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Review of the EU ETS : Financial actors, ETS2 & compensation

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The role of financial and compliance entities in the carbon market

- In order to reach its ambitious climate goals, the EU needs a **well-functioning carbon market** fostering cost-effective solutions to emerge.
- The **EP's proposal** aims at **limiting the access to the EU's carbon market** to obligated parties, with the intention to curb speculation. Financial players can operate in the market only on behalf of the obligated parties.
  - This may hamper the market's functioning by affecting long-term markets, auctions and the transferring of emission allowances.
- The **liquidity of the carbon market** is essential to support the decarbonization of EU industries and allow them to implement cost-effective solutions. To achieve such objective, the co-legislators should consider that:
  - **Diversification and broad market participation** support liquidity, reduce the risks of price volatility and ensure a regular and predictable supply of allowances and of auction revenues.
  - The EU ETS already provides for **mechanisms and transparency requirements** (MSR and article 29a) to avoid sudden shocks subject to improvement and ensure trust in the market.
  - Additional measures can be designed to **further transparency**, ensure a careful monitoring of non-compliance actors, and trust in this market.

The extension of carbon pricing to road transport and buildings

- The EP's report diverts from a market-based approach, as it proposes several market intervention mechanisms (e.g. a price cap of €50 or limitation of the cost-pass through) that would make it very difficult to implement.

- The Council General Approach includes derogations until the end of 2030 for regulated entities established in a MS where a carbon tax is in place which raises concerns regarding the intra-EU level playing field.

A well-designed ETS 2 should :

- Ensure legal predictability and clarity through a real "cap and trade" system;
- Enable cost-effective solutions to emerge through technology neutrality and a wide enough scope;
- Avoid price caps and interferences with price formation and assure the liquidity of the market (frontloading of allowances in case insufficient during the first years of the regulated period);

- Additional measures, complementing the ETS2, should support investments in Renewable & Low Carbon Liquid Fuels and the scale-up of their production.

Interlinkage between EU ETS and CBAM : impact on free allocation (1)

- **Carbon leakage** is a major threat for both environmental integrity and EU industrial competitiveness . Current carbon leakage protection measures, such as free allowances, have proven to be effective.

- The three institutions agreed to proceed with the phase out of FA as long as a CBAM would be introduced. However, they propose different approaches:

  - The EC proposal provides for a phase out of FA by 2035 for the sectors covered by the CBAM, through a yearly CBAM factor of 10%;
  - The Council General Approach proposes a gradual **Phase-out of FA/Phase-in of CBAM** to be completed by 2035, **with a lower CBAM factor in the first years, to be increased after 2030.**
  - The EP Position to delay the start of the Phase-out of FA (2027) and to anticipate its end (2032).

- The Council's proposed trajectory might better reflect the decarbonisation path of EU companies, ensuring the sustainability of the EU investments in the transition.

Interlinkage between EU ETS and CBAM : impact on free allocation (2)

- In any case, to achieve an effective protection against the risk of carbon leakage, it is recommended to the institutions to take into account that:

  - A **gradual Phase-out of FA/Phase-in of CBAM**, in particular in the first years, would safeguard the competitiveness of the EU industry and protect the investments needed to achieve the EU climate objectives. A cautious interaction between ETS and CBAM is needed: the effectiveness of the CBAM for imports may be tested when the FA are at benchmark level (as proposed by the EC, article 31) ;

  - A FA allocation conditionality may alter the idea of carbon leakage protection and may affect many companies' decarbonisation pathway;

  - An effective carbon leakage protection should cover **both imports and exports**, and should grant an **equal protection**, especially until the EU would not share the same climate ambition with third countries.

Interlinkage between EU ETS & CBAM : impact on indirect cost compensation

- **Effective measures** for indirect costs: direct and indirect electrification represents one of the key solutions for transforming EU industry towards the climate neutrality target, but high electricity prices are a major barrier for such process;

- Both the adoption of the General Approach and the vote in the EP seem to demonstrate the importance of **continuing to grant indirect cost compensation.** It remains a **key measure to protect exposed sectors from the carbon leakage risk**. At present, indirect costs compensation is insufficient and fragmented across EU Member States.

- The **inclusion of indirect emissions in the CBAM scope** should be thoroughly assessed before considering the deletion of the indirect cost compensation mechanism, and in any case carbon leakage protection should not be undermined.

- To ensure an adequate level of protection, the co-legislators should consider to:
  - ➢ Ensure an **EU-wide harmonised system of mandatory financial compensation** for exposed sectors, and an effective protection in all EU Member States;
  - ➢ Embrace a careful approach in the discussion regarding the **inclusion of indirect emissions in the CBAM scope**, avoiding an abrupt decrease in the level of indirect cost compensation, until a global level-playing field is reached or fully effective alternative arrangements are in place.

THANK YOU FOR YOUR ATTENTION

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