

UFE's proposals on the ETS revision by the European Commission

The European Union has set a very high ambition for decarbonising its economy, with a goal of achieving carbon neutrality by 2050 and reducing greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels. **UFE firmly supports these two objectives, which are consistent with scientists' recommendations to limit climate change.**

Achieving them requires drastically reducing CO₂ emissions in all sectors, particularly those covered by the EU-ETS (currently the electricity sector and a part of the industry in ETS 1, and in the future, buildings, road transport, and other sectors in ETS 2). The EU-ETS explicitly prices the negative externality of CO₂ emissions, enabling the most cost-effective investments in emission reduction. This approach is particularly relevant as climate targets may become more ambitious. Given the substantial macroeconomic costs of the transition, optimising expenditure remains a top priority.

At the same time under EU ETS1, achieving these objectives will require strong and targeted support for industrial decarbonisation through dedicated European instruments such as the Industrial Decarbonisation Bank and the Investment Booster, as well as through the effective use of ETS revenues by Member States to accelerate investments in industrial transformation and competitiveness, in line with the principle of technological neutrality.

Preserving the core principles of the EU-ETS to ensure its proper functioning

Safeguarding the integrity of the EU ETS

In the long term, decarbonisation targets are becoming even more ambitious, and the price of CO₂ will need to consistently follow an upward trend. More concretely, to minimise the overall cost of decarbonisation by 2040, CO₂ pricing should be predictable and provide a sufficiently strong incentive **in sectors where the decarbonised technologies are sufficiently mature and accessible to replace current uses**. Reducing emissions by 90% by 2040 compared to 1990 is only feasible if CO₂ prices are incentivising enough in the sectors where substitutions are desired by that horizon.

Therefore, UFE calls for an ambitious revision of the ETS framework to ensure that sufficiently robust and efficient decarbonisation incentives are sent to all sectors in order to achieve the 2040 GHG emission reduction targets at the lowest cost. In this context, UFE calls for long-term visibility on CO₂ price and for the price level to be consistent with climate trajectories.

In this regard, if international carbon credits are to co-exist with the current EU ETS framework, they should be of high-quality and high-integrity, and be certified in line with European standards. In particular, the direct integration of international carbon credit would require compliance with a wide range of criteria to avoid distorting the EU-ETS, including transparency, scope of coverage, price levels, tendering processes, etc. **For these reasons, UFE stresses the importance of maintaining a stable and predictable carbon price and supports preserving the integrity of the EU ETS through the continued use of EU Allowances (EUAs) as the sole compliance unit.** The Commission's proposal to finance international credits through the issuance of a dedicated volume of EUAs provides greater predictability regarding additional supply while avoiding the risks associated with the

direct integration into the ETS, including the introduction of lower-cost units that could weaken the carbon price signal. Any future evolution of the system should indeed preserve market stability and ensure full visibility on the volume of additional allowances introduced. By centralising the procurement of international credits, the Commission can reduce uncertainties regarding future supply adjustments and improve the predictability of the ETS trajectory.

Delivering long term visibility through an ambitious linear reduction factor

Article 8 of the Directive 2023/959 amending Directive 2003/87/CE provides that: *“In 2026, the Union-wide quantity of allowances shall be decreased by 27 million allowances. [...] The linear factor shall be 4,3 % from 2024 to 2027 and 4,4 % from 2028.”*

The Linear Reduction Factor (LRF) increased from 2.2% to 4.3% as of 2024 and will increase further to 4.4% as of 2028. This factor is intended to deliver a 62% reduction in emissions from sectors covered by the EU ETS by 2030 compared with 2005 levels. The adoption of a LRF consistent with the emissions reduction pathway for 2040 and 2050, will support the emergence of a carbon price signal capable of driving long-term investment in low-carbon technologies. Such LRF path should ensure sufficient market liquidity in order to preserve industrial competitiveness beyond 2030. In addition, the post-2030 ETS cap trajectory should remain coherent with technological decarbonisation pathways.

