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# Summer Playlist 2026 | Episode 4
## Mark Lewis, Partner and Managing Director, Climate Finance Partners LLC

**Our Summer Playlist rolls on this week with Mark Lewis, Partner and Managing Director at Climate Finance Partners LLC. David Greely sits down with Mark to discuss the recently released European Commission's EU ETS review proposals and what they'll mean for the outlook for the EU ETS and other carbon markets.**

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**Announcer** (26s):
Welcome to SmarterMarkets, a weekly podcast featuring the icons and entrepreneurs of technology, commodities, and finance ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together we examine the questions: are we facing a crisis of information or a crisis of trust, and will building Smarter Markets be the antidote?


**David Greely** (01m 47s):
Welcome back to Summer Playlist 2026 on Smarter Markets. I am Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is Mark Lewis, Partner and Managing Director at Climate Finance Partners. We will be discussing the recently released European Commission's EU ETS review proposals and what they all mean for the outlook for the EU ETS and other carbon markets. Hello, Mark. Welcome back to Smarter Markets.

**Mark Lewis** (02m 16s):
Hey, Dave. Great to be back as always.

**David Greely** (02m 18s):
Well, great to have you here. Thanks for joining us. It's perfect timing because just recently on July 17, the European Commission presented its EU ETS review proposals, and I'm really glad to have you here to help us make sense of it all. I know many people in the carbon markets were holding their breath, waiting on this report. What issues were under consideration by the European Commission?

**Mark Lewis** (02m 44s):
Well, thanks, Dave and great to be back, as I say. I mean, we are 10 days after. Now we are recording this 10 days after the publication by the European Commission and I think the Commission was really balancing two main policy priorities. Number one, which has been playing out over the last six months, this growing sense of urgency amongst many member states and amongst European industry that there is a crisis of European industrial competitiveness and the Commission had to be very conscious of that in the proposals that it put forward and we can get into that. And on the other hand, of course, there is the overriding policy objective, which is how does the Commission make the European carbon market fit for the next decade between 2031 and 2040 in order to enable the EU to meet number one is 2040 climate target, which is 90% emissions reduction target versus 1990 levels. And number two, ensure that beyond 2040 and on to 2050, we are still on a trajectory that allows the EU to hit net zero, which is legally enshrined in EU law by 2050. So those I would say are the three kind of big picture issues that the EU was grappling with when it put this forward.

**David Greely** (04m 05s):
And before we get into those specifics, as you said, it's only been about 10 days. But broadly speaking, how is the market receiving this report? And are you seeing it as bullish or bearish for the carbon market?

**Mark Lewis** (04m 19s):
Very interesting. I mean, I think on the day that it was launched, and typically, these things are put out by the Commission around midday European time and what you saw on the day of publication was in the morning, prices came off to maybe even three euros at the low in the morning before the paper was published, then the paper was published. And by the end of the day, we were back to kind of where we had been the night before, but I think what captured all the headlines on the day of publication, and that's what explains why the market was perhaps weaker in the earlier part of the day, as we were getting leaks about what was going to be in it, was the headline about the linear reduction factor and that's a key piece of information, key data point, that's the rate at which the cap falls over time. Currently, we are on a trajectory, the cap is falling very sharply to 2030, 4.3%, until 2028, and then 4.4%. So what the market was always going to be most focused on, I think, was how does the decline in the trajectory of the cap over 2031 to 2040, as put forward in the proposal by the Commission, compare with the current rate of decline and what the Commission said there was, we will reduce it slightly between 2031 and 2035 to 3.7%. That was broadly priced in, I mean, everyone was expecting that. But what was more aggressive was they then said, and we will cut it to only 1.7% from 2036 to 2040. Now, that was much lower, I think, than anybody, certainly than I had expected and anybody in the market had expected. So I think the initial gut reaction was this is bearish. This is bearish, because the Commission is playing more to that first concern that I mentioned a few moments ago, namely, the need to ensure European industrial competitiveness. So let's reduce the cap at a lower rate to give the European industry more time to adjust.

