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## **AFME and ISDA response to the European Commission public consultation on the EU ETS and MSR**

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8 July 2025

The Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA) welcome the opportunity to respond to the European Commission's public consultation on the EU Emissions Trading System (EU ETS) for maritime, aviation and stationary installations, and on the Market Stability Reserve (MSR).

In this submission, we have chosen to focus on a select number of questions, particularly those concerning carbon removals (Section 5.7.1) and linking with other carbon markets (Section 5.8.3), where we believe our members can provide meaningful input. Given the character limitations of the online questionnaire, we are using this accompanying document to expand on the rationale behind the positions expressed in our response.

We also take this opportunity to welcome the outcome of the EU-UK Summit held on 19 May 2025 and strongly support the decision to "work toward" linking the EU ETS and UK ETS. Such linkage would bring substantial mutual benefits: it would enhance confidence in both carbon markets, reduce compliance costs for covered entities, improve price discovery, and enable participants to manage their carbon exposure more effectively. Crucially, linking would eliminate the need for carbon borders between the UK and EU, helping to prevent carbon leakage and alleviating the significant challenges industry is likely to face with the implementation of carbon border taxation.

### **Section 5.7.1: Carbon Removals**

#### **5.7.1.1 (multiple-choice question)**

***Q.1: Removals certified under the CRCF should NOT be allowed for use by EU ETS regulated entities towards their compliance obligations.***

Strongly disagree.

#### **5.7.1.2 (multiple-choice questions)**

***Q.1: Removals certified under the CRCF should NOT be allowed for use by EU ETS regulated entities towards their compliance obligations.***

Strongly disagree.

***Q.2: Permanent removals\*\* certified under the CRCF should be allowed for use by EU ETS regulated entities towards their ETS compliance obligations.***

Strongly agree.

***Q.3: Temporary removals\*\*\* certified under CRCF should be allowed for use by EU ETS regulated entities towards their ETS compliance obligations.***

Strongly agree.

***Q.4: CRCF removals should be acquired by a central agency and inserted into the EU ETS under specific conditions We therefore urge the government to consider a more cautious approach and not to move forward.***

Neutral.

***Q.5: EU ETS regulated entities should be allowed to purchase CRCF removals directly from removal suppliers and use them to fulfil surrender obligations.***

Strongly agree.

***Q.6: EU ETS installations should be allowed to deduct from their compliance obligations any removals generated from their own activities, i.e. an ETS installation is able to obtain negative emissions by capturing and storing any of its emissions which are rated zero, without having to obtain a CRCF credit.***

Strongly agree.

***Q.7: The use of CRCF removals by ETS regulated entities should not be unlimited, but subject to restrictions.***

Somewhat agree.

***Q.8: The use of CRCF removals by EU ETS regulated entities should be phased in slowly over time.***

Somewhat agree.

***Q.9: There should be a limit on gross emissions by EU ETS regulated entities (not only net ones).***

Strongly agree.

### **5.7.1.3**

***Please provide explanations to support your views.***

Our stance is driven by the need for market stability, liquidity, and clear investment signals. Allowing permanent removals certified under the CRCF into the EU ETS is essential for driving demand and incentivising investment in these crucial technologies. Representing a broad range of market participants, AFME and ISDA see a clear benefit in expanding the compliance options for regulated entities. This can support more cost-effective mitigation across the system, aligning with the principal objective of the EU ETS to reduce greenhouse gas emissions in a cost-effective manner.

The further development of carbon markets will be integral to meeting the EU's net-zero emissions target by 2050. This will require both scaling up voluntary carbon markets (VCMs), where companies can buy verified

carbon credits (i.e. carbon reduction, carbon removal, and carbon offsets), and maximising the reach and impact of the EU ETS.

Moreover, a robust international VCM plays an important role in delivering a reliable, market-based approach to reducing emissions and developing the liquidity needed in carbon derivatives markets. This facilitates risk management for market participants and can unlock financing for climate mitigation projects.

