

## IIGCC RESPONSE TO EUROPEAN COMMISSION CONSULTATION ON EU EMISSIONS TRADING SYSTEM

The Institutional Investors Group on Climate Change (IIGCC) is the European membership body for investor collaboration on climate change and the voice of investors taking action for a prosperous, low-carbon future. IIGCC has more than 270 members, mainly pension funds and asset managers, across 16 countries, with over €35 trillion in assets under management.

Our mission is to mobilise capital for the low-carbon transition and to ensure resilience to the impacts of a changing climate by collaborating with business, policy makers and fellow investors. IIGCC works to support and help define the public policies, investment practices and corporate behaviors that address the long-term risks and opportunities associated with climate change. Members consider it a fiduciary duty to ensure stranded asset risk or other losses from climate change are minimised and that opportunities presented by the transition to a low-carbon economy – such as renewable energy, new technologies and energy efficiency – are maximised. For more information visit [www.iigcc.org](http://www.iigcc.org) and @iigccnews.

### Section A: The contribution of EU ETS to the overall climate ambition for 2030

*Question 1: With the increased 2030 GHG reduction ambition of at least 55%, what should be the current EU ETS sectors' contribution to the increased 2030 target (i.e. without the accounting for the possible inclusion of new sectors)?*

- ✓ **The current ETS sectors should increase their current ETS contribution (compared to 2005) in line with the new target. Based on cost-efficiency considerations as calculated in the Impact Assessment accompanying the Communication on stepping up the EU's 2030 climate ambition (table 26), the current ETS sectors should contribute around -63% compared to 2005**
- The contribution of the current ETS sectors should be more than what their potential for cost-efficient emissions reductions would indicate*
- The contribution of the current ETS sectors should be more than 43% reductions (compared to 2005) but less than what their potential for cost-effective emissions reductions would indicate*
- Other – please specify (1000 characters maximum).*

**IIGCC's position is to support a scaled up EU ETS in line with at least 55% reductions in greenhouse gas emissions by 2030 and net zero emissions by 2050, i.e. current ETS sectors should contribute around -63% compared to 2005, as set out in the Commission's Impact Assessment. IIGCC continues to support the EU ETS as a cornerstone instrument of EU-wide climate change policy.**

*Question 2: A strengthened EU ETS 2030 ambition can be achieved through different combinations of policy options. Considering the current EU ETS sectors, please rate the following aspects in terms of relevance? Please rate from 1 (not important) to 5 (very important):*

	1	2	3	4	5
Strengthen the cap through the increase of the linear reduction factor					✓
Strengthen the cap through a one-off reduction ('rebasings the cap')		✓			
A combination of increasing the linear reduction factor and a one-off reduction				✓	

<i>Canceling allowances held in the Market Stability Reserve (MSR)</i>				✓	
<i>Maintain the increased feeding rate of the MSR after 2023</i>				✓	
<i>Early application of a strengthened cap (e.g. 2023 instead of later)</i>					
<i>Other, please specify _____</i>					

IIGCC supports technical adjustments to the EU ETS to support a smooth emissions reduction trajectory to 2030 in line with the EU’s updated 2030 greenhouse gas reduction target. Specifically:

- **Linear reduction factor** - IIGCC’s position is to support increasing the linear reduction factor so that the amount of allowances within the cap is reduced at a faster rate each year (first option in question 2 above). In addition, IIGCC in principle would not object to the starting point on which the linear reduction factor is applied shifting downwards (second option in question 2 above), i.e. an initial cancellation of allowances followed by a less steep reduction curve, but only if it can be demonstrated that this can be implemented in a smooth and efficient manner.
- **Market Stability Reserve (MRS)** - IIGCC’s position is that MSR parameters will need to change and be strengthened, in line with EU’s updated energy and climate targets and to address any supply/demand imbalances due to the economic crisis. This may include measures such as cancelling allowances in the MSR (fourth option in question 2 above) and ensuring a sufficient intake of allowances after 2023 (this may require maintaining intake to the MSR rather than decreasing the rate to 12% per year after 2023, as per the fifth option in question 2 above).

