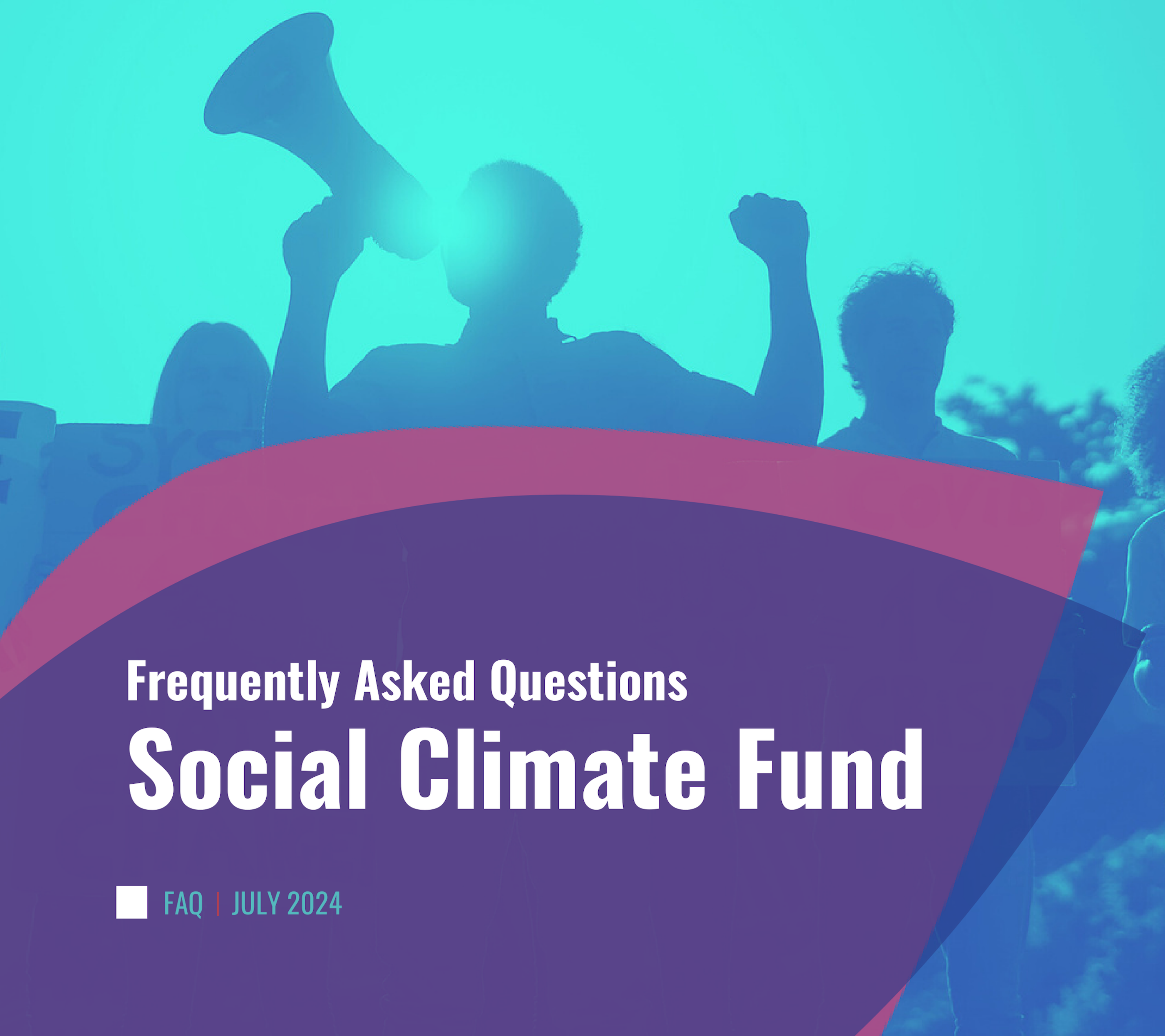

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Frequently Asked Questions

Social Climate Fund

FAQ | JULY 2024

The Social Climate Fund (SCF) is the first EU fund developed with the explicit purpose of alleviating energy and transport poverty resulting from the transition towards zero-emission mobility and decarbonised buildings. Our latest FAQ has the answers to everything you always wanted to know about the SCF.

