EXPLANATORY MEMORANDUM TO

THE VEHICLE EMISSIONS TRADING SCHEMES (AMENDMENT) (NO. 2) ORDER 2025

2025 No. 1101

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Transport (DfT) and is laid before Parliament by Command of His Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

2.1 The Rt Hon Heidi Alexander MP, Secretary of State for Transport, confirms that this Explanatory Memorandum meets the required standard.

2.2 Rosalind Marshall, Deputy Director for Zero Emissions Vehicle Regulations, at the Department for Transport confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 James Vickery at the Department for Transport can be contacted by email at the following address with any queries regarding the instrument: james.vickery@dft.gov.uk. Alternatively, James Vickery can be contacted by telephone: 07773 074513.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument amends the Vehicle Emissions Trading Schemes Order 2023 (the VETS Order)[1]. It introduces additional regulatory measures to support manufacturers.

4.2 The VETS Order consists of four trading schemes that implement a zero emission vehicle (ZEV) mandate and a carbon dioxide (CO_2) standard for new cars and vans registered in the UK. To meet the targets set out in the trading schemes, manufacturers are given flexible routes for compliance, such as borrowing allowances from future years, converting allowances between the trading schemes, and the ability to earn bonus credits.

4.3 This instrument extends existing flexibilities and introduces new flexibilities to provide manufacturers with further routes to compliance. It also reduces compliance payments, implements technical changes to assist manufacturers with the treatment of plug-in hybrid vehicles and makes some small technical amendments.

Where does the legislation extend to, and apply?

4.4 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

[1] S.I. 2023/1394.

4.5 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 Under the Climate Change Act 2008, the UK Government is legally committed to reach net zero greenhouse gas emissions by 2050.

5.2 Since 2019, the transport sector has accounted for the largest share of the UK's annual domestic greenhouse gas emissions. Most of these emissions have come from petrol and diesel road vehicles[2]. The VETS Order is a crucial lever to reduce exhaust emissions from new cars and vans sold in the UK.

5.3 The VETS Order has been in force since 3 January 2024 and implements the ZEV mandate and the CO_2 standard.

5.4 The ZEV mandate consists of two trading schemes:

5.4.1 the Non-Zero-Emission Car Registration Trading Scheme (CRTS)

5.4.2 the Non-Zero-Emission Van Registration Trading Scheme (VRTS).

5.5 The CO_2 standard consists of two trading schemes:

5.5.1 the Non-Zero-Emission Car CO_2 Trading Scheme (CCTS)

5.5.2 the Non-Zero-Emission Van CO_2 Trading Scheme (VCTS).

5.6 The ZEV mandate (CRTS and VRTS) sets vehicle manufacturers' annual targets for the proportion of new zero emission cars and vans registered in the UK. The CRTS and VRTS ZEV targets start at 22% for cars and 10% for vans in 2024, rising steadily to 80% of cars and 70% of vans by 2030.

5.7 Within the VETS Order, the CRTS and VRTS targets are expressed as percentage targets for the proportion of vehicles in a manufacturer's fleet that may be non-ZEV (i.e. petrol/diesel/hybrid/plug-in hybrid electric). These percentage targets are the inverse of the ZEV target – in 2024, the ZEV target was 22%, so manufacturer fleets were permitted to be up to 78% non-ZEV. These targets are enforced by allocating manufacturers with 'allowances' equal to the manufacturer's registrations in a given year multiplied by that year's non-ZEV target. Vehicle manufacturers are required to surrender an allowance for every new non-ZEV registered in the relevant calendar year.

5.8 The CO_2 standard (CCTS and VCTS) sets CO_2 baseline targets for vehicle manufacturers to ensure that their non-ZEV CO_2 emissions do not exceed 2021 levels. The CCTS and VCTS targets are enforced by requiring vehicle manufacturers to surrender one allowance per 1gCO_2/km emitted by their new non-ZEV vehicles registered in a calendar year. As with the ZEV mandate, manufacturers are allocated allowances equal to their 2021 emissions baseline, multiplied by the number of non-ZEVs that they register in each calendar year.

5.9 Manufacturers that overachieve against their targets will have spare allowances at the end of each calendar year. They are free to sell (i.e. trade) those allowances to any manufacturers, including manufacturers that have not met their target, thus allowing those manufacturers to comply through the purchase of allowances. For example, manufacturers that overcomply with the VRTS target will have excess VRTS

[2] https://www.gov.uk/government/statistics/final-uk-greenhouse-gas-emissions-statistics-1990-to-2023

allowances. These excess VRTS allowances can be traded/sold to other manufacturers, including to those that have not met their VRTS targets.

