



Navigating EU ETS 2 Reform Proposals Options, Impacts and Procedural Considerations

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List of abbreviations

EU	European Union
EIB	European Investment Bank
ESR	Effort Sharing Regulation
ETS	Emissions Trading System
ETS 2	European Union's Emissions Trading System for heating and road transport
GHG	Greenhouse Gas
MSR	Market Stability Reserve
SCF	Social Climate Fund
SCPs	Social Climate Plans
TFEU	Treaty on the Functioning of the European Union

Executive summary

The European Union's (EU) Emissions Trading System 2 (ETS 2) will extend carbon pricing to buildings and road transport from 2027 (or 2028) by requiring fuel suppliers and distributors to purchase and surrender emission allowances. The ETS 2 is designed to transmit a clear carbon price signal along the supply chain, encouraging households and businesses to improve energy efficiency and shift to low-carbon alternatives.

Adopted in 2023, the ETS 2 is expected to play a crucial role in meeting the EU's legally binding targets of reducing greenhouse gas (GHG) emissions by at least 55% by 2030 and 90% by 2040 compared to 1990 levels as well as achieving climate neutrality by 2050.

The ETS 2 was planned to commence in January 2027, but EU environment ministers agreed on 5 November 2025 to postpone its start by one year. The European Parliament voted in favor of this postponement on 13 November 2025. Yet, this decision was part of the Regulation to change the European Climate Law and did not change the ETS Directive, which only allows for a 2028 start in the event of exceptionally high energy prices (Article 30k, ETS Directive). This raised questions regarding the legal character of the postponement.

Over the course of 2025, some Member States and stakeholders expressed concerns about high and volatile allowance prices as well as societal impacts of the ETS 2. They proposed several changes to the ETS 2 design and implementation. On 27 November 2025, the European Commission proposed targeted amendments to the Market Stability Reserve (MSR) Decision and the Auctioning Regulation in line with some of the proposed changes.

While legitimate concerns exist regarding certain aspects of the ETS 2 design and selective reform may have merit, full abolition but also postponement would be counterproductive and likely exacerbate the very challenges it seeks to address. Delaying the ETS 2 would undermine the necessary investment certainty for effective policy.

This report provides an overview of the main proposals for change published by September 2025 and discusses their potential impacts and procedural feasibility. The main reform proposals identified are:

- Reforming the Market Stability Reserve (MSR)
- Frontloading revenues
- Strengthening the Social Climate Fund (SCF)
- Early auctions
- Improving information provision

Our analysis focuses on the EU level and excludes proposals targeted at Member State policies. Nonetheless, national-level actions remain central to the success of the ETS 2.

We find that the proposals would require diverse procedures, ranging from amendments to the ETS Directive to statements issued by the European Commission, implying very different timelines and levels of complexity. Overall, several changes could be implemented by amending laws related to ETS 2 such as the MSR Decision and the Auctioning Regulation. This appears more feasible, faster and likelier to provide certainty of outcomes than reopening the ETS Directive. The report includes a detailed mapping of which proposed changes would require which legislative or administrative action.

The environmental, economic and societal impacts of the proposals are assessed. While some measures could shift incentives for abatement investments into the future, others could have the opposite effect by accelerating investment earlier than in a no-change scenario. This shows that a careful balancing of environmental, economic and societal impacts is important when considering the proposals for change.

It is therefore critical to recognize that the proposals are complementary rather than mutually exclusive. They address different concerns and ETS 2 provisions. For this reason, ideally, they should be considered together so that interactions are properly accounted for.

1 Introduction

The European Union (EU) Emissions Trading System 2 (ETS 2) marks a significant evolution in EU climate policy by extending carbon pricing to the building and road transport sectors. Adopted in 2023 as part of the “Fit for 55” legislative package of several climate measures, the ETS 2 is expected to play a crucial role in meeting the EU’s legally binding targets of reducing greenhouse gas (GHG) emissions by at least 55% by 2030 and 90% by 2040 compared to 1990 levels as well as climate neutrality by 2050. It complements the binding GHG reduction targets that the Effort Sharing Regulation (ESR) determines for each of the EU Member States in the sectors not covered by the EU’s first ETS (ETS 1), which addresses the energy sector, manufacturing industry, aircraft operators within the EU, Switzerland and the United Kingdom, and maritime transport.

The ETS 2 was planned to commence in January 2027, but EU environment ministers agreed on 5 November 2025 to postpone its start by one year. The European Parliament voted in favor of this postponement on 13 November 2025. However, this decision was added as a stand-alone provision to the Regulation changing the European Climate Law. The ETS Directive, which only allows for a delay by one year in the event of exceptionally high energy prices (Article 30k, ETS Directive), has not (yet) been changed. This has raised questions regarding the legal character of the postponement decision.

Over the course of 2025, several Member States and stakeholders have raised concerns about possible ETS 2 allowance price developments and societal impacts. Consequently, they put forward several proposals for changing the ETS 2 to address their worries. This report provides an overview of the main reform proposals published by September 2025 and discusses their possible impacts and procedural feasibility.

Emission reductions in the road transport and building sectors have lagged well behind the pace required to meet EU targets. In the building sector, GHG emissions had fallen by only 14.7% between 2015 and 2022 – far below the trajectory needed for achieving the 2030 target. In road transport, progress has been even weaker, with emissions slightly

increasing relative to 1990 levels. These trends underscore the need for more robust policy instruments to mitigate emissions from these sectors.

The ETS 2 was introduced to accelerate progress. By requiring fuel suppliers and distributors to purchase and surrender emission allowances, the ETS 2 aims to transmit a clear carbon price signal along the supply chain, encouraging households and businesses to improve energy efficiency and shift to low-carbon alternatives.

While mechanisms such as the Social Climate Fund (SCF) and the Market Stability Reserve (MSR) are embedded in the legislation to cushion negative effects on vulnerable groups and to help stabilize prices, concerns persist about whether current safeguards are sufficient to counter regressive outcomes. Possible allowance price spikes could undermine public and political support. As the start date approaches and analyses of price dynamics and distributional effects proliferate, policymakers and stakeholders are actively considering reforms to strengthen the ETS 2 and ensure its success.

A mere postponement of the start from 2027 to 2028 will not address these concerns. Instead, it delays tackling the pressing challenge of reducing emissions in the road transport and building sectors.

In fact, on 27 November 2025 the European Commission proposed targeted amendments to the MSR Decision and the Auctioning Regulation in response to the rising concerns.¹ Specifically, the proposal includes doubling the number of allowances to be released when the allowance price exceeds a threshold of €45 (in 2020 price levels, indexed for inflation) for two consecutive months, extending the MSR operation beyond 2030 and introducing a more gradual release of allowances when the number of allowances in circulation drops to 210-260 million. Moreover, the Commission proposed to start auctions earlier than originally foreseen and explores a new ETS 2 Frontloading Facility. At the time of publishing this report, the Commission proposal was in the lawmaking procedure.

This report examines the main reform proposals that EU Member States and stakeholders have put forward. It focuses on changes to the functioning of the current ETS 2 instead of proposals to abolish or

¹ European Commission. 27 November 2025. *Commission proposes targeted adjustments to the Market Stability Reserve Decision to support a smoother start for ETS2*: https://climate.ec.europa.eu/news-other-reads/news/commission-proposes-targeted-adjustments-market-stability-reserve-decision-support-smoother-start-2025-11-27_en (last accessed on 1 December 2025). European Commission. 27 November 2025. *Proposal for a*

Decision of the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards the market stability reserve for the buildings, road transport and additional sectors. COM(2025)738: [https://ec.europa.eu/transparency/documents-register/detail?ref=COM\(2025\)738&lang=en](https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2025)738&lang=en) (last accessed on 1 December 2025).

delay its implementation since this would not help the EU and its Member States in solving any of the strategic challenges they face. Delaying the ETS 2 would not improve its design, would defer climate action and could jeopardize the EU's legally binding climate targets.

The next section provides an overview of the ETS 2 and its importance as a central EU climate policy. Section 3 summarises key concerns about the ETS 2 and explains how the legislation currently addresses them. Section 4 outlines the reform proposals that Member States and stakeholders have put forward, discusses their possible emissions, economic and societal implications, and considers procedural aspects. The concluding section compares the evaluations of the five proposals and discusses them in the context of EU climate policy.

2 The fallout of scrapping the EU ETS 2

The EU ETS 2 is a landmark addition to the EU's climate policy mix. It is designed to complement both the ESR and the EU ETS 1. While the ESR sets binding annual GHG reduction targets for Member States across a range of sectors not covered by the ETS 1, the ETS 2 introduces a carbon pricing mechanism to help reach those targets in the building and road transport sectors that also fall within the ESR. By pricing emissions, the system will incentivize GHG emission reductions. Using a market-based instrument will ensure these reductions are made in a cost-effective way, thereby decreasing the total societal cost of climate action.

Preparation for the ETS 2's commencement in 2027 (or 2028) has coincided with geopolitical turmoil, high energy prices, sluggish economic growth and growing political polarization, creating a difficult context for governments to proceed with a consumer-facing carbon pricing system such as the ETS 2.

While legitimate concerns exist regarding certain aspects of ETS 2 design and targeted reforms may be warranted, full abolition or postponement would be counterproductive and likely exacerbate the very challenges abolition or postponement claim to address. Delaying the ETS 2, and especially abandoning it altogether, could lead to several severe negative consequences outlined below.