But as we digested that information over the weekend, of course, it came out on a Friday. As we digested it over the weekend and had more time to read through it, the key message that came through was that the rate of reduction in the cap from 2036 onwards and some of the other extra supply or reserves, market reserves coming to market that was in the package is conditional. And what I mean by that is the Commission is attaching investment commitments on the part of European industry to a large proportion of the supply that is contained in this package and I think that was not really appreciated on the day and so what happened in the first half of last week, Monday, Tuesday, Wednesday, we saw the market reacting more positively. And I myself put out a couple of pieces saying conditionality is constructive. In other words, because of all this potential extra supply being conditioned upon commitments to serious decarbonization investments on the part of industry, to such an extent indeed, that as the proposal is put forward by the Commission, and we will see whether that survives now the triangulation process between the Commission, the Parliament and the Council.

But what the Commission is arguing is, if we are going to continue giving European industry free allowances for a longer period, then European industry has to commit to decarbonization investments. And crucially, and this was the key part that I don't think anybody picked up on the day, which is the most bullish part of the proposal, is even the ongoing ordinary free allocation of supply to European industry, 20% of that, as the Commission would like it, will now be withheld at source until industry has not only put forward a plan to say these are kind of decarbonization plans, but has proved that they are actually reducing emissions with those extra investments. There is already been pushed by European industry lobbies, by the way. But that's a very crucial, potentially bullish signal, because it basically says no more free lunch for European industry, you have to be really serious about decarbonizing your activities if you are going to get the full supply free of charge that we have earmarked for you. So that's what happened in the first half of last week. And then it gave back some of the gains. But at one point last week on the Wednesday, so only three days after the publication, we were up 10% versus where we had been on the Friday. We are now back to sort of being up more like 4%. So it's given back some of those gains, but the market is holding quite steady around the 83, 84 level.

**David Greely** (09m 02s):
And in terms of the trading activity in the market, did you get the sense that just removing that uncertainty is changing the dynamic where people holding back from taking a position one way or the other, until they kind of saw what the proposal would actually be?

**Mark Lewis** (09m 19s):
Yeah, I think that's fair, Dave. I mean, these, as you know, these kinds of announcements, big policy announcements from the Commission, they only happen once every five years. So they are very big announcements, people tend to want to see what's in there before taking a strong view. And of course, the nature of the timing is such that we are right ahead of the major European holiday. I mean, we are now at the end of July, next week, the European Commission basically shuts down for the whole of August. Many European traders are on holiday and as a result, you kind of tend to see that this is the slow part of the year in any case. So I think there

was some of that going on and there was a sense of relief amongst much of the market, particularly, as I say, after having had the weekend to digest the fine print of what was in there, there is no doubt that the headlines were more bearish than the details. And once people had got themselves on top of the details, it was clear that actually, there is a bullish on this. But I think the most important thing is, really, when you step back from it all, the Commission has taken and struck a very balanced view here, I think and they have tried to say, look, we understand that European industry is under incredible cost pressure from high energy prices, essentially high gas prices, which then feeds through into high electricity prices. So compared with other parts of the world, particularly North America, European gas and power prices are much, much higher and as a result, they have done a good job, I think, in sending a clear signal to European industry, we understand and we don't want to see if you had said this to me, we were having this conversation eight months ago, as indeed we were, we did have a conversation, I would have said, right, the market's really getting ready for the rubber to hit the road. I think that's a phrase I actually used in a previous podcast we did. But really, from the end of January, until the Commission published their paper, only 10 days ago, the key issue has been cost pressures and competitiveness pressures. So the Commission has really taken on that on board. I don't think anybody can say they haven't taken that on board. At the same time, they remain cognizant that there is a European climate policy objective written into law that must therefore be achieved. And they have balanced it with this element of conditionality, I think is a very clever and very meaningful, intelligent piece of policymaking. Because in conditioning, more generous supply upon investments, it is still giving industry an incentive to decarbonize their activities. So I think in the circumstances, this is probably the best and most even handed package we could have hoped for.

