

REACTION PAPER: LEGISLATIVE PROPOSAL ON CARBON REMOVALS IN THE EU EMISSIONS TRADING SYSTEM

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THE EU ETS 1 REVIEW IS A LANDMARK MOMENT FOR EUROPEAN CARBON REMOVALS

The 2026/27 review of the EU Emissions Trading System (ETS) 1 is a **critical opportunity to create a large-scale demand signal for carbon dioxide removal (CDR) in the EU**. Since 2021, the EU has repeatedly outlined that carbon removal at scale will play a role in achieving climate neutrality by 2050. As a result, important policy progress has been made, focused primarily on governance and voluntary market development, with the Carbon Removals and Carbon Farming (CRCF) Regulation as a flagship policy. **Yet, for megatonne-scale removals to be realised in Europe, we need megatonne-scale policy.** Creating reliable demand at scale is among the most important policies for CDR. In this context, ETS integration is a critical next step.

On 17 July, the Commission published an Impact Assessment and legislative proposal for the ETS review. The review covers a range of topics including scope expansion, changes to the cap, and new mechanisms for channelling ETS revenues. The review also assesses and lays out plans for the inclusion of carbon removals. Carbon Gap's reaction to the removals integration is outlined in this reaction paper.

OBJECTIVES FOR INTEGRATION: REAL SCALING OF CDR WITHOUT UNDERMINING THE REDUCTION PATH

Any CDR integration process should be designed to meet the dual objectives of **(1) driving CDR to scale** while **(2) ensuring no adverse impacts of CDR on the effectiveness of the ETS** as the EU's central decarbonisation tool.

To achieve objective (1), the integration needs to provide **predictable, bankable demand at scale**. Scale means demand should be on an order of magnitude relevant to expected ETS residual emissions. Predictability means there should be a well-defined overall market size and reliable price trajectory. Bankable demand means giving certainty that CDR will be purchased, rather than simply creating the option for it to be purchased. Additionally, demand must come in a timely fashion, frontloaded where possible, and should limit administrative complexity for CDR suppliers.

To achieve objective (2), the ETS needs an appropriately **ambitious cap**, safeguards against **mitigation deterrence**, and complementary support for investment in CDR projects. An ambitious cap means that the linear reduction factor (LRF) and Market Stability Reserve (MSR) should keep the ETS carbon budget aligned with European climate targets and sustain a strong carbon price signal to incentivise reductions. It also means CDR should not be used to create extra "breathing space", but to instead target a portion of emissions that are expected to be harder to abate. Safeguards are essential so that where CDR under-delivers, the overall ETS target can still be achieved. Deployment support is needed to ensure CDR projects attract sufficient finance to be delivered at the scales needed so that net targets are not missed.

MEANINGFUL IMPACT WILL DEPEND ON THE SPECIFIC POLICY DESIGN

The Commission considered several possible models for CDR integration. Each of these has risks and benefits in terms of EU CDR scale-up and ETS integrity. Analysis of each option is laid out in the Impact Assessment.

ABOVE THE CAP

Direct integration by operators

ETS operators would purchase CDR units, have them certified, and then get credits that can be surrendered to fulfil their ETS obligations.

Any such purchasing by operators **would add to the overall number of allowances** in the ETS.

BELOW THE CAP

ETS operators would purchase CDR units, have them certified, and then get credits that can be surrendered to fulfil their ETS obligations.

Purchasing by operators **would not add to the overall number of allowances** in the ETS, as an equivalent amount of EUAs would be removed (one-in-one-out). The cap would be pre-increased in anticipation of CDR units coming in.

Indirect integration by an intermediary (or “public authority”)

An intermediary body would purchase CDR units, retire them, and issue (a corresponding amount of) EUAs into the EU ETS, separating covered entities in the ETS from the CDR market itself.

Purchasing by the intermediary **would add to the overall number of allowances** in the ETS (as specified by the LRF and MSR).

CARBON GAP'S PREFERRED

An intermediary body would purchase CDR units, retire them, and issue (a corresponding amount of) EUAs into the EU ETS, separating covered entities in the ETS from the CDR market itself.