2.1. Failure to meet the EU's legally binding climate targets

The European Climate Law² establishes binding EU-wide GHG reduction targets for 2030 and climate neutrality by 2050. It is being amended in 2025 to add a 2040 target. The ETS 2 constitutes a core instrument for delivering these objectives. Abolishing the ETS 2 without an alternative capable of delivering equivalent emission reductions would be politically, legally and diplomatically problematic. Moreover, even deferring the ETS 2 start to 2028 could pose difficulties for reaching the EU's legally binding targets.

In the absence of the ETS 2, achieving EU targets without additional policy measures is highly unlikely, considering that to date EU-wide emissions in those sectors have decreased either too slowly (in the

buildings sector) or not at all (in the road transport sector). Designing and adopting substitute policy instruments such as bans and minimum performance standards will require long preparation and adoption time and, most likely, entail higher compliance and administrative costs instead of the cost-efficiency and flexibility an ETS offers. Regulatory instruments have proven challenging to enact, as evidenced by, for example, the controversial Buildings Energy Act (Heizungsgesetz) in Germany and the contested EU-level post-2035 ban on the sale of new combustion engine cars. Abolishing the ETS 2 would thus leave the EU without an essential tool to achieve its legally binding climate targets.

2.2. Undermining regulatory certainty for business and risking timely investment decisions

Regulatory certainty and credible commitments are essential prerequisites for irreversible, capital-intensive investments. Firms and households are more likely to undertake expenditures such as electric vehicle purchases, heat pump installations and deep building retrofits, when policy signals imply durable future cost advantages relative to inaction.

Delaying ETS 2 implementation would put on hold many investments that are already planned or have started, leaving affected businesses and households in limbo. For this reason, business associations, including in the heating, energy and automobile sectors, call for adjustments, not for the postponement or abolition of the system.

2.3. Prolongation of dangerous over-dependency on imported fossil fuels

Foregoing the ETS 2 as an important policy tool curbing fossil fuel use would prolong and exacerbate the EU's dependence on energy imports, with the associated geopolitical and balance-of-payments implications. In 2024, the EU spent over €420 billion, which is equivalent to 2.5% of its GDP,³ for fossil fuel imports, many of them sourced from politically unstable regions.

² Regulation (EU) 2021/1119: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R1119> (last accessed on 6 November 2025).

³ European Commission, 26 February 2025. *Report on Energy Prices and Costs in Europe*, COM(2025) 72 final: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52025DC0072> (last accessed on 6 November 2025).

By contrast, the ETS 2 will mobilise investment in low-carbon alternatives within the EU, including clean fuels and related industrial capacities, instead of channelling substantial financial resources to non-EU suppliers. Furthermore, by driving demand for domestic clean energy and efficiency solutions, the ETS 2 will help shield European households and businesses from the volatility of global fossil fuel markets, enhancing energy security and price stability across the EU.

2.4. Compromising the EU's role as global climate and clean technology innovation leader

The international ramifications of postponing or abolishing the ETS 2 would be significant. The Paris Agreement's architecture relies on countries signaling and implementing ambitious national climate measures. The EU has long acted as a credibility anchor, illustrating the compatibility of emissions mitigation with economic growth and welfare improvements. A retreat from ambition due to a failure to achieve its binding climate targets would weaken international mitigation efforts and heighten the probability of crossing climate tipping points with potentially irreversible impacts.

Moreover, the EU would abandon its position as leader in climate innovation and low-carbon technologies. The ETS 2 will stimulate innovation and job creation within the EU's clean energy and technology sectors, helping to build a robust internal and export market for renewable technologies, heat pumps and electric vehicles.

This not only supports the EU's climate goals but also enhances strategic autonomy by reducing reliance on volatile global markets and the associated political risks. It strengthens the EU's competitiveness on global markets.

2.5. Forgoing a chance to address energy poverty using ETS 2 revenues

The ETS 2 is creating a new revenue stream for Member States that could help address the energy poverty that 41 million people across Europe currently face.⁴ Member States' shares of ETS 2 revenues are substantial: Under a moderate carbon price assumption of approximately €55 per tCO₂, aggregate revenues could reach around €195 billion.⁵ Postponing the ETS 2 to 2028 would reduce these revenues and also the maximum size of the SCF to

€54,6 billion instead of €65 billion (Article 30d, ETS Directive). This means fewer available resources for much needed support for households and micro-businesses.

Channeled into targeted programs such as improving the energy efficiency of housing, upgrading heating systems and expanding reliable, safe alternatives to private car use, ETS 2 revenues can mitigate distributional impacts while tackling underlying structural drivers of high energy expenditure. This, in turn, can enhance social acceptability and accelerate emission reductions by aligning short-term relief with long-term investment.

2.6. Increasing future costs of adaptation and disaster recovery

Delaying emission reductions implies higher cumulative GHG emissions and raises the expected costs of adaptation, disaster recovery following extreme weather events and agricultural losses, among other damages. These costs can exceed the costs of timely mitigation, falling disproportionately on young generations. By contrast, if mitigation is implemented today, future damage and irreversible change are reduced.

Text box 1: How an ETS works

An emissions trading system (ETS) sets a cap on the number of greenhouse gases that covered sectors can emit. Under this cap, companies must hold one allowance for every tonne of CO₂-equivalent they emit. Regulators create and release a finite number of allowances, typically via auctions, often complemented with some free allocation. In most systems, the cap declines over time. Firms that reduce emissions below their allowances can sell the surplus; those facing higher abatement costs can buy additional allowances. This creates a market price for carbon that reflects scarcity and drives least-cost emission reductions across the economy.

The main advantages are efficiency, certainty on environmental outcomes, and innovation incentives. A fixed (and tightening) cap delivers predictable emissions reductions, while trading ensures they happen where it's cheapest, minimizing overall compliance costs. The carbon price rewards early movers and clean technologies, encouraging investment and innovation. Market transparency and revenue from allowance auctions can support fairness.

⁴ European Parliamentary Research Service. February 2022, *Energy Poverty in the EU*, Briefing: [https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733583/EPRS_BRI\(2022\)733583_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2022/733583/EPRS_BRI(2022)733583_EN.pdf) (last accessed on 6 November 2025).

⁵ See figure 2 in section 4.2 for a breakdown of ETS 2 revenue distribution and spending: Social Climate Fund and Member State allocations (2026-2032).

3 Key concerns and their current remedies

Despite the ETS 2's major potential contributions as outlined in the previous section, the system sparked debate already at its design stage about its societal and economic impact. In particular, the risk that allowance price spikes could undermine public and political support shaped discussions. In response, the adopted legislation includes several important provisions to address these concerns, which are described in this section.

3.1. Risk of elevated and volatile prices

In an ETS, the carbon price is market-determined rather than administratively set. It can sometimes be volatile and occasionally excessive. Sharp price spikes that rapidly raise fuel costs for households and small businesses can have considerable societal and economic impacts and therefore risk eroding public and political support.

To mitigate this risk, the ETS 2 includes a Market Stability Reserve (MSR): If there are only few emission allowances in circulation in the carbon market or if allowance prices exceed specified thresholds for a sustained period, additional allowances may be released to stabilize the market. Additionally, a so-called soft price cap is activated when the allowance price exceeds €45 (in 2020 price levels, indexed for inflation) for two consecutive months, which also leads to an extra allowance release. Moreover, the start of the system may be postponed by one year if energy prices are exceptionally high in the run up to implementation.

3.2. Distributional impacts within Member States

Carbon pricing in high-income countries often exhibits regressive effects, as lower-income households spend a larger share of their income on energy and transport.

To address this, the ETS 2 is paired with the Social Climate Fund (SCF), which channels revenues from allowance auctions to targeted support for vulnerable households, micro-enterprises and transport users. Figure 2 in section 4.2 provides an overview of the total ETS 2 revenue use. Support instruments include limited direct income assistance (up to 37% of available funds), investments in energy efficiency and measures to expand access to sustainable mobility.

The SCF will be available to all 27 Member States, provided they successfully submit to the European Commission their respective national Social Climate Plan (SCP). The SCF is capped at a fixed amount of €65 billion, coupled with further €21.7 billion of co-financing from Member States. In the event of an ETS 2 commencement in 2028, however, the SCF maximum amount is only €54,6 billion (Article 30d, ETS Directive).

3.3. Distributional impacts between Member States

The ETS 2 will set a uniform carbon price across the EU, but substantial cross-country differences in average household income imply that an identical price can impose uneven burden. The ETS 2 therefore redistributes a portion of the revenue towards Member States with larger shares of vulnerable citizens.

The SCF allocation formula accounts for factors such as population size, poverty rates and energy poverty indicators, directing a greater share of funds to more vulnerable countries. The largest allocation shares are expected for Poland (17.6%), France (11.19%), Italy (10.81%), Spain (10.52%), and Romania (9.25%). Adjusted for smaller population sizes, Slovakia (2.35%) and Hungary (4.33%) will also receive significant support.

The built-in safeguards aim to ensure the ETS 2's societal fairness and political feasibility, while maintaining its environmental effectiveness. With the system's launch drawing nearer and as analyses of price behavior, distributional effects and MSR performance proliferate, policymakers and stakeholders are actively examining options to explore how the remaining concerns can be addressed. The following section discusses and evaluates the proposals for amending the ETS 2 Member States and stakeholders have put forward.