**David Greely** (12m 10s):
I want to dig into some of those details with you now. And clearly people look to the EU ETS, the preeminent cap and trade program for the reduction of carbon and greenhouse gas emissions and there is so many levers that can be pulled. And as a cap and trade program, as you have mentioned, the level of carbon emissions at which the cap is set and how it changes over time can be adjusted, how allowances are granted or earned, the scope of emissions and participants that fall under the cap, and what credits from other programs are accepted, can all be adjusted and I kind of want to walk through those just to try to look at it a little bit holistically. And you mentioned the cap and how it changes over time. The last time we talked, you did note that the rubber would hit the road because that linear fall in the cap over time would begin to bite on industry. Sounds like it's much more balanced. I am curious a little bit about that out year part that you mentioned. How do you see that adjustment and was that about industry or was that about something else?

**Mark Lewis** (13m 15s):
So you are talking about sort of the period 2036 to 2040?

**David Greely** (13m 20s):
Yes.

**Mark Lewis** (13m 21s):
That's a great question, because I think if we just to round out the answer to your previous question, how did the market respond and was it bullish? Was it bearish? I think all markets tend to focus more on the short term. That's where there is more visibility and I think the first thing we can very clearly say is that one of the clouds that had been hanging over this market was the threat of more supply coming between 2026 and 2030 under the so-called investment booster, right and up to 400 million allowances. Now, because of this very clear conditionality that I mentioned, it now seems that very few of those 400 million allowances will actually reach the market before 2030. So first thing I would say is, if we break it up into three, five-year periods, the period now from 2026 to 2030 looks tight and certainly tighter than most people's worst fears were before the package was published. And kind of we are looking back at where we were three, four months ago. The market thinks, this is tight between 2026 and 2030. This is tight. First thing I would say. Second thing I would say is 2031 to 2035 also looks tight because the conditionality on the second batch of 400 million under the so-called industrial decarbonization booster will be subject to the same conditionality that the investment booster is subject to. I mentioned also the fact that 20% of the ongoing normal free allocation will be withheld upon proof of emissions reductions and the cap is still being set at 3.7. So although it's coming down, it's still at a serious number. The cap is falling by 73 million tons per year. Now that naturally leads, so I would say the next 10 years, in other words, are actually looking good. They are looking tight, which is why your question about the back end is particularly interesting, because certainly some of the comments in the last few days has been, well, okay, great that we gave got tight market to 2030. And even 2031 to 2035 doesn't look oversupplied, but isn't the risk, therefore, that what you are going to end up with is all that conditioned supply, all of a sudden coming to market at the back end between 2036 and 2040. Now, what I would say there is two things.

Number one, if that extra supply has come to market by then and is coming to market by then, it will mean that serious decarbonization investments are taking place. That's a good thing. That's what this scheme is designed to engineer. And the scheme is not an end in itself. It's a means to an end. High prices are important to send the decarbonization incentive signal. If industry is actually making the investments we want them to make, and therefore the conditioned supply is arriving, that can only be a good thing. That's the first thing I would say. The second thing I would say is whether we get that 1.7% linear reduction factor over the back end between 2036 and 2040 will be contingent upon the commission deciding, and it will make this decision in January 2033, still a long way off, are they able to source on the market 260 million Article 6 credits of sufficiently high quality for them to effectively bring them under the cap, but not have them used as compliance instruments in themselves. In other words, what the commission is saying is, look, in January 2033, we are going to publish a report setting out whether or not there is a sufficient number of high-integrity Article 6 credits available. If there are, we, as the European Commission, or some other central authority that we have established by then, or will establish, will purchase 260 million tons of Article 6 credits. To raise the money in order to purchase that, we will use EUAs. We will auction an equivalent number, 260 million EUAs and as a consequence of that we will be able to reduce the linear reduction factor from 3.7% to 1.7%. What we will do is, we will use those Article 6 credits immediately to, well, we will cancel those credits, which has the effect of offsetting the 260 million EUAs extra that is available under the cap compared with the alternative scenario.

