A joint call for a prompt and strong revision of the EU ETS to effectively support the increased European climate ambition

1. The EU ETS plays a key role, but all sectors must contribute jointly

We, the undersigned companies, have consistently supported the EU emissions trading system (ETS) as the main instrument of the EU climate policy. It is EU-wide, market-driven and technology-neutral; thereby rewarding the most effective technology mix to bring emissions down at the required rate. It has been **successful** in reducing emissions without jeopardizing affordability or security of electricity supply; by 2019 ETS emissions had declined by 43% from 2005, compared with 12 % in the non-ETS sectors (covered by the Effort Sharing Regulation, ESR) in the same period.

In light of the sharpened 2030 climate target, the EU legislators now need to establish a feasible pathway for achieving a fair energy transition. Social acceptance is key in this context and requires **a more evenly spread decarbonization across all sectors**. We believe that this can be achieved through a fair and cost-effective allocation of the efforts amongst the three main policy domains (ETS, ESR, LULUCF); by introducing carbon pricing step-by-step to all sectors, possibly first through separate carbon pricing systems in combination with existing policy tools in these sectors and later linking to the existing EU ETS; and by focussing on cost-efficiency, while mitigating the social effects on vulnerable groups. Direct electrification of transport, buildings and industry and indirect electrification of hard-to-abate sectors via hydrogen and e-fuels play a very important role in decarbonizing end-uses in these sectors. This type of sector integration also increases both cost- and energy efficiency and should be enhanced by sharing the EU's total emissions reduction effort between ETS and ESR sectors fairly.

2. A higher LRF needs to take effect from 2023

The Linear Reduction Factor (LRF) is the most important design parameter to align the EU ETS with the EU's new ambitious 2030 and 2050 climate targets. The LRF defines the pace for the annual cap reduction and thereby provides long-term predictability and gives incentives for companies to invest in climate mitigation.

An efficient ETS cap trajectory towards 2030 should take into account recent improvements in the CO2 emissions intensity, future CO2 abatement costs, as well as the impact of other EU 2030 targets and national overlapping policies. Unforeseen developments in these parameters can cause significant changes in the demand for ETS allowances and lead to excess supply and high price volatility. We also believe that a smooth and forward-looking decline of the cap provides most stability and cost-effective decarbonisation pathway. Therefore, a **higher LRF needs to take effect from 2023, or 2024 at latest**. The later the revised LRF is implemented, the higher it needs to be to ensure reaching the targets. By implementing the ETS reforms early, policy makers can provide more market certainty and avoid putting a disproportionate burden on the last few years of the decade.

3. Tighter MSR is needed to ensure future market resilience

In our view, the main role of the MSR is to **stabilize the ETS when needed.** Despite its novelty (started in 2019), the MSR has proven to be highly efficient in stabilizing the price development in the ETS. The beauty of the MSR is that it can address situations of both too high and too low prices, while only making adjustments in the ETS supply when it is actually and objectively needed.

We believe that a strong market stabilizing mechanism is important also beyond 2023. The past 10 years have illustrated the risk of external shocks (financial crisis, pandemic) and their impact on economic activity and increased price volatility in the ETS. This can happen again, and the ETS should not loose effectiveness under such circumstances. The effects of various overlapping policies, especially on national levels, will be difficult to fully accommodate when setting the cap trajectory. Rebasing the ETS cap in addition to setting a higher LRF may contribute to reducing the current oversupply, but it would not protect against future oversupply. A strong MSR that can mitigate these effects is therefore needed.

Therefore, **the MSR's "intake rate" needs to be maintained at minimum 24 %**. In addition, the current activation threshold band of 400-833 Mt should be lowered to better reflect the reduced hedging demands resulting from increased decarbonisation, especially in the power sector.

Finally, the automatic invalidation rule in the current MSR should be maintained by limiting the allowances held in the MSR to the auction volume of the previous year. The market needs certainty that these excessive volumes of ETS allowances are invalidated and cannot re-enter the market at a later stage. In any case, a certain amount of EUAs will be kept in the MSR to return some supply in case there is too much scarcity.

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