4 Reform proposals and their impacts

The various reform proposals aim to further strengthen the measures addressing the concerns identified in the previous sections. They target different pieces of legislation and activities including the ETS Directive, but also the MSR Decision, the Auctioning Regulation, the Social Climate Fund Regulation and activities the European Commission could undertake. The proposals are complementary and not mutually exclusive or incompatible. They rather address different concerns and provisions of the ETS 2.

Our analysis focuses on the EU level only and excludes proposals that are targeted at Member State policy. National level actions are, however, central to the success of the ETS 2. The report touches upon these actions and their role, as they inevitably emerge in several places throughout our analysis.

We identified the different reform proposals based on a synthesis of Member State and stakeholder papers proposing ETS 2 change published by September 2025. We found eight papers that are listed in table 1. Further details are provided in annex 1.

The main reform proposals that we identified are:

- Reforming the Market Stability Reserve (MSR)
- Frontloading revenues
- Strengthening the Social Climate Fund (SCF)
- Early auctions
- Improving information provision

Reforming the MSR and strengthening the SCF can be done through various sub-elements and are grouped because they pertain to the same ETS 2 provision such as the MSR or the SCF.

For each of the proposals, we discuss the likely emissions, economic and societal impact, based on a review of academic and think tank studies, available data and qualitative assessment.

The discussion of each proposal ends with procedural considerations on the required activity to implement the proposed change. The required changes range from amending the ETS Directive to the European Commission issuing a statement. They imply very different timelines and levels of difficulty, and can be categorized as:

Administrative activities: There is some scope for the European Commission and other actors to engage in activities that can help improve the functioning of the ETS 2 and its implementation, based on existing provisions and without requiring any legal change.

Organisations	Paper title
Carbon Market Watch & others	EU ETS revenues from polluters to the people
Carbon Market Watch & other NGOs	Joint letter to establish an EU lending facility for ETS2 revenue for member states
EPICO & Frontier Economics	Strengthening the EU ETS 2 through revenue frontloading
France	Revision of price stabilisation mechanisms for EU ETS 1 and ETS 2 (non-paper from the French authorities)
Austria, Belgium, Bulgaria, Croatia, Czechia, Estonia, Germany, Italy, Latvia, Lithuania, the Netherlands, Poland, Romania, Slovakia, Slovenia, Spain	Revision of price stabilisation mechanisms for EU (non-paper)
Transport & Environment	How to turn the ETS 2 implementation into a success
Klimaallianz, Germanwatch, WWF, BUND & others	5-Punkte-Plan: EU-Emissionshandel für Gebäude und Verkehr effektiv und sozial gerecht in Deutschland umsetzen
CAN Europe	CAN Europe views on ETS2

Table 1: Overview of the analyzed proposals for ETS 2 reform

Amendments to ETS 2-related laws: Several changes could be implemented by revising laws that are related to the implementation of the ETS 2. This includes the MSR Decision and the Auctioning Regulation. These laws tend to be narrow in scope.

Changes requiring EU ETS Directive revision: Other reforms would necessitate amending the EU ETS Directive.

The pathway of amending the ETS Directive is broader in scope and riskier than amending related laws. Reopening the ETS Directive could expand the range of issues subject to amendment, potentially delaying decisions and weakening the ETS 2 as a result rather than the envisaged improvements.

This is the case because even if the European Commission proposes limited and targeted changes to the ETS Directive, nothing prevents the European Parliament and the Council of Ministers from adding amendments to other provisions. Ultimately, the European Commission has of course the right to withdraw its legislative proposal at any time of the process (Article 294, Treaty on the Functioning of the EU),⁶ but this would not serve the purpose of implementing the envisaged changes. Reopening the ETS Directive could therefore be a lengthy and politicized process with an uncertain outcome that risks not yielding the envisaged changes.

By 1 January 2028 (or 2029, in case of ETS 2 postponement), the European Commission must report on ETS 2 implementation and where appropriate make a legislative proposal for changes (Article 30i, ETS Directive).⁷ This could provide an opportunity for changing provisions of the ETS Directive. It would however be too late for changes that target the first years of ETS 2 operation.

Under normal circumstances, legislative changes via the Ordinary Legislative Procedure, which is applicable in the cases of the ETS Directive and the MSR Decision, require the European Commission to initiate the process. It has the prerogative to make a legislative proposal. Although the European Parliament and the Council of the EU cannot start the process by making a legislative proposal, they may request the Commission to consider a legislative proposal (Article 293, Treaty on the Functioning of the EU). Although the Commission is not obliged to issue a legislative proposal reflecting the changes requested by Parliament or the Council, it must justify its decision. If there is sufficient support for certain changes, it would politically be difficult for the Commission not to respond to the requests.

Overall, changes that can be implemented through revisions of related laws and administrative activities could be easier, faster and provide more certainty of achieving the envisaged result.

This is what the European Commission initiated with its 27 November 2025 proposal. It proposed targeted amendments to the MSR Decision and the Auctioning Regulation.⁸

The following subsections delve into the five reform proposals. Since they predate the November decision to postpone the ETS 2 to 2028, they refer to a 2027 start and would require certain adjustments if the ETS 2 were to start only on 1 January 2028.

⁶ European Union, Consolidated Version of the Treaty on the Functioning of the European Union, *Official Journal of the European Union* C 202, 7 June 2016, 196: https://eur-lex.europa.eu/resource.html?uri=cellar:9e8d52e1-2c70-11e6-b497-01aa75ed71a1.0006.01/DOC_3&format=PDF (last accessed on 6 November 2025).

⁷ European Union, Directive (EU) 2023/959, 189.

⁸ European Commission. 27 November 2025. *Commission proposes targeted adjustments to the Market Stability Reserve Decision to support a smoother start for ETS2*. European Commission. 27 November 2025. *Proposal for a Decision of the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards the market stability reserve for the buildings, road transport and additional sectors*. COM(2025)738:.

4.1. Reforming the Market Stability Reserve

Price levels and volatility have been central to the ETS 2 debate from the outset. In response, the ETS Directive provides for an MSR that can be activated when prices rise too quickly or to excessively high levels. The MSR Decision⁹ stipulates that the placement of allowances into the MSR will operate only from 1 September 2028 and that the MSR will cease in 2031.

The MSR can be activated through three mechanisms:

Soft price cap: If the allowance price exceeds €45 (in 2020 price levels, indexed for inflation) for two consecutive months, 20 million allowances are released from the MSR to temper the price increase. This provision expires on 31 December 2029, by which date the European Commission must report on its effectiveness and may make a new legislative proposal (Article 30h (2) and (5), ETS Directive).¹⁰

Rapid price increase: If, for more than three consecutive months, the average allowance price is more than twice the average price over the preceding six months (or 1.5 times in 2027 and 2028), 50 million allowances are released. If the average price over three consecutive months exceeds three times the preceding six-months average, 150 million allowances are released (Article 30h (1) and (3), ETS Directive).¹¹

After any of these releases, no further allowances can be injected for the subsequent 12 months. However, for the soft price cap, the Commission may modify this constraint via an Implementing Act. If the allowance price again exceeds €45 (2020 prices, inflation-adjusted) during the second half of the 12-month period, the trigger may be activated a second time (Article 30h (6) and (7), ETS Directive)¹².

While the first two mechanisms are linked to the allowance price, the third is linked to the number of allowances in circulation.

Number of allowances in circulation: If the number of allowances in circulation falls below 210 million, 100 million allowances are released from the MSR. Conversely, if allowances in circulation exceed 440 million, 100 million are withdrawn and placed into the MSR (Article 1a (5) and (6), MSR Decision).¹³

Although it incorporates three mechanisms for injecting additional allowances into the ETS 2 market, concerns about volatility and high carbon prices persist among Member States¹⁴ and stakeholders.¹⁵ Existing stabilization measures are viewed as inadequate, prompting a range of proposals to reform the MSR.

4.1.1. Higher allowance injections for the soft price cap and the number of allowances in circulation measure

The MSR has been criticized for the relatively small release of 20 million allowances under the **soft price cap** when the carbon price exceeds €45 (in 2020 prices), a modest quantity relative to the estimated market size of the entire ETS 2. For 2027, the cap will amount to 1,036,288,784 allowances. 20 million allowances may be insufficient to dampen price spikes and stabilize the market at an acceptable level.¹⁶

It has also been proposed to increase releases to more than 100 million when the **number of allowances in circulation** falls to 210 million. In a very tight market, larger injections would strengthen the mechanism's ability to moderate prices.¹⁷

Operationally, larger releases could be implemented through a top-up mechanism included in the MSR Decision. There is, however, a difference between the

⁹ Decision (EU) 2015/1814: <https://eur-lex.europa.eu/eli/dec/2015/1814/oj/eng> (last accessed on 6 November 2025).

¹⁰ European Union, 16 May 2023. Directive (EU) 2023/959 of the European Parliament and of the Council of 10 May 2023 amending Directive 2003/87/EC as regards the extension of the scope of the EU Emissions Trading System, the inclusion of emissions from maritime transport activities and the establishment of a new system for buildings and road transport, and amending Regulation (EU) 2015/757, *Official Journal of the European Union* L 130, 188–189: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023L0959> (last accessed on 6 November 2025).

¹¹ European Union, Directive (EU) 2023/959.

