

EUROFER Position Paper: Review of the EU's Emissions Trading System (ETS)

Strengthening carbon leakage protection is essential to ensure the carbon price signal remains aligned with the enabling conditions needed for decarbonisation investments

KEY MESSAGES

- The European steel industry supports the EU's target of becoming climate neutral by 2050 and is committed to contributing responsibly to this objective.
- The business case for decarbonisation investments requires these enabling conditions along carbon pricing:
 - internationally competitive low-carbon energy;
 - protection from global overcapacity and carbon leakage risk across the entire value chain, both in domestic and export markets;
 - increased funding for both CAPEX and OPEX;
 - lead markets for low CO₂ steel and low CO₂ steel-intensive products;
 - retaining more ferrous scrap within the EU.
- Investment decisions have been taken for approximately 35 million tonnes of low-CO₂ steel projects becoming operational between 2027 and 2032, but the current lack of several of these enabling conditions has already caused delays and structural uncertainties for several decarbonisation projects.
- Without urgent and structural solutions to these critical challenges, deindustrialisation will accelerate.
- The ETS Review should not be conducted in isolation, but closely aligned with the wider climate and energy package and the progress in delivering the enabling conditions for industrial decarbonisation, while preserving the carbon price signal and incentives for investments.
- Free allocation should support decarbonisation investments and, in combination with an effective CBAM, provide effective carbon leakage protection across the entire value chain through the following measures:
 - slowing down significantly the CBAM factor over the next five years to reflect the limits of the CBAM like the lack of an export solution and resource shuffling risks as well as the reality of enabling conditions for decarbonisation investments;
 - prolonging the rule on the hot metal benchmark post-2030 to reflect the gradual transformation of the sector;
 - avoiding or at least mitigating the application of the cross sectoral correction factor, e.g. by increasing the flexibility between the auctioning and free ETS allocation shares.
- Free allocation conditionality should be rethought following the points below:
 - Developing “positive conditionality” through a reward, incentive-based mechanism for investments, covering also those by the first movers;
 - Repealing the “negative conditionality” based on penalties to avoid new distortions with imports;
 - If, “negative conditionality” is retained, it should be fully mirrored in the CBAM to avoid an undue advantage to imports and be significantly adjusted to reflect investment realities, recognise first-movers and to avoid counter effective impacts on investments.
- A structural solution for exports should be introduced, for CBAM sectors and for downstream industries.
- Indirect costs compensation should be strengthened and fully implemented in all Member States.
- Revenues generated from the phase-out of free allowances for CBAM sectors should be reinvested fully in those sectors, e.g. with dedicated calls of the Investment Booster and the Industrial Decarbonisation Bank. Participation to the funding schemes should be allowed also to existing low-carbon production and/or installations under construction where production has yet to start.
- All auctioning revenues should be reinvested in ETS sectors with a high share for energy-intensive industries.
- The Market Stability Reserve (MSR) should be reviewed to:
 - avoid further invalidation of allowances, as already proposed by the European Commission;
 - avoid excessive price volatility in the future, including through mechanisms like an evolving carbon price corridor

Introduction: The enabling conditions for decarbonising the EU steel industry and the role of carbon pricing

The European steel industry supports the EU's goal of becoming climate neutral by 2050 and is committed to contributing responsibly to delivering this objective. Turning this ambition into reality requires a major transformation of the sector at unprecedented scale and speed. The sector has been making the necessary preparations for this transformation by launching multiple large-scale decarbonisation projects in recent years. For instance, financial investment decisions have been taken for approximately 35 million tonnes of low-CO₂ steel projects becoming operational between 2027 and 2032. This capacity should replace about half of conventional blast furnace technology that would be in operation otherwise. Yet, the business case for making such large investments is only possible on a broad scale if the EU urgently delivers the following enabling conditions:

- access to internationally competitive low-carbon energy and raw materials, including the necessary infrastructure for electricity, hydrogen and CO₂;
- effective implementation of the new trade measure on global steel overcapacity, including the downstream scope extension to shield the value chains;
- effective carbon leakage instruments to address direct and indirect carbon costs in domestic and export markets for the steel industry and the downstream sectors;
- increased funding across the EU for both CAPEX and OPEX related to decarbonisation technologies;
- developing lead markets for low-CO₂ steel and low CO₂ steel-intensive products;
- ensuring sufficient ferrous scrap availability within the EU by retaining more scrap within the EU market.

