SEI Response: Proposed review of the EU Emissions Trading System

With reference to the European Commission's proposal and the request for input from the Swedish Ministry of Climate and Enterprise under Remissärende: KN2026/01568.

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Background to this response

The Stockholm Environment Institute (SEI) Stockholm Environment Institute is an international non-profit research institute that tackles climate, environment and sustainable development challenges. We empower partners to meet these challenges through cutting-edge research, knowledge, tools and capacity building. Scientific quality and integrity are foundations of our work. Partnership is at the heart of our approach, leading to change that lasts. Through SEI's HQ in Stockholm and seven centres around the world, we engage with policy, practice and development action for a sustainable, prosperous future for all

Key Points

- Maintain a predictable ETS trajectory that supports investment in domestic decarbonization.
- Recognize first movers in Industrial Decarbonization Bank support without creating windfall gains or incentives to delay investment.
- Assess international credit integrity earlier than 2033 to reduce investor uncertainty and avoid creating additional domestic emissions space before qualifying credits can be secured.
- Provide early EU demand signals and forward-purchasing commitments to develop high-integrity international credit supply.
- Ensure all international credit use contributes to overall mitigation in global emissions and adaptation finance.

Response

The effectiveness of the EU ETS in reducing industrial and power-sector emissions depends partly on providing a predictable framework for investment. The proposal may reduce investment certainty and penalize first-mover investors by weakening the domestic emissions reduction trajectory through a slower Linear Reduction Factor (Article 9) and the use of international credits (Article 9b). Extended free allocation for CBAM sectors under amended Article 10a(1a) would also reduce incentives for investment in industrial decarbonization.

SEI's response focuses on two connected areas where we have relevant expertise: investment certainty and first movers, and the proposed link between international credits and the ETS.

1. Investment certainty and first movers

In addition to the weaker emissions reduction trajectory under Article 9, there may be mixed incentives for investment provided by the operation of the proposed Industrial Decarbonization Bank under Article 10cc. An initial Investment Booster would be funded by revenues from 400 million reserved ETS allowances to support industrial decarbonization projects. There are provisions to ensure a proportion of allowance revenue flows to projects in Member States with lower GDP per capita.

The Bank's initial Investment Booster is intended to accelerate investment through a "first in, first served" approach. However, the proposed rules appear geared towards new projects. It is unclear how projects that have already reached financial close or begun construction would be treated. This raises the question of whether the scheme would reward those who are first to apply rather than those who were first to act.

The Investment Booster is expected to become operational from 2028. Until then, companies considering investment may not know whether reaching financial close or starting construction will affect their eligibility for future support. This could create a perversive incentive to delay investment until the rules are clearer. The design of the scheme should avoid putting companies that invest before the Booster becomes operational at a competitive disadvantage.

For the Bank's second phase, Article 10ce(6) explicitly allows financial contributions to cover some actions started before an application was submitted. However, this possibility is formulated quite narrowly as "where necessary for the implementation of projects deemed essential for security and economic resilience." The risk of creating competitive disadvantages for early movers could be mitigated by clarifying how this provision would apply tosuch cases and whether comparable treatment should be available under Article 10cd. These rules should recognise early investment and avoid providing support in a way that creates new policy driven competitive disadvantages for companies that have invested early in energy/industrial transition. The rules should also avoid windfall gains, double funding or support that exceeds what is needed for first movers. This would help maintain confidence that companies investing under the existing policy framework and new entrants under the proposed rule changes are competing on a level playing field.

2. Article 9b and international credits

Article 9b would make up to 260 million ETS allowances available to finance the purchase of "up to 260 Mt of high-quality and high-integrity international credits" for the period 2036–2040. These credits must fulfill the criteria under the European Climate Law (Regulation 2021/1119/EU). This would contribute to a yet-to-be determined portion of the Climate Law's overall allowance for international credits under the Climate Law of up to five percentage points.[1]

[1] The total number of international credits the EU will need depends on multiple variables, including actual progress in reducing EU domestic emissions and the accounting approach used to apply carbon

The proposed amendment to Article 9 sets an LRF of 1.7% from 2036. Under Article 9b(4), this would revert to 2.7% if qualifying, cost-effective international credits were unavailable, subject to an assessment by the Commission in 2033. Under Article 9b(3), the Assessment by the Commission will report by 31 January 2033 on the development and availability of high-quality and high-integrity international credits.