What is the Social Climate Fund?

The Social Climate Fund has been created to address potential social impacts arising from the ETS2 - the new Emissions Trading System (ETS) that applies a carbon price to fuel used in buildings and road transport. It is the first EU fund developed with the explicit purpose of alleviating potential energy and transport poverty resulting from the transition towards zero-emission mobility and decarbonised buildings. From 2026-2032 the fund will channel almost €87 billion in targeted support to all EU member states.[1]

Why was the Social Climate Fund established?

The SCF was created to prevent increases in energy and transport poverty resulting from the introduction of ETS2, which will apply carbon pricing to fuels used in buildings and road transport. It will begin in 2027[2] and run as a separate system in parallel to the EU's existing ETS1 (which covers industry, aviation and shipping).

The ETS2 was introduced due to a lack of progress in reducing emissions across buildings and road transport sectors as outlined in Figure 1, which shows that emissions from transport have increased since 1990 and emissions from buildings not falling fast enough for the EU to reach climate neutrality by 2050.

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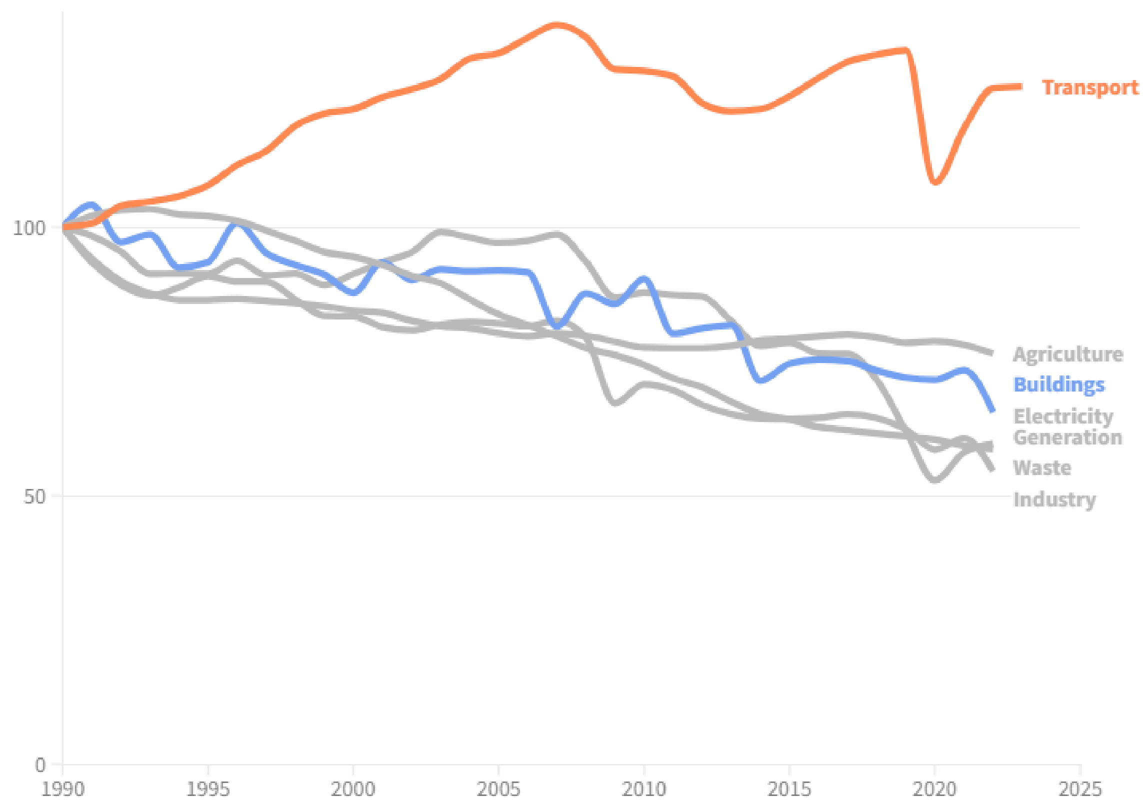
[1] €65 bn in revenues for the Social Climate Fund, and €21.7 bn of mandatory co-financing by Member States.