A predictable and effective carbon pricing system provides an important investment signal for decarbonisation by creating reliable expectations for future carbon costs as well as a support for existing low carbon production. Such carbon pricing signal needs to keep the balance between investment certainty for low-carbon technologies and avoiding disproportionate cost burdens for conventional technologies so that throughout the transition companies retain sufficient financial capacity to invest while maintaining the competitiveness of existing production assets. However, carbon pricing must form an integral part of a broader industrial and competitiveness framework based on the aforementioned enabling conditions. Yet, the absence of several of these enabling conditions has already created delays and structural uncertainty in the delivery of several decarbonisation projects. Notably, projects for more than 10 million tonnes of steel capacity have already been stalled.

In particular, with the current market designs and fundamentals, electricity and hydrogen prices remain significantly above competitive levels - approximately twice and three/four times their respective target levels of €50/MWh and €2/kg¹, while low-carbon and renewable hydrogen is still extremely scarce. Moreover, although the recent launch of the Carbon Border Adjustment Mechanism (CBAM) and the EU's new steel trade measures are important steps towards creating a better level playing field for the EU steel industry, circumvention risks persist. Notably, the current CBAM design is ineffective against the risk of resource shuffling, i.e. the practice of exporting to the EU only products with lower carbon footprint while deviating other products to other markets. Furthermore, downstream sectors remain vulnerable to loopholes in these measures, and the current CBAM proposals and Temporary Decarbonisation Fund fall short in closing these gaps structurally. Finally, the European

¹ 50 €/MWh is the target electricity price of the EU's Clean Industrial Deal State Aid Framework (CISAF), while 2€/kg hydrogen is the indicative target price for steelmaking according to publicly available information.

Commission's ETS proposal does not offer any structural solution for exports during the coming years which are critical for the transition.

On the demand side, lead markets for low-carbon steel remain uncertain in the coming years. Recent proposals under the EU's automotive legislation and the Industrial Accelerator Act are first steps in the right direction. Yet, the resulting demand signals for sustainable products depend on the ambition of the ongoing legislative process and a robust 'Made in EU' requirement for steel.

Without structural solutions to these critical challenges, there is a serious risk that the deindustrialisation trend observed in recent years will continue and potentially accelerate. This would undermine the EU's objective of increasing the manufacturing's share of GDP to 20% by 2035, as outlined in the Industrial Accelerator Act.

Therefore, while preserving the carbon price signal, the review of the EU ETS should not be conducted in isolation from the rest of the climate and energy package and be closely aligned with delivering progress in the other enabling conditions required for industrial decarbonisation and competitiveness. The EU should intensify efforts to strengthen the enabling conditions for decarbonisation investments, including for the ongoing investments by first movers. For example, lead markets for low-carbon products "Made in the EU" should be introduced with significantly greater ambition. In parallel, more effective measures to reduce energy and raw materials costs and prices, including electricity and hydrogen, should be launched to bring them at an internationally competitive level.

Stronger, not weaker, carbon leakage protection is necessary

Avoiding carbon leakage is a key pillar of the EU's legal framework, since it ensures the environmental integrity of the overall legislation. Despite the EU's diplomatic efforts, there exists no equivalent carbon price system among the other most competing economies in the world. Therefore, it is crucial to strengthen the carbon leakage protection framework against both direct and indirect carbon costs, for EU products sold on the EU market as well as for those exported to third countries, both for the steel industry and for downstream sectors.

Instead, several elements of the European Commission's proposal weaken the carbon leakage framework. These include the absence of a dedicated rule for the main steel benchmark after 2030, the lack of an export solution combined with an insufficient reduction of the CBAM factor, and new conditionality rules that risk undermining the effectiveness of free allowances.