Now, what's the alternative scenario? The alternative scenario is that the commission determines at the end of January 2033, actually, we can't find enough high-integrity credits. They just aren't there. The cap that's been falling at 3.7% per year between 2031 and 2035 will now fall at 2.7%, which is still quite a severe rate of reduction. You hit the same target by 2040 of a 90% emissions reduction target. The only difference is that, remember, this goes back to the decision taken at the end of last year, where the European Union decided that in terms of meeting the 90% emissions reduction target by 2040, 5% of that, assuming the credits were available, could be met via offsetting. So in other words, there is a scenario where there is a sufficient number of Article 6 credits that the commission can purchase them and offset the higher number of emissions, higher volume of emissions within the European Union by cancelling Article 6 credits and there is a scenario, in other words, only 85% of the 90% target is achieved domestically in Europe. And there us another scenario where the commission says there just aren't enough credits. We have to achieve the full 90% domestically within the European Union. And that's why the linear reduction factor would be higher at 2.7% rather than 1.7% if those Article 6 credits are not available in commission's judgment. In other words, they are not sufficiently high quality for the commission to purchase them. So that's what's in play. There is a lot of moving factors in the back end, which is why it's very interesting that you identified that as one of the most interesting features of the package.

And one of the things I would throw into the mix is the commission is also looking at carbon removals in the back end by saying, okay, we will create, and this is outside the cap, because this is very different from what they are doing with Article 6 credits. They are saying, we will create 250 million EUAs outside the cap. And we will sell those to purchase carbon removals, direct air capture, and so forth. And that will allow us to take concentrations of $CO_2$ out of the atmosphere. And in a sense, they offset one another. In my view, personally, that's the one false note in the entire package, because that's outside the cap. And I think that is potentially a slippery slope, because that establishes the precedent that you can create EUAs, as it were, out of thin air. In other words, these allowances are not subject to the Linear Reduction Badge at all. It's just 250 million EUAs that have been magicked up out of a hat like a magician pulling a rabbit out of a hat.

**David Greely** (20m 47s):
And I wanted to ask you, because there always is, and the accounting can quickly get confusing in these sorts of things. So I wanted to go a little bit more slowly through a couple of these on how the allowances are granted or earned. So going back to the Article 6 piece that you just described, I am hearing basically, if quality Article 6 credits are available, the EU would effectively purchase those on its own account. It would then make the cap less stringent to reflect that it's offsetting through these Article 6 credits, and it would fund that purchase through EUAs. So are those additional, or are they taking some that would have been granted free to industry and then auctioning them off? I am trying to understand if there is a double counting or not, because if they are creating more EUAs and not making the cap as stringent, it feels like that's double counting. So I am wondering what I am missing.

**Mark Lewis** (21m 47s):
Right. I think it's not double counting. I see where you are going with it. But I think it's not double counting in the sense that what it is really is this difference between gross and net emissions, right? So either we achieve the full 90% emissions reduction target internally in Europe, and there are no offsets allowed at all. That's one scenario. If the Commission determines that there are not enough quality Article 6 credits that are available, then all of the emissions reductions will have to be achieved inside the EU itself, both for the ETS, as we know it today, the EU ETS1, and ETS2, as people are calling it, which is the other cap and trade scheme that will be introduced now

in 2028 to cover the heat and transportation sector and that's even more politically sensitive. So to be honest, I think you can assume that they will find enough high quality credits, because it will be extremely problematic to assume that Europe would allow the heat and transportation sectors, which have a direct impact in the home, and when you drive your car, and those people vote, right? In other words, the EUA cap is more generous. That's certainly true. The EUA cap is more generous, and the ETS2 cap would be more generous if we can find enough credits, because then the Commission will say, well, it doesn't matter that there are more EUAs, because we are offsetting the impact of that environmentally anyway, by purchasing high quality Article 6 credits. So in a way, it's very different from how we treated the CDMGI credits, if you remember, where it was up to the individual companies to go and source. Everyone was given a quota, hey, we will allow you to use a certain amount of CDMGI credits, but you have to go into the market and buy them yourselves. Here, the Commission is saying, no, no, no, no, no, we will purchase those credits centrally. That has a number of advantages, by the way, and I think this is a point that hasn't been picked up sufficiently.