¹² *Ibid.*, 189

¹³ European Union, 1 January 2024, *Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC*, consolidated version, 4-5: [https://eur-](https://eur-lex.europa.eu/eli/dec/2015/1814/oj/eng)

[lex.europa.eu/eli/dec/2015/1814/oj/eng](https://eur-lex.europa.eu/eli/dec/2015/1814/oj/eng) (last accessed on 6 November 2025).

¹⁴ Government of France, 19 March 2024. *Revision of Price Stabilisation Mechanisms for EU Emission Trading Schemes (ETS 1 and ETS 2)*: Non-paper: <https://carbon-pulse.com/wp-content/uploads/2025/04/FR-ETS-non-paper-pdf> (last accessed on 6 November 2025).

¹⁵ European Roundtable on Climate Change and Sustainable Transition (ERCST). May 2025., *2025 State of the EU ETS Report*: <https://ercst.org/wp-content/uploads/2025/05/2025-State-of-the-EU-ETS-Report.pdf> (last accessed on 6 November 2025).

¹⁶ Government of France, *Revision of Price Stabilisation Mechanisms*. Austria, Belgium, Bulgaria, Croatia, Czechia, Estonia, Germany, Italy, Latvia, Lithuania, the Netherlands, Poland, Romania, Slovakia, Slovenia, and Spain. 25 June 2025., *Joint Non-paper on ETS2 Price Uncertainties and Possible Improvements*: <https://carbon-pulse.com/wp-content/uploads/2025/06/Joint-Non-paper-ETS2-update.pdf> (last accessed on 6 November 2025).

¹⁷ Austria et al., *Joint Non-paper on ETS2 Price Uncertainties*.

Text box 2: Overview of market stability measures

Soft price cap: If the allowance price exceeds €45 (in 2020 price levels) for two consecutive months, 20 million allowances are released.

Rapid price increase: If, for more than three consecutive months, the average allowance price is more than twice the average price over the preceding six months, 50 million allowances are released. If the average price over three consecutive months exceeds three times the preceding six-months average, 150 million allowances are released.

Number of allowances in circulation: If the number of allowances in circulation falls below 210 million, 100 million allowances are released. If allowances in circulation exceed 440 million, 100 million are withdrawn and placed into the MSR.

two provisions. The soft price cap is included in the ETS Directive while the number of allowances in circulation provision is part of the MSR Decision. This could mean that changes to the soft price cap might require a change of the ETS Directive, but a top-up that is additional to the ETS Directive could be made via the MSR Decision. Equally, the number of allowances in circulation provision can be adjusted by changing the MSR Decision.

4.1.2. Higher frequency of interventions

The annual activation limit has been cited as constraining the MSR's responsiveness to price surges. In this context, several actors propose strengthening the activation frequency of the soft price cap.¹⁸ Ensuring the permissible frequency of activations could curb price spikes more effectively, given that the current rule allows one activation every 12 months, with the optional possibility to activate it a second time after six months.

Activating the soft price cap twice in 12 months could easily be implemented because it is already permitted by the ETS Directive, but it is optional and depends on the European Commission's decision to make use of the provision. To ensure regulated entities of its intention to use this possibility, the European Commission could issue a commitment to initiate the procedure permitting a second intervention after a minimum of six months (Article 30h (7), EU ETS Directive),¹⁹ thereby confirming that two

interventions per 12 months will occur if trigger conditions are met.

Changing the frequency of the other two market stability measures or activating the soft price cap more often than twice in 12 months requires changes to the ETS Directive for the soft price cap and the rapid price increase and to the MSR Decision for the number of allowances in circulation measure.

4.1.3. More gradual MSR activation approach

Another criticism targets the fixed activation threshold of 210 million allowances under the number of allowances in circulation provision, which can create a threshold effect. The current rule of releasing 100 million allowances once the number of allowances in circulation drops below 210 million lacks nuance and may induce unnecessary volatility, as small fluctuations around the threshold can trigger abrupt injections. A shift towards a gradual, rule-based approach has therefore been proposed. This could smoothen volatility and promote a more stable carbon price.²⁰

A revision of the tight market provision would require a change of the MSR Decision. This could include the trigger as well as the quantities.

4.1.4. Earlier start of the MSR

The late start of MSR operations has also drawn criticism. Under the MSR Decision, injections may begin only from September 2028 onwards (Article 1a (2), MSR Decision),²¹ roughly 21 months after the ETS 2 becomes fully operational, precluding early intervention.

One proposal is to permit injections from September 2027, based on verified emissions from 2024–2026.²² Advancing the start date could help maintain acceptable price levels during the rollout phase. The MSR will be filled with 600 million allowances in 2027 (Article 30d (2), ETS Directive). Implementing this change would require a revision of the MSR Decision.

4.1.5. Extension beyond 2031

Extending the MSR beyond 2031 has been recommended by the French government.²³ Unlike the EU ETS 1 MSR, the ETS 2 MSR is set to expire in

¹⁸ Government of France, *Revision of Price Stabilisation Mechanisms*; Austria et al., *Joint Non-paper on ETS2 Price Uncertainties*.

¹⁹ European Union, Directive (EU) 2023/959, 189.

²⁰ Government of France, *Revision of Price Stabilisation Mechanisms*; Austria et al., *Joint Non-paper on ETS2 Price Uncertainties*.

²¹ European Union, Decision (EU) 2015/1814, 4.

²² Government of France, *Revision of Price Stabilisation Mechanisms*.

²³ Government of France, *Revision of Price Stabilisation Mechanisms*; Austria et al., *Joint Non-paper on ETS2 Price Uncertainties*.

2031 (Article 1a (3), MSR Decision),²⁴ potentially leaving later price spikes and volatility unaddressed.

An allowance shortage is anticipated in the early 2030s as frontloaded allowance supply will be absorbed. This refers to the provision that in the first year of ETS 2 operation 130% of the auctioning volume for 2027 will be auctioned to ensure market liquidity. The excess 30% will be deducted from auctioning volumes during the 2029-2031 period (Article 30d (2), ETS Directive). Removing the end date and continuing the MSR could mitigate these risks and strengthen market confidence. If extended, a calibrated reduction in releases could be considered.

Extending the MSR's duration would require a change of the MSR Decision. Table 2 provides an overview of the concerns raised by Member States and stakeholders and the corresponding MSR-related reform proposals.

Concerns	Proposed solutions
High ETS 2 prices during the starting period	Higher allowance injection for the soft price cap
	Higher allowance injection for the tight-market provision
	Higher frequency of interventions
	More gradual MSR activation approach
	Earlier start of the MSR
Risk of elevated and volatile prices	Extension beyond 2031
	Greater frequency of interventions
	More gradual MSR activation approach
	Earlier start of the MSR
	Extension beyond 2031

Table 2: Overview of concerns and corresponding measures in the MSR-related reform proposals

4.1.6. Emissions impact

Revising the MSR primarily affects the distribution of emissions over time rather than their cumulative quantity. Because the ETS cap remains unchanged, allowances placed in or released from the MSR still count within the ETS 2's foreseen allowances; the total emissions budget is therefore fixed over the system's duration. MSR revisions do not increase aggregate GHG emissions.

However, the timing of abatement is likely to shift. If the proposed MSR reforms are effective, near-term allowance prices could settle around €45 (2020

prices), which is lower than in most no-reform scenarios.²⁵ Price increases could be shifted to the future. Lower prices reduce the immediate incentive for abatement investments where marginal abatement costs exceed the allowance price. The lower price could encourage regulated entities to pay for emissions and defer investment. This would increase emissions during the early years of the ETS 2 compared to a higher-price scenario, even though the cap ultimately constrains total emissions of the entire ETS 2. The resulting early-period emissions profile implies higher atmospheric concentrations, with potential implications for climate risks such as tipping points and path-dependent, irreversible impacts.

The abatement investment incentives are, however, equally influenced by other policies and provisions such as strategic investments through the Social Climate Fund and other ETS 2 revenues. This is further discussed in section 4.2 and demonstrates that the different ETS 2 design provisions interact and should not be considered in isolation.

One practical consideration of the MSR-related reform proposals has not been problematized yet. It relates to the volume of the MSR. More frequent or higher allowance injections could deplete the MSR quicker than in the no-change scenario.

The MSR will be filled with 600 million allowances in 2027 (Article 30d (2), ETS Directive) and could additionally be filled when the number of allowances in circulation exceeds 440 million allowances.²⁶ In this case, 100 million allowances will be deducted and placed in the MSR (Article 1a (5), MSR Decision).²⁷ Since most studies predict a tight rather than a loose market, replenishing the MSR via Article 1a (5) seems unlikely. This means that when the initial 600 million allowances are used, currently there is no provision to place additional allowance in the MSR. It is not clear from where they could come if a loose market situation does not occur. This means that all current triggers would naturally cease when the MSR is depleted.

4.1.7. Economic impact

For firms, changes to the MSR and greater regulatory certainty could yield financial benefits that derive not only from lower expected prices but also from reduced volatility.

Greater price predictability and strong political commitment improve investment planning, lowers the option value of waiting with abatement investment decisions and can bring forward capital

²⁴ European Union, Decision (EU) 2015/1814, 4.

²⁵ Claudia Günther et al., 2023. *Carbon Prices on the Rise: Shedding Light on the Emerging Second EU Emissions Trading System* (EU ETS 2). Berlin: Agora Energiewende.

²⁶ European Union, Directive (EU) 2023/959, 184–187.