[2] As stated in the Directive, in case the Commission finds in June 2026 that energy prices have been exceptionally high during the six preceding months, the ETS2 will be delayed until 2028, with an 'emergency brake' triggered. One of these conditions must materialise: 1) the average price of gas (TTF) in the first half of 2026 is higher than the average price in Feb-March 2022, or 2) the average price of Brent crude oil in the first half of 2026 is higher than double the average price during the 5 preceding years (2021-25). This so-called 'emergency brake' will prevent households paying a carbon price on top of high energy prices. As a result of the fewer number of auctioned allowances, the SCF revenues will decrease from €65 to €54.6 billion.

Figure 1. Change in greenhouse gas emissions by sector in the EU, $MtCO_2e$ (1990 = 100)



Source: UNFCCC GHG inventories, EEA, Stratas Advisors • Transport includes international aviation and maritime emissions. Public electricity includes heat generation

Under the ETS2, fuel suppliers - such as Shell, TotalEnergies and Engie - will be required to purchase auctioned emission allowances for every tonne of carbon released as a result of the use of the fuel they sell. However, the expectation is that suppliers will pass on the cost of these permits to consumers. This would lead to higher fuel costs for heating homes and powering vehicles. When the system starts in 2027, there is an initial soft price ceiling[3] at €45t/CO2, which would translate into an estimated 11 cents per litre to the filling of the tank of an average car and less than 1 cent per kWh to fossil gas heating.

By decreasing the number of pollution permits for sale, the ETS2 aims to incentivise consumers to make greener choices and lower their emissions over the longer term. A well-functioning ETS2 market should deliver a gradual increase in carbon prices over time as the total amount of allowances in the system (the 'cap') reduces.

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[3] If prices reach €45 per tonne for two consecutive months, 20 million allowances will be added to the market.

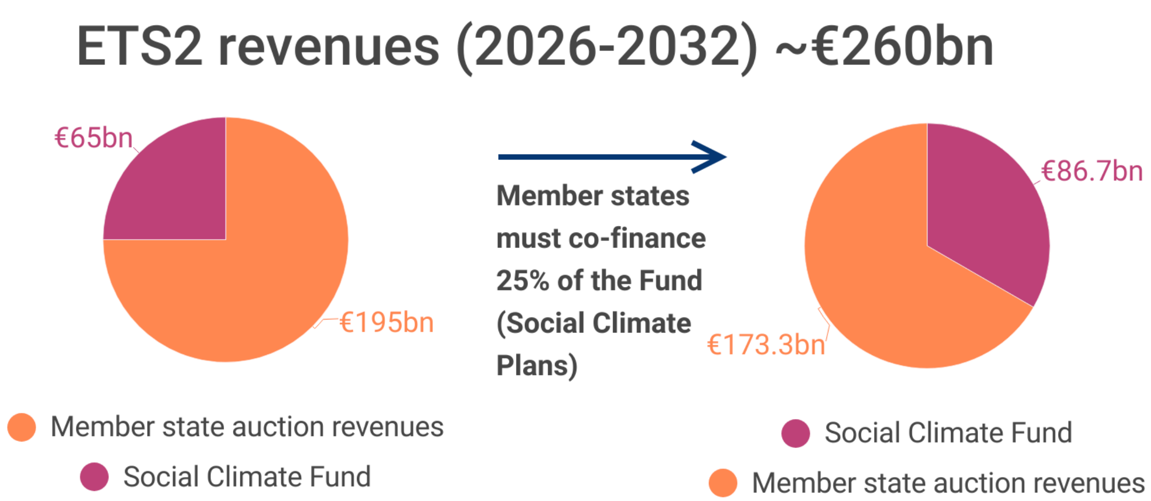
Higher prices stimulates more investment in energy savings and zero-emission technology which in turn reduces emissions. However, as the ETS2 price is levied equally and regardless of income across all member states, it could exacerbate energy and transport poverty.