Number one, that eliminates, it makes it a level playing field for everybody, right? I think under the old CDMGI rules in the EU ETS between 2008 and 2020 there was an unfair advantage for bigger companies. They had the wherewithal to go out and source these credits much more cheaply. Smaller companies had an information disadvantage. They had a capacity disadvantage. Here, the Commission is saying, we will take care of it all. Everyone will have the same level playing field. You will get more EUAs as a result of this, but we will offset the impact of more EUAs being out there. There is a second advantage, which is having one centralized buyer with a credit rating like the European Union means that you are sending a much clearer long-term signal to the Article 6 market to gross up supply, to scale up supply. I think it's much more effective as a market scaling mechanism globally for the Paris Agreement. Those are two just in parenthesis. I wanted to make those points because it's important. It's not double counting per se. It's really the difference between gross and net. I am not concerned, therefore, about the issue of double counting. In the end, Europe either achieves the 90% target completely domestically, or it achieves 85% of the 90% domestically and offsets 5% with an extra 5% of domestic EUAs being available for the market.

**David Greely** (25m 16s):
That's really helpful. The one other part I wanted to come back to is something you mentioned a couple times earlier, which is this investment booster. Because on the one hand, you tend to think, well, if there is a cap and trade system in effect and people can project forward this linear decline, they can know that they'll be compensated in the future for investments by the value of the EUAs on their reduced emissions. I guess that's why it's called a booster. How does this work, the investment booster piece?

**Mark Lewis** (25m 47s):
So, the first thing to say is, where are these allowances coming from? Again, to your point about double counting and so on. These 400 million, it's pretty clear they will come from the new entrant reserve. Now, the new entrant reserve was established. There is always a new entrant reserve at the beginning of any trading period. The current trading period runs from 2021 to 2030. At the beginning of this trading period the Commission set aside a number of allowances, significant number of allowances, for new entrants. In other words, we have the existing industrial base in Europe, but over any period of time, you would expect new facilities to be built, new factories, new manufacturing plants, etc. and the Commission wanted to set aside a number of allowances for potential new entrants. As it has turned out, because of the very difficult macroeconomic circumstances, we have talked about the ongoing cost of energy in the EU, which is the single largest source of angst amongst European industry, arising most notably from Russia's invasion of Ukraine and high gas prices feeding through and turning to high power prices. There has been very little uptake from that new entrant reserve. There is hardly been any new entrants. So, you have got approximately 500 million allowances and bearing in mind, at the moment, annual emissions in the EU ETS are running at about 1.1 billion tons a year you have got 500 million, which is getting on for 50% of annual emissions in the scheme, 500 million sitting in a reserve, not doing anything at the moment, not in the market.

The commission is saying, we are going to take 400 million of that under the so-called investment booster, and we are going to make it available to European industry if they meet certain eligibility criteria. That's what the market has been unclear on for the last two, three months. That's why prices have been relatively volatile, because there has been this question of, how is the commission going to allocate these allowances? Will they be auctioned, which was what was first rumored in well-sourced media reports? Myself and many other people were assuming they would be auctioned. They would never auction 400 million allowances in one year, but I assumed 80 million per year over five years seemed to be a reasonable way of thinking about it. Then all of a sudden, a week or 10 days before the Commission published the review we got well-sourced media articles saying, no, no, no, no, they are going to allocate these allowances for free on a first-come, first-served basis, whatever that means. We didn't know what the eligibility criteria were going to be. And so that then made it open season for the market to speculate, well, actually, that means all these 400 million allowances are going to hit the market before 2030. And there was a lot of angst around that. In the end, what they are going to do, this is why I say it's unequivocally bullish between this first of the five-year periods covered by this package, because what they are saying is, yeah, there is $400 million allowances available for people who want to commit to investing in new facilities. But before you get any allowances, you are first going to have to put forward a credible plan. By the way, you then got to start building the facility within 30 months and if you don't, then there is no question you won't get any of those allowances and then secondly, you will only start receiving the free allowances retrospectively, once you have shown that your investment is actually reducing emissions, and finally, those free allowances will be dispersed over a period of up to 10 years. So you can see that we have swung around a lot on this issue of the investment booster in the last two months from thinking okay this is going to be auctioned, it will be very orderly and it will be very clear and anyone can just go in and purchase these allowances at the auction to no, no, no. The whole point is we want to make it free for European industry, but it comes with these rather stringent condition. And I think that is probably the single most bullish element in the package in terms of the market reaction, because that's the one that influences the immediate horizon. Most obviously, as I said earlier, though, for my money, the single most important and bullish element in this package is the withholding of 20% of the ongoing free allocation, the normal free allocation beyond 2030, because that really introduces an element of conditionality for existing supply.