Prolonging the rule on the hot metal benchmark post-2030 to reflect the gradual transformation of the sector

The ETS Directive currently in place fully acknowledges the specificity and complexity of decarbonising the steel industry. As clearly stated in recital 49² and article 10a, paragraph 2, sub-paragraph 3, point (e)³, the value of the main steel benchmark (hot metal) should be based on the existing prevailing technology of blast furnaces without being impacted by the low-carbon technology of direct reduced iron plants (DRI), even though the same benchmark is used to grant free allowances to DRI plants. On one hand, this solution ensures effective carbon

² Recital 49: "To incentivise new breakthrough technologies in the steel industry and to avoid a significantly is proportionate reduction of the benchmark value and in light of the particular situation of the steel industry such as the high emission intensity and the international and Union market structure, it is necessary to exclude from the calculation of the hot metal benchmark value for the period from 2026 to 2030 installations that were operational during the reference period from 2021 to 2022 and that would otherwise be included in that calculation due to the review of the definition of the product benchmark for hot metal".

³ Article 10a, paragraph 2, sub-paragraph 3, point (e): "For the period from 2026 to 2030, the annual reduction rate for the product benchmark for hot metal shall not be affected by the change of benchmark definitions and system boundaries applicable pursuant to paragraph 1, eighth subparagraph".

leakage protection to the entire primary steel sector in the early stages of the transformation, and on the other supports early movers investing in the DRI technology with additional free allocation.

However, the existing legal provisions only refer to the period up until 2030, and the European Commission's latest proposal does not prolong them. Without a prolongation, the hot metal benchmark value for the period 2031-2035 would be significantly reduced in comparison with the prolongation of the current situation. Depending on the exact number of DRI plants being operational in 2026-2027 - which is the reference period for the calculation of the benchmark update - the 2031-2035 hot metal benchmark would be reduced by up to 50% vs. the initial value valid in 2013-2020, instead of the 7.5% reduction implied by the current rules. Such a disproportionate increase of carbon costs would occur when the DRI technology represents still a minor percentage of the market, because benchmarks are set by the lowest 10% emitting installations, which in the case of primary steel is a very limited number of installations (i.e. two installations out of around 20). This would prematurely reduce carbon leakage protection as well as financial means for the entire primary steel industry and increase the risk of carbon leakage from third countries.

Significantly slowing down the CBAM factor over the next five years to reflect the lack of an export solution and the reality of enabling conditions for decarbonisation investments

The combined effect of the EU's ETS and CBAM must be to incentivise decarbonisation investments and deliver effective carbon leakage protection. It must therefore ensure the transition is economically viable across the entire EU. The legal framework should be calibrated to the sector's operational and investment realities, also taking into account the situation of downstream industries, the export exposure and well as the specific local conditions across the EU.

As outlined earlier, critical bottlenecks persist in several enabling conditions for decarbonisation investments, notably in the field of energy availability and prices. Moreover, the extension of the CBAM scope to downstream industries remains very fragmented and the European Commission's proposal does not contain any structural carbon leakage solution for exports.

In this context, the proposed minor adjustment of the CBAM factor is insufficient to avoid the negative impact on the EU steel industry and the downstream sectors relying on it, both within the EU and on export markets. Notably, maintaining free allocation at 59% of the benchmark by 2030 instead of 51.5%, does not reflect a realistic decarbonisation pathway of the primary steel sector with the current implementation of the enabling conditions across the EU. Furthermore, maintaining the CBAM factor at 15% in 2034-2037 fails to offer any meaningful relief for EU exports during the critical early years of the transition when carbon costs will increase for the entire European production, including exports.

Under these rules, even taking into account the successful implementation of the ongoing decarbonisation projects, the steel sector would face carbon costs of around €5.7 bn in 2030 and €8.2 bn in 2031, compared to €3.4 bn in 2026, and a free ETS allocation shortage⁴ of 50% in 2030 and 76% in 2031. The carbon costs for primary steel based on the blast furnace technology would roughly double by 2030 in comparison to today, reaching around €100/t in 2030 and surging above €200 in 2031. Moreover, the combined effect of the CBAM factor and the revised hot metal benchmark would further increase the carbon costs to around €230 per tonne for blast furnace steel as of 2031.