We support the European Commission's proposal for the revision of the European Climate Law and the objective to include permanent domestic removals, such as Biogenic emissions Capture with Carbon Storage (BioCCS) and Direct Air Capture with Carbon Storage (DACCS) in the EU ETS because they offer a credible and durable solution to atmospheric CO<sub>2</sub>. We encourage the EU to consider their inclusion already in the 2026 EU ETS revision, notwithstanding this must be done carefully to preserve system integrity and must include safeguards to prevent removals from offsetting necessary emissions reductions or weakening price signals.

However, we believe the EU should not rule out the future integration of high-integrity temporary removals, particularly nature-based solutions, into the EU ETS. Building up nature-based removal capacity in Europe is crucial, and compliance demand can offer a financing pathway to scale these projects. The UK Government's consultation on removals under its ETS has usefully pointed to design options that could support this, such as equivalence ratios that account for differing levels of permanence. Given the performance risks of certain nature-based credits, independent carbon credit ratings could play a key role in ensuring only high-integrity, low-risk credits are used for compliance.

With priority given to domestic reductions, we also support the integration of high-quality international removals into the ETS, provided they meet strict environmental and methodological standards. Under Article 6 of the Paris Agreement, high-quality international removals could support additional climate finance, particularly for the Global South, and expand demand for removal projects globally. With appropriate supply and demand limits, this could enhance market liquidity and cost-efficiency without undermining incentives for domestic removal capacity. We therefore suggest that international credits be considered as a complementary tool, with robust safeguards in place. Policy mechanisms like those used in Japan and South Korea, where international credits must be linked to domestic corporate involvement, could help address concerns around economic opportunity cost. As with nature-based credits, carbon ratings could help ensure integrity and support market confidence.

We support the option for EU ETS regulated entities to purchase CRCF removals directly from removal suppliers. This direct interaction fosters a more efficient market, allowing for direct price discovery and potentially reducing administrative burdens compared to a centralised agency model. That said, we would not want to see the option of a centralised purchasing model ruled out prematurely. A range of centralised models, such as pooled procurement or hybrid systems, should be explored in more detail by the Commission.

In this regard, we welcome the direction outlined by DG CLIMA during the recent CRCF Workshop, which indicated a preference for a hybrid purchasing model combining elements such as an EU-coordinated Buyers' Club, an EU Removals Fund, and a Centralised Procurement Agency. The proposed approach to take strategic, portfolio-based purchases, rather than prioritising only the lowest-cost credits, is particularly important to support a diversity of removal technologies, including high-durability but more capital-intensive options like DACCS and BECCS.

We note that the Commission anticipates using competitive tenders with strategic criteria as an initial method, with a potential shift to reverse auctions as the market matures and volumes grow. In light of this phased development, we would support allowing bilateral purchases in the interim period, until the EU centralised purchasing framework is fully operational.

It is important that the use of CRCF removals is not unlimited but subject to restrictions, and that there is a limit on gross emissions. Direct integration without restrictions risks deterring emissions reductions and could lead to gross emissions increasing if companies substitute reductions with removals. This would hamper

the environmental integrity of the system. Maintaining the gross emissions cap (meaning for each removal allowance, one fewer traditional EUA is auctioned) is a safeguard to address this deterrence and preserve the incentive to reduce emissions.

A phased-in approach for the use of CRCF removals is prudent. This allows the market and regulatory frameworks to adapt, ensuring that robust MRV, permanence rules, and liability mechanisms are fully established and tested. It also allows for careful assessment of impacts on environmental integrity and market functioning before potentially adjusting safeguards.

Importantly, VCMs could also complement the EU ETS and CBAM in the future. For CBAM, where importers are required to demonstrate that an equivalent carbon price has been paid abroad, and once regulators have established a robust process to verify the accuracy of such claims (i.e. the third country carbon price), properly certified international carbon credits could be used to evidence compliance. This would require minimum quality standards and full transparency to ensure environmental integrity.