5.10 Manufacturers may also use other flexibilities to support their routes to compliance. These flexibilities include, but are not limited to:

5.10.1 **Banking:** Manufacturers that overcomply with the CRTS or VRTS targets in one year will have excess allowances. These excess allowances can be banked for use against future CRTS and VRTS targets (respectively) for up to three years. Any unused banked allowances will expire after three years.

5.10.2 **Borrowing**: Manufacturers that do not meet their CRTS or VRTS targets in one year will be in a deficit of allowances. To cover this deficit, manufacturers can borrow allowances from their future years' allocations of CRTS or VRTS allowances, subject to a yearly cap. Manufacturers must pay back the borrowed CRTS/VRTS allowances at a yearly compounding interest rate of 3.5%.

5.10.3 **Conversion:** Manufacturers that overcomply with the targets from the CRTS or VRTS will have excess CRTS/VRTS allowances. These excess CRTS/VRTS allowances can be converted for use against CCTS/VCTS targets. Conversely, manufacturers that overcomply with CCTS/VCTS targets will have excess CCTS/VCTS allowances; these too can be converted for use against the CRTS/VRTS targets, subject to an annual cap.

5.11 A manufacturer that does not meet their targets, whether through vehicle registrations, trading, or use of flexibilities, would then be required to make a compliance payment.

5.12 With regard to the borrowing and CCTS/VCTS to CRTS/VRTS conversion flexibilities, these were originally designed to be available from 2024-26, and were subject to certain caps and eligibility criteria. This approach was taken to provide manufacturers with a transitional period to adapt to the new requirements from the regulation, and in recognition of the fact that manufacturers may have had product plans that were already in place.

5.13 In recognition of the global challenges faced by the automotive industry in recent years, the UK government and the devolved governments jointly launched a consultation to seek views on the existing flexibilities, and on further flexibilities, to ensure their efficacy.

5.14 The public consultation was titled 'phasing out sales of new petrol and diesel cars from 2030 and supporting the ZEV transition'[3] and ran for eight weeks from 24 December 2024 to 18 February 2025. Ministers held a number of bilateral meetings and roundtables, and officials delivered several stakeholder workshops to ensure that the widest possible set of views was obtained. Most manufacturers requested further flexibilities to better support industry through the transition to zero emission vehicles.

5.15 On 7 April 2025, the UK government and the devolved governments published a joint response to the consultation[4]. The response confirmed that existing flexibilities would be extended and that new flexibilities would be introduced. This instrument amends the VETS Order to implement these commitments.

[3] https://www.gov.uk/government/consultations/phasing-out-sales-of-new-petrol-and-diesel-cars-from-2030-and-supporting-the-zev-transition/

[4] https://www.gov.uk/government/consultations/phasing-out-sales-of-new-petrol-and-diesel-cars-from-2030-and-supporting-the-zev-transition/outcome/phasing-out-sales-of-new-petrol-and-diesel-cars-from-2030-and-supporting-the-zev-transition-summary-of-responses-and-joint-government-response/

What was the previous policy, how is this different?

5.16 The previous policy imposed certain conditions and restrictions on flexibilities available under the VETS Order. This instrument amends some of those conditions, and introduces new pathways to compliance, as detailed below.

5.17 Originally, the borrowing flexibility was only available from 2024-2026, each year was subject to a borrowing cap, and all borrowed allowances had to be repaid by 2027. This instrument extends the borrowing flexibility to 2029, meaning borrowing is now possible from 2024-2029 inclusive, and introduces new borrowing caps for the new 2027-2029 borrowing period. The borrowing cap for both cars and vans has also been increased for 2025 only. The instrument also extends the borrowing repayment deadline to 2030 (instead of 2027).

5.18 Originally, the flexibility to convert overachievement against the CO_2 targets (from the CCTS and VCTS) into compliance for the ZEV targets (under the CRTS and VRTS) was only available from 2024-2026, and each year was subject to a specific conversion cap. This instrument also extends that deadline to 2029, meaning such conversions are now permitted from 2024-2029 inclusive. New conversion caps for 2027-2029 have also been established, and the conversion caps for 2025 and 2026 have been increased, meaning manufacturers may benefit from reducing the emissions of their new non-zero emission vehicles for longer, and to a larger extent.