UFE also acknowledges the proposed revision of the LRF to 3.7% between 2031-2035, and 1.7% from 2036. **In order to prevent the risk of carbon price depreciation if the trajectory is inappropriately adjusted, UFE is aligned with the European Commission’s proposal regarding the revision of the LRF.** Subsequently, UFE recognises that maintaining the current post-2035 cap trajectory could prove increasingly challenging as residual emissions remain difficult to eliminate in several industrial sectors. In this context, **the Commission’s proposal to adjust the Linear Reduction Factor to 1.7% thereafter represents a pragmatic approach to maintaining the credibility and long-term sustainability of the ETS while preserving the incentive to decarbonise.** UFE nevertheless stresses that the credibility of this pathway will depend heavily on the effective deployment of the expected volumes of high-integrity international credits and permanent CDRs. Without their timely availability and scaling, there is a risk that the pace of ETS emissions reductions could become misaligned with the EU's climate objectives. In this respect, the review clause foreseen by the Commission, including a reassessment of the 1.7% LRF linked to the use of international credits, will be essential. **UFE therefore supports an ETS trajectory that remains aligned with the 2040 climate target while avoiding excessive system tightening that could undermine market functioning and predictability.** Moreover, UFE stresses the importance of an overall policy framework that maintains a sufficiently robust and predictable carbon signal to support decarbonisation investments.

Ensuring a cautious integration of carbon dioxide removal and carbon capture

While reducing emissions must remain the absolute political priority, UFE welcomes the EC's proposal to support the development of permanent domestic Carbon Dioxide Removals through a centrally managed mechanism. Under the Commission’s proposal, an additional volume of 250 million EU Allowances (EUAs) would be dedicated to financing the deployment of 250 Mt of permanent domestic removals over 2031-2040, complemented by an additional 10 million allowances intended to address potential funding gaps. The revenues generated through the auctioning of these allowances would be used by the Commission to procure high-integrity permanent removals certified under the Carbon Removal Certification Framework (CRCF).

UFE supports this approach as it preserves the role of EUAs as the sole compliance instrument under the ETS while providing additional flexibility for addressing residual emissions from hard-to-abate sectors. By centralising the procurement of CDR units, the Commission improves predictability regarding the volume of additional allowances entering the market and reduces uncertainties related to the future availability and cost of removals.

UFE further supports the Commission's intention to prioritise a portfolio of high-integrity and cost-effective CDR projects, with remuneration based on the verified delivery of certified removals. In the future, the role of removals could extend beyond technological removals only, following the 2034 impact assessment. High-quality nature-based solutions and other certified carbon removals should also be assessed as potential contributors to a cost-efficient transition comparing the abatement costs of the different sectors including ETS2 and ESR. This integration would maximise the use of different decarbonisation technologies and could help reduce the costs of the transition of the whole European sectors to a zero-carbon economy. In the short term, a gross cap model integrating CDR under a strict “one-in, one-out” rule should be prioritised in order to safeguard the environmental integrity of ETS1 while preserving strong incentives for decarbonisation. This approach should be accompanied by a central role for public authorities in the procurement and integration of CDR units, ensuring greater predictability regarding the volume of gross emissions covered. Over the medium to long term, the system should evolve towards a net cap framework allowing additional integration of CDR, thereby supporting its scale-up without constraining its development. Any evolution towards a more direct participation of removals within the ETS should be subject to a thorough impact assessment and carefully evaluated against its implications for market integrity, carbon price stability and investment incentives.

Regarding Carbon Capture and Usage (CCU), UFE highlights the importance of ensuring the avoidance of double counting and quickly establish robust rules for the accounting of emissions in the EU-ETS for the CCU value chain. Stakeholders need a clear, stable, and predictable regulatory framework for the treatment of captured and reused CO₂ to enable investments.