⁴ Assumptions: EU steel production at 130Mt (2024 level); decarbonisation investments commissioned by 2030 and fully operational as of 2032 with a capacity of 17Mt of DRI and 36 Mt of electric arc furnace (EAF) steel; 2% annual reduction rate of benchmarks; cross sectoral correction factor from COM Impact Assessment, scenario CL 90_50; carbon price at 100€/t in 2026-2030 and at 150€/t in 2031-2035.

In this context, EUROFER calls for a significantly slower phase-out of free ETS allocations for CBAM sectors from 2028 onwards, particularly until 2031, to ensure a smoother transition to the CBAM for both the steel sector and its downstream value chains. Notably, the CBAM factor should be slowed down in line with the following proposal:

CBAM factor	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038
COM proposal	97.5%	95.0%	91.5%	81.0%	59.0%	48.0%	37.5%	27.0%	15.0%	15.0%	15.0%	15.0%	0.0%
EUROFER proposal	97.5%	95.0%	95.0%	92.5%	90.0%	82.0%	65.0%	50.0%	35.0%	20.0%	10.0%	5.0%	0.0%

The revision of the CBAM factor according to the EUROFER proposal in combination with the prolongation of the hot metal benchmark provision would provide an effective legal framework that on one side supports first-movers and incentivises the transformation to low-carbon technologies and on the other side smoothens the carbon cost impact on existing technologies throughout the transition.

At the same time, the EU should use these years of slower free allocation phase-out to intensify efforts to strengthen the enabling conditions for decarbonisation investments so that the business case for deeper emissions reductions in the EU is more feasible and predictable.

A structural solution for exports should be introduced, both for ETS sectors covered by CBAM and for downstream industries

The European steel industry has emphasised for long time the need to ensure a level playing field for CBAM goods exported to third countries. Exports play a very important role in the economic sustainability of the sector, both directly and indirectly. On one side, direct exports of steel goods contribute to reaching the capacity utilisation rate necessary to achieve the break-even of production costs. On the other side, downstream steel intensive sectors are even more export oriented and their cooperation with EU steelmakers contribute to higher value creation in the EU. In the last decade, the EU, which was a net steel exporter until 2015, has become a structural net steel importer, losing around 10 million tonnes of steel products.

In this context, an export solution is not only a measure justified by industrial competitiveness but also -and mainly- by environmental integrity, since it secures that industrial production remains subject to the declining cap of the EU ETS rather than being replaced by third countries producers with higher footprint and/or not subject to a foreseeable emission reduction pathway.

Yet, contrary to the previous political announcements, the current proposal does not include any structural solution for preserving EU exports to third countries. The Temporary Decarbonisation Fund, whose concrete implementation remains very uncertain due to the deadlock in the negotiations in the Council, is extremely limited. Notably, it is meant to be an interim solution only for 2026 and 2027 and it covers less than a quarter of the steel goods exported to third countries. A structural, legally certain export solution should be developed and implemented without any delay.

Free allocation conditionality should be rethought structurally

The European Commission's proposal to make free ETS allocation conditional on the development and implementation of decarbonisation plans, distorts the nature of free allocation from a carbon leakage instrument into an alleged investment mechanism. As explicitly stated in recital 42 of the proposal, these new provisions have been built "*on the experience of conditionalities relating to district heating*". Yet, by its own nature, district heating is not a sector exposed to global competition. Hence, the ETS Directive stressed that free allocation was granted to that sector for social reasons linked to energy prices rather than for exposure to carbon leakage risk,

as is the case for energy-intensive industries exposed to global competition. In sectors such as steel, the current rules on free allowances strike a balance between supporting decarbonisation investments and preventing the carbon leakage risk. This is achieved through strict product benchmarks based on the performance of the best 10% of installations. Under the existing framework, free allowances do not constitute freely available liquidity. Companies usually use them promptly to meet their surrendering obligations under the EU ETS, as their emissions generally exceed free allocation. Hence, free allowances constitute neither an asset nor a source of funding for investment but serve to fulfil legal compliance while maintaining international competitiveness and protecting against carbon leakage. Moreover, conditionality based on climate neutrality plans and a penalty corresponding to 20% of the free allocation already applies to the installations above the 80th percentile of the benchmark curves.

