08/07/2025

The EU Emissions Trading System and Market Stability Reserve beyond 2030 - vision IFIEC Europe

IFIEC Europe represents the interests of industrial energy users in Europe for whom energy and climate policies are significant components of production costs and a key factor of competitiveness in their activities in both Europe and throughout the world.

The commission launched a public consultation on the EU Emissions Trading System and the Market Stability Reserve, including an evaluation questionnaire as well as a call for evidence, in view of a revision in 2026 of these instruments for the post-2030 framework.

IFIEC Europe understands and supports the EU's continuous efforts to reduce greenhouse gas emissions and recognizes that the energy transition towards a climate-neutral energy system constitutes an essential pillar of that policy. This transition inevitably comes, however, with a higher cost for energy for European households and companies. It is therefore of vital importance to minimize overall energy system costs. As energy and climate policies are strongly interlinked, also crucial changes to the ETS are needed to safeguard the competitiveness of the industry.

Currently the energy intensive industry is facing major economic challenges due to geopolitical context and high energy prices. As a result, deindustrialization in Europe is happening at this moment. In addition, the regulatory uncertainty and ambitious climate and energy policy in Europe not followed by the rest of the world, hampers new industrial investments in Europe. Under these specific circumstances IFIEC therefore asks to speed up the process of the well needed ETS revision, and to include as soon as possible emergency measures to maintain current level of free allocation (e.g. avoiding benchmark updates and CSCF activation) for industrial sectors under carbon leakage risk and to freeze the MSR working.

In addition a good functioning ETS system will not be sufficient for industry to make the needed transition. To achieve broader greenhouse gas emission reductions, industry needs to implement new low-carbon technologies that involve higher CAPEX and OPEX costs compared to conventional production costs, resulting in more expensive low-carbon products. However, on consumers level, there seems no willingness to pay for these additional costs. Hence, no market currently exists for these low-carbon products. Measures on demand side like market pull measures are needed to support the uptake of low-carbon products.

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This paper, next to the answers on the questionnaire, is IFIEC's response to the open public consultation. This paper contains three chapters and will address potential adjustments to the system relating to stationary installations, but will not cover aviation nor maritime transport. The first chapter tackles aspects which are related to the functioning of the EUA market post-2030, including the need to increase liquidity and the adapt design of the MSR to the market functioning. The second chapter addresses solutions to carbon leakage, based on improving Free Allocation, Indirect Emission Compensation and CBAM. The third chapter elaborates on remaining topics: potential ETS scope extension and ETS revenue use and funds.

Quick Summary

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1 A resilient EUA market post-2030

1.1 Linear Reduction Factor in line with innovation curve

IFIEC supports climate neutrality by 2050 but advocates for a realistic trajectory, aligned with the typical innovation curve, accounting for adoption and diffusion of new technologies.

Industrial processes need transformational innovation to reduce greenhouse gas emissions from combustion and processes. This requires large-scale investments in low-carbon energy production (including in infrastructure), and low-carbon technologies like hydrogen, CCUS, and chemical recycling. While promising technologies are being developed, they follow the typical innovation curve meaning their large scale implementation is often expected at a later stage. The ETS cap should reflect this innovation curve (see "innovation path" figure 1).

The Linear Reduction Factor (LRF) was updated as part of the Fit for 55 package in order to reduce aggressively towards the 2030 target (-62% compared to 2005 levels). When the ETS is not amended, the annual ETS-cap will continue to decline under the accelerated LRF, reaching zero by 2039. In order to allow industry to make the transition by 2050, an adjustment of the LRF post-2030 is necessary. **A post 2030 LRF in line with innovation curve is needed, meaning a lower LRF until 2040 and a higher LRF after 2040.**

