CONSULTATION RESPONSE

EUROPEAN COMMISSION CONSULTATION ON UPDATING THE EU EMISSION TRADING SYSTEM (ETS) AND EU EFFORT SHARING REGULATION

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PRI Association

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3,000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US $100 trillion in assets under management.[1]

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society. The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

This consultation response represents the view of the PRI Association and not necessarily the views of its individual members.

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[1]See https://www.unpri.org/signatory-directory/

SUMMARY OF THE PRI'S POSITION

The PRI welcomes the leadership shown by the European Commission to address climate change. The new EU 2030 emission reduction target of 55% on the 1990 baseline, as agreed by EU leaders in December last year, will require stronger policy mechanisms to reduce emissions at this faster rate.

Investors attach high importance to carbon pricing, as the most economically efficient way to reduce emissions. This consultation is a crucial opportunity to revise the EU Emission Trading System (ETS) Directive and ensure its contribution to the EU climate and energy policy goals.

Based on PRI's climate policy work in the EU and other markets, we recommend:

1) **Strengthening the EU ETS *before* any expansion is considered.** Specifically:

    - Achieving an increase in the Linear Reduction Factor (LRF) and a one-off reduction in the emission CAP inline with new EU 2030 emission reduction target.
    - Tightening the Market Stability Mechanism to increase the reduction rate of surplus trading allowances, in line with EU's updated energy and climate targets and to address any supply/demand imbalances due to the pandemic-related economic downturn.
    - Public auctions should be the primary means of allocating allowances, yet depending on the design of the carbon border adjustment mechanism, retaining some free allocation of permits may be necessary to help safeguard overall EU industrial competitiveness[2].

2) **Expanding the EU ETS and "double coverage" of sectors.** PRI supports integrating additional sectors into the EU ETS where it is clearly demonstrated that this would be the most efficient and effective means of addressing emissions. A detailed analysis would be needed to ensure the inclusion of the aviation and maritime sector as well as assessing alternative policy options.

    The study should include administrative and policy effectiveness of "double coverage" of these additional sectors with the use of the ETS as a primary and / or a backstop policy measure.

3) **Not including road transport and buildings in the revised ETS**. These sectors are more effectively addressed through standards and non-pricing policy instruments (such as internal combustion engine bans and interim electric vehicle sales targets) and should be included as part of the EU Effort Sharing Regulation by member states or alternatively EU directives. Carbon pricing for both of these sectors could be administratively complex to implement. If applied as a fuel duty it risks regressive impacts on EU consumers. PRI notes that such national-level measures have been a source of public unrest and political instability in some European countries.

[2] See research paper by Evans, Mehling, Ritz and Sammon (2020) Border Carbon Adjustment and Industrial Competitiveness in a European Green Deal https://www.eprg.group.cam.ac.uk/wp-content/uploads/2020/05/2007-Text1.pdf

4) **Increase the earmarking of revenue from emission trading from 50% to 100%.** The current EU Directive lacks harmonised obligations on how auction revenues are used. This should be revised to require that all auction revenues are invested in renewable energies, energy efficiency, deployment of new clean technology in hard-to-electrify sectors, just transition, and international climate finance. In addition, 'climate-related purposes' should be activities aligned with the climate objectives of the EU sustainable finance taxonomy.