**David Greely** (30m 45s)
I want to turn to the topic of potentially unwilling entrance into the EU ETS, because one of the things people were holding their breath over was the potential extension of the scope of the EU ETS outside of Europe's borders. I am talking about the CORSIA and CBAM proposals. For those not familiar, CORSIA is the Carbon Offsetting and Reduction Scheme For International Aviation, so the international airlines, and CBAM is the Carbon Border Adjustment Mechanism for goods coming into Europe. What is the EU review proposal on CORSIA and how do you see it impacting not only the EU ETS market, but how do you see it impacting the CORSIA market?

**Mark Lewis** (31m 28s):
Great question and again, there was a lot of speculation about this. Just a bit of context for people before I get into that. Remember why we are in the position we are in today. CORSIA only exists because the European Union originally wanted to bring all flights entering and leaving the European Union under the scope of the ETS. However, in 2012, because of pushback from the United States, China, India, Russia, and essentially every other large country in the world, who didn't want their airlines to be burdened with the cost of higher CO2 prices, we reached this agreement where the commission wrote this clause, the so-called stop the clock clause. And it said, okay, we will stop the clock on including all flights entering and leaving the EU under the scope of legislation, so long as the global aviation industry can, under the aegis of the ICAO, the UN body responsible for international civil aviation organization, it's a UN body that regulates global aviation, you guys can get together and come up with a credible scheme for offsetting and or reducing emissions from global aviation in such a way that it satisfies what we want to see as the European Union. Now, that's why CORSIA was set up in the first place, CORSEA being the carbon offsetting and reduction scheme for international aviation. That's what it stands for. I think it's fair to say that CORSIA so far has had a mixed reception in the European Union.

If you look at prices at the moment, EUA prices right now are trading at €83 a ton, let's call that $90, just over $90 a ton. CORSIA credits are trading somewhere between $10 and $15 a ton. So we are talking about prices that are seven to eight times higher in Europe relative to CORSIA. The EU, or the European Commission, I should say, held out this threat before it announced this package 10 days ago, that it would include not all flights entering and leaving, but all flights departing, all flights leaving. So they seem to have dropped this idea of all flights entering the EU, but all flights departing, which would still be a significant thing to get through in the face of a very dogged and determined international position to this. So in the end, what they have come up with is this fairly transparent compromise. And I say it's transparent, you will see this when I say what they have decided to do. So they have said in the end, all flights departing the EU within a 5,000 kilometer radius from the center of the European Union, which they determined to be more or less the main airport in Frankfurt, Germany, will be included. But if you are going further than 5,000 kilometers from that part of the European Union, you won't be covered. Now, the first thing I did was check how far is New York from Frankfurt, and it's 6,000 and something kilometers. So there will be no flights covering the United States, flights covering China, there will be no flights coming India, Moscow is within 5,000 kilometers. But there is hardly anybody flying from Europe to Moscow at the moment for obvious reasons.

So this seems to be politically the easiest way for the European Union to save face to not cause another global fight over should these flights be included or not. And it gives more time to CORSIA to prove itself. This is the important point if we bring it back to CORSIA now. That CORSIA can prove to be an effective way of offsetting and reducing emissions for the global aviation industry between 2027 and 2032. So this proposition of the European Commission now to include flights up to 5,000 kilometers will apply until 2032 and then they will look at it again. And I think what they are saying is, let's just hope that CORSIA is a much more credible scheme by 2032 than it appears to be today and the aviation industry is taking it more seriously. Of course, that also means that the EU is giving CORSIA time to prove that because remember, CORSIA runs initially on a voluntary basis. And then from 2027 to 2032, it's a mandatory, in theory at least, a mandatory scheme for those countries that have signed up to it. There is a large number of countries that have signed up to it, including most of the bigger ones and we will see again in another five years' time we may be doing another podcast, Dave, hopefully we will and will be wondering, okay does the EU now think that CORSIA is credible and I guess the Occam's razor for judging whether CORSIA is credible or not is how close is the CORSIA price to the European price?