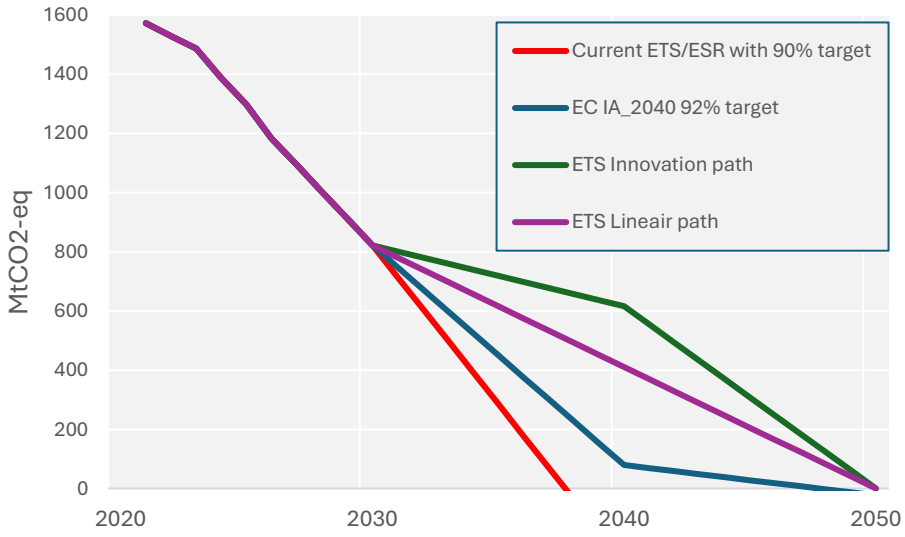

Figure 1: Different trajectories towards climate neutrality for ETS

In this context it is important to note that the **2040 overall climate target** directly impacts ETS and must be set in line with the innovation curve. According to the EC's 2040 impact assessment, the ETS emissions cap under the proposed 92% climate target, reaches nearly zero emissions in 2040, in fact completely opposing the innovation curve.

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Although the post-2030 ETS framework will be reviewed next year, the 2040 climate target of a 90% emissions reduction already places a significant constraint on this reform.

The accelerated action curve in line with the 90% reduction proposal by 2040, or current LRF brings forward climate neutrality for ETS to 2040, which further accelerates the exit of the industry out of Europe, leading to massive job losses and economic decline. Given the risk to ETS and the impact on society, IFIEC doesn't support a 90% target. Any 2040 target must include a competitiveness safeguard, based on a clear sector-specific impact assessment.

1.2 A smarter and more predictable MSR fit for economic cycles without invalidation

Within the EU ETS, the market stability reserve (MSR) was intended to increase resilience to demand shocks and to stabilize the carbon market. Since its introduction, the MSR has played a role in addressing the historical surplus of allowances by withdrawing allowances from the market annually— and was complemented by the backloading of allowances and the rebasing of the cap.

However, the current MSR design is no longer fit for purpose. It lacks the flexibility to respond effectively to situations of scarcity caused by rapid economic recovery or an accelerated reduction of the cap. The invalidation rule undermines the MSR's original purpose and risks reducing the long-term cap, ultimately harming the competitiveness of European industry. ETS must remain flexible, with the ability to increase supply quickly when demand rises to ensure stable conditions for industrial production.

The European industry is under severe pressure, with capacity utilization remaining below its long-term average for almost three consecutive years. This has reduced demand for EUAs, contributing to the transfer of ~270 million allowances into the MSR in 2024 —all of which were permanently invalidated on 1 January 2025 [1]. During economic recovery, these allowances will not return, resulting in scarcity and upward prices.

To improve the MSR, we propose the following adjustments:

1. **Invalidation of allowances should at all times be avoided.** Allowances should not be permanently removed when a certain threshold is reached. Instead, they should be retained in the reserve for future use—e.g. to prevent a Cross-Sectoral Correction

[1] C(2025)/3120 Communication from the Commission: Publication of the total number of allowances in circulation in 2024 for the purposes of the Market Stability Reserve under the EU Emissions Trading System

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Factor (CSCF), or to support decarbonization efforts, such as through funding the Industrial Decarbonisation Bank.

