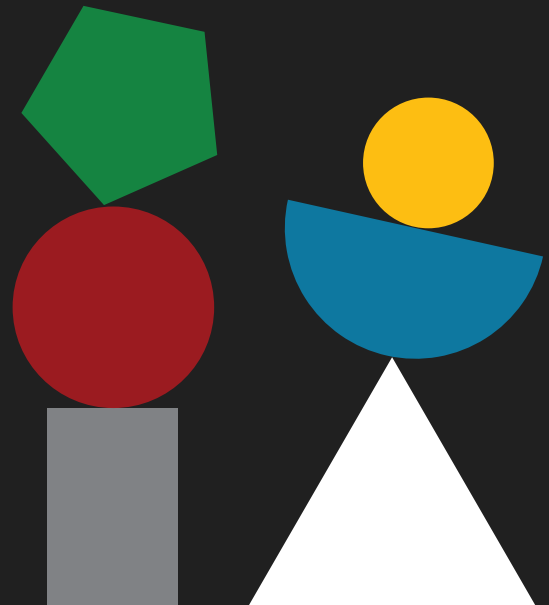


3D CarbonAccounting

An Oliver Wyman solution

CARBON BORDER ADJUSTMENT MECHANISM (CBAM)

Firms that import carbon-intensive products into the EU will soon need to pay import taxes based on the embedded carbon emissions. Here we set out the regulations and how Oliver Wyman can help.



CBAM IN A NUTSHELL

In May 2023, the **world's first carbon import tariff**, the Carbon Border Adjustment Mechanism (CBAM), officially entered into force, with far-reaching consequences for world trade.

A key part of the EU's climate action plan, CBAM is an instrument to counter **carbon leakage**, i.e., the risk of producers of carbon-intensive goods moving their operations to countries outside the EU with no carbon pricing scheme in place. CBAM creates a level playing field by applying to EU imports the exact same carbon price that EU producers must pay in the context of the EU ETS (Emissions Trading System), which is particularly crucial given the substantial growth of ETS prices in recent years (+800% since 2018).

Introducing CBAM will allow for the **phase-out of free allowances**, a controversial mechanism set up to protect carbon-intensive industries in the EU, not well suited to incentivise decarbonisation. CBAM will also drive **climate action outside the EU**, either through countries adopting a price on carbon or through suppliers forced to decarbonise their operations to compete with their EU peers.

Given the complexity of setting up CBAM and the associated data requirements, the initial focus will be on **selected, primarily upstream, carbon-intensive products** such as aluminium, steel and cement, but with the clear aim to expand the scope to all products in the EU ETS by 2030. For that reason, some EU companies, particularly those further downstream in the value chain (e.g., Auto OEMs), will face **adverse impacts** in the transition period as they, in contrast to their non-EU counterparts, pay for the carbon content of their input materials.

Export-oriented EU companies in carbon-intensive sectors are also negatively affected. While they have lost access to free ETS allowances, they compete with lower-cost peers in non-EU markets that are not subject to carbon pricing. To address the issue, the EU Commission is considering a mechanism for export rebates and may present a legislative proposal by 2025.

CBAM will launch in **October 2023**, initially with reporting obligations for EU importers only. By **January 1st, 2026**, EU firms will have to start paying for the carbon content of their imports by purchasing the corresponding amount of CBAM certificates.