The EU CBAM currently does not envisage use of voluntary carbon credits (VCCs), in contrast with other jurisdictions' carbon tax regimes, which allow a limited use of VCCs to offset taxable emissions. We believe the EU should consider the potential role of high-integrity international VCCs in both the EU ETS and CBAM frameworks, alongside a regulatory architecture that addresses issues of consistency, comparability and credibility. A common framework could bridge gaps between compliance and voluntary markets and help channel capital into climate mitigation globally.

#### 5.7.1.4 (multiple-choice question)

***Do you consider that alternative or complementary policies to the integration of carbon removals in the EU ETS are necessary to scale up carbon removals?***

Complementary policies are needed.

#### 5.7.1.5

***Please explain which.***

- Ensuring appropriate regulation and the swift implementation of initiatives like the Net-Zero Industry Act (NZIA) and the Industrial Carbon Management Strategy (ICMS). Accessible and secure CO<sub>2</sub> transport and storage infrastructure is a prerequisite for scaling up many carbon removal technologies, and robust regulatory frameworks are necessary to provide certainty for investors and developers.
- Establishing distinct targets or sub-targets for emissions reductions, Land Use, Land Use Change and Forestry (LULUCF), and permanent carbon removals within the 2040 EU climate policy framework. This ensures that robust efforts are made on both fronts and prevents removals from undermining emission reduction incentives.
- It will also be critical to ensure that non-EU firms, particularly in emerging markets and developing economies, have the ability to develop high-integrity carbon removal projects that are eligible for certification under the EU CRCF or international crediting programmes. This would allow EU-based companies and financial institutions to support global decarbonisation, while maintaining high environmental standards.

- With respect to CBAM, developing a robust verification process to assess the credibility of carbon prices or taxes applied in third countries, which EU importers may seek to deduct from their CBAM liabilities.

### Section 5.8.3: Linking with other carbon markets

#### 5.8.3.1 (checkbox question – maximum 3 selections)

***Since 2020, the EU ETS and the Swiss ETS are linked, and the ETS Directive governs how links with other emission trading systems can be set up. Should the EU pursue further linking opportunities and if so, what would be the main motivations for the EU to do so?***

A key motivation for linking emissions trading systems (ETSs) is to harmonise the price of one tonne of CO<sub>2</sub> across jurisdictions. This helps prevent implicit subsidies, ensures a level playing field across regions, and promotes fair competition among all market participants.

Additionally, the EU should pursue linking to improve cost-effectiveness of the emissions reduction under the ETS via price convergence and to reduce the risk of carbon leakage for ETS sectors.

#### 5.8.3.2 (checkbox question – maximum 3 selections)

***For EU ETS to link with other international compliance carbon markets, certain critical criteria must be met. These include robust monitoring, reporting, and verification (MRV) of emissions; transparent governance processes with strict respect to the rule of law; and a Paris-aligned Nationally Determined Contribution (NDC).***

***What are the most important additional characteristics that a potential partner ETS must have for linking with the EU ETS?***

1. Compatible (but not necessarily identical) market stability mechanisms.
2. Compatible (but not necessarily identical) approach to allowance banking and borrowing.
3. Similar (but not necessarily identical) approach to market rules on participation, derivatives, etc.

#### 5.8.3.3.

***Please specify.***

Linked ETSs need compatible (not identical) rules on market stability, allowance banking/borrowing, and participation. Alignment prevents arbitrage, volatility, and disruption, while supporting price stability, smooth trading and investor confidence across systems.

Thank you for the opportunity to comment, and we stand ready to support the European institutions throughout the legislative process and the negotiation of EU legislation that will need to be amended to achieve the 2040 climate target. Our members are committed to working constructively with policymakers to ensure that carbon markets continue to deliver environmental integrity, market efficiency and the investment needed for a net-zero future.

**AFME Contacts**

Carlo De Giacomo, Associate Director, Commodities, [carlo.degiacomo@afme.eu](mailto:carlo.degiacomo@afme.eu)

Kathleen Traynor, Advisor, Commodities, [kathleen.traynor@afme.eu](mailto:kathleen.traynor@afme.eu)

**ISDA Contacts**

Stevi Iosif, Senior Advisor, Public Policy, [siosif@isda.org](mailto:siosif@isda.org)