2. **A volume-based MSR that uses minimum and maximum carbon price thresholds, aligned with international carbon prices, could provide greater clarity and predictability**. Transparency in the MSR's operation is crucial to support informed investment decisions and long-term planning by industry.
3. **When the carbon price thresholds are not implemented**, the minimum and maximum **thresholds need to increase** to make them fit for economic cycles. **Release rate** (from MSR back to auction volume) **should be increased** as well, so it is more balanced with the outtake rate. Post-2030, as the cap declines and the market tightens, dynamic (relative) thresholds and rates will likely be more effective than absolute values.
4. As an **emergency measure**, the MSR could **be temporarily frozen** during periods of low industrial activity to avoid penalizing the industry twice. No allowances will then be taken from the Auction Volume.

It is crucial to note that these proposed improvements on the MSR need to be introduced as soon as possible before 2030.

1.3 Recognition of carbon removals and avoided emissions

Fully mitigating industrial emissions is economically and technically unfeasible. Therefore, recognition of avoided (CCU) and even negative emissions – thereby ideally creating closed carbon cycles- within the ETS- is indispensable for achieving EU climate neutrality.

While avoiding additional emissions is a priority, the role of carbon cycles is pivotal to make carbon circular. Various sectors currently require, and will continue to require in the future, carbon molecules as essential raw materials for their products. Therefore, the EU should allow actors to invest in carbon removal and recycling solutions, as these are key drivers in reducing emissions.

A crucial step for further development of CCUS and carbon removal technologies is that all avoided or removed CO_2 emissions are fully recognised. A robust accounting framework could be designed while avoiding gaps or double counting in emissions and needs to include following elements:

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1. **Credit for CCS with zerorated[2] CO_2 or with CO_2 from Direct Air Capture (DAC)**
2. **Recognition of avoided fossil CO_2 used to produce materials**
3. Zerorating for fuels produced from fossil CO_2
4. **Credits for productions of materials with zerorated CO_2 or with CO_2 from Direct Air Capture (DAC)**
5. **Credit for the use of bio-based feedstock in products**

Figure 2 gives an overview of the different cases and the proposed accounting rules. +1 indicates the surrendering of an EUA, 0 indicates no surrendering of EUA, -1 indicates reduction of EUA. In red are the changes required in the MRR accounting rules. For more details on these accounting rules see Annex 1.

It is important to note that the Carbon Removal Certification Framework (CRCF) is not designed for industrial carbon removal technologies and does not follow the same robust accounting principles as established under the Monitoring and Reporting Regulation (MRR). It is therefore difficult to use the Carbon Removal Certificates within ETS for compliance purposes. A direct solution within in the ETS MRR is needed for example by opening up article 49 to capturing all types of CO_2.

In addition, although CCU is currently recognised in article 12(3b), there are too stringent requirements on the final products for which the captured CO_2 is used. For the majority of products, requirements related to permanence and zero emissions at the end-of-life stage are impossible to fulfil and discriminate CCU products over fossil-based products, where such requirements don't exist. The ETS foresees a revision in 2026 to include other CCU materials, however to not further hamper CCU developments it is key to provide clarity on the future rules as soon as possible.

[2] Zerorated CO_2 is CO_2 originating from the burning of fuels with a zero rating (e.g. biomass fuels, or CCU fuels),