5.19 Originally, the VETS Order did not permit interactions between the car (CRTS and CCTS) and van (VRTS and VCTS) trading schemes; the CRTS/CCTS schemes were separate from the VRTS/VCTS schemes. This instrument allows bidirectional trading and conversion between the ZEV mandate schemes only (CRTS and VRTS). These bidirectional trades and conversion are subject to new exchange rates.

5.20 Compliance for the CCTS/VCTS relies on a vehicle's CO_2 emissions value calculated through the Worldwide harmonised Light vehicle Test Procedure (WLTP). The WLTP laboratory test measures the fuel consumption and CO_2 emissions from vehicles, as well as their pollutant emissions. Plug-in-hybrid vehicles (PHEVs) have both an internal combustion engine and a battery electric drivetrain, and as such a variable known as the utility factor (UF) is used to calculate a PHEV's WLTP CO_2 emissions value. The UF represents the assumed share of driving done by PHEVs in 'charge-depleting' mode (i.e. using the battery as the primary source of power) compared to driving done using the internal combustion engine.

5.21 Research has shown that the UF used within the WLTP calculations under Euro-6d (the current WLTP testing cycle recognised in Great Britain) overestimates how often drivers charge their PHEVs, and thus how much they are driven in 'charge depleting' mode (i.e. how much they are driven using the battery as the primary source of power). In the real-world, PHEVs tend to be driven much more in 'charge-sustaining' mode, where the internal combustion engine provides the primary source of power.

5.22 This implies that real-world PHEV CO_2 emissions are substantially higher than the values calculated under the WLTP cycle, resulting in a globally recognised performance gap between official WLTP CO_2 emissions figures for PHEVs and real-world CO_2 emissions.

5.23 Therefore, in the relevant United Nations Economic Commission for Europe (UNECE) regulations and in the European Union (EU), the UF used has been updated from 2025, with a further update currently due in 2027, to better reflect the real-world performance of PHEVs. This 2025 update is officially known as the Euro-6e-bis standard. As the UK is a signatory to the relevant UNECE Regulations, new vehicles

type approved according to UNECE legislation, and thus Euro-6e-bis regulations, are allowed to be sold on the UK market. New vehicles sold in Northern Ireland will also be required to be approved in accordance with the latest EU standards by virtue of the Windsor Framework, which also stipulate Euro-6e-bis. As a result, PHEVs with CO_2 emissions calculated according to Euro-6e-bis/with the new UF may already be sold on the UK market from 2025 onwards.

5.24 The CO_2 standards (CCTS and VCTS) measure a manufacturer's CO_2 emissions against a 2021 'baseline'. The change in how PHEV CO_2 emissions are calculated will have an impact on compliance with the CO_2 baseline targets from the CCTS and VCTS. Due to the wider changes to the UF, manufacturers would have been required to report the updated CO_2 values of plug-in hybrids, as uplifted in 2025 and 2027, respectively. These uplifts would have made it more challenging to comply with the CO_2 baseline targets which were based on the PHEV CO_2 values as they applied in 2021. This instrument allows relevant manufacturers to apply for the CO_2 emissions values of relevant PHEVs to be determined in accordance with new Schedule 3A to the VETS Order. Schedule 3A approximates CO_2 emission values of those PHEVs to the values that the vehicle would have received under the Euro-6d WLTP test cycle (rather than the updated values coming into force in 2025 and 2027). The instrument allows this alternative reporting until 2030.

5.25 Manufacturers that miss their ZEV (CRTS and VRTS) targets (i.e. do not meet the target through vehicle registrations, trading, or use of flexibilities) must make a compliance payment for every zero emission car or van by which they have missed their target. The compliance payment level was originally set at £15,000 per car and £9,000 per van for 2024 only, rising to £18,000 per van for the remaining duration of the regulation. This instrument reduces the compliance payment levels to £12,000 per car, and to £15,000 per van, for the 2025 scheme year and the remaining duration of the regulation.