²⁷ European Union, Decision (EU) 2015/1814, 4–5.

deployment compared to scenarios characterized by elevated uncertainty and price volatility.

4.1.8. Societal impact

Lower and more stable allowance prices would likely yield positive societal and, by extension, political effects. Household impacts, especially for low-income groups, would be moderated relative to a no-reform scenario with higher and more volatile prices.

Lower and steadier prices would create a context in which the Social Climate Fund, complementary revenue recycling and other companion policies can more effectively mitigate regressivity; the higher the carbon price, the more extensive such measures need to be.

4.1.9. Procedural considerations

The proposed revisions differ in complication and risk. Confirming commitment to two soft price cap activations per 12 months is comparatively straightforward since the legal provision already exists. A Commission statement signaling readiness to initiate the enabling procedure could provide near-term certainty and bolster market confidence.

Several other proposed changes including topping up allowance injections under the soft price cap and the number of allowances in circulation provisions, bringing forward the MSR start date and extending the MSR duration could be implemented by revising the MSR Decision. Other proposed reforms would necessitate amending the EU ETS Directive.

Timing is critical for certain measures. Advancing the MSR start date, and consequently any associated adjustments to trigger design and allowance volumes, would need to be enacted swiftly to influence early-phase price formation. If there is sufficient political support for these changes, they should be initiated soon.

Where feasible, revising the MSR Decision offers a more targeted and timelier route since it is narrower in scope focusing on market stability only. It seems a more realistic option but even this pathway would need to be initiated as soon as possible for the changes to enter into force on time. Table 3 provides an overview of the reform proposals and the respective required changes.

Proposed MSR revisions	Required change
Higher allowance injection for the soft price cap	A top-up mechanism via the MSR Decision could be explored as additional measure to the ETS Directive without changing the Directive itself.
Higher allowance injection for the number of allowances in circulation provision	Top-up mechanism via the MSR Decision since the number of allowances in circulation provision is determined by the MSR Decision.
Higher frequency of interventions	If it is limited to triggering the soft price cap twice within 12 months, the Commission declaring its intention could be sufficient. More fundamental changes would require a change to the MSR Decision for the number of allowances in circulation measure and to the ETS Directive for the rapid price increase measure.
More gradual MSR activation approach	A change of the triggers related to the number of allowances in circulation (tight market) could be implemented by changing the MSR Decision. Changes to the price-related triggers would require changing the ETS Directive.
Earlier MSR start date	Amendment to the MSR Decision.
Extending the MSR beyond 2031	Amendment to the MSR Decision.

Table 3: Proposed MSR revisions and required legal changes for ETS 2 reform

On 27 November 2025, the European Commission proposed three measures in line with some of the proposals for change described in this subsection. Specifically, it proposed to double the number of allowances to be released when the allowance price exceeds a threshold of €45 (in 2020 price levels, indexed for inflation) for two consecutive months, to extend the MSR operation beyond 2030 and to introduce a more gradual release of allowances when the number of allowances in circulation drops to 210-260 million.²⁸

²⁸ European Commission. 27 November 2025. *Proposal for a Decision of the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards the market*

stability reserve for the buildings, road transport and additional sectors. COM(2025)738.

4.2. Frontloading revenues

Questions about sufficiency of the funds available to Member States to timely prepare for the upcoming ETS 2 have been among the concerns raised.²⁹ The ETS Directive envisages auctioning 30% more allowances in 2027 than allocated for that year as a frontloading measure to make revenues available for early decarbonization investments. This amounts to a total of roughly 1,347 million allowances. In the event of a deferred ETS 2 commencement, this figure will be adjusted (Article 30k (c), ETS Directive). Another 50 million ETS 1 allowances are to be auctioned in 2026, and their revenues will be directed to the SCF to support Social Climate Plan (SCP) implementation in the year prior to system start. Still, concerns that these funds will not be enough remain.

Business associations and civil society organizations have proposed to frontload ETS 2 revenues to increase funds available to Member States for decarbonization investments ahead of the system's start.³⁰ Frontloading here refers to making future ETS 2 allowance revenues available to Member States ahead of those auctions taking place.

The rationale is that early financial support enables Member States to prepare for the impact of the ETS 2, particularly by supporting low- and middle-income households and facilitating investments that reduce carbon emissions in buildings and road transport. These reductions can result in lower demand for allowances and thus lower carbon prices once the system starts. Figure 1 illustrates the impact chain from revenue frontloading to lowering ETS 2 prices. The proposal does not suggest changes to the auctioning schedule; thus, no market distortion should arise.³¹

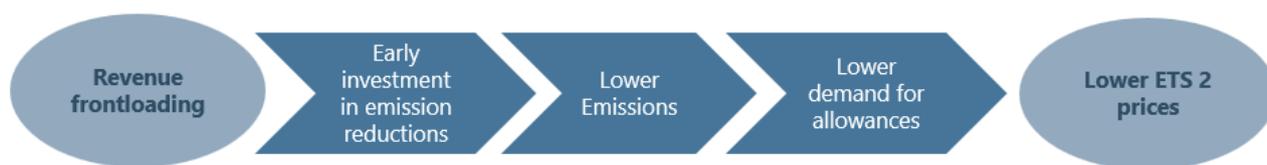


Figure 1: Impact chain from revenue frontloading to lowering ETS 2 prices

The proposed frontloading would involve establishing an EU lending facility, possibly managed by the European Investment Bank (EIB), that would extend loans to Member States guaranteed by future ETS 2 revenues. These loans would be used for investment-related spending in 2026 and 2027 and subsequently repaid from future auction revenues.³²

Proposals stress that such financing should uphold SCF spending principles, e.g. targeting primarily vulnerable groups and be aligned with SCPs. Loans received under this mechanism should not count against national debt and be voluntary for Member States, according to the proponents.³³

The size of available funding can be significant, because the proposal targets the overall auction volumes, not just the SCF share. Estimates range from EUR 21.6 billion over 2025-2026³⁴ and EUR 50 billion over the 2025-2027 period.³⁵ Since the price levels are still unknown, revenue frontloading needs to be conservative about the assumed price levels.

A robust mix of enabling complementary policies is critical for revenue frontloading to deliver the expected impact. Complementary policies refer to a mix of measures, comprising CO₂ emissions and energy efficiency standards, but also an enabling legislative and administrative framework allowing citizens to uptake emission reduction measures. This includes building renovation and heating replacement support programs, EV leasing programs, fiscal measures for business to decarbonize their car fleet, EV charging network expansion, and many more. Table 4 provides an overview of the concerns raised and how the revenue frontloading proposal aims to address them.

²⁹ Klima-Allianz Germany, May 2024. *Fünf-Punkte-Plan: Bundeshaushalt 2025: Neustart für Verkehrsinvestitionen*: <https://www.klima-allianz.de/publikationen/publikation/fuenf-punkte-plan-bundeshaushalt-2025-neustart-fuer-verkehrsinvestitionen> (last accessed on 6 November 2025).

³⁰ Carbon Market Watch, 10 December 2024. *Joint Letter: EU ETS Revenues from Polluters to the People*: <https://carbonmarketwatch.org/publications/joint-letter-eu-ets-revenues-from-polluters-to-the-people/> (last accessed on 6 November 2025). Sofie Defour, Juliette Egal, Federico Terreni. 2025. *How to Turn the ETS2 Implementation into a Success*. Transport & Environment.

EPICO KlimaInnovation and Frontier Economics. 2025. *Strengthening the EU ETS 2 through Revenue Frontloading*: <https://epico.org/en/policy-report-strengthening-eu-ets-2-through-revenue-frontloading> (last accessed on 6 November 2025).

³¹ Ibid.

³² Ibid.

³³ Ibid.

³⁴ Defour et al., *How to Turn the ETS2 Implementation into a Success*.

³⁵ EPICO KlimaInnovation and Frontier Economics, *Strengthening the EU ETS 2 through Revenue Frontloading*.

Concerns	How the proposal addresses
High ETS 2 prices	Provides additional funds for upfront investments into decarbonization measures, curbs demand for ETS 2 allowances, decreases ETS 2 price
Distributional impact within Member States	Co-finances implementation of Social Climate Plans allows Member States to provide more financing for emissions reduction measures to vulnerable groups, incl. low-income households, vulnerable transport users and small business.

Table 4: Overview of concerns and corresponding measures in the revenue frontloading-related reform proposals

4.2.1. Emissions impact

The impact of the proposed revenue frontloading on GHG emission is twofold. On the one hand, it does not envisage changes to the cap, which means that the overall number of emissions within the system will not change.

On the other hand, the timing of emission reductions could change. Through the availability of additional financial resources in 2026-2027, companies and consumers have greater incentives to invest in low-carbon alternatives. This will reduce emissions early, reducing risks of climate tipping points and irreversible climatic changes.

4.2.2. Economic impacts

Additional two-digit billions of Euros for low-carbon investments in the road transport and building sectors, available early on, could speed up the development of lead markets for low-carbon technologies, thereby enhancing Europe's potential to become a front-runner in the race for green solutions in both sectors.

Frontloaded funds can help create stable demand for low-and-zero-carbon solutions in both sectors, providing industry with the certainty it needs to invest in and expand production of low-carbon materials and technologies. Equally, it provides certainty for projects that implement renewable

energy-based solutions (e.g. offering heat pumps as a standard option for heating replacement).