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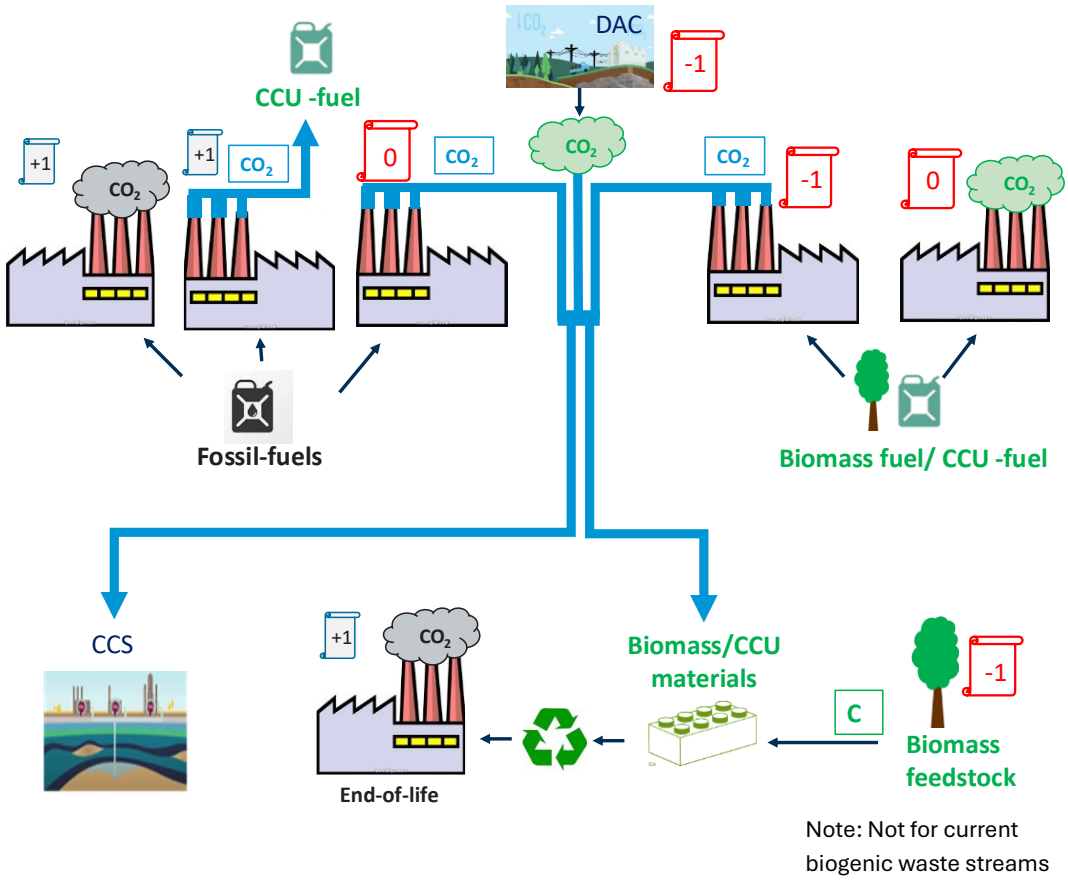

Figure 2: Overview of the different cases with proposal of accounting rules.

1.4 Allow High-Integrity International Credits and Interlinking with other Carbon Markets

It is important to open new options for reaching GHG-reductions on the way to the 2040 target in Europe: especially the use of international certificates should be allowed within the EU Climate Law under below conditions. This will enhance flexibility for future ETS revisions.

1. **Alignment with the international obligations under the Paris Agreement (Internationally Transferred Mitigation Outcomes (ITMO), Art. 6.2; Paris Agreement Crediting Mechanism (PACM), Art. 6.4)** should be ensured. All credits used in Europe should be generated and transferred in a manner that avoids double counting and preserves the integrity of both the EU's and host countries' climate commitments.
2. **High-integrity standards should be imposed**: this means only allowing credits that meet stringent criteria for additionality, accurate measurement, verification,

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and permanence. Past experiences underscore why rigorous standards are needed.

3. **If a quantitative limit is set on the use of international credits for EU ETS compliance, it should reflect the reality of the decreasing cap.**

As we consider a global CO_2 pricing system as the ultimate goal to avoid carbon leakage during the transition to climate neutrality, we are also in favor that the **EU further explores possibilities for interlinking the EU ETS with other systems**, under the following conditions:

1. It must be ensured that the result of the interlinking **improves carbon leakage protection for the European industry**, and not evolves as a disadvantage. A clear impact assessment on competitivity will be necessary.
2. The other system must have **similar scope** of coverage in terms of GHGs and sectors and **similar market rules**.

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2 Improve Carbon Leakage protection

Carbon leakage protection needs to be as firm as the cap reduction. An appropriate, coherent, and dedicated framework is required that will facilitate a cost-effective transformation and prevent carbon leakage. IFIEC is confident that such framework can be provided.