Creating a level playing field for EU and non-EU producers

Production in the EU



EU firms must purchase ETS allowances to cover the CO₂ emissions in their production process

Production outside the EU



EU buyers must purchase CBAM certificates associated with the carbon content of imported goods from non-EU countries

SCOPE, PRICING AND TIMELINE

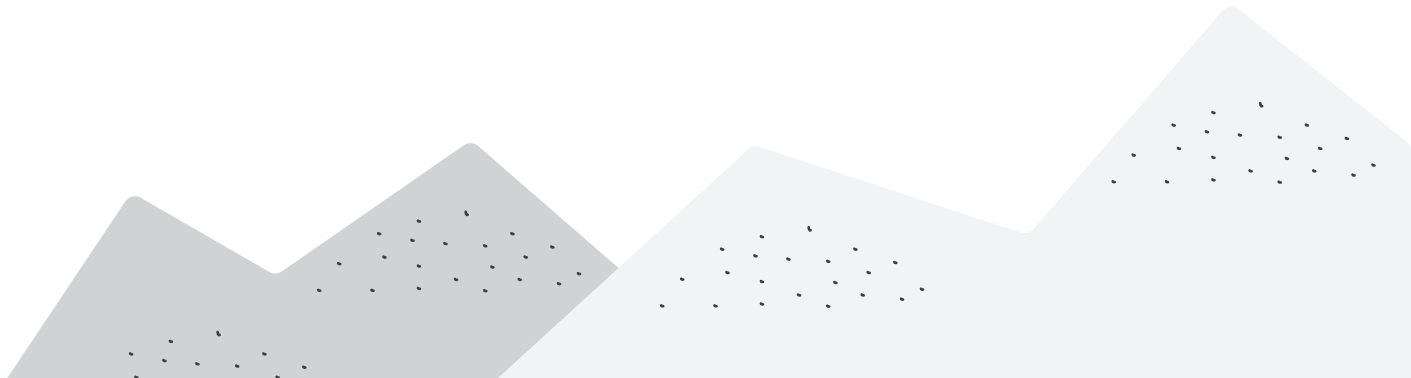
Initially, CBAM will apply to selected goods at high risk of carbon leakage including

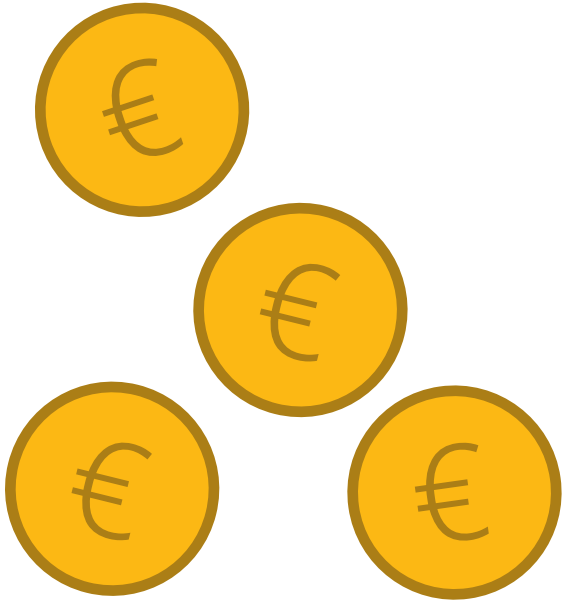
- **Basic materials/ products** such as iron and steel, aluminium, cement, fertilizer, electricity, hydrogen
- **Selected precursors** such as agglomerated iron ores, ferrochrome and ferronickel
- **Selected downstream products** such as screws, bolts and similar articles of iron and steel

From the outset, CBAM will cover **Scope 1 emissions** (i.e., the direct emissions from owned/controlled resources associated with the production of the imported good) for all CBAM products, while **Scope 2 emissions** (i.e., the indirect emissions from purchased electricity, steam, heat, cooling) will only be included for imported fertilizer, cement and electricity.

Depending on a review by the European Commission that will be concluded by 2025, further products including **chemicals, plastics, semi-finished** or **finished products** (such as cars) may be added to the scope of CBAM, with the clear intention to include all goods covered by the EU ETS by 2030. The feasibility of assessing environmental footprints, i.e., the carbon content of the full product lifecycle, is also part of the review.

The product extension under review would essentially add **upstream Scope 3 emissions** to the scope of CBAM, requiring EU importers to buy certificates to also cover emissions associated with the product's upstream value chain, including input products.





