Yet only around 5% currently directly supports industrial decarbonisation*
- **Proposal:**
  - at least **50% of national ETS revenues** "shall" be directed towards decarbonising ETS sectors; remainder "may" be used for other climate & energy purposes
  - Tighter reporting and transparency rules



Source: E3G; EU Commission data

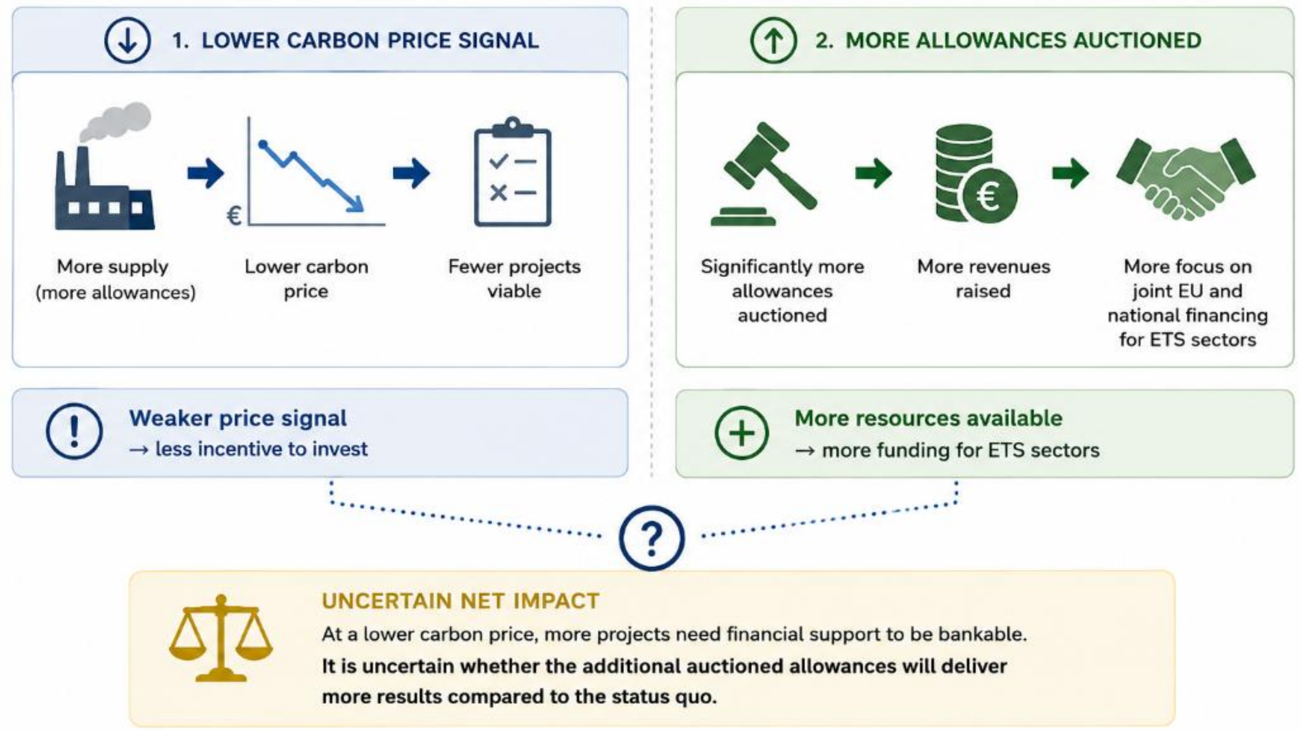
Our assessment:

Reprioritisation, not additional funding. Legal language weakened. The test is whether it drives genuinely additional, strategic investment.

Conclusion and discussion

Conclusion (I)

A PROPOSAL PULLING IN OPPOSITE DIRECTIONS?



Conclusion (II)

THE PROPOSAL AIMS TO BUY MORE TIME – BUT FOR WHAT?

- The proposal aims to give industry some additional breathing room, but **does not change the destination**.
- Climate neutrality remains only **around one major industrial investment cycle away**.
- The value of this flexibility depends on whether **governments improve investment conditions and companies accelerate investment**.
- Otherwise, the result risks being **a weaker signal for frontrunners without solving the underlying transition challenges.**

Does the package add up?

Key questions:

- Does the package provide a credible post-2030 investment signal and reward early movers?
- Can a stronger funding architecture compensate for a weaker carbon price signal?
- Where do you see the biggest opportunity – or risk – in the proposal? What must be protected, clarified or improved?

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Thank you

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