Reinforcing the Market Stability Reserve

The carbon price signal could be improved by a **reform of the Market Stability Reserve (MSR)**, initially implemented by Decision 2015/1814 of October 6, 2015. This mechanism was created to adjust the supply of quotas on the EU ETS market in case of a supply/demand imbalance. Today, the MSR operates as follows: if the volume of quotas in circulation is above 1096 Mt, 24% are placed in the reserve; if it is between 1096 and 833 Mt, the difference is placed in the reserve; below 400 Mt, 100 Mt are injected from the reserve into the market.

While the MSR notably adjusted the supply of quotas during the Covid crisis (as the decline in industrial activity abruptly reduced the demand for quotas), it enabled a more flexible and resilient mechanism in the event of macroeconomic shocks. However, several aspects can still be improved.

Strengthening the Market Stability Reserve (MSR) to preserve the ambition of the ETS1 should be a central pillar of an ambitious revision of the EU ETS framework, as it plays a critical role in ensuring both the stability and credibility of the carbon price signal over time. Enhancing the MSR would improve long-term visibility for market participants and support a more gradual and predictable increase in carbon prices, which is essential to guide low-carbon investments and avoid excessive volatility that could undermine confidence in the system.

As the emissions cap tightens and the overall supply of allowances declines, the existing thresholds risk becoming less responsive to market imbalances. In this perspective, lowering the current activation thresholds of the MSR is a positive improvement that will maintain its effectiveness beyond

2030. This evolution is particularly important in the context of additional EUA issuance foreseen to support future decarbonisation policies.

UFE welcomes the Commission's proposal to introduce a buffer to the lower threshold in order to make the MSR more progressive when it is needed to re-inject permits, which can prevent too strong adjustments of the EUA supply especially at a time when the market is already tight.

Any further weakening of the post-2030 cap trajectory or the introduction of additional flexibility mechanisms should be carefully assessed against their potential impact on the carbon price signal and on the overall integrity of the ETS. The MSR review should be carefully aligned with the broader evolution of the ETS framework. Ensuring coherence between these elements is essential to maintain the environmental integrity of the system and to ensure that its overall design remains consistent with the level of ambition needed to meet the EU's 2040 climate targets. Greater predictability regarding the long-term evolution of the ETS is particularly important for investors, in particular energy-intensive industries, which require stable investment signals to undertake large-scale decarbonisation projects while preserving their competitiveness.

Moreover, to provide investors with greater visibility and predictability, UFE supports the introduction of a carbon price floor for the ETS 1 carbon quota. **A progressively increasing carbon floor price would prevent the marginal cost of coal-fired power plants from falling below that of gas-fired power plants, thereby undermining the EU's climate ambitions. Therefore, UFE calls for a carbon price floor for ETS 1 starting at €60/tCO₂ and increasing over time, thus providing investors with visibility to trigger investments in decarbonisation.**

The EU-ETS is a truly useful tool for supporting European industrial policy

The role of ETS revenues in financing the Investment Booster and the Decarbonisation Bank

European funding for industrial decarbonisation should promote electrification of industrial processes, as it represents one of the most effective and scalable pathways to reduce emissions while leveraging the progressive decarbonisation of the power sector under the EU ETS. Instruments such as the Industrial Decarbonisation Bank and Investment Booster should therefore focus on supporting the large-scale deployment of mature electrification solutions, complementing the Innovation Fund and addressing both CAPEX and OPEX barriers—particularly the persistent price gap between fossil fuels and electricity. To ensure effectiveness, support mechanisms must provide long-term visibility (notably through extended aid duration) and enable full cumulation with other EU and national schemes. **UFE acknowledges the proposal of the Commission to finance the Investment Booster in 2027-2030 and the Industrial Decarbonisation Bank in 2031-2040 through the sale of 400 million allowances each. However, UFE states that the investment needs are urgent, and therefore calls for a sooner implementation of the Industrial Decarbonisation Bank, starting in 2028.** Moreover, the financing of these instruments should be carefully designed to prevent the release of additional allowances into the market, which could weaken the carbon price signal and undermine investment incentives, thereby preserving the overall integrity and ambition of the ETS.