Pricing

The price for CBAM certificates, expressed in Euro/tons CO₂, will mirror the price of **EU ETS allowances** and will be applied to the carbon content of the imported goods. EU importers will be responsible for verifying the emissions through an accredited body. In the absence thereof, punitive default values will apply. If the country of origin has an existing carbon pricing scheme, a corresponding **rebate** on CBAM costs can be claimed.



Timeline

Starting in **October 2023**, a simplified CBAM will apply with reporting obligations for Scope 1 and 2 emissions. Starting in **January 2026**, EU importers will have to start purchasing CBAM certificates that correspond to the emissions embedded in their imports. CBAM will be gradually phased in, at the same speed that free EU ETS allowances will be phased out and become fully operational by 2034 when all free allowances have been eliminated.

HOW WILL THE CBAM MECHANISM WORK IN PRACTICE



Non-EU supplier

No formal obligations under CBAM as entities are not regulated by the EU. May provide EU buyers with: Product-level emissions data (Scope 1 and 2), verification of emissions by an accredited entity, certification of carbon costs paid in country of origin (if applicable).

EU buyer

Purchase/surrender CBAM certificates, verification of embedded emissions by an accredited entity, annual declaration of CBAM imports, quarterly CBAM reporting (including Scope 1 and 2 emissions). Failure to surrender sufficient CBAM certificates subject to penalty of 100 €/ton CO₂, obligation to surrender outstanding CBAM certificates.

Note: CBAM will not apply to (a) Iceland, Norway, and Liechtenstein as they are part of the EU ETS, and (b) Switzerland, as its emissions trading system (ETS) is linked to the EU ETS.

WHAT YOU NEED TO DO

If you run a business in the EU that imports products that fall under the scope of CBAM, you will need to be prepared to:

✓ **Assess your suppliers' carbon footprint**

You may be responsible, as soon as October 2023, for assessing (and by 2026, verifying) your suppliers' Scope 1 and 2 emissions if they are unable to provide you with the required data.

✓ **Extend your carbon accounting capabilities to include Scope 3 emissions**

Further finished/ semi-finished products may be added to the scope of CBAM in time for the 2026 launch and by 2030, all EU ETS sectors may be covered. As an importer, you may be required to assess the carbon content of complex products, covering not only Scope 1 and 2 but also Scope 3 upstream emissions.

✓ **Assess the carbon footprint of all potential suppliers**

As you will have to pay for the emissions embedded in your imports, your current supplier may not be the most cost-competitive option. Be ready to assess and evaluate the carbon footprint of all potential suppliers to identify the most economic choice.

