Questions and answers on the provisional agreement to revise the EU Emissions Trading System (EU ETS)

Q1: What does the revision of the EU Emissions Trading System involve?

The EU Emissions Trading System (EU ETS) is the EU's key tool for reducing greenhouse gas emissions, in line with the Paris Agreement. The EU ETS covers almost half of the emissions from the European economy. The agreement reached between the European Parliament and Council brings changes in three key areas that are needed to make the system ready for the period 2021-2030: strengthening the system, ensuring robust safeguards against the risk of carbon leakage for industry, and providing funding instruments for low-carbon investments. The revised EU ETS Directive builds on the European Commission proposal from July 2015, which followed conclusions adopted by European leaders in October 2014.

Q2: How and when will the agreement strengthen the European carbon market in order to address the existing oversupply?

Several measures have been agreed to substantially strengthen the EU ETS, notably to increase the annual emissions reductions from 2021 and to tackle the existing surplus of allowances on the market more quickly from 2019. The surplus will be addressed by doubling the pace at which surplus allowances are removed from the market and placed in the Market Stability Reserve (MSR) for the first five years of operation, i.e. until 2023.

Q3: **How will the EU ETS contribute to Europe's climate objectives for 2030?**

A faster annual decrease in the overall number of EU ETS allowances ("cap") – 2.2% per year from 2021, compared to the current 1.74% – will contribute to the EU's overall goal to reduce emissions by at least 40% by 2030, consistent with its commitment under the Paris Agreement. This reduced "cap" will ensure the necessary emissions cuts in sectors covered by the system.

Q4: How will Europe's industrial competiveness be safeguarded while ensuring a sufficient reduction in greenhouse gas emissions?

The agreement includes several key measures to safeguard the competitiveness of European industry, through the continuation of free allocation of allowances to sectors at risk of carbon leakage, with a higher share to be given to those sectors deemed most exposed to this risk.

The number of free allowances is limited. In order to reduce the risk of insufficient availability of free allowances and the need for a correction factor, the agreement foresees a "free allocation buffer" of over 450 million allowances initially earmarked for auctioning can be made available as an extra safeguard, if the initial amount is fully used up for the period 2021-2030 (thereby avoiding or reducing a correction factor).

The existing possibility to compensate sectors for indirect carbon costs will continue (see Question 5).

Moreover, a new Innovation Fund will help European industry to maintain its competitive edge, by providing support for pioneering low-carbon technologies (see Question 6).

Q5: Will there be compensation for indirect carbon costs?

Yes, compensation by Member States will continue to be possible, subject to EU state aid rules. The agreement reached by the Parliament and Council will also substantially enhance rules on transparency and reporting related to such support by Member States.

Q6: What measures have been agreed to promote industrial innovation and the low-carbon transition?

The agreement foresees the creation of a new Innovation Fund, with a size of at least 450 million allowances (representing a value of over € 3 billion at market prices in late 2017). The fund will provide financial support for low-carbon innovation in industries covered by the EU ETS, to aid the development of breakthrough technologies, as well as carbon capture and storage/use and renewable energy.

In addition, the Innovation Fund will be supplemented by any remaining resources from the existing NER300 fund which supports carbon capture and storage and renewable energy. Furthermore, up to 50 million additional allowances may be made available for the fund during the second half of the period 2021-2030, if these allowances are not needed for free allocation to prevent or lower a correction factor (see Question 4 on safeguarding European industry's competitiveness).

Q7: What measures have been agreed to support the low-carbon transition and modernisation of energy systems in low-income Member States?

Two funding instruments have been agreed to support the transition and modernisation of energy systems in 10 Member States with incomes below 60 % of the EU average in 2013 (Bulgaria, Estonia, Latvia, Lithuania, Hungary, Romania, Poland, the Czech Republic, Slovakia and Croatia).

Firstly, a Modernisation Fund with at least 310 million allowances will support investments in modernising energy systems, such as the improvement of energy efficiency in installations for power and heat that use natural gas or renewable energy sources, and investments to support a socially just transition to a low-carbon economy (such as retraining for affected workers). The fund will be supplemented by up to 75 million additional allowances during the second half of the period 2021-2030, if these are not needed for free allocation to prevent or lower a correction factor (see Question 4).