Making 100% of the free allocation conditional for the very large majority of installations represents a disproportionate change of this legal framework. In the real, daily life of steel companies, investment decisions depend on the existence of a viable business case, supported by the right enabling conditions. The European Commission's proposal assumes that making free allocation conditional will unlock additional investments. Yet, this assumption overlooks the main obstacles facing the steel industry today. In most cases, the primary barrier is not the lack of regulatory pressure, but the higher level of capital and operating costs of low carbon technologies in comparison with conventional technologies and international competition, as well as the ability of downstream industries to pass on these costs within the value chains without losing market share. While making access to free allowances conditional on decarbonisation investments may appear to strengthen investment incentives, in practise it would reduce carbon leakage protection whenever the necessary enabling conditions are not in place. This would be the case, for example, where high electricity and hydrogen costs prevent low-carbon technologies from operating on internationally competitive terms, or delays are caused by permitting procedures, infrastructure delivery and public support decisions that are beyond the control of companies. More broadly, the deferred allocation of the final 20% allowances would undermine the financial ability of companies to invest, as in most cases they will have to bridge finance the economic value of those 20% allowances. Hence, such deferral is running against the ultimate objective of spurring decarbonisation projects.

Moreover, the free allocation conditionality introduces a new, structural distortion and asymmetry between the European producers and importers. This would occur only a few years after the introduction of the CBAM, which was explicitly meant to establish a level playing field in this area. While European producers would become subject to extensive investment obligations as a condition for maintaining protection against carbon leakage, importers covered by the CBAM would not face comparable requirements. At the same time, importers would continue to benefit from a bigger discount from the CBAM costs, calculated as if European producers still received their full free allocation unconditionally. This asymmetry would clearly penalise European producers, which in most cases are more carbon efficient than importers; hence, the rule would undermine both the international competitiveness of European industry and the environmental integrity of the legislation. In fact, the Impact Assessment accompanying the Commission's proposal has acknowledged this situation and explicitly excluded the application of the conditionality to CBAM sectors⁵.

Finally, the new provisions on conditionality add significant legal uncertainty and administrative burden, which is inconsistent with the intended objective of spurring investment. In particular, the Commission proposal excludes

⁵ The policy measures [on conditionality] were designed to apply to sectors not currently covered by the CBAM. The rationale for this was that a phase out of free allocation for CBAM sectors was already legislated for under the CBAM regulation and the focus of the impact assessment was on how best to reform free allocation for the remaining sectors": Source: Commission Impact Assessment, part IV, Annex 12, page 19.

from the conditionality assessment the multibillion investments made before 2030, and investments supported by other funding instruments not listed in the legal text, such as the Modernisation Fund or national schemes compliant with the EU state aid regime. Excluding investments made before 2030 from the conditionality assessment would send the wrong signal to industry. Companies that took early investment decisions and committed substantial capital to decarbonisation projects should not be penalised for acting ahead of regulatory requirements. Moreover, the timeline foreseen in the conditionality provisions does not reflect the long-time horizon of investments in energy intensive industries, since the rules require to develop the plan, implement the investment and deliver emissions reductions in around five years. Such a strict timeframe is disproportionate, especially when this involves complete changes in the process technology while continuing existing production to be able to serve the market. Also, the requirement to reinvest the equivalent of the 5-year free allocation will be often disproportionate to the actual investment possibility, and the provisions on reimbursement in case of relocation introduce a new, major layer of legal uncertainty, with the risk of heterogenous and unpredictable implementation within the EU.

Finally, the Commission proposal does not clarify which zero and low carbon installations would be exempted from the conditionality. These definitions and all other practical details for complying with the conditionality requirements will only be set through implementation rules in the coming years, leaving limited time for adaptation before the first compliance deadline of September 2029.

