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MEETING DOCUMENT

From:	General Secretariat of the Council
To:	Working Party on the Environment
Subject:	ETS Review: WPE on 4 September 2026: Presidency steering note

With a view to the above WPE meeting, delegations will find attached the Presidency steering note on the above.

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Working Party on the Environment

4 September 2026

Proposal to amend the EU ETS Directive

Block 1A Ambition/Cap focusing on changes to the Linear Reduction Factor, consideration of international credits and permanent carbon removals. | Block 1B Free Allocation

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Guidance for discussions:

Following the presentations by the Commission of the proposals for the revision of ETS1 on 20 and 22 July, delegations were requested to submit written comments by 24 August to inform discussions at subsequent WPEs. Delegations were advised that the Presidency wish to organise discussions thematically in blocks.

On 4 September, the first block for discussion will be Block 1.A Ambition/CAP. This covers proposals regarding the adjustment of the linear reduction factor, the use of international carbon credits, and the use of permanent carbon removals.

The second part of the day will cover Block 1.B Free Allocation, which covers benchmarks, conditionality, and exports/CBAM.

The Commission will present these elements of the proposal to the Working Party. This will include responding to questions by Member States received from delegations in writing compiled in a document found on the Delegates Portal (Ref: WK 13109/26).

The text below summarises the proposal for information and is not intended to give a full detailed explanation of the provisions.

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Part 1 – Block 1.A Ambition/Cap

1. Linear Reduction Factor

The Commission has proposed to make amendments (under **Article 9**) that will slow the annual reduction of the overall cap on allowances and to continue to issue allowances into the 2040s (current legislation sees allowance issuance cease c. 2039). This involves decreasing the linear reduction factor (LRF) to (i) align with the Union's emission reduction target of -90% by 2040 as compared to 1990 levels; and (ii) take account of the European Climate Law provisions regarding the use of high-quality international credits as contribution towards the EU 2040 climate target (starting in 2036). The Commission has proposed:

- to adjust the LRF from 4.4% currently to 3.7% from 2031 – 2035 and 1.7% from 2036. If high-quality international credits are not available, the LRF would revert to 2.7% from 2036. The LRF would apply to new municipal waste incineration allowances from 2034 (further information below).
- the LRF would not apply to the increase of allowances for the purchase of domestic permanent carbon removal units (**Article 9c (7)**) and would no longer be applied to allocations to new entrants

2. International Credits

The Commission proposes (under new **Article 9b**) that up-to 260Mt of international credits may be purchased to contribute to EU ETS emissions reductions targets from 2036-2040. These will be funded by the auctioning of up-to 260 million allowances, purchased centrally by the Commission, and their use reflected in the LRF adjustments described above.

The Commission proposes that such credits must be high quality, high integrity and cost-effective, and the Commission proposes to publish a report assessing the availability of such credits by 31 January 2033. If the number of available credits is deemed to be insufficient, the LRF for 2036 onwards will automatically readjust to 2.7%. Unused allowances would be allocated to the Industrial Decarbonisation Bank.

3. Domestic Permanent Carbon Removals

The Commission proposes to incorporate domestic carbon removals into the EU ETS under a new **Article 9c**. The Commission proposes a centralised purchasing model, with the intention to auction 250 million allowances from 2031 to 2040 to generate revenue for the purchasing of an equivalent amount of domestic permanent removal units (from domestic permanent biogenic emissions capture with carbon storage (BioCCS) and Direct Air Carbon Capture and Storage (DACCS)

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technologies certified under the EU Carbon Removal Certification Framework). A reserve of an additional 10 million allowances can be auctioned in the event that the allocated allowances are insufficient. The cap will be increased by the number of these new allowances meaning the amount of removals does not impact the LRF.

The proposal includes a review clause for assessment in December 2034 covering progress of purchasing, the transition from Commission management to full private-operator integration and use, and to further examine the potential role of nature-based removals and carbon farming sequestration units under the CRCF.

Article **14 (1a)** also allows the Commission to adopt implementing acts which would allow operators, aircraft operators and shipping companies to reduce their ETS obligations with the use of their own CRCF certified BioCCS carbon removals. This compensation mechanism (i) cannot generate negative emissions; and (ii) requires an adjustment mechanism for the purchase of carbon removals to prevent total emissions space from increasing beyond what is intended.

4. Cap Increase with regard to scope extension

It is proposed that a proportional increase to the cap will take place to facilitate the proposed inclusion of additional emissions in the system from the inclusion of municipal waste incineration, additional flights and additional shipping journeys. Therefore, the discussion of the related cap increase will be incorporated in the discussion of scope extension under blocks 2.A Aviation, 2.B Maritime and 2.C Waste.

