

EFET views on the future role of the EU ETS

15 December 2020

EFET

European Federation
of Energy Traders
SO YOU CAN RELY ON THE MARKET



European Federation of Energy Traders (EFET)

We promote competition, transparency and open access in the European energy sector. We **build trust in power and gas markets across Europe**, so that they may underpin a sustainable and secure energy supply and **enable the transition to a carbon neutral economy**.

Since our establishment in 1999, EFET has been playing a prominent role in facilitating the development of **open, competitive, liquid and transparent electricity and gas markets**, actively contributing to the development of the EU energy market design.



Improving the **functionality and design** of European gas, electricity and associated markets for the benefit of the overall economy, society and especially end consumers.



Developing and maintaining **standard wholesale supply contracts** and standardising related transaction and business processes (e.g. the EFET Master Agreement and the EFET standard CPPA).



Facilitating debate amongst TSOs, regulators, policy makers, traders and others in the value chain about the **future of the European energy market**.

Agenda

1. Status quo: EU ETS – the cornerstone of Europe’s climate policy
2. European Green Deal: setting the policy vector towards strengthening and expansion of the EU ETS
3. EU 2030 Climate Target Plan: introducing a vision for a reinforced EU ETS
4. Frontier Economics report to EFET “Gas decarbonisation and sector coupling: ensuring a market-based approach”
5. Future design of the EU ETS and its alignment with other energy and climate policies at EU and at national level
6. CBAM: which way forward?

Status Quo: EU ETS – the cornerstone of Europe’s climate policy

Over the last 15 years the European carbon market has evolved into the largest and one of the most mature carbon markets in the world. The revision of the EU ETS has already brought tangible results and improved the functionality of the carbon market in Europe.

The 2020 carbon market report published by the Commission on 18 Nov 2020

Highlights:

- Emissions from installations covered by the EU ETS decreased by 9.1% in 2019 compared to 2018
- Verified emissions from aviation continued to grow, albeit more modestly, with an increase of 1% compared to 2018
- The 2020 Market Stability Reserve surplus indicator (1.385 billion allowances) continues to lead to allowances being placed in the reserve, reducing the 2020 auction volume by some 35% (almost 375 million allowances).
- In 2019, Member States generated some 14 billion Euro from auctioning ETS allowances and spent or planned to spend close to 77% of 2019 revenues on advancing climate and energy objectives - well above the 50% required in the legislation.

European Green Deal: setting the policy vector towards strengthening and expansion of the EU ETS

The Commission will

- ✓ *launch work on the possibility of including emissions from buildings in European emissions trading, as part of broader efforts to ensure that the relative prices of different energy sources provide the right signals for energy efficiency*
- ✓ *propose to extend European emissions trading to the maritime sector, and to reduce the EU Emissions Trading System allowances allocated for free to airlines*
- ✓ *consider applying European emissions trading to road transport*

- European Commission Communication on the European Green Deal, 11 December 2019



EU 2030 Climate Target Plan: introducing a vision for a reinforced EU ETS

The EU 2030 CTP published in September 2020

- Introduces an EU-wide, economy-wide GHG emissions reduction target by 2030 compared to 1990 of at least 55% including emissions and removals (the target was approved by the Council on 11 December 2020)
- Foresees “an increasing role for emissions trading and energy taxation”: strong support for the role of the EU ETS as an effective tool to reduce CO2 emissions in a cost effective way; strengthening and expansion of the EU ETS – a clear priority for the Commission.

ETS expansion

- Aviation: Commission will propose to reduce the free allocation of allowances
- Maritime: Commission will give “fresh political consideration to the international aspects of the EU ETS, taxation and fuel policies for aviation and maritime”
- Effort Sharing Regulation: Commission will give consideration to different options in light of an **expansion of emissions trading to all fossil fuel use**. In case of a full transition to an EU ETS covering all fossil fuel combustion emissions, the Regulation would predominantly cover non-CO2 emissions. The Commission will use the upcoming impact assessment for both the review of the Emissions Trading System and the Effort Sharing Regulation

Next steps on emissions trading

1. Assessing how to strengthen the cap in the context of an extension of the system and next year’s review of the functioning of the MSR
2. Revisiting the LRF to guarantee that the sectors covered by the EU ETS deliver the necessary emissions reductions.
3. Introducing a CBAM

Harnessing Europe's energy markets to enable cost-effective decarbonisation of the gas system and efficient coupling of the gas and power sectors

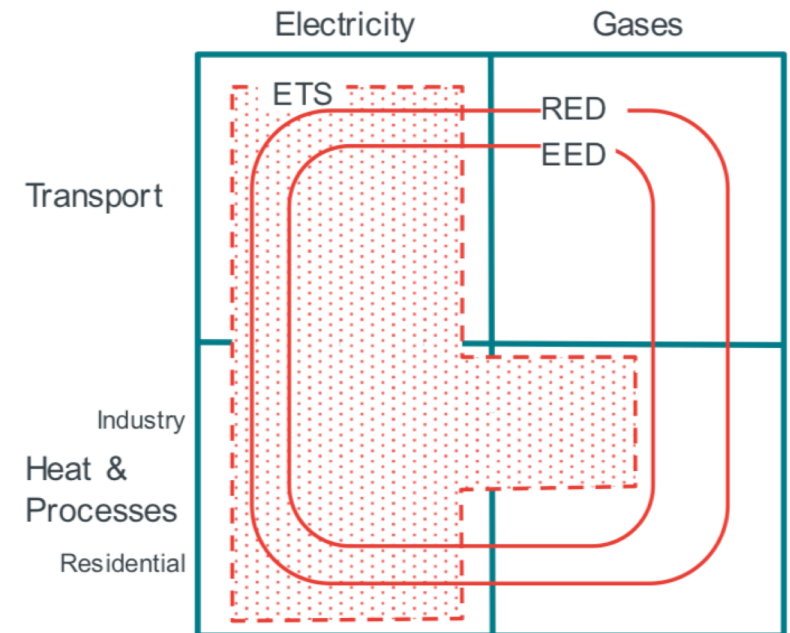
[Frontier report to EFET published on 26 February 2020](#)