This is where the SCF comes in. The SCF was created to increase the accessibility and affordability of clean alternatives for lower income groups and micro enterprises in the face of rising energy costs.

Where does the money in the Social Climate Fund come from?

Between 2026 and 2032, €86.7 billion will be made available in targeted support for lower income groups and micro enterprises. The SCF will provide a maximum of €65 billion from the auctioning of 50 million allowances under the ETS1,[4] and at least 150 million allowances under the ETS2. In addition, member states are required to co-finance 25% of any measures financed through the EU's Fund, which brings total funding to €86.7 billion. To meet this obligation, member states can use their share of ETS2 revenues funnelled back directly to them. Total auction revenues are estimated at €195 billion from 2027-2032.[5]

Figure 2. Distribution of ETS2 auction revenues



EU member states can use their auction revenues from ETS2 to provide the 25% co-financing.

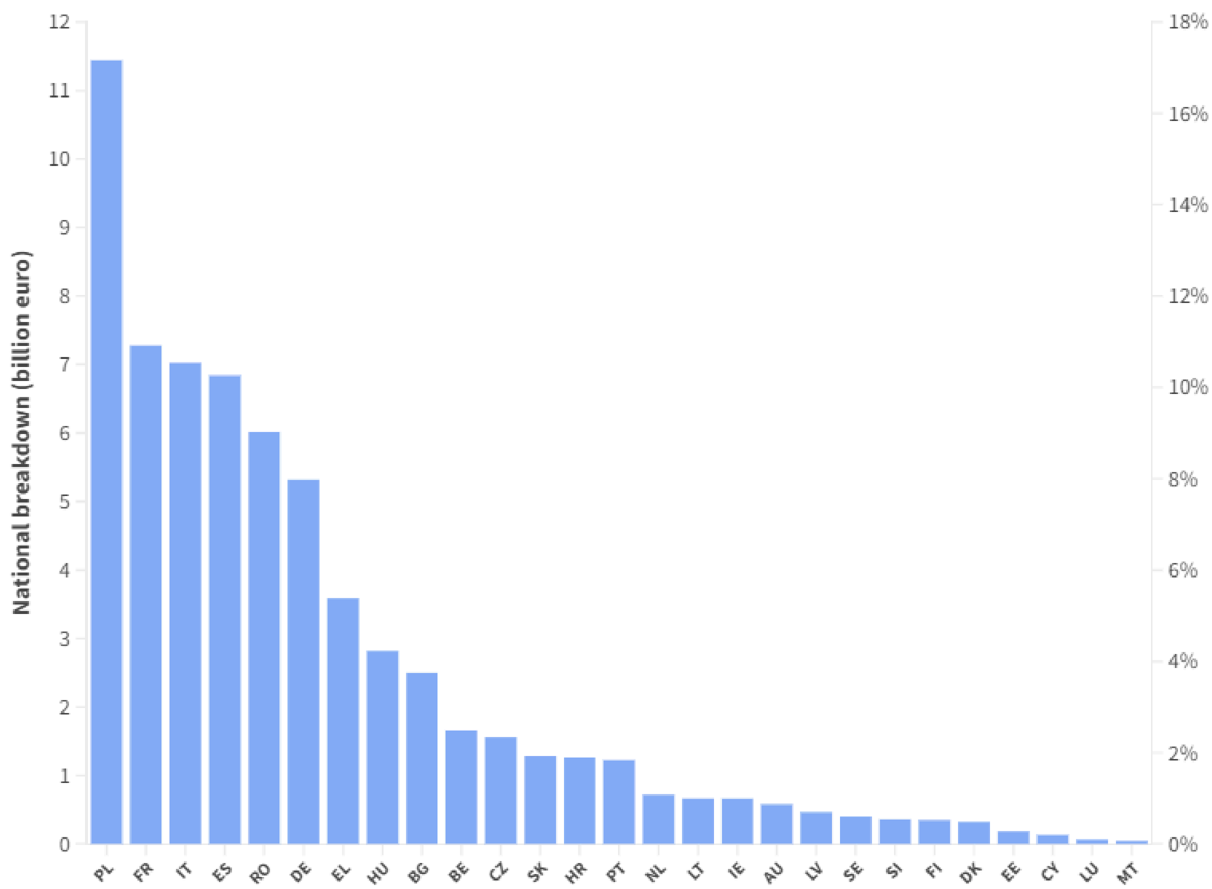
[4] To read more on how ETS works, please see LIFE ETX (2024) EU ETS 101 – A beginner's guide to the EU's Emissions Trading System. Link.