Although this assessment precedes the proposed change in the LRF in 2036, it is late for industrial projects making investment and location decisions during this decade. Uncertainty over whether the LRF will be 1.7% or 2.7% could also affect carbon-price expectations and the business case for early investment.

This approach creates a risk that additional domestic emissions space is built into the ETS trajectory before the credits have been purchased and before their quality, availability and cost are known.

Furthermore, the approach appears premised on assessing whether a market for high-integrity international credits will have reached a sufficient scale by 2033, independent of EU demand, for the EU to feasibly acquire up to 260 million credits in the 2036-2040 period. However, development of a robust market for high-integrity credits is likely to require active engagement by the EU between now and 2036. This is because high-integrity international mitigation activities themselves are likely to require significant lead times, as well as forward-purchasing commitments extending over multiple NDC periods to ensure their bankability. Thus, for this market to develop, a strong demand signal will be needed from the EU.

Given required lead times, uncertainties about supply and demand, and the timing of reporting requirements under the Paris Agreement, the best strategy to assure adequate supply may be to build up a reserve of credits over time, from which the EU could draw to meet its targets (Bart and Barata 2025; Schneider and Moosman 2026).[2] For the EU ETS, this could mean starting to auction allowances in the near term (e.g., prior to 2030) and using the proceeds to develop a pipeline of mitigation activities that could deliver required volumes of high-quality international credits in the 2036-2040 time frame.

3. Integrity requirements and SEI's related 2025 response on the EU Climate Law

SEI's 2025 consultation response on the EU Climate Law[3] recognized that properly designed international cooperation could mobilize finance for transformative mitigation and help partner countries raise their ambition. These benefits depend on robust credit quality, accounting and safeguards.

The final European Climate Law adopted in 2026 contains substantially stronger integrity language than the proposal reviewed for SEI's response. It expressly refers to credible and

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credits towards the EU's 2040 emission reduction target, e.g., "averaging" or a multi-year accounting approach (cf. Schneider and Moosman 2026).

[2] Under this approach, unneeded credits could either be sold to other buyers or canceled to provide an additional contribution to global climate finance.

[3] SEI Response: Proposed amendments to the EU framework for achieving climate neutrality (Remissärende: KN2025/01524), 22 September 2025, https://www.sei.org/wp-content/uploads/2025/09/kn202501524-sei-response-eu-climate-law-and-2040-target-250922.pdf

transformative activities, additionality, permanence, avoidance of double counting, transparent governance, robust monitoring, reporting and verification, economic, social and environmental co-benefits, and human-rights safeguards. It also refers to adaptation contributions and sharing mitigation benefits with partner countries.

To ensure the Climate Law criteria are upheld, international credits should meet at a minimum the methodological and procedural standards of the Article 6.4 mechanism, whether those credits are acquired through the Article 6.2 or Article 6.4 mechanism.

This includes ensuring that all mitigation activities from which the EU acquires credits contribute to an overall mitigation in global emissions (OMGE) and contribute towards adaptation finance. On OMGE, the EU should require an equivalent or stronger contribution for credits acquired under Article 6.2. On adaptation finance, applying the Article 6.4 standard to all credits would provide for a share of proceeds to the Adaptation Fund amounting to 5% of issued credits, which can be monetized to support adaptation in developing countries. This would help ensure that international cooperation arising from international credits supports both mitigation and adaptation.

Recent research led by SEI has identified solid evidence suggesting that locally led adaptation is a good investment to support communities' capacity with positive social and economic benefits (Browne et al. 2026). The Adaptation Fund, among other funders, should use existing evidence to channel funding towards adaptation actions where local people, communities and institutions have the decision-making power and access to resources needed to define, prioritize, design, implement and evaluate interventions that affect them.

References

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