Purchasing by the intermediary **would not add to the overall number of allowances** in the ETS (as specified by the LRF and MSR). The cap would be pre-increased in anticipation of CDR units coming in.

OUR POSITION: CARBON GAP HAS CALLED FOR AN INDIRECT INTEGRATION WITH MINIMAL IMPACTS ON THE CAP

Carbon Gap's [position paper](#) lays out the key principles for CDR integration in the EU ETS. In the months leading up to the proposal, we have advocated for seven key outcomes:

CORE RECOMMENDATIONS

1 Indirect integration through an intermediary. This would provide timely and large-scale demand for CDR compared with a “leave it to the market” operator integration and offer certainty about net and gross ETS emissions. It could enable better control over CDR quality and the CDR methods deployed. It would limit complexity for ETS-covered firms by keeping CDR units separate from emitters.

2 “Below the cap” as much as possible. When integrating CDR into the EU ETS, there are two possible roles for CDR. They can be integrated “below” the existing cap to reduce the net emissions of the ETS while keeping gross emissions the same or integrated “above” the existing cap to provide “breathing space” through increased gross emissions, while keeping net emissions the same. These options are not mutually exclusive and could be pursued in tandem. Given there is a limited volume of sustainable CDR supply in Europe, CDR should be brought in below the cap as much as possible, targeting the hardest-to-abate emissions and limiting the risk of mitigation deterrence (where CDR leads to more emissions than intended). However, some CDR could be used to provide breathing space in recognition of the objective of increased “flexibility” specified in the Climate Law. Providing breathing space with CDR should be prioritised over providing breathing space without the use of CDR (for example through lowering the LRF). Moreover, aligning the ETS with a net 90% domestic reduction would ensure its continued success as the EU’s central climate policy instrument.

OTHER RECOMMENDATIONS

Beyond this, we have also called on the Commission to: (3) introduce tools to **address the price gap** between CDR units and ETS allowances (EUAs); (4) define a clear quality threshold for CDR methods and **promote a mix of different CDR methods** rather than allowing a least-cost approach; (5) establish a **hierarchy** between domestic permanent removals and international carbon credits; (6) develop the ETS as a **long-term market** for CDR rather than a standalone opportunity; and (7) **establish an explicit CDR volume mandate** for the public authority to clarify the overall contribution of CDR.

OUR INITIAL REACTION: POSITIVE STEPS FOR CDR MARKET-MAKING, IN A CHALLENGING WIDER CONTEXT

THE MOST PROMISING ELEMENTS

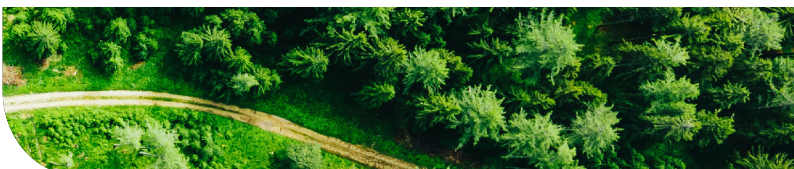
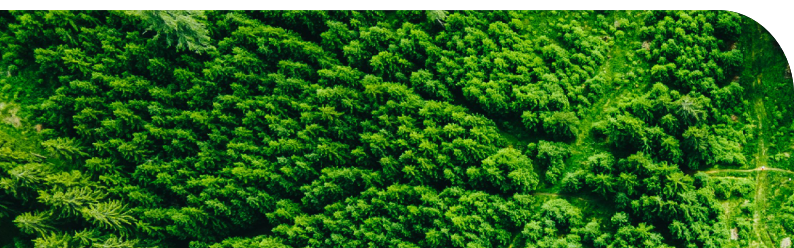
The legislative proposal published on 17 July could be truly groundbreaking for European CDR. CDR-relevant provisions are set out across Article 9c, Article 14(1a), and the recitals. Notable elements include:

- **Indirect integration** through a purchasing programme, funded mainly by polluters by earmarking ETS revenues.
- An indicative **volume mandate** of 250 Mt, albeit more efforts are needed here (see below).
- A **financing plan** for CDR. This includes the auctioning of 250 Mt additional allowances, supplemented by a further 10 Mt (which we understand to be non-additional) of allowances to address the EUA-CDR “price gap”.
- A **focus on the most robust CDR methods** – namely “those removals for which reversals are subject to monitoring” (Recital 32), identified as BioCCS and DACCS.
- An **emerging vision for longer term market development**, indicating a possible transition towards direct, operator-led integration over time (Art. 9c(8)), and positing a role for novel mechanisms to pay for CDR beyond 2040 (Recital 31). We are also encouraged to see scope expansions, especially across aviation and waste incineration – sources of residual emissions that will increasingly rely on CDR towards 2050.