Part 2 – Block 1.B Free allocation

Further to its assessment of the risk of carbon leakage, the Commission proposes to extend the allocation of free allowances while slowing the phase-in of CBAM. The proposal also amends the conditions that must be met by installations if they are to receive a free allocation.

1. Free Allocation Extension and Conditionality

For sectors considered at risk of carbon leakage, the Commission proposal extends free allocation from 2030 to 2040 (**Article 10b (1)**).

Free allocation from 2031 would be made conditional on investment in decarbonisation (**Article 10a (3b)**). The amendment requires operators to invest an amount equivalent to the value of free allocation for the five-year period into eligible decarbonisation investments in the EU. 80% of the free allocation would be allocated on submission of the decarbonisation investment plan, with the

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remaining 20% allocated after confirmation that the investments were implemented at the level expected in the EU and with significant emissions reductions realised.

This condition, based on investment in decarbonisation (**Article 10a(3a)),** replaces the existing condition requiring implementation of decarbonisation actions recommended by energy audit or certified energy management system, as well as conditionality on the least efficient installations - above 80th percentile for relevant product benchmarks (**Article 10a (1) subparagraphs 3-6)**.

The proposal exempts (**Article 10a (3c)**) the 10% most efficient installations, small installations remaining voluntarily in the ETS, and zero emissions or low-carbon installations from the new conditionality under **Article 10a(3b/3c)**. Also exempt would be installations with projects supported by the Industrial Decarbonisation Bank and Investment Booster, or the Innovation Fund when the IF funding is disbursed or in the case of IB/IDB construction works have started. In both cases, exemption will apply only if the amount of funding from IF, IB and IDB match at least the economic value of 100% of FA in the relevant allocation period.

2. CBAM Sectors

The proposal aims to reduce remaining carbon leakage risk by slowing down CBAM phase-in (**Article 10a (1a)**). For goods already listed in Annex 1 of the CBAM Regulation, the CBAM factor (the rate at which CBAM charges are discounted during phase-in) is amended as follows:

CBAM Factor		
Year	Existing	Proposed
2026	97.5	97.5
2027	95	95
2028	90	91.5
2029	77.5	81
2030	51.5	59
2031	39	48
2032	26.5	37.5
2033	14	27
2034 - 2037	0	15
2038	N/A	0

It is proposed that goods that are newly added to Annex 1 of the CBAM Regulation retain a 100% CBAM factor until the next five-year free allocation period (under Article 11) begins. Thereafter, the CBAM factor would be 97.9% and 95.8% in the first and second year respectively, and from the third

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year onwards would decrease with the same CBAM factor set out in the table above, starting with the 2028 factor of 91.5%.

3. Benchmarks

For 2026–2030, benchmark values are updated using an annual reduction rate (ARR) subject to a 2.5% maximum or 0.3% minimum (**Article 10a (2.c)**). Where the ARR falls outside this range, the minimum or maximum rate, as relevant, is applied for each year between 2008 and 2028.

For the period 2031 – 2035, the same methodology applies (**Article 10a (2.f)**). However, the maximum ARR would be lowered from 2.5% to 2.0% while the minimum would remain at 0.3%. The relevant ARR would be applied for each year between 2008 and 2033.

For 2036 - 2040 the same range would apply, while the relevant ARR would be applied for each year between 2008 and 2038 (**Article 10a (2.h)**).

Article 10a (2a) has been added to account for the proposed 2026-2030 benchmark regulation (COM(2026) 619), allowing for the full use of a buffer of allowances (per **Article 10a (5a)**) to be used to reduce the heat and fuel benchmarks (2027-2030), while maintaining the existing auctioning share. The buffer would be increased from 3% to 4% from 2031 to 2040 (per **Article 10a(5a)**).

Further to the adjustments above, up to 50 million allowances can support the Innovation Fund and remaining allowances to support the IDB if less than 3% or 4% allowances are needed under **Article 10a(5a)** for the periods up to 2030 and post-2030, respectively (**Article 10a(5b)**).

4. Sector Specific Treatment

<u>Sector specific heat/fuel benchmarks</u>

The Commission proposes to provide, via delegated acts, sector-specific definitions of heat and fuel benchmarks to include system boundaries and starting point values (**Article 10a (2)**). Currently heat and fuel benchmarks apply to all sectors that are not covered by the 52 product-specific benchmarks.

<u>District heating</u>

Currently **Article 10b (4)** subparagraphs 2-5 provides for an additional 30% free allocation to district heating from 2026-2030 for certain MSs, subject to investment in and progress on carbon neutrality plans. From 2031, the Proposal removes (**Article10a (3a)**) the reporting requirement and 30% top up.

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In relation to district heating, free allocation would decrease under the proposal by equal amounts annually such that by 2040 there would be no free allocation.

Guiding Questions

Delegations are invited to comment on the Commissions presentation including providing any preliminary considerations on the proposal.