Small businesses, especially micro-enterprises eligible for support from SCF and those looking into renovating their vehicle fleet, will also benefit from support available early on, avoiding further carbon lock-ins and related disadvantages in the coming periods.

4.2.3. Societal impact

Where and how effectively revenues are spent is very important since this determines how many emissions are reduced and to what extent they address key distributional concerns.

Studies show that the effectiveness of complementary policies is the main factor impacting ETS 2 price determination.³⁶ Under a scenario of strong effectiveness of legislated energy efficiency policies,³⁷ ETS 2 prices in 2030 are expected to stay at reasonable 71 €/tCO₂ but risk to spike to over €260 should those policies be only weakly effective.

The Ariadne project yields similar conclusions. Looking at the range of the most recent modelling studies, the project concludes that ETS 2 prices in 2030 could stay below €100. Main drivers for such an outcome are complementary policies and high technological innovation.³⁸ At €100/tCO₂, prices of diesel and gasoline are projected to rise just slightly above the past 20-year average and remain well below price hikes observed in the past when triggered by oil price fluctuations, geopolitical and other uncertainties, including the 2022 energy crisis.³⁹ The impact of a €100 ETS 2 carbon price will be more tangible, and without revenue redistribution could result in additional annual costs of €269 for an average EU household with gas boiler or about 58% of the 2020 energy crisis impact.⁴⁰

The impact of the proposal on the ETS 2 prices will depend on the size of frontloaded funds and where they are spent. The proposed amounts of €21.6-50 billion represent roughly 25-60% of the total SCF. This is a sizable addition to Member States resources for timely SCPs implementation.

Moreover, spending revenue earlier should not have negative implications for Member States in later years as investments in energy efficiency, renewable energy heating and cooling and low-carbon transportation

³⁶ Günther et al., *Carbon Prices on the Rise*.

³⁷ Here, the effects of some more recent policy changes, such as revised Energy Performance of Buildings Directive and strengthened ESR targets are not included. See Günther et al., Table B1 for the full list of considered policies.

³⁸ Michael Pahle, 6 December 2023. *Interactions between the New ETS II and National Carbon Pricing Instruments – The Case for ‘Higher’ National Carbon Prices? And What about the Revenues?* Presentation, Bundesministerium für Bildung und Forschung.

³⁹ Defour et al., *How to Turn the ETS2 Implementation into a Success*, 8.

⁴⁰ Keliauskaitė, Ugnė, Ben McWilliams, Giovanni Sgaravatti, and Simone Tagliapietra. 2 July 2024. *How to Finance the European Union's Building Decarbonisation Plan*. Bruegel. <https://www.bruegel.org/policy-brief/how-finance-european-unions-building-decarbonisation-plan> (last accessed on 6 November 2025).

reduce energy use and corresponding emissions permanently. In other words, the positive effects of emission reduction investments implemented in 2026-2027 will extend over the next years, in parallel reducing the overall need for direct income support and other compensation measures for vulnerable groups, as their vulnerability to carbon prices will be curbed early on.

For this reason, the use of funds should be limited to supporting investment measures of SCPs, rather than be used for additional direct income support or other compensation. The latter provides only temporary relief and does not lead to lowering dependency on fossil fuels or help decrease pressure on ETS 2 prices.

Another important consideration is timing. There is a considerable lead time between investment decisions and the moment when these investments produce their expected reductions and get reflected on households' energy bills. In this respect, the proposed revisions should be agreed upon and set in motion within the next 3-6 months, including setting up the EU lending facility. Two more considerations include the robustness and accessibility of the lending facility and uptake of loans by Member States.

4.2.4. Procedural considerations

The proposal does not require changes to the ETS 2 auctioning schedule or changes to the SCF design. Article 13 of the SCF Regulation already allows measures supported by the SCF to be co-financed by other sources, including EU funds.⁴¹

It will require decisions on the EU facility, either on establishing a new one or on amending the rules of an existing one chosen for this purpose. Member States may need to approve their participation and the use of ETS 2 revenues for such guarantees, either via national government's decision or parliamentary action, depending on the required procedures.

Proposal	Decisions needed	Required changes
Frontloading revenue	Decision on rules, governance structure and operational model for the EU facility	May require new regulation or changes to existing laws (for example Regulation (EU) 2021/241 on establishing the Recovery and Resilience Facility) depending on the choice of the fund's legal set-up
	Agreeing on the use of future ETS 2 revenues for loan guarantee	Decisions by the Member States

Table 5: Revision proposals and required changes for Social Climate Fund implementation

The European Commission proposal of 27 November 2025 includes the intention to explore a new ETS 2 Frontloading Facility.⁴²

⁴¹ European Union, 16 May 2023. Regulation (EU) 2023/955 of the European Parliament and of the Council of 10 May 2023 establishing a Social Climate Fund, *Official Journal of the European Union* L 130/1; <https://eur-lex.europa.eu/legal->

[content/EN/TXT/PDF/?uri=CELEX:32023R0955](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023R0955) (last accessed on 6 November 2025).

⁴² European Commission. 27 November 2025. *Commission proposes targeted adjustments to the Market Stability Reserve Decision to support a smoother start for ETS2.*

4.3. Strengthening the Social Climate Fund

Because the ETS 2 introduces a uniform carbon price, concerns of uneven and unfair burden distribution between Member States and between different socio-economic groups within Member States have been widely raised and acknowledged. The Social Climate Fund, run by the European Commission, has been set up in response alongside the ETS 2 as a solidarity measure to address both concerns.

First, it provides targeted support to groups deemed most vulnerable to the introduction of the ETS 2 carbon price within each Member State. This is done through the financing of policy measures put forward in national SCPs. Identifying such vulnerable groups, referred to in the legislation as “vulnerable households”, “vulnerable micro-enterprises” and “vulnerable transport users”, and designing a set of measures and investments to provide the necessary support to them are tasks of each Member State. The SCF Regulation defines how Member States must prepare, consult on, structure, and submit their SCPs. The Commission evaluates and approves them for funding. It also approves the payments, which are conditional on achieving milestones and targets for the measures and investments in SCPs, giving the Commission a useful leverage in ensuring funds are spent effectively and deliver expected results.

Second, the SCF Regulation sets maximum allocation amounts from the SCF to each Member State to reflect significant differences between Member States that affect each country's vulnerability to the ETS 2. These factors include total population, share of households at risk of energy poverty, gross national income, CO₂ emissions in the housing sector, among others. Annex II to the SCF Regulation sets out the maximum amounts for which each Member State is eligible. In addition, the EU ETS Directive specifies annual limits for allocations from the SCF.

The total size of the SCF is capped at €65 billion if the ETS 2 starts in 2027 and at €54,6 billion if it is pushed to 2028. In addition, Member States must co-finance their national SCPs with at least 25% of the total SCP cost (Article 15, SCF Regulation).⁴³ Member States can, but are not obliged, to use their national ETS 2 revenues for this purpose. Figure 2 provides an overview of ETS 2 revenue distribution and spending.

There are three main reform proposals regarding the SCF: First, lifting the upper limit of €65 billion and, second, making more resources available for the implementation of SCPs. Both proposals address in-country burden distribution concerns, calling for more support to be made available to those most vulnerable to carbon pricing. The third proposal calls for more transparency and robustness in SCPs implementation.

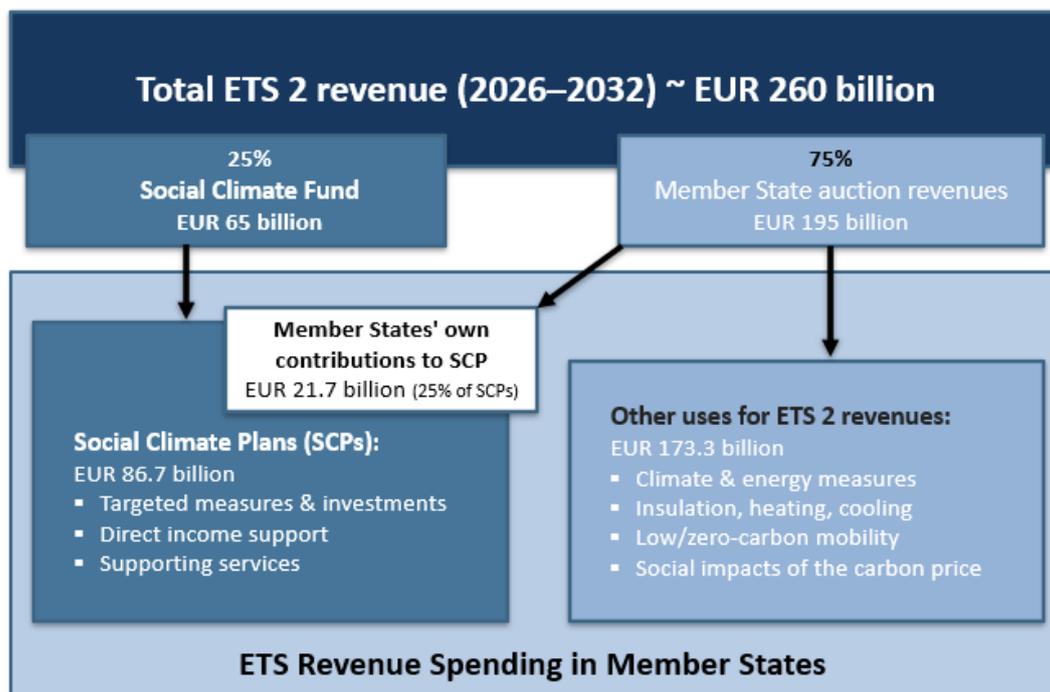


Figure 2: Breakdown of ETS 2 revenue distribution and spending: Social Climate Fund and Member State allocations (2026-2032)

⁴³ European Union, Regulation (EU) 2023/955, 18.