Against this background, the structural solution to avoid such new asymmetries and issues is to repeal the “negative” free allocation conditionality based on penalties. Instead, “positive conditionality” should be developed through a reward, incentive-based mechanism for investments, covering also those by the first movers. If, however, “negative conditionality” is retained, it should be fully mirrored in the CBAM to avoid an undue advantage to EU imports by removing the free allocation adjustment from the calculation of the CBAM levy or by imposing the same conditionality requirements on imports. Moreover, the detailed provisions on conditionality should be significantly adjusted to reflect investment realities, recognise first-movers and to avoid counter effective impacts on investments.

In order to preserve incentives for circularity in Europe, conditionality should not apply to secondary steelmaking and, more generally, when the costs of the investments are disproportionate, as it is in the case with the existing conditionality clauses.

Increasing the flexibility between the auctioning and free allocation shares to mitigate the cross sectoral correction factor

The cross sectoral correction factor (CSCF) significantly undermines the carbon leakage protection because it reduces free allocation below the level of benchmarks, which are already set by the best 10% installations. Therefore, the design of the EU’s ETS should be reassessed to avoid, or at least mitigate, its application after 2030. The European Commission’s proposal to increase the flexibility between the auctioning and the free allocation shares only by 1% point, from 3% to 4%, is largely insufficient to achieve this target. In fact, the current distribution of the ETS cap between auctioning and free allocation is based on outdated pre-2013 historical emissions of the power and industry sector. Hence, a higher flexibility should be introduced to ensure sufficient free allocation for carbon leakage protection, while retaining expectations on the carbon price signal. In parallel, complementary solutions should be explored. For instance, if allowances originally intended for the free allocation for industry remain unused by 2030, they should be retained and made available for free allocation after 2030.

Indirect carbon costs compensation should be fully implemented in all Member States

Affordable electricity is essential not only for the short-term competitiveness of the steel industry, but also for its medium-term decarbonisation, since low-carbon and circularity technologies rely heavily on direct and indirect electrification. The European Commission's proposal on ETS prolongs the existing provisions on indirect costs compensation for the post-2030 period.

However, according to the current CBAM legislation, indirect emissions from electricity consumption are excluded from the CBAM scope during the definitive period for sectors eligible for compensation of indirect ETS costs, such as steel. The legislation nevertheless requires the European Commission to reassess this exclusion by the end of 2027. Due to the current functioning of the electricity market which is based on marginal pricing, indirect costs paid by EU industry in the electricity price are not linked to the actual emissions of the electricity consumption but to the emissions of the marginal electricity producer. Therefore, even if the EU power grid is decarbonising quickly, the indirect carbon costs remain set by the marginal production, which is expected to remain fossil based beyond 2030, according to the recent report by the Joint Research Institute.

Indirect costs compensation based on the relevant marginal emission factor of each electricity zone takes into account this unique characteristic of the European electricity market. Yet though it is allowed under EU State Aid rules, financial compensation is possible for 75%-80% of eligible costs and is not implemented at all or to the full extent in several Member States, leaving local industries exposed to indirect costs without protection. Therefore, indirect costs compensation should be increased to 100% of eligible costs and fully implemented in all Member States without additional national requirements, as long as the average grid factor deviates substantially from the marginal factor.

Unintended effects of the legal framework on indirect emissions should be addressed on a case-by-case basis, where relevant. Notably, the Prodcom code for ferro-nickel (FeNi) and nickel pig iron (NPI) (24101240) is included in the list of sectors eligible for indirect costs compensation because the eligibility assessment was performed at the level of NACE 4-digit codes; hence, all the subcodes of 2410 are considered as eligible, including the one of FeNi. However, there is no FeNi or NPI producer in the EU. Despite this concrete situation, the fact that the code is included in the list prevents the consideration of indirect emissions under the CBAM for the corresponding Combined Nomenclature (CN) code, notably 72026000. This legislative framework leads to the inconsistent result that there is neither indirect carbon leakage protection for this ferro-alloy (since it is not produced in the EU), nor for the European stainless-steel producers, since the indirect emissions of FeNi and NPI embedded in stainless steel are excluded from the CBAM. In order to solve the current inconsistent situation, the Prodcom code of FeNi and NPI should be removed from the list of sectors eligible for indirect costs compensation, and the corresponding CN code should be removed from the Annex II of the CBAM Regulation 2023/956, so that their indirect emissions are included in the CBAM, both as CBAM goods and as precursors of stainless steel.