5.26 Originally, the flexibility to convert overachievement against the ZEV (CRTS and VRTS) targets into compliance for the CO_2 (CCTS and VCTS) targets was subject to an eligibility criterion. The criterion required manufacturers to meet their ZEV (CRTS and VRTS) targets using allowances for the current scheme year only. The eligibility criterion has been clarified to bring the legislation in alignment with the original policy intent for manufacturers to be rewarded for early ZEV deployment. This instrument therefore amends the eligibility criterion to permit CRTS and VRTS allowances from the current scheme year, and any banked CRTS and VRTS allowances from previous scheme years, to be considered when determining eligibility for the conversion flexibility.

5.27 Some vans are built in a multi-stage process, whereby each stage of the van has a different manufacturer and CO_2 value associated with it. In these instances, the base vehicle manufacturer creates a 'base' vehicle which includes the drivetrain (the system that transmits power from the engine to the wheels, enabling the vehicle to move). A second manufacturer will then obtain the 'base' vehicle and complete the vehicle's build to produce a completed van. The completed van may then go on to be registered in the UK and thus would be subject to the VETS Order. Under the VETS Order, the base vehicle manufacturer is deemed to be the manufacturer responsible for the completed van. In these cases, the VETS Order contains a series of formulae to approximate the weight of the final vehicle using figures from the base vehicle stage, which can then be used to simulate a CO_2 emissions value, to provide base vehicle manufacturers with emissions certainty. One of the formulae assumes that a certain mass will be added to the vehicle, called the mass representative of the vehicle load

(MVL). The MVL is determined by a formula in Schedule 3 of the VETS Order. Currently, one of the brackets in the formula is incorrectly positioned, resulting in a potential overestimation of the simulated final vehicle weight, and thus the simulated specific CO_2 emissions that are used for VCTS compliance purposes. Therefore, this instrument corrects this error in the application of the formula for MVL to ensure that the correct specific emissions value is calculated.

6. Legislative and Legal Context

How has the law changed?

6.1 This instrument amends the VETS Order using powers under sections 44 and 90(3)(a) and (b) of, and Parts 1 and 3 of Schedule 2 and paragraph 9 of Schedule 3 to, the Climate Change Act 2008. This instrument makes amendments to the VETS Order to extend the timeframes, caps and eligibility criteria of flexibilities, and update compliance payment amounts. It also introduces new articles into the VETS Order to deliver new flexibilities.

Why was this approach taken to change the law?

6.2 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 On 24 December 2024, the UK government, the Department for Infrastructure (Northern Ireland), the Welsh Government and the Scottish Government jointly launched a public consultation[5] seeking views on measures to support the transition to zero emission cars and vans. A series of workshops was also delivered to industry stakeholders.

7.2 The consultation closed on 18 February 2025 and received over 600 responses from a range of stakeholders including vehicle manufacturers, charge point operators, and non-government organisations.

7.3 On 7 April 2025, the joint government response to the consultation was published. It committed to extending existing flexibilities and creating new flexibilities to address manufacturers' concerns, whilst also maintaining wider climate ambitions. This commitment was made on the basis that it would be subject to further engagement with industry on detailed legislation.

7.4 On 10 July 2025, DfT and the devolved governments held a further workshop with industry to explore the detailed legislative implementation of these commitments. On 16 July, DfT (on behalf of the UK government and the devolved governments) issued a technical consultation document (with the written proposals from the workshop) to stakeholders to provide an opportunity for comment on the legislative implementation of announcements made on 7 April 2025.

7.5 The technical consultation closed on 7 August 2025 and received 9 written responses: 8 from vehicle manufacturers and one from a trade body. Almost all respondents agreed with the proposed technical implementation proposals.

7.6 Alongside the consultation, the UK Government and devolved governments jointly commissioned the Committee on Climate Change (CCC) for advice on this

[5] https://www.gov.uk/government/consultations/phasing-out-sales-of-new-petrol-and-diesel-cars-from-2030-and-supporting-the-zev-transition/

instrument, in accordance with section 48 of the Climate Change Act 2008. The CCC issued this advice on 29 September 2025 and published this on its website[6].

8. Applicable Guidance

8.1 DfT will update and publish revised guidance for the VETS Order by 1 January 2026 to align with this instrument coming into force.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument as the measure is not within the scope of the Better Regulation Framework. Instead, a full cost benefit analysis is published alongside this instrument on the legislation.gov.uk website.

Impact on businesses, charities and voluntary bodies

9.2 There is no significant impact on business, charities or voluntary bodies. As a whole, we expect a net saving to society from the purchase and operation of vehicles. However, for those groups who continue to purchase petrol or