The current protection mechanism is directly tied to emissions, meaning that as GHG emissions decrease, so does the level of protection. However, the risk of carbon leakage will remain unchanged as the cost of low carbon technologies is high. To ensure continued protection and enable the transition toward climate neutrality, a new parameter will be needed in the framework—one that reflects the ongoing exposure to carbon leakage, regardless of emission reductions, and provides financial support for decarbonization efforts. It is also clear that there is a need to explore incentive mechanisms to support the uptake of low-carbon products.

In the absence of such a new parameter, the following sections outline how the existing framework can be improved, focusing on Free Allocation, Indirect Cost Compensation, and CBAM.

2.1 A Robust Adequate Free Allocation system based on Representative Benchmarks

Free Allocation is still the most important carbon leakage system that has proven to be effective. As long as no alternative carbon leakage system is proven equal effective, IFIEC insists on maintaining this system with some well-needed adjustments.

2.1.1 Foresee sufficient Free Allocation budget

Currently, the free allocation budget is limited to 43% of the CAP. That means that, carbon leakage protection level decreases as the CAP reduces. It is known that industry emissions are more hard-to-abate than power emissions and will reduce at a slower rate than power emissions. Therefore, the relative share of industrial emissions exposed to carbon leakage will increase, and carbon leakage protection levels need to be adjusted to that new situation. When the cross sectoral correction factor (CSCF) is activated, this undermines the necessary protection. A sufficient free allocation budget needs to be foreseen to guarantee the needed protection by:

- deleting the dependency of the free allocation on the CAP and
- using otherwise invalidated allowances from the MSR to prevent a CSCF.

Furthermore, ensure that allocation is more closely related to real industrial activity levels in order to support economic growth and to prevent both under and over allocation.

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The creation of an Activity Level Change regulation for the ETS phase IV was already one step in the right direction, however, a further improvement would be to abolish or at least reduce the 15% threshold for a direct and more correct link of free allocation to real activity levels. It should be noted that Free Allocation is a carbon leakage measure and should be unconditional.

2.1.2 Use Realistic Benchmarks

IFIEC supports the usage of benchmarks to determine the amount of free allocation however these benchmarks need to be realistic and representative. Therefore following elements needs to be considered in the next phase:

- Using a baseline starting from 2007/2009 for Benchmark updates, leads to unrealistic extrapolations, as it ignores the slowdown in achievable reduction rates after initial efficiency gains. Benchmark values must reflect the current stage of industrial decarbonization, where most of the "low-hanging fruit" has already been addressed, and remaining emissions are significantly harder to abate. Extrapolating from a more recent period – such as 2016/2017 to 2022/2023-curve - better aligns with current technological and economic realities and avoids setting unachievable benchmarks.
- Benchmark values should be based on a representative part of the production activity, reflect the economic reality and should be technically possible for all sector participants. Where installations use resources, infrastructures or technologies that cannot be implemented broadly or in economies of scale in Europe, those installations should not determine the benchmark. The current applicable fallback benchmarks for example include scarce, not widely available resources (e.g. biomass or exothermic heat) with zero greenhouse gas emissions. This methodology drives the resulting heat benchmark to unrealistically low levels thereby disadvantaging the majority of ETS companies that simply cannot reach such levels due the limited availability of these resources. Equally important, end-of-pipe technologies like CCS should be excluded from the benchmarks, as the lack of infrastructure in remote areas will distort the level-playing field within Europe.
- Max Benchmark update rates should again be reduced post 2030, back from 2.5% to 1.6%, to ensure sufficient carbon leakage protection.