4.3.1. Lifting the upper limit

The SCF Regulation establishes a maximum amount of €65 billion to be made available for the implementation of the SCF during the period 2026-2032 (Article 10, SCF Regulation), which would be lowered in the event of a delayed ETS 2 start. The ETS Directive specifies the sources of these funds:

- Auctioning of 50 million ETS 1 allowances (Article 10a (8b), ETS Directive)⁴⁴
- Auctioning of 150 million ETS 2 allowances (Article 30d (3), ETS Directive)
- Auctioning of additional allowances as needed to reach the maximum amount (Article 30d (4), ETS Directive)

It also sets annual limits for allocation to the SCF (Article 30d (4), ETS Directive).

The reform proposal is to lift the upper limit and tie the total SCF budget to actual ETS 2 carbon prices.⁴⁵ That is, the size of the SCF should grow proportionally with the ETS 2 price and hence ETS 2 revenues. In this way the SCF will be flexible and could allocate more resources to vulnerable groups, should the prices rise higher than those used to calculate the currently legislated SCF volume (e.g. €45–€85 per tCO₂ over the period 2026–2032). At the same time, the €65 billion should remain as a fixed minimum SCF amount to ensure compensation measures can be implemented as planned even with lower CO₂ prices.

4.3.2. Additional resources to implement Social Climate Plans

Another part of the proposed reforms is to expand the financing of the SCPs, beyond the legislated SCF and mandatory Member States co-financing.⁴⁶ Considering that the size of the SCF is likely not enough to finance the investments needed to shield low-income groups and provide them with resources to decarbonize their homes,⁴⁷ it is recommended that Member States use more of their national ETS 2 revenues to further strengthen SCPs implementation.

This could be done by changing the SCF legislation (for example, by increasing the mandatory Member State co-financing of the SCPs and thus raising the total SCF envelope beyond €86.7 billion) or by

⁴⁴ According to the November decision by the Council and Parliament, this provision would not be deferred but apply also in 2026.

⁴⁵ Climate Action Network Europe, August 2025. *Position Paper ETS2: CAN Europe Views on ETS2*: <https://caneurope.org/content/uploads/2025/08/Position-paper-ETS2-CAN-Europe-August-2024.pdf> (last accessed on 6 November 2025).

⁴⁶ Carbon Market Watch, *Joint Letter: EU ETS Revenues from Polluters to the People*. Climate Action Network Europe, *Position Paper ETS2: CAN Europe Views on ETS2*,

⁴⁷ Carbon Market Watch. July 2024, *Joint Briefing on the Social Climate Fund: Frequently Asked Questions*:

strengthening the social component of the ETS revenue earmarking provisions as specified in Article 10(3) of the ETS Directive.⁴⁸

4.3.3. Increased transparency and effectiveness of Social Climate Plans implementation

There are also strong calls for improved transparency, sound quality and robust implementation of SCPs⁴⁹ to ensure that they most effectively address possible regressive effects. As shown by various studies complementary policies can help ensure lower allowance prices.⁵⁰

These proposed changes are not paired with the need to make legislative revisions at the EU level. They require diligent implementation of the already approved legislation, both from the side of national governments and the European Commission.

4.3.4. Emissions impact

The proposed expansion of the Social Climate Fund is not expected to have an impact on the level of GHG reduction target or on its achievement. The proposals do not suggest increasing the proportion of SCF to be spent on direct income support,⁵¹ that is for support that does not lead directly to GHG cuts. It thus does not divert the funds away from emission reduction measures but rather facilitates more investments into decarbonization measures. Since ETS 2 revenues in any case must be spent on energy and climate purposes, they have the potential to serve climate goal achievement even if proposed revisions will not be implemented.

4.3.5. Societal impact

The size of the SCF was calculated during the impact assessment and used a carbon price of €45–€85 per tCO₂ over 2026-2032. In a situation of the actual prices rising higher, not an unlikely scenario, there is a risk that the SCF will be insufficient to shield vulnerable groups from an excessive burden. Having a fund that is responsive to ETS 2 prices could give Member States more confidence that they will have

<https://carbonmarketwatch.org/wp-content/uploads/2024/07/Joint-SCF-briefing-080724.pdf> (last accessed on 6 November 2025).

⁴⁸ European Union, Directive (EU) 2023/959.

⁴⁹ CAN Europe, Klima-Allianz Deutschland, and WWF, 2023. *Criteria for an Effective and Socially Just EU ETS 2*. Klima-Allianz Germany, *Fünf-Punkte-plan*.

⁵⁰ Michael Pahle, *Interactions between the New ETS II and National Carbon Pricing Instruments*.

⁵¹ This is currently capped at 37% of the total cost of the Social Climate Plans

additional resources available to support their vulnerable populations if ETS 2 prices spike at certain times, for example, when the MSR response takes time to kick in.

Allocation of more funds to the benefit of low-income households and SMEs can have a direct positive societal impact. Studies show that while on average an ETS 2 price of €70 will have a limited impact on household expenditures, without redistribution measures it will be regressive, thus disproportionately affecting low income households with fewer means to adapt.⁵² Spending more ETS 2 revenues in support of vulnerable groups would better mitigate regressivity, helping more households and SMEs invest in energy efficiency and low-carbon heating and transport alternatives.

It will also generate important co-benefits. Well-designed green investments lead to decreased fossil fuel consumption and energy cost savings, helping to reduce energy poverty, improve health and quality of life of households currently struggling with their energy bills. Accompanied by a good communication strategy that highlights positive changes enabled by ETS 2 revenues, targeted investments could contribute to increasing public support for the system and for climate action more broadly.

Yet, ETS 2 revenues are not infinite, although quite large. Redistributing more revenues to low-income groups potentially leaves fewer funds for non-targeted programs such as railroad expansion and improving grid infrastructure.

Nonetheless, considering how concerned many Member States are with the ETS 2's possible impact on their citizens, it seems reasonable to consider redistributing additional parts of national ETS 2 revenues to support those who will be hit hardest to mitigate the impact and to not leave them behind in the energy transition.

4.3.6. Procedural considerations

The various proposals to strengthen the Social Climate Fund will require changes to different legal documents and actions as summarized in table 6.

Lifting the upper limit of the SCF and tying the maximum amount to the ETS 2 prices would require changes to both the ETS Directive and the SCF Regulation.

Mandating Member States to spend more funds on SCPs implementation requires changes to Recital 31 and Article 15 of the SCF Regulation, but not to the ETS Directive.

For Member States to be able to spend a larger share of their ETS 2 revenue on co-financing the SCPs no change to EU-level legislation is needed. Current legislation prescribes a minimum but not a maximum co-financing share. Article 13 of the SCF Regulation provides for SCPs to be financed from sources other than SCF.

Both the ETS Directive and the SCF Regulation can be changed by Ordinary Legislation Procedure, as discussed in detail in Section 4.1.

Revision proposal	Required changes
Lifting the upper limit of SCF	Changes to both ETS Directive and SCF Regulation
Increasing mandatory co-financing of SCPs by Member States	Changes to SCF Regulation
Increasing voluntary co-financing of SCPs by Member States	At discretion of Member States, no legislative changes at EU level are needed

Table 6: Revision proposals and required changes for strengthening the Social Climate Fund

⁵² Alexander Eden, Iryna Holovko, Johanna Cludius, Nelly Unger, Viktoria Noka, Katja Schumacher, Piotr Gutowski, and Krzysztof Głowacki, 2023. *Putting the ETS 2 and Social Climate Fund to Work*. Öko-Institut e.V.;

<https://www.oeko.de/en/publications/putting-the-ets-2-and-social-climate-fund-to-work> (last accessed on 6 November 2025).

4.4. Early auctions

Starting the allowance auctions six months prior to the official launch of the ETS 2 and spreading the auctioning for the first compliance period, which currently is 12 months, over 18 months could help market participants gain a better view of the expected price. Households, businesses, fuel distributors, and national authorities could better prepare for the entry into force in January 2027 (or 2028). The early auctions would start already in July 2026 (or 2027), and the share of 2027 (2028) allowances would be spread over 1.5 years instead of one year.

4.4.1. Emissions impact

Since the number of allowances as well as the timeline for emissions reporting will remain the same with a start in 2027, there is no anticipated impact on emissions.

4.4.2. Economic impact

Because all ETS 2 allowances will be auctioned from the start, companies are expected to be exposed to the full carbon cost already from 2027. Early auctions will support early price discovery, allowing companies to craft their hedging strategies, integrate carbon cost into pricing models and manage compliance costs ahead of time and with more certainty.

4.4.3. Societal impact

The early price information could help companies and households make informed decisions based on the price signal.

Early auctions will also allow Member States to generate revenue earlier which they can use for support measure programs (see more details in sections 4.2. and 4.3).

4.4.4. Procedural considerations

The ETS Directive's Article 10(4) empowers the European Commission to adopt Delegated Acts concerning the timing, administration and other aspects of auctioning.