[5] Eden et al. 2023 "Putting the ETS2 and Social Climate Fund to Work: Impacts, Considerations, and Opportunities for European Member States". Link.

How will the Social Climate Fund be shared between member states?

The Social Climate Fund allocates a different amount to every member state, based on an assessment of need.[6] Factors taken into consideration include the percentage of the population at risk of poverty in rural areas, CO_2 emissions from fuel in homes, percentage of households at risk of poverty with arrears on utility bills, total population, and GNI per capita. As a result, Poland (17.6% of the Fund's budget), France (11.2%), Italy (10.8%), Spain (10.5%), and Romania (9.3%) will receive the most funding.[7]

Figure 3. SCF revenues (national breakdown and respective share)



[6] Maximum financial allocations in euros per MS can be found in Annex II of the SCF Regulation.

[7] The emission allowance auction shares of Poland, France, Italy, Spain and Romania (the five largest beneficiaries of the SCF) are respectively, 8.1%, 15.6%, 13.2%, 8.3% and 2.5%. For more information, please see Öko-Institut e.V. (2024), *Supply and demand in the ETS 2*. Link.

How do member states receive funding under the Social Climate Fund?

To access the fund member states must submit **Social Climate Plans (SCPs)** by June 2025 for review and approval by the Commission, following a mandatory consultation process with stakeholders.

What is the timeline and process for developing Social Climate Plans?

The SCF will begin in 2026, one year prior to the start of the ETS2. Member states must submit SCPs for review by the European Commission by June 2025. Once submitted, the Commission has two months to seek additional information or make observations and then the member state may revise the plan if needed. Plans are assessed based on their relevance, effectiveness, efficiency, and coherence. A final decision is then made within five months of submission. A positive assessment leads to a Commission act outlining all the information related to the implementation of the SCP, including the maximum financial allocation and the national contribution.

The disbursement of the funding is conditional on the achievement of the milestones and targets outlined in the plan. Member states can request payments twice a year, with first payments commencing in 2026. Member states are required to amend their SCPs if they are no longer achievable or need to be significantly adjusted. The Commission can reject the amended plan after giving the member state the opportunity to report its findings and provide explanation for discrepancies.

What will Social Climate Plans contain?

The Social Climate Plan for each member state has to include:[8]

- an estimate of the **anticipated effects of price increases** resulting from the introduction of ETS2, particularly in relation to energy and transport poverty;

[8] Template for the national Social Climate Plan is available in Annex V of the SCF Regulation.

- **estimated number and identification** of vulnerable households, micro-enterprises and transport users (across public transport and private vehicles);
- **concrete policies and investments** planned to reduce the negative effects of the price increase on these target groups, including temporary income support and long term decarbonisation measures;
- **milestones, targets and indicators** to track implementation and completion by mid-2032;
- **costs** of the plan, and an explanation of how cost efficiency is ensured;
- explanation of how the plan fulfils the '**do no significant harm' principle**;
- information detailing the **public consultation processes** used to create the plan.

A public consultation with local and regional authorities, representatives of economic and social partners, relevant civil society organisations, youth organisations and other stakeholders must be undertaken. The plan itself must contain a summary of such consultations, which will be considered in the Commission's assessment.

What is the connection between National Energy and Climate Plans (NECPs) and Social Climate Plans?