2.2 EU-wide and fair Indirect cost compensation

As electrification is increasing due to the transition, IFIEC stresses that the indirect CO_2 cost compensation scheme will become an even more important carbon leakage instrument, beyond 2030. Direct and indirect CO_2 emissions

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costs that are passed on in electricity prices, significantly impact competitiveness and increases the risk of carbon leakage, as non-European industries do not bear these costs. As outlined in its specific paper titled *State Aid Guidelines for Indirect CO2 Cost Compensation in Electricity*, IFIEC Europe recommends:

1. **All Exposed Sectors and Sub-Sectors should be Eligible:** All industrial sectors at genuine risk of carbon leakage due to high exposure to international trade and significant indirect ETS costs should qualify for compensation. A reassessment based on electricity consumption, GVA data, and CO_2 prices is essential to ensure fair treatment; both at sector level and at sub-sector level if necessary.
2. Safeguarding European Strategic Independence
3. **Sufficient Budgets and Uniform Implementation** including:
    a. prolonging existing compensation schemes in order to continue to protect the concerned industries.
    b. increasing the available budgets for compensation schemes in order to better protect the currently concerned industries and to extend the protection to other sectors subject to carbon leakage.
    c. guaranteeing both adequate financial support and consistent application to maintain fair competition across the EU.
4. **Removal of Aid Intensity and Efficiency Factor**
5. **Realistic Benchmarks and Emission Factors:** Industry benchmarks must reflect actual processes and not be based on niche or experimental processes. Emission factors should accurately represent the real marginal electricity generation emissions in each country.
6. **No Conditionalities:** Indirect cost compensation offsets the loss of international competitiveness caused by high CO_2 costs in electricity. It should not be tied to additional requirements, such as mandatory investments in decarbonization or energy efficiency.

2.3 CBAM Fit for Export and Integrated Value Chains before any extension to other sectors.

The CBAM lacks to deliver the same level of protection as free allocation under the ETS. High bureaucracy costs, no export competitiveness protection, no or insufficient downstream protection, inadequate default values and high risks of fraud, are only some of the issues to be solved. Scope extension to other sectors should only happen once the CBAM proved to be effective and specific needs of those sectors can be addressed. Provisions must also be

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established in the CBAM regulation to guarantee that EU producers remain competitive in the EU and non-EU markets, thereby maintaining the profitability of European production sites.

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3 Other Elements

3.1 No ETS scope extension by lowering the thermal 20MW threshold

We do not support lowering the 20 MW threshold for Annex I activities under the EU ETS after 2030, as this would place a disproportionate administrative and financial burden on smaller sites, many of which have limited capacity to absorb such costs, without delivering significant additional emissions reductions.

In addition, we recommend for sites exiting ETS 1 as a result of energy efficiency improvements or decarbonization efforts, that operators are given the option to remain under ETS 1 in the next phase, thereby continuing to receive free allocation. Without such a mechanism, early movers may face unintended disadvantages. A fair transition must ensure that progress in decarbonization does not lead to a distortion of the level playing field between ETS 1 and ETS 2 participants.

To maintain investment certainty and industrial competitiveness, any changes to the scope or allocation system must be carefully aligned with carbon leakage safeguards.

3.2 Including Waste Incineration in ETS

The inclusion of waste incineration under ETS1 may offer an opportunity to strengthen consistency in climate policy and to enhance circularity. IFIEC sees value in treating both industrial and standalone waste incinerators similarly within the ETS.

However, the scope of Waste inclusion in ETS must be carefully defined, where the necessary exemptions for hazardous waste should be ensured. In addition it should be noted that the inclusion of waste in ETS should not lead to unwanted side effects like more landfill disposal. Therefore the introduction of waste into ETS should go hand in hand with measures to avoid landfill disposal like a European landfill ban, or a comparable cost determined by the carbon content and CO_2 price.

3.3 ETS revenues back to industry

IFIEC Europe calls for streamlined government financial support, with all auction revenues directed to industry through simple, accessible subsidies that accelerate investment in transformative decarbonisation technologies. This can be achieved either through a strengthened EU-level budget with simplified rules and fair access for all, or through the Member States, provided that a more balanced and equitable distribution between Member States is ensured. The new state aid rules risk further distorting competition between EU Member States and will undermine the level playing field within Europe. It is crucial to prevent an even greater imbalance than already exists.