## Section B: Addressing the risk of carbon leakage

*Question 4: Do you believe the current carbon leakage framework addressing direct carbon costs, consisting of free allocation, should be maintained, amended or replaced? Multiple answers are possible.*

- The current carbon leakage protection framework should be maintained without changes*
- The current carbon leakage protection framework should be modified by targeting the support even more to the sectors most at risk*
- For selected sectors, the current carbon leakage framework should be replaced by a Carbon Border Adjustment Mechanism*
- Free allocation should be made conditional to beneficiaries carrying out investments for reducing their GHG emissions*
- Other measures to further incentivise GHG reductions should be introduced*

**IIGCC’s position is that any CBAM would replace, rather than supplement, the current free allocation and compensation provisions in the ETS Directive which are in place to address the risk of carbon leakage. Replacing these would prevent ‘double compensation’ to EU operators and uphold the environmental integrity and climate ambition of the EU ETS.**

It is noted that some stakeholders have proposed a phased approach, whereby the CBAM would be introduced in parallel to phasing out free allocation, ostensibly in order to allow for the smooth transition to a new regime. This would still constitute double protection, albeit on a time limited basis, but the proponents have not been able to provide any underpinning detail on technical design or timelines so far. Explanation is also needed as to why extra time would be

needed for a smooth transition on top of the usual notices provided for usual EU entry into force timelines.

In addition:

- To foster investor confidence in the net zero transition, any potential CBAM must prioritise greenhouse gas emission reductions first and foremost (and not serve, or give the impression of serving, simply as a protection measure for high emitting sectors)
- IIGCC supports full compatibility of any potential future CBAM with WTO rules in order to make such a mechanism workable. This is important from a technical, legal and political perspective.
- IIGCC would expect EU policymakers to ensure a potential CBAM did not impact more broadly on the EU's international relations including its ongoing climate diplomacy work and global climate leadership. Due consideration to the political acceptability of the CBAM to third countries is required, especially noting that the level of global ambition on climate change is a rapidly developing picture.

Question 5: In view of the likely lower amount of allowances available for free allocation, (due to increased ETS target) which of the following aspects in relation to the benchmark-based allocation do you consider most relevant? Please rate from 1 (not important) to 5 (very important):

	1	2	3	4	5
<i>Modified method to determine benchmark values to ensure faster incorporation of innovation and technological progress (e.g. by not limiting the annual reduction rate for each benchmark when updating benchmark values)</i>					✓
<i>Additional product benchmarks</i>					
<i>Revised definitions of product benchmarks to incentivise innovation</i>					
<i>Increased transparency regarding benchmark values and process via mandatory publication of underlying data by industry</i>					
<i>Other, please specify in the box below</i>					

**IIGCC's position is to encourage faster incorporation of innovation and technological progress within the benchmarks (as opposed to seeking additional or revised benchmark definitions).**

Question 6: Should the approach to indirect cost compensation be modified? Multiple responses possible.

- Yes, the rapidly on-going decarbonisation of the electricity production in the EU will sufficiently reduce indirect costs and therefore, indirect cost compensation can be gradually phased out
- ✓ **Yes, indirect cost compensation should be further harmonised in Europe, sectors exposed to the risk carbon leakage due to indirect costs should be compensated equally regardless of the Member State where they are active**
- Yes, the approach to indirect cost compensation should remain the same, but additional requirements should be set to ensure that Member States granting it do not spend more than a given percentage of their auctioning revenues on it
- No, Member States should maintain flexibility to grant indirect cost compensation or not, subject to State Aid control

IIGCC position seeks to emphasise the importance of a level playing field.

### **Section C: An increasing role for emissions trading**

IIGCC's position is to support integrating additional sectors into the EU ETS where it is clearly demonstrated that this would be the most efficient and effective means of addressing emissions. A detailed analysis of each sector must ensure that their inclusion in the ETS would entail the most efficient and effective means of reducing emissions, and their introduction into the EU ETS be as smooth as possible to avoid any shocks to the concerned sector and wide carbon market.