Every EU member state is required to complete NECPs to outline how they will reduce greenhouse gas emissions and improve energy efficiency in order to meet EU 2030 targets.[9] Plans covering the 2021-2030 period were submitted in 2019, and an update of the plans was required by 30 June 2024.[10]

NECP template requirements do not oblige member states to make a comprehensive socio-economic impact assessment of the impacts of climate and energy policies. However, European Commission guidance[11] urges member states to explain in the updated NECPs the methodology used to prepare Social Climate

[9] As per Governance Regulation (EU) 2018/1999. This Regulation also sets out the requirement for national Long Term Strategies with a perspective of 30 years.
[10] However, as of July 2024, several Member States have not yet delivered these documents.
[11] Commission Notice: Guidance to Member States for the update of the 2021-2030 NECPs (C/2022/9264 final).

Plans and to outline how revenue from the SCF will be used to achieve relevant objectives and targets. It is important that NECPs lay a foundation upon which SCPs can develop a strategic approach to using SCF revenue. However, each of the 26 submitted NECPs '*do not contain sufficient information for the preparation of Social Climate Plans*.'

Additionally, the National Building Renovation Plans (NBRPs), which must be submitted by December 2025 under the Energy Performance of Buildings Directive, must correspond with the SCPs. The NBRPs must include an overview of national building stock, measurable indicators on how the number of people affected by energy poverty will be reduced, and a strategy explaining how 2030, 2040 and 2050 targets relating to renovation of the worst performing residential buildings, in which many of those experiencing energy poverty reside, will be met.

What can the Social Climate Fund be spent on?

The SCF can be spent on investments to increase the affordability and accessibility of emissions reductions technologies. Investments can include energy saving renovations, decarbonisation of heating and cooling systems, and zero/low-emission vehicles. Member states can use SCF funds for fiscal incentives or financial support to make zero- and low-emission vehicles and bicycles more affordable, or to modernise infrastructure. The SCF Regulation specifically mentions the development of a second-hand zero-emission vehicles market, incentivising the use of affordable and accessible public transport and supporting private and public entities to provide accessible and zero-emission transport options, shared mobility services (e.g. car-pooling) and active mobility options (cycling, walking).

A limited amount, up to 37.5% of a country's plan, can be spent on temporary income support, as many investments, such as the renovation of a home, or the improvement of a public transport line, can take multiple years. Over that time, vulnerable households dependent on public support for those investments are exposed to the carbon price, and monetary support may be needed.

Up to 2.5% of costs under a member state's SCP can be spent on public consultation, communications activities, conducting studies or providing technical assistance and capacity building for implementing bodies. This category can cover training to ensure the proper management of the fund and the achievement of its objectives or the creation of 'one stop shops' to help citizens overcome difficulties in benefiting from government schemes relating to home renovation.

Will the Social Climate Fund be enough to combat energy and transport poverty?

No. The SCF only aims to alleviate new and additional poverty risks resulting from the introduction of the ETS2. Based on today's figures and prior to its introduction, 41 million people across Europe are unable to adequately heat their homes.[12] The actual number is likely much higher given the complexities of collecting accurate data on energy poverty. Transport poverty indicators are still in their infancy in the EU, with the latest data available from 2014 highlighting that 2.4% of all people in the EU and 5.8% of those at risk of poverty could not afford to use public transport regularly.[13]

Overall, both energy and transport poverty are complex, interlinked with social vulnerabilities such as low income, old age, disability, health and regional disadvantages. The amount available in the Social Climate Fund is insufficient to combat the root causes and existing levels of energy and transport poverty. But **the creation of the first EU-level budget for energy and transport poverty is a welcome step in the right direction towards a just transition, and the SCPs could inspire consequential national policies that combat poverty beyond the impact of carbon pricing**.

[12] European Parliamentary Research Service (2023), Energy poverty in the EU. Link.
[13] European Commission (2023), Report on access to essential services in the EU (Commission staff working document). Link.

What if my country already has a carbon tax on road transport or heating fuels?