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3.3.1 Innovation Fund & Decarbonisation Bank

We support the establishment of the new Decarbonisation Bank. While the Innovation Fund should remain available to support first-of-a-kind technology developments, the Decarbonisation Bank plays a complementary role by facilitating the broader implementation of climate technologies. One should not exclude the other — both instruments are essential. Industry should not be excluded from benefiting from either source.

To support the business case for industrial decarbonisation, IFIEC believes the new Industrial Decarbonisation Bank should offer a mix of instruments —such as fixed premia for low-carbon products, contracts for difference, and grants—to meet different needs across sectors.

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Annex 1: Detailed information on robust accounting rules for CCUS in ETS

CCS with zerorated CO_2 or with CO_2 from Direct Air Capture (DAC)

Emissions from biomass and CCU fuels are have are zero rated in the MRR. However, when CO_2 derived from biomass or a CCU fuel is captured and stored geologically instead of being emitted, it becomes a net carbon sink, effectively removing CO_2 from the atmosphere. In this case, the emission factor should be considered as -1 credits without imposing additional requirements to allow recognition for compliance in the ETS. Als when CO_2 is captured directly from atmosphere (DAC), CO_2 is removed from air, this should lead to a -1 credit.

It is important to note that the carbon removal certification framework is not designed for industrial carbon removal technologies and is not designed on the same basis rules of robust accounting as the MRR. The carbon removal certificates can't be used within ETS for compliance purposes and a direct solution within in the ETS MRR is needed for example by opening up article 49 to capturing all types of CO_2.

CCU to materials from fossil CO_2

CO_2 can be recycled to use for production of chemicals, which in turn can be used as building blocks in the manufacturing of various materials. To promote the recycling of CO_2 in products and materials, it is important to recognize the avoided CO_2 when used in materials where the C it is intended to remain in the material during the usage phase. This means no allowances should be surrendered in the ETS for the CO_2 that has been captured and incorporated into these products. In such cases, any CO_2 released during the end-of-life treatment of these products is already accounted for within the ETS (e.g., cement kilns) or non-ETS sector (e.g., waste incineration) and there should be no additional requirements on lifetime or end-of life treatment diverging from requirement put on conventional products.

Although CCU is currently recognised in article 12(3b), there are too stringent requirements on the final products for which the captured CO_2 is used. For the majority of products, requirements related to permanence and zero emissions at the end-of-life stage are impossible to fulfil and discriminates CCU products over fossil-based products due to requirements where such requirements don't exist. The ETS foresees a revision in 2026 to include other CCU materials, however it is key to provide clarity on the future rules as soon as possible.

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CCU to fuels from fossil CO_2: carbon neutral or zerorated fuel

IFIEC is in favour of the recent recognition of the avoided CO_2 emissions in the case a CCU fuel or carbon neutral fuels and supports zero rating of these carbon neutral fuels in the MRR.

CCU to materials with zerorated CO_2 or with CO_2 from Direct Air Capture (DAC)

Zerorated CO_2 or CO_2 from DAC can in stead of being stored underground (CCS) also be used to produce materials. Similar to the CCS case and to encourage the transition to this climate-neutral feedstock sourcing, -1 credit should be granted at the production level for these products. This can only be done if the emissions are accounted for at end-of-life. What is currently also the case as these products are classified as fossil in end-of-life accounting (e.g., plastics in waste incineration) as no distinction between these products and products based of fossil feedstock is possible. Providing a -1 credit for the usage of zerorated CO_2 or CO_2 from DAC these production routes are incentives and it the end of life treatment is simplified as no distinction between the different products would be required.

The use of bio-based feedstock in products

Industry is looking to into a feedstock transition, substituting fossil based feedstock by biogenic, recycled or CO_2 origin. ETS has a focus on CO_2 emissions, and incentivise the avoidance of emissions. The use of sustainable biomass fuels is incentivised by a zero emission factor. However no incentive for the use of biomass based feedstock exist. This could be done by giving a -1 credit to the usage of biomass as feedstock. This can however only be done if at end of life the emissions of the resulting are accounted for. This would have the advantage of that at end of life no complex distinction between products based on fossil feedstock, or biogenic feedstock have to be made.

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