SUMMARY REPORT

17 July 2026

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Revision of the Emissions Trading System (ETS)

On 17 July 2026 the European Commission published the revision of the **Emissions Trading System (ETS)** together with the proposal to address the **Fallback Benchmark** as well as the **Energy Package**, containing the **Electrification Action Plan (EAP)** and a proposal on **Network Charges**. The ETS revision was presented by **Teresa Ribera, Executive Vice-President for a Clean, Just and Competitive Transition** and **Wopke Hoekstra, Commissioner for Climate Net Zero and Clean Growth.** It aims at delivering on climate ambition while reconciling the 2040 target with competitiveness and boosting investments.

The main elements of ETS revision proposal foresee:

- Adjustment of the **Linear Reduction Factor** (LRF) to 3.7% between 2031-2035 and then to 1.7% from 2036 onwards aligned with the 2040 Climate Target.
- Adjustment of the intake rate of the **Market Stability Reserve** to 12% as well as dynamic parameters
- **Conditionality** to receive free allocation linked to companies decarbonization plans
- Integration of **international carbon credits** in the EU ETS
- Integration **permanent carbon removals** in the EU ETS

Press release | Commission proposal | Factsheet | Q&A | Fallback Benchmark proposal | Electrification Action Plan | Proposal on network charges

Executive summary of the proposal

Linear Reduction Factor (LRF)

The proposal adjusts the EU ETS Linear Reduction Factor (LRF) from 2031 onwards to align the system with the EU's 2040 climate target.

- The cap would **decline by 3.7% annually** between **2031** and **2035** and **by 1.7% from 2036 onwards**, allowing allowances to continue to be auctioned beyond 2040. The lower LRF from 2036 reflects the possibility of using up to **2% high-quality international credits towards the 2040 target.** Allowances would be set aside for the purchase of international credits corresponding to this contribution.
- The Commission will present a report on the development of a high-quality and high-integrity international credit market, by 31 January 2033. **If sufficient high-quality, high-integrity and cost-effective international credits are not available, the LRF would revert to 2.7% from 2036.**
- The proposal also provides for the integration of **permanent carbon removals** through the issuance of allowances to the Commission for the purchase of an equivalent quantity of permanent removals. **The LRF would not apply to these allowances**, as they would be matched by an equivalent amount of removals.

Market Stability Reserve (MSR)

The proposal reforms the Market Stability Reserve (MSR) to strengthen market stability, investment predictability, liquidity and reduce excessive price volatility. It complements the Commission's previous proposal (from April 2026) to **stop the automatic invalidation of allowances held in the reserve**. The reform will make the MSR parameters dynamic as the ETS cap shrinks, with **thresholds and release amount decreasing by 4% annually from 2029.** The **MSR intake rate will be reduced from 24% to 12% from 2028**.

Conditionality & Free Allocation

Free allocation will continue beyond 2030 but will be subject to conditionality.

- From 2031, **Free Allocation will be conditional on the submission and implementation of an EU decarbonisation investment plan. 80%** of free allocation in each five-year period will be granted upon approval of the plan, while the remaining **20%** will only be allocated after verification that the investments have been implemented and have delivered significant emissions reductions.
- Operators relocating activities outside the **EU would be required to return the allowances received.**
- The proposal also **increases the free allocation buffer to 4%** of the total quantity of allowances to reduce the risk of a cross-sectoral correction factor before 2040.
- While **15% of the free allocation otherwise phased out under CBAM would be reintroduced**, slowing the phase-out of free allocation and extending it until **2038**.

Benchmarks

- The proposal extends the benchmark update framework to **2031–2035** and **2036–2040**. Benchmark values will continue to be based on verified installation data and the performance of the **10% most efficient installations**, with annual benchmark update rates ranging from **0.3% to 2%**.
- To better reflect the decarbonisation potential of different sectors, the proposal also introduces **sector-specific heat and fuel benchmarks ("fallback benchmarks")**, allowing the Commission to define sector-specific benchmark values, system boundaries and reference values for benchmark updates.
- **For the current update of the fallback, the proposal is adjusting the maximum benchmark reduction rates**, by using the totality of allowances available for free allocation for the period 2026-2030 (about 80 million), while ensuring that the Cross-Sectoral Correction Factor is not triggered and product benchmark allocations remain unaffected.

Funding

1. Solidarity Mechanisms

To support lower-income Member States, the proposal maintains the **10% solidarity redistribution mechanism** for auctioning rights, continues the **Modernisation Fund** for investments in energy-system modernisation, energy efficiency and industrial decarbonisation, and introduces an **Investment Booster** under the Industrial Decarbonisation Bank. The Modernisation Fund excludes support for fossil-fuel-based generation and infrastructure, while the Investment Booster reserves part of its support for eligible lower-income Member States and provides access to the remaining funding on a broader basis.

2. Industrial Decarbonisation Bank (IDB)

The proposal establishes an **Industrial Decarbonisation Bank (IDB)** from 2028 to accelerate industrial decarbonisation, including electrification, through support for both capital and operational expenditure. Between 2028 and 2030, an **Investment Booster** will reserve **400 million allowances** for industrial decarbonisation projects, allocating support through fixed carbon premiums on a **first-in, first-served basis**. From 2031 to 2040, a further **400 million allowances** will be reserved to support industrial decarbonisation projects through competitive bidding procedures awarding **Carbon Contracts for Difference (CCfDs)**, carbon premia and other forms of support where appropriate.

3. Member Sates – Use of ETS Revenues

The proposal highlights that only around **5%** of reported expenditure was allocated to **industrial decarbonisation**. Therefore, it suggests that member states shall **at least spend 50% of ETS revenues back in ETS-paying sectors.** It also introduces stronger safeguards to prevent fossil-fuel lock-in and calls for greater transparency on how Member States spend ETS revenues.

Waste incineration

- The proposal introduces the gradual inclusion of **non-hazardous municipal waste incineration installations** in the EU ETS. The obligation to surrender allowances would be phased in between **2031 and 2034**, with installations required to surrender allowances corresponding to **100% of their verified emissions from 2034 onwards**.
- Member States implementing appropriate equivalent measures could benefit from a temporary national opt-out, while **hazardous waste incineration installations would remain excluded from the EU ETS**. Monitoring, reporting and verification requirements would continue to apply.

Next Steps

The proposed Directive will be negotiated by the European Parliament and the Council of the European Union before its adoption and entry into force.

The Commission, the Council and the European Parliament agreed in the **One Europe, One Market** roadmap to aim at finding an agreement in Q1 2027.

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