✓ **Unlock value by hedging your CBAM price risks**

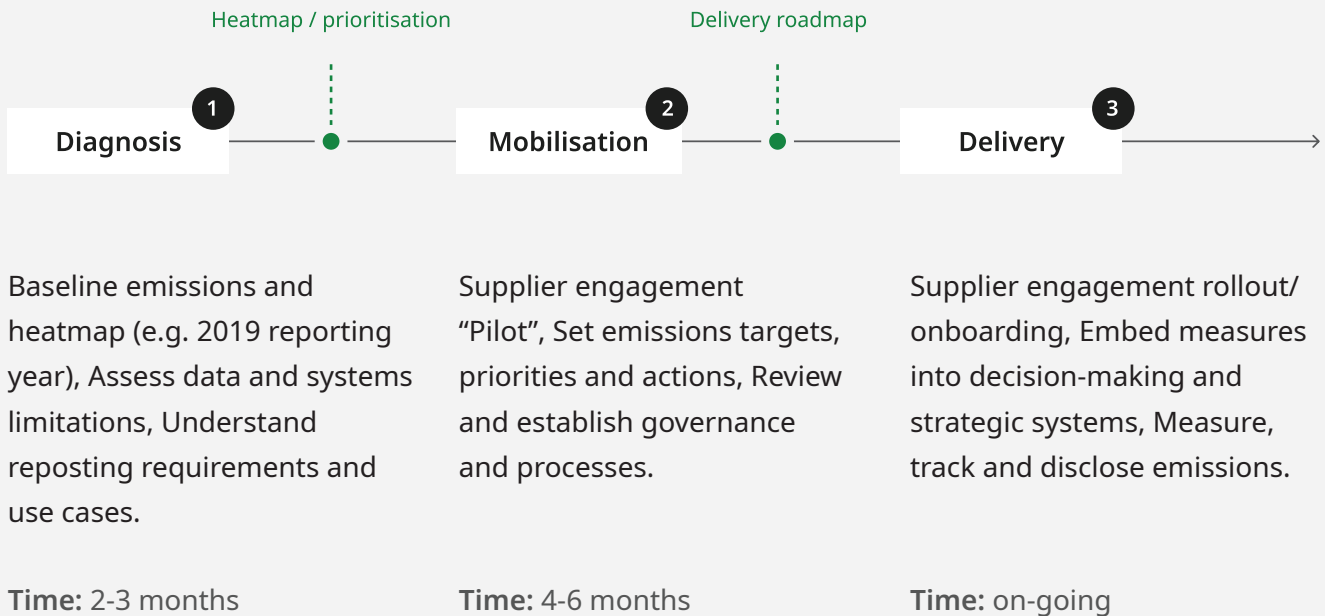
As excess CBAM certificates can be held for up to two years and are directly linked to a very liquid market (EU ETS), you could manage CBAM price risks through a sophisticated ETS hedging strategy.

HOW OLIVER WYMAN CAN HELP

We have a rigorous process to calculate relevant Scope 1, 2 and 3 emissions that includes building a supplier engagement strategy which will be key to accurately calculating your CBAM costs.

We can expand the scope to include all your scope 3 emissions in a transparent and auditable manner that will serve as the foundation of your decarbonisation strategy while enabling your company to meet its CBAM and future EU Sustainability Reporting Standards (ESRS) obligations.

Implementing an emissions disclosure program



100,000S LCA STUDIES INTEGRATED

We aim to help our clients to develop and enhance their own internal carbon accounting capabilities drawing upon our databases and industry-specific models. Our datasets include 100,000s of LCA studies and our models have been tailored to all of the major industry segments.



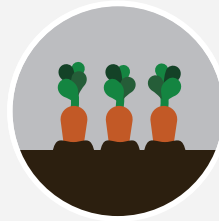
Automotive



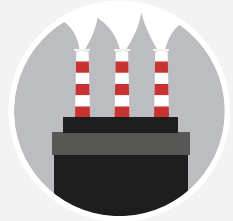
Aviation



Chemicals



Food and agriculture



Manufacturing



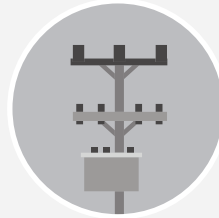
Media
and sport



Mining
and metals



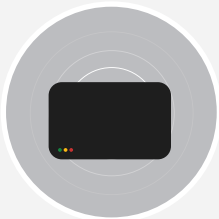
Pharmaceuticals
and healthcare



Power
and utilities



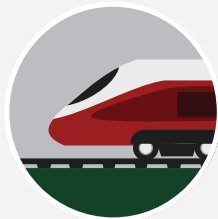
Real estate
and construction



Telco and
technology



Textiles
and apparel



Transportation



Waste

INTRODUCING 3D CARBON ACCOUNTING

Granular, accurate, transparent and well-documented emissions models that are ready to meet your reporting obligations and inform a wider decarbonisation strategy.

The example below shows the data associated with the repair of an aircraft engine following a bird strike. Every task and component is identified and the emissions quantified, illustrating the level of detail and rigour we apply.



STAY CONNECTED