Revision proposal	Required changes
Early auctions	Implemented through Delegated Acts

Table 7: Revision proposal and required changes for Early Auctions

On 27 November 2025 the European Commission proposed to start auctions earlier than originally foreseen.⁵³

4.5. Improving information provision

Since the ETS 2 is new, it is difficult for regulated entities and other stakeholders to anticipate price developments and craft their abatement and broader carbon market strategy. Information on several market indicators can facilitate this process.

For this reason, a proposal put forward by several Member State governments is the collection and publication of relevant data, including electric vehicle sales, heat pump installations, building renovation rates, and other relevant sectoral data that directly impact allowance demand, possibly supplemented with market surveys.⁵⁴ Such data can help regulated entities and other stakeholders generate a better understanding of the expected demand for ETS 2 allowances, which can help devise an entity's own investment and market strategy.

Similarly, public forecasts can help national authorities better tailor their policy measures and consumers to gauge the profitability of low-carbon investments.

4.5.1. Impacts

Better information collection and dissemination can help the market function better and has in this sense impacts on emissions, the economy and society. It can support tackling price volatility, but in itself is insufficient to address the problem singlehandedly. It is a useful complementation of other measures.

4.5.2. Procedural considerations

The proposal does not require any legal changes, and the European Commission could initiate the collection and provision of data relatively easily through collaboration with the Statistical Office of the EU (EuroStat) and Member State statistical offices.

⁵³ European Commission. 27 November 2025. *Commission proposes targeted adjustments to the Market Stability Reserve Decision to support a smoother start for ETS2.*

⁵⁴ Government of France, *Revision of Price Stabilisation Mechanisms*; Austria et al., *Joint Non-paper on ETS2 Price Uncertainties.*

5 Conclusions

Overall, the analyzed proposals are neutral with respect to the ETS 2 cap and thus EU-wide ambition; none increases cumulative emissions. Several measures are nevertheless instrumental for bringing abatement forward, most notably frontloading revenues, by enabling early investment in efficiency, clean heating and sustainable mobility. Earlier abatement reduces the need for costly compensation later, moderates allowance demand at launch and can lower near-term carbon prices relative to a no-change scenario. Table 8 summarizes the qualitative evaluation of the five proposals for reforming the ETS 2.

The analyzed proposals tend to converge on the finding that a targeted package of market stability measures and revenue timing can smooth the ETS 2

start-up phase without diluting environmental integrity.

Most of the proposals for revisions also tend to have rather positive socio-economic impacts, especially when it comes to making more resources available for early decarbonization action. The faster emissions are reduced, the fewer money will be needed for cost compensation measures.

At EU level, reform options span different legal instruments and timelines. Several high-impact adjustments can be enacted by revising ETS 2-related laws, principally the MSR Decision and the Auctioning Regulation, offering a narrower scope, faster delivery and lower legislative risk than reopening the ETS Directive.

ETS 2 reform proposal	Environmental impact	Economic impact	Societal impact	Procedural considerations
Reforming the MSR	The timing of abatement could shift to a later stage.	Greater price predictability can improve investment planning.	Lower and more stable prices can yield positive societal effects.	Many of the changes can be implemented through amending the MSR Decision, some require amending the ETS Directive, one through a Commission statement.
Frontloading revenues	The timing of abatement could shift to an earlier stage.	Early investments can help create stable demand for low/zero-carbon solutions	Early investments and effectively spent revenues can address distributional concerns.	A decision on an EU facility is required.
Strengthening the SCF	No discernible effect on emissions.	n/a	An SCF responsive to ETS 2 prices could give Member States more confidence that sufficient funds are available.	Changes to the ETS Directive and the SCF Regulation would be required.
Early auctions	No discernible effect on emissions.	n/a	The early price information could help companies and households make informed decisions.	The Commission could adopt a Delegated Act.
Improving information provision	No discernible effect on emissions.	Better information collection and dissemination can help companies take informed decisions.	Better information collection and dissemination can help consumers take informed decisions.	The Commission could initiate the collection and provision of data.

Table 8: Summary of the qualitative evaluation of the five proposals for reforming the ETS 2

The European Commission has already followed up on some of the proposed changes with its 27 November 2025 proposal that includes measures to strengthen the MSR, early auctions and the frontloading of revenues.⁵⁵ Other elements reviewed in this report, such as changes to the SCF, have not been incorporated. At the time of publishing this report, the Commission proposal was in the legislative procedure and its outcome remains to be seen.

All analyzed proposals predate the November 2025 decision by the Council of Ministers and the European Parliament to postpone the start of the ETS 2 by one year. For this reason, a possible start in January 2028 is not fully considered yet. As discussed in section 2, postponement could jeopardize the EU's legally binding climate targets and would not improve its design to address the raised concerns.

Moreover, questions have been raised regarding the legal character of the postponement decision. It was adopted in the context of the European Climate Law revision. Policymakers added a stand-alone provision to the Regulation amending the European Climate Law stating that the ETS 2 "is postponed until 2028" and that the provisions of Article 30k of the ETS Directive apply (Article 1a, proposed Regulation amending the EU Climate Law). The ETS Directive has so far not been amended, and it still prescribes a start in January 2027. Article 30k only allows for a postponement in the case of exceptionally high energy prices determined by a notice that the European Commission publishes in the Official Journal of the EU. These circumstances are currently not given.

As this report illustrates, the ETS Directive but also many related laws such as the MSR Decision include dates and deadlines, which would need to be reconsidered in the event of a deferred start. While Article 30k of the ETS Directive provides guidance on deferring many provisions, policymakers could consider ensuring that the provisions that aim at incentivising and accelerating investments in reducing emissions in the building and road transport sectors are not delayed to harness the effects outlined in section 4.2 of this report.

It is plausible that ETS 2 postponement could be included in the legislative proposal that the European Commission is expected to submit in mid-2026. The original purpose of this legislative proposal is to revise the ETS 1. The European Commission is only required to report on the implementation of the ETS 2 and where appropriate make a legislative proposal for changes by 1 January 2028 (Article 30i, ETS Directive). It could however open the ETS 2 already in 2026 and introduce certain changes, but with the

risks outlined in section 4 above. The Ordinary Legislative Procedure could be a lengthy and politicized process that risks not yielding the proposed changes but other uncertain outcomes.

Member States play a decisive role. While this report focuses on EU-level measures, the success of the policy will depend heavily on the actions of national governments. Robust and timely preparation and implementation of SCPs, alongside effective complementary policies, are key to ensuring that the two main concerns with the ETS 2, high CO₂ prices and low social acceptance, are effectively addressed.

Considering their different effects, a prudent *mix of changes* seems advisable. Feasible, targeted adjustments that address the most prevalent concerns such as price volatility in the start-up phase and distributional impacts could proceed now through the MSR Decision and auctioning rules, while more fundamental redesign questions could be considered in the European Commission's mandated review.

Proceeding with ETS 2 on schedule, paired with early-phase stability measures, can help close the emissions gap in the building and road transport sectors this decade, preparing an orderly pathway to climate neutrality by 2050. The risk of locking in high-cost, path-dependent outcomes can be reduced. Conversely, delay or abolition would weaken investment signals, threaten compliance with binding targets and forgo substantial resources to address energy poverty.

⁵⁵ European Commission. 27 November 2025. *Commission proposes targeted adjustments to the Market Stability Reserve Decision to support a smoother start for ETS2*. European Commission. 27 November 2025. *Proposal for a Decision of*

the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards the market stability reserve for the buildings, road transport and additional sectors. COM(2025)738.

Annex 1: Overview of proposals analysed in the study

Title	Organisation	Organisation type	Date	Proposed revisions				
				MSR reform	Price floor / ceiling	Revenue frontloading	Changes to SCF / Additional funds for SCPs	Complementary policies
EU ETS revenues from polluters to the people	Carbon Market Watch & others	NGO	December 2024	No	No	No	Yes	Yes
Joint letter to establish an EU lending facility for ETS2 revenue for member states	Carbon Market Watch & other NGOs	Industry associations, NGOs	March 2025	No	No	Yes	Yes	No
Strengthening the EU ETS 2 through revenue frontloading	EPICO & Frontier Economics	Consultancy / think tank	May 2025	No	No	Yes	No	Yes
Revision of price stabilisation mechanisms for EU ETS 1 and ETS 2 (non-paper from the French authorities)	France	Member State	March 2025	Yes	No	No	No	No

Title	Organisation	Organisation type	Date	Proposed revisions				
				MSR reform	Price floor / ceiling	Revenue frontloading	Changes to SCF / Additional funds for SCPS	Complementary policies
Revision of price stabilisation mechanisms for EU (non-paper)	Austria, Belgium, Bulgaria, Croatia, Czechia, Estonia, Germany, Italy, Latvia, Lithuania, the Netherlands, Poland, Romania, Slovakia, Slovenia, Spain	Member States	June 2025	Yes	No	Yes	No	No
How to turn the ETS 2 implementation into a success	Transport & Environment	NGO	June 2025	Yes ⁵⁶	Yes	Yes	No	Yes
5-Punkte-Plan: EU-Emissionshandel für Gebäude und Verkehr effektiv und sozial gerecht in Deutschland umsetzen	Klimaallianz, Germanwatch, WWF, BUND & others	NGO	June 2025	No	No	No	Yes	Yes
CAN Europe views on ETS2 (position paper)	CAN Europe	NGO	August 2025	No	No	Yes	Yes	Yes

⁵⁶ Not as primary proposal