Using free allowances to encourage electrification investments in Europe

Free allocation of carbon allowances, initially implemented to protect from carbon leakage risks, should also be used in a way that maximises the efficiency of decarbonisation projects. In particular, closer links should be established between free allowances and decarbonisation investments in Europe, and more specifically in technologies that deliver efficient and durable emissions reductions, especially electrification solutions. **UFE believes that the allocation of free allowances should encourage economic agents to undertake investments in emissions reduction, thereby contributing to the achievement of the EU's long-term climate objectives.** UFE thus welcomes the Commission's proposal to co-design, together with industrial stakeholders, a whole new distribution scheme that allocates a greater share of free allowances to installations delivering decarbonisation investments. Moreover, to safeguard decarbonisation investments already made, the allocation of free allowances should be maintained throughout the investment period.

The EU-ETS is a lever for mobilising investments in climate action in Member States

As the energy transition accelerates, industrial actors will need to reinforce their efforts to reduce the carbon intensity of their activity. **A strong CO₂ price signal will help them in this effort by protecting their decarbonisation investment decisions over time.** However, it will also be increasingly crucial to rely on robust and well-targeted redistribution mechanisms to guarantee a fair distribution of costs.

UFE recalls that the sale of carbon allowances generates substantial revenues for Member States to support climate action and energy transformation. **In 2024, the total auction revenue amounted to EUR 38.8 billion¹. Of this amount, 62.8% (EUR 24.4 billion) went directly to the Member States,** while the remainder supplied the EU Modernisation Fund (6.3 billion), the EU Innovation Fund (EUR 2.3 billion) and the Resilience and Recovery Facility to fund the REPowerEU Plan (EUR 5.6 billion). **UFE thus welcomes the Commission's proposal to ensure that Member States spend at least 50% of EU-ETS revenues to support investments in the decarbonisation of industrial sectors covered by ETS1, particularly sectors exposed to international competition and carbon leakage risks.** A significant share of ETS revenues should contribute to industrial decarbonisation projects through national and European instruments, while preserving sufficient flexibility for Member States to address their domestic transition priorities.

Of the EUR 24.4 billion that Member States collected in ETS revenue in 2024, 86.8% (EUR 21.2 billion) is subject to the spending obligation under Article 10(3) of Directive 2003/87/CE, as amended by Directive (EU) 2023/959. **UFE highlights that Member States used 13% (EUR billion 2.3) of their EU-ETS revenues to finance aid for electricity-intensive industries to compensate indirect carbon costs.** Indeed, the offset of indirect costs of the EU-ETS allows member states to offset part of the ETS costs internalised in the wholesale electricity prices for energy-intensive industrial consumers in sectors exposed to international competition and carbon leakage (aluminum, hydrogen, fertilisers, steel, paper, copper, etc.). It takes the form of aid provided by the Member States: each State can invest, without justification, up to 25% of the revenue it derives from ETS auctions and compensate up to 75% of the identified costs. **UFE recalls that the compensation of indirect carbon costs is a fundamental tool for Member States to protect their industry and ensure their international competitiveness.** UFE therefore reinforces the need to maintain the compensation of indirect carbon costs throughout the investment period.

¹ Report from the Commission to the European Parliament and the council on the functioning of the European carbon market in 2024

By contrast, out of the EUR billion 21.2 subject to Article 10(3), 22% has been used in public transport and mobility, 20% to energy efficiency, heating and cooling in buildings, and a further 20% in energy supply, grids and storage. **UFE therefore stresses that the EU-ETS enables Member States to reinvest auction revenues in support of their climate objectives.** While the European framework requires Member States to dedicate ETS revenues to climate and sustainable-transition objectives, UFE considers that greater transparency regarding the allocation and effective use of these revenues would strengthen public confidence in the mechanism and improve its overall acceptability.