**David Greely** (36m 22s):
So it's got a lot of room to move and what's the state of play on CBAM now because people have been talking about that for a long time?

**Mark Lewis** (36m 31s):
I think fairly straightforward what they have done in the proposal is to say we will extend the timeframe by which CBAM covers 100% of the industries that it's meant to cover by four years from 2034 to 2038. So in other words, those industries that are covered by CBAM legislation will get an extra four years of free allowances, albeit tapering down, but the tapering down will be slower than it was foreseen under the existing legislation. So rather like the CORSIA thing, it gives everybody a bit more time to adjust with, these things are complicated, and you are creating a lot of red tape and bureaucracy for people to get their heads around, particularly smaller companies that are affected by this. And as a result, I think it was inevitable that they would be forced into an extension of that. I think it's positive that they have still stuck with the idea that over the course of the next decade, CBAM will become 100% operational by 2038. So it gives you an extra four years of runway basically to get up to speed with it.

**David Greely** (37m 45s):
I know CBAM was one of the things motivating other countries to create their own schemes. Do you see that having any impact on how those other schemes progress?

**Mark Lewis** (37m 57s):
I mean, I think again, it gives them a bit more time, doesn't it? But the pressure is still there and the EU market is, depending on how you measure it, it's either the biggest or second biggest market in the world. So it's always going to be a market that people want to sell their goods into. So I think it retains an incentive. It means the incentive for other jurisdictions to develop their own carbon pricing policies is still there, but they have a little bit more time to think about the best structures for them, I suppose.

**David Greely** (38m 30s):
Just to close the circle, I know we talked about the EU purchasing directly Article 6 credits, the potential for that. Is there any potential for outside credits to be allowed into the scheme for individual companies to purchase? Has there been any change in that?

**Mark Lewis** (38m 50s):
No, there definitely is not. I mean, they have been very clear on that. This was one thing that for the Commission was a red line. And I must say, I had never really. I guess we are all prisoners of our own history and preconceptions, right? And I lived through that entire CDMGI period. That was how my mind had thought about it. I think most people in the market have thought about it in this way. When the Commission first started talking about, well, perhaps we can have Article 6 credits in, but with a centralized authority, I was thinking, what on earth? What would that look like and of course, the way they unveiled it, as we explained earlier, is effectively to enable a more generous EUA cap and this difference between the gross and net emissions. But they are very clear, they do not want individual companies to be able to use this. That's different, by the way, from the carbon removals, which, again, although there will be a central acquisition piece by the Commission as well, individual companies will be able to use carbon removals that meet the eligibility criteria for compliance. There is a qualitative difference in how those credits are treated there. But I think for the Commission, this was all about retaining control and having a strict limit on the amount of emissions that could be offset using Article 6 credits. I think a lot of us who have been observing this market for a long time assumed that if we were going to use Article 6 credits, it would be a way of. I mentioned right at the beginning, didn't I, that the third thing the Commission was trying to do here was prepare everybody for the final decade, the decade between 2041 and 2050. I think allowing a certain number of credits to be used, albeit in a centralized way by the Commission itself, is a prelude to enabling a much more generous use of Article 6 credits between 2041 and 2050, when they will be more needed, because the cap will be falling to zero at some point between 2040 and 2050. If you assume that the 1.7% LRF is retained in perpetuity, then the cap falls to zero as late as 2048. But my suspicion is they will revisit that again, and it will be a more draconian reduction than 1.7%, because they want to free up as much emission space as possible for ETS2, which is the more politically sensitive one, and which will not have reduced its emissions by anywhere near as much as ETS1 already by 2040. So I think