AREAS WHERE MORE WORK IS NEEDED

On CDR, the initial markers are surely positive, but there are several areas where **more work is needed**.

- Secondary legislation is to be prepared setting out the modalities for CDR purchasing. For projects to secure finance based on these purchases, such legislation must be suitably specific on **auction design, auction frequency**, and the design of purchase (offtake) contracts to ensure appropriate **risk-sharing** between the buyer and the suppliers. To ensure impact in the very near term, secondary legislation must be developed swiftly.
- The proposal commits to 250 Mt of EUA auctioning but not explicitly to 250 Mt of CDR, despite this being necessary for achieving the net 85% goal. Article 9c should be revised to **provide a legal mandate for a specific CDR amount to be delivered**.
- The proposal risks putting domestic CDR and international credits on an **uneven playing field** – removals must be permanent, and are stringently monitored, but international credits only need to meet a vague “high quality and high integrity” bar, with detailed criteria deferred to later. Yet most international credits traded today represent reductions or avoidance, not removals activities. With higher integrity benchmarks for international credits, carbon removals could also emerge as a prominent credit source internationally, increasing the overall capacity of CDR potentially available for the EU.



CAUSE FOR CONCERN

CDR integration comes at a time of much wider change to the EU ETS, with a focus on “breathing space” and “flexibility”. Three aspects stand out as concerning:

- Regarding **overall ETS ambition**, the proposal targets an 85% net (domestic) reduction for the ETS. This approach will dramatically increase allowance supply, and thus gross emissions, relative to the Fit for 55 baseline, even despite the current oversupply in the ETS.¹ A stronger LRF and MSR must be reconsidered to ensure ETS sectors contribute fairly.
- The proposal integrates CDR but does not provide protections against the risk of CDR under-delivery. This means ETS sectors could emit more than expected if CDR projects fail, for example due to inadequate financing, putting the entire ETS net reduction target at risk. Two measures are therefore essential:

a) **Ensure funding levels are commensurate with expected CDR deployment.** While the proposal promisingly allocates 10 Mt to bridge the price gap, this figure is based on highly optimistic price assumptions and is unlikely to be adequate. The figure should be robustly stress-tested. The Commission should also give clarity on CDR eligibility for funding instruments such as the Industrial Decarbonisation Bank.

b) **Introduce safeguards against slow CDR development.** As part of the review set to take place in 2034, the Commission should be empowered to increase the stringency of the LRF if the CDR market is too slow to develop (e.g. because of insufficient funding). This would mirror the approach for international credits.

- Article 9c(3) risks amplifying these mitigation deterrence issues. The Article suggests that allowances set aside to fund CDR shall be returned to the wider pool if they are not auctioned for the purposes of CDR. Such a measure would release up to 250 Mt of additional allowances into the market with no balancing by CDR, increasing cumulative emissions and putting the achievement of the EU 2040 climate target at risk.

¹ Recent [analysis by thinktank Sandbag](#) suggests the EU ETS ended 2025 with a total surplus worth two years of emissions, and that proposed changes to the LRF and MSR are likely to sustain this effect.

ABOUT CARBON GAP

Carbon Gap is the leading independent not-for-profit focused exclusively on carbon dioxide removal (CDR) policy in Europe. We are entirely philanthropically funded allowing us to deliver impact on behalf of the planet.

AUTHORS

Francesca Battersby, Associate Policy Lead

Louis Uzor, Policy Director

Anna Costova, Associate Policy Lead

Valter Selén, Collaborator



 www.linkedin.com/company/carbongap

 www.x.com/carbongap

 contact@carbongap.org

 www.carbongap.org

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