Revenues from the CBAM free allocation phase-out should be reinvested fully in CBAM sectors

While within existing legislation the free allocation phased-out to CBAM sectors was destined to the Innovation Fund, with the option of dedicated calls for these sectors, the European Commission's proposal distributes those allowances in the following way:

- 50 million to the New Entrants Reserve;
- 200 million to the Innovation Fund but without dedicated calls for CBAM sectors;
- the rest to the auctioning share of Member States.

This new distribution de facto transfers most of the revenues from such allowances from CBAM sectors to other sectors. This creates the major risk that funding support for CBAM sectors will be insufficient for the timely transformation required to these sectors by the ETS framework, including the trajectory of the CBAM factor.

Hence, the proposal should be amended to ensure that 100% of the revenues are reinvested fully in the CBAM sectors, for instance with dedicated calls via the Investment Booster and the Industrial Decarbonisation Bank.

All ETS auctioning revenues should be reinvested compulsorily in ETS sectors and a high share allocated to energy-intensive industries

Together with the launch of the Investment Booster and the Industrial Decarbonisation Bank, the European Commission's proposal of directing at least 50% of the auctioning revenues to ETS sectors is a first positive step. We welcome this new focus on increasing funding support for ETS sectors. Yet, as mentioned above, revenues from the CBAM free allocation phase-out should be granted exclusively to CBAM sectors. Moreover, all auctioning revenues should be reinvested in ETS sectors and a large share should be allocated for energy-intensive industries to prevent the risk that such revenues are spent on other ETS sectors. To ensure a level playing field, participation to the schemes should be allowed also to existing low-carbon production and/or installations under construction where production has yet to start.

Aligning the ETS cap trajectory to the new 2040 target while still enabling compliance

The combination of the rules on the linear reduction factor (LRF) until 2040, carbon removals and international credits need to ensure that the new 2040 target is achieved in a cost-efficient way. It needs to take into account both the necessary carbon price signal and the current status of enabling conditions to deliver the target.

Any flexibility mechanism such as carbon removals and international credits must preserve both the environmental integrity and the proper functioning of the EU ETS market. While intra-EU actions should be prioritised over international credits, international credits may still be necessary to ensure the overall cost-efficiency of offsetting very hard-to-abate emissions. Yet, their use should not finance third countries' industrial sectors directly competing with EU industry. Similarly, carbon removals should add flexibility to the ETS but remain focused only on industrial sectors, since scarce resources such as biomass should be prioritised for feedstock and very high temperature processes.

To ensure transparent monitoring of the transition, the accounting of climate targets should clearly distinguish emissions reductions achieved through investment and innovation from those resulting from deindustrialisation.

The Market Stability Reserve should evolve with the market reality

The current design of the Market Stability Reserve (MSR) was developed when the EU carbon market was still affected by the historical surplus from phase 2 and 3. Under its current design, the MSR has invalidated around 3 billion allowances. As already recently proposed by the European Commission, the immediate priority should be to prevent the invalidation of further allowances as soon as possible, to ensure that such allowances are still available in the reserve when the market will be shorter.

In parallel, the MSR should be used as an instrument to respond to the evolution of market liquidity and to avoid excessive volatility when the market shrinks significantly, while preserving the carbon price signal. In this context, the functioning of the MSR should be reviewed to avoid excessive price fluctuations, for instance by linking it to an evolving price corridor so that it provides more visibility to the future market and enables better financial and investment planning.

New rules on CCU are a welcomed positive step to be fully implemented in secondary legislation

The ETS surrendering rules need to reward the environmental benefits of carbon capture and usage by taking into account avoided emissions compared to the business-as-usual scenario (i.e. considering the displacement of fossil carbon). In this regard, EUROFER welcomes the new provisions shifting the surrendering obligation to



downstream sectors and, in order to ensure environmental integrity, robust monitoring and reporting of emissions in the waste sector. However, such provisions will require a consistent implementation in the secondary legislation fully integrating existing rules and schemes.