Member states had to notify the Commission by the end of the transposition period set out in the Directive (June 2024) if they have a national carbon tax higher than the ETS2 price and wish to exempt regulated entities from surrendering emission allowances until the end of 2030. In this scenario, the member state cancels the emissions allowances as a result of the opt-out, but is still obliged to allocate the equivalent of the expected revenues towards climate action including their contribution to the Social Climate Fund, therefore revenues assigned to the SCF will not be affected by potential opt-outs.

Recommendations on SCF implementation and future development

The FAQ above explains the basics of how the SCF will operate. Member states and EU institutions also have choices as to how to best implement the SCF, and how to improve its functioning.

1. Increase the pool of available funds

The SCF is smaller than originally proposed, but expectations remain high for its ability to combat energy poverty and increase public support for ETS2 and citizens across the EU are already feeling the impact of an increased cost-of-living. As a starting point, ETS2 revenues that are sent directly to the budgets of member states should be mobilised to combat energy and transport poverty. For the period 2026-2032, a total of 5,746 million allowances will be auctioned[14] and assuming an average price of €45 (based on the soft price ceiling), total revenues would be at least €258.6 billion. Given that the total size of the SCF budget is capped at €65 billion, only 34% of ETS2 revenues would go to the SCF, while the remaining 66% would go directly to member states. Current legislation dictates that all ETS revenue is to be spent on 'climate action' but lack of clear definition on what constitutes 'climate action' and limited transparency means that funds are likely to be spent on things that are unhelpful - or even counterproductive - in climate terms.[15] The definition of 'climate action' should be updated to ensure ETS2 revenue is dedicated entirely to socially just measures that increase the accessibility and affordability of emissions reduction technologies in buildings and road transport. To ensure sufficient measures against energy and transport poverty, member states should also top up SCF co-funding by sourcing additional funds from their national budgets or allocating more of their ETS2 revenue to this.

[14] Öko-Institut e.V. (2022). The Social Climate Fund - Opportunities and Challenges for the buildings sector. Link.

[15] WWF (2022). Where Did All the Money Go? How EU ETS Member States Spent Their Money and Why Tighter Rules are Needed. Link.

2. Ensure earlier availability of funds

Money from the SCF can be spent from 2026, only one year in advance of the introduction of the ETS2, but investments in energy efficiency and renewable energy (through building renovations or development of transport schemes/infrastructure) take time. To ensure that measures are in place to mitigate the impact of ETS2 from the very start of that system, the European Commission should extend loans directly to member states for SCF-related spending as of 2025. These loans could be recouped from future guaranteed ETS2 revenues. Such a mechanism would supplement the initial – and underwhelming – €4 billion available for the SCF in 2026, the first year of its operation, provided for in the Regulation.[16]

3. Avoid all future fossil fuel lock-in

SCF spending criteria do not prohibit investment in low-emission (fossil-fuel based) transport and building solutions such as more efficient gas boilers or hybrid transport options. On the contrary, 'low-emission' solutions are explicitly mentioned as eligible. Considering the lifespan of a typical gas boiler is up to 15 years, any investment in low-emission rather than zero-emission alternatives locks lower income groups into prolonged use of potentially expensive fossil fuels, wasting precious time and resources that could be spent on long term solutions. Member states should therefore not use any SCF funding on fossil-based energy technologies. The SCF should only allow zero-emission investments to ensure that lower income groups are fully insulated from high and /or volatile fossil fuel prices, and from increases in the ETS2 price as the market develops.

As the 'Do No Significant Harm' principle (the guidelines that EU funds must follow to ensure actions do not contribute to the degradation of the environment) applies to the Social Climate Fund, the SCF must prevent lock-in of harmful fossil fuels. The European Commission should make it clear within its guidance for member states on how to implement the criteria that will be issued in Q3 of 2024.[17]

[16] In 2026, the SCF will be financed through the auctioning of 50 million ETS1 allowances, with an annual ceiling of €4 billion.
[17] Have Your Say: Social Climate Fund - Applying the Do No Significant Harm Principle.