Secondly, the 10 Member States listed above also have the option to continue providing a limited number of free allowances to modernise the power sector, after investments to modernise the energy sector have taken place. The Parliament and Council have agreed robust safeguards to ensure that funding instruments contribute to the EU's climate and energy goals while operating in a fully transparent manner.

Q8: Have any changes been agreed on emissions in the shipping sector?

The agreement recalls that all sectors of the economy should contribute to emissions reductions, mandates the Commission to report at least annually to the Parliament and the Council on progress made in the International Maritime Organisation (IMO) and emphasises that action by the IMO or the EU should start in 2023, including preparatory work on the adoption and implementation of measures.

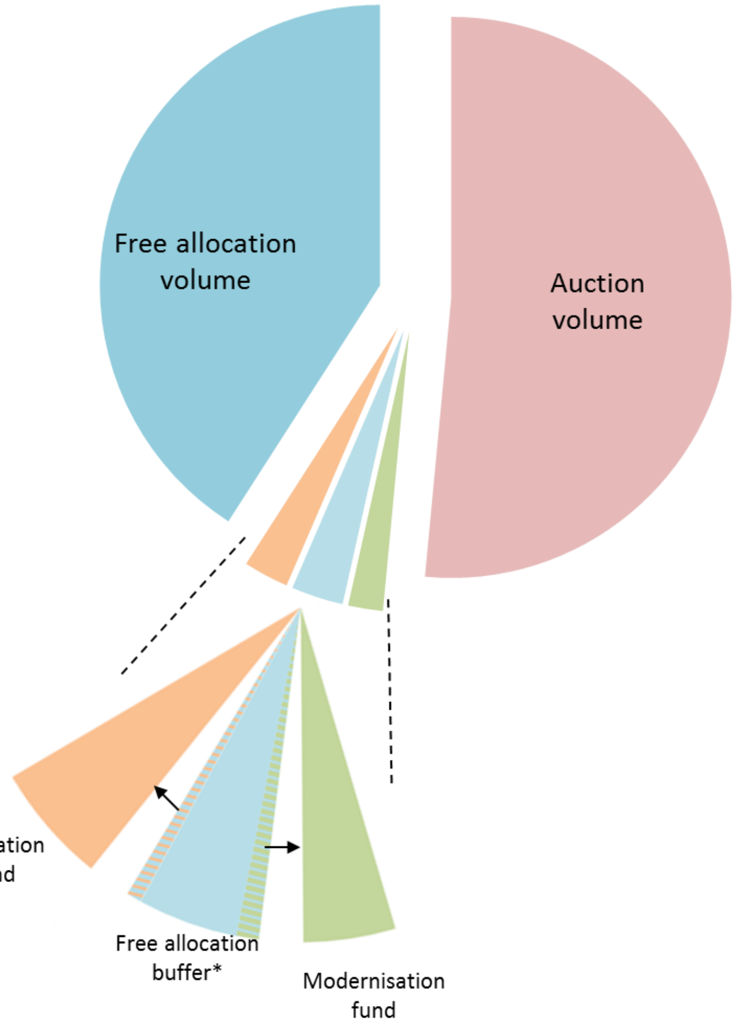
Q9: What are the next steps for implementing the agreed changes to the EU ETS?

The provisional agreement must now be formally approved by the European Parliament and the Council. Once it has been endorsed by both EU co-legislators, the revised EU ETS Directive will be published in the EU's Official Journal and enter into force 20 days after publication.

Once the revised Directive is in force, further work will be needed for its implementation. For example, the necessary data will need to be collected by Member States and industry in order to prepare the steps related to free allocation of allowances. Necessary steps will also need to be taken in order to operationalise the Modernisation Fund and the Innovation Fund, in terms of governance and project selection.

More detailed information on the revision of the EU ETS will be added to these questions and answers in due course.

Overview of EU ETS phase 4 allowances share (total of 15,5 billion allowances)



* Allowances dedicated for auctioning that may be converted