there is an element of experimentation on the part of the EU. How easy is it to do this? Let's do it centrally first, and then perhaps between 2040 and 2050, we can think more imaginatively about using Article 6 credits, by which time the market will be bigger. The EU will have helped scale it up through this mechanism, because one final word on this. It's 260 million in ETS1. That implies, because it's only 2% of the 5% total of offsets, i.e. this difference between 85% and 90% gross and net, 2% of that 5% is ETS1, 3% is ETS2 plus residual emissions outside either of those two schemes. What that means is, in total, the EU will be purchasing up to 700 million Article 6 credits between 2036 and 2040, which is why I say having one centralized purchaser with the credit quality of the European Union is a very effective way of scaling up Article 6 globally and so I think what the Commission is saying is, this is the experimentation period, and then 2040 to 2050 is when Article 6 needs to be producing allowance, carbon credits at scale, so that the European Union and many other jurisdictions around the world can have more ambitious emissions reduction targets.

**David Greely** (42m 48s):
Well, thanks for going into all those details, Mark. Just for folks who may have gotten a little bit lost in all the detail, if you take a step back and put it all together, how would you summarize the key takeaway for how you are thinking about what this means for fundamentals and pricing within the EU ETS?

**Mark Lewis** (43m 07s):
I think if this package survives more or less in the format that the Commission has proposed it, it's a whole other podcast to get into all of that, because there will be pushback from industry on all of the conditionality. There will be pushback from some people who want a tougher linear reduction factor. There is seven countries out there, the Scandinavian countries and others, that don't want to see any dilution of the linear reduction factor. But I mean, overall, if this package goes through broadly as the Commission has put it forward, I come back to what I said earlier, I think it's a very sensible, balanced package that will give enough of a long-term price signal for industry to invest and in a way, it should take some of the volatility out of this market that we have seen in the last few years with all the issues around high energy prices, both the political volatility and the market volatility as gas prices have moved around all over the place. This, to me, seems to be the Commission's attempt to say, we want to bed this down for the long term. We want to ensure the existential survivability of this scheme politically, but we want to retain a long-term price signal. So I actually think that from an industrial point of view, it's giving industry enough breathing space from the cost pressure, which is very real, whilst at the same time giving them an incentive to invest. And for financial investors, it's giving them a perhaps not such an exciting ramp up in prices as we were talking about the last time we met to discuss this when I was talking about the rubber hitting the road. But and perhaps the rubber doesn't hit the road quite so quickly or dramatically as we were thinking eight months ago. It certainly doesn't.

But you can still see the point in time down the road where the rubber will be hitting the road. And one way to summarize this is to say the European market is coming to resemble the Californian market a bit more closely. In other words, it's not a market that is going to credit, so not going to go from €80 a tonne to €150 a tonne over the next two years, as some people, many people, perhaps myself included, eight months ago, were thinking was a very real possibility. But perhaps that was never a desirable thing in the first place, because that calls into question the political survivability of it. And in a way, what California and some of the other US schemes have done is manage that kind of balance between cost containment and incentive better. That's not to say Europe has gone down the track of actual price management the way California has. But California has a very clear cost containment above this level, you can't go. But I think it's a bit closer to the Californian model where cost containment becomes more important. And we are not managing for price explicitly. But we are saying now that there is a limit to how quickly the European Union will allow carbon prices to go up in the future. But I think that's no bad thing and I think it still gives enough of a, an incline, an upward incline to this market that it should still be an interesting market for investors, whether we are talking about hedge fund investors, who have been the main type of financial players in this market so far, and institutional investors, long only institutional investors who so far been absent from the European market, whereas they have been present in California from the beginning, right. So I think they prefer to see a long term upward trend, rather than prices that can go up 20% one year 40 50% one year and crash 10% 15% the next year. I think that's, I think the world we are heading into a stably bullish long term picture, sustainably bullish.

**David Greely** (46m 58s):
Thanks again to Mark Lewis, Partner and Managing Director at Climate Finance Partners. We hope you enjoyed the episode. We will be back next week with another episode of Summer Playlist 2026. We hope you will join us.

**Announcer** (47m 12s):
This episode is brought to you in part by Abaxx Technologies. AI agents are fundamentally changing how people and organizations interact with computers and the internet. A race is underway to establish the path that will govern the nature of these interactions.

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