4. Begin the work now! Identify vulnerable groups and design the most impactful investments to deliver targeted support.

Developing effective Social Climate Plans involves the collection and analysis of accurate data on transport and energy poverty. Within their SCP member states are required to explain how definitions of energy and transport poverty are applied at national level. An estimate of the likely effects of the increase in prices resulting from the ETS2 on households and micro-enterprises must be outlined, in particular on the incidence of energy and transport poverty. Data must be provided on access to public transport and basic services to identify the most affected areas. A description of the methodology used to establish data must be outlined. While the framework definitions for energy and transport poverty are detailed in the SCF Regulation, it is for member states to determine appropriate indicators. Each country will have to identify its own high risk groups and design appropriate policies accordingly. Income is an important factor in determining vulnerability but other factors such as high energy costs due to inefficient buildings, the type of fuel used for heating and rural isolation also negatively impact levels of energy poverty. This process will involve stakeholders and experts at both the local and national level and given the scale of the task, and designing effective and targeted support measures must begin now as SCPs are due in June 2025.

5. Balance direct income support and investments.

A major challenge with the introduction of the ETS2 is to balance the need for temporary income support for lower income groups and the need for green investments that lessen the reliance of these groups on fossil fuels. This is vital as the fund is not intended to create dependencies but rather enable solutions for long term decarbonisation. Without direct investment support, millions of people across Europe will be burdened by increased fuel costs while lacking resources to invest in solutions such as home renovation and clean heating. Moreover, it will take time to renovate homes and install clean heating and cooling at scale and to deliver zero-emission public transport investments. And while this is being done, vulnerable groups will still be exposed to the ETS2 price. Temporary income support can help maintain quality of life for those unable to absorb- or take action to avoid - higher energy costs.

Some best practices include:

a. **Income support**: Differentiated distribution of carbon pricing revenue along socially just criteria protects the most vulnerable while ensuring that higher earners do not increase their consumption or emissions as a result of the redistribution. Precedent exists for this practice; Austria redistributes the revenues from its own national ETS to citizens as a climate dividend. On top of a universal annual base rate of €110, which ensures all citizens benefit and are included in the scheme, a 'regionally staggered' allowance is granted with four different levels - €0, €40, €75, or €110 - depending on the place of residence. Handing out more to those in regions with poorer public transport connections or public service infrastructure ensures a greater share of targeted support goes to those who need it.[18]

b. **Buildings**: To overcome upfront costs, home renovation schemes such as 'Gent Knapt Op' in Belgium provide loans of up to €30,000, that must only be repaid when the house is eventually sold. 'On-bill' financing schemes[19] in which upfront costs of renovation are typically covered by private actors such as the utility company or financial institution and recouped in small transactions such as through monthly utility bills have also delivered increased affordability and provided a solution to issues of financing.

c. **Road transport**: The SCF could enable social leasing schemes for electric vehicles to be rolled-out across the EU. The French system (closed for 2024 due to overwhelming demand,[20] and due to reopen in 2025) enables low-income households to access an electric vehicle for a monthly rent starting from €100.

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[18] Eden et al. (2023), "Putting the ETS 2 and Social Climate Fund to Work: Impacts, Considerations, and Opportunities for European Member States. Link.

[19] Buildings Performance Institute Europe (2022), European on-bill building renovation roadmap. Link.

[20] Transport & Environment (2023). Lancement du leasing social : Un dispositif utile mais encore trop restreint. Link.

6. Undertake a meaningful consultation process.

As the NECP process consultation phase has highlighted,[21] climate policy can sometimes favour a top-down approach at the expense of community input. Multi-stakeholder engagement and consultation requires time and resources, but is essential for well-informed and effective plans. A participatory and collaborative approach is needed to ensure public support for carbon pricing. In order for the SCP to go beyond becoming a box ticking exercise, and avoid the risk of opposition, it must engage with actors at the sub-national level to reach target groups, share data and develop awareness and trust.

[21] Energy Cities (2024), The assessment is in! The European Commission reviewed the 21 draft national energy and climate plans submitted by Member States. Link.

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