Objective: to explore how market-based mechanisms can be harnessed, to enable cost-effective decarbonisation of the gas system and efficient coupling of the gas and power sectors.

Key findings:

- **Incomplete coverage of the EU ETS leads to inefficient abatement of carbon emissions. The limited sectoral reach of the ETS constitutes one of the critical gaps in the current EU climate policy framework, thereby undermining its effectiveness.**
- The report points to the need for a coherent policy framework that rewards carbon abatement in a market-based, technology-neutral way.
- In particular, it describes a pan-European system of quotas, which retail suppliers would need to fulfil for reducing carbon in their gas supplies by purchasing certificates.
- Such a mechanism could also facilitate the coupling of the gas and power sectors, pending an expansion of the EU ETS into energy consumption areas such as transport and heating of buildings.

Figure 1. Sectoral coverage of current climate policy arrangements



Source: Frontier report for EFET [“Gas decarbonisation and sector coupling: ensuring a market-based approach”](#)

Future design of the EU ETS and its alignment with other energy and climate policies at EU and at national level (I)

Gradual expansion of the EU ETS to road and maritime transport, buildings and ultimately all fossil fuel use

- ✓ Gradual expansion of the EU ETS to cover all fossil fuel use will be key for cost-effective decarbonisation of the EU economy
- ✓ Setting up robust functioning monitoring, reporting and verification for new sectors is necessary and transitional arrangements/ a pilot period is necessary before these new sectors can be gradually integrated into the EU ETS
 - In the short to medium term (over the next five years), a separate EU-wide emissions trading system for road transport and buildings or – preferably – for all fossil fuel use should be put in place
 - A clear timeline for integrating a new ETS for all fossil fuel use in the existing EU ETS is necessary

Future design of the EU ETS and its alignment with other energy and climate policies at EU and at national level (II)

MSR review

- ✓ Having entered into force in 2019, the MSR has already proven to be effective. According to the latest EC report on the functioning of the EU carbon market, on the basis of the 2019 and 2020 TNAC and the revised legislation, the auctions in 2020 were reduced by nearly 35%. Auction volumes in 2021 will also be reduced following the same approach.
- ✓ The upcoming MSR review would have to address the sharp increase of the EUA surplus driven by the economic downturn caused by the Covid-19 pandemic, as well as the impacts of the overlapping energy and climate policies on the carbon market (i.e. the uptake of renewables and energy efficiency measures, as well as coal phase out in Germany).
- ✓ The MSR review should ultimately be part of a comprehensive EU ETS revision, and be aligned with the prospective strengthening of the EU ETS cap and increase of the LRF.

Future design of the EU ETS and its alignment with other energy and climate policies at EU and at national level (III)

Ensuring coherence between the EU ETS and the overlapping instruments and policies introduced both at EU and the and at national level

- ✓ A key prerequisite for enabling the EU ETS to play a reinforced role envisaged by the 2030 EU Climate Target Plan is to ensure coherence and alignment between the revision of the EU ETS Directive and the overlapping instruments and policies introduced both at EU level (i.e. the revision of RED II and the EED) and at national level, which have an impact on the European carbon market.
- ✓ At EU level ensuring alignment and consistency between the EU ETS as a cap and trade system on the one hand, and other EU climate policies (in particular, renewable energy and energy efficiency) on the other, should constitute a policy priority in the framework of the EU 2030 CTP implementation.
- ✓ At national level, we are observing that governments are increasingly considering bans on, or progressive prohibitions of, particular uses of unabated fossil fuels or particular technologies used in end energy applications. EU-wide harmonisation of implementation of such bans and prohibitions will be key to ensure that the ETS cap and LRF take account of their anticipated impact within the sectors covered by the EU ETS.

CBAM: which way forward?

- ✓ The current carbon leakage framework should be replaced by a CBAM, if the CBAM is integrated in the EU ETS.
- ✓ At the same time, CBAM should be seen as a means to an end, rather than the end goal in itself. Addressing carbon leakage ultimately requires greater integration and linkage between the EU ETS and other carbon schemes internationally.
- ✓ Strengthening the international role of the EU ETS and fostering expansion of carbon trading internationally is key to address carbon leakage and to reduce global CO2 emissions cost-effectively. In this context, CBAM can serve as a negotiating tool for Europe to form a wide international coalition around carbon pricing.
- ✓ A CBAM integrated with the EU ETS could also give an impetus to the ongoing work on implementation of Article 6 of the Paris Agreement - which provides for the use of international carbon markets for achieving the emissions reduction targets set by the Parties - one of the key topics on the agenda of the upcoming COP26.