In addition, it is noted that road transport and buildings are already regulated for their emissions at the EU level, and hence the impact of parallel policy instruments would need to be considered as part of integrating these sectors into the EU ETS (e.g. cancellation of allowances). As such, the Commission and the Member States should take this into full consideration in the event that they design the integration of these new sectors into the ETS, in order to ensure full coherence of the policy landscape and to further boost confidence in the EU carbon market.

If it becomes clear while undertaking these analyses that the existing regulatory landscape for road transport and buildings would be a better basis for pursuing further emissions reductions (compared to inclusion in the EU ETS), IIGCC would support the EU continuing to pursue the existing regulatory approach for these sectors.

### **Section D – Extension to maritime greenhouse gas emissions**

IIGCC's position is to support integrating additional sectors into the EU ETS where it is clearly demonstrated that this would be the most efficient and effective means of addressing emissions. As stated above, a detailed analysis would be needed to ensure the inclusion of the maritime sector in the EU ETS would entail the most efficient and effective means of reducing emissions, and its introduction into the EU ETS would be as smooth as possible to avoid any shocks to the concerned sector and wide carbon market.

In particular, for the maritime sector, it is important to ensure that any inclusion of this sector in the EU ETS does not result in negative impacts on the wider global process to reduce emissions or third country relations which could lead to counter-productive outcome. It is vital for the Commission to take into account the lessons learned from the initial inclusion of aviation into the ETS, which resulted in a global backlash and widespread non-compliance. This temporarily undermined the environmental effectiveness of the ETS in a key sector, damaged third country relationships which were vital to preserve as part of the UNFCCC process, and took up large amounts of political capital which could have been better deployed elsewhere.

Shipping is as global a sector as aviation and has similar dynamics and challenges in terms of how emissions are tackled (both sectors fall outside of the Paris Agreement and are managed by the slow-moving UN agencies International Civil Aviation Organization (ICAO) and (International Maritime Organization) IMO). A full analysis of the pros and cons of bringing shipping into the ETS must also consider the differences between both shipping and aviation, and between ICAO

and the IMO. It must also consider how to use any expansion of the ETS into shipping as a positive, rather than a negative, force in the wider IMO and UNFCCC negotiations.

### Section E – Market stability

IIGCC's position is that the MSR parameters will need to change and be strengthened, in line with EU's updated energy and climate targets and to address any supply/demand imbalances due to the economic crisis. This may include measures such as cancelling allowances in the MSR and ensuring a sufficient intake of allowances after 2023 (this may require maintaining intake to the MSR rather than decreasing the rate to 12% per year after 2023).

### Section F – Revenues

Question 22: *In your opinion, how should the ETS revenue be used? (Multiple answers are possible)*

- Facilitating just transition and the social impacts of the climate transformation*
- Addressing social and distributional impacts related to the review of ETS Energy efficiency, in particular the renovation of buildings*
- Low-carbon and zero-emissions mobility***
- Support for clean investments in ETS sectors*
- Providing financial incentives for consumers to buy more climate friendly goods and services, including more fuel efficient vehicles/ vehicles not using fossil fuels***
- More support to innovation***
- Lowering taxes such as labour taxation and increasing transfers to EU citizens, in particular low-income households*

Question 23: *Are stricter rules necessary to ensure Member States spend their ETS auction revenues in line with climate objectives?*

- Yes, the ETS Directive should require Member States to spend more revenues on climate-related purposes***
- Yes, the ETS Directive should require that Member States spend ETS revenues in a way compatible with the climate neutrality objective ('do no harm')*
- No, Member States should be free to determine how they want to spend the revenues, taking into account that 50% should be used for climate-related purposes.*

**IIGCC's position is the ETS Directive should require Member States to spend more revenues on climate-related purposes. In addition, 'climate-related purposes' should be activities aligned with the climate objectives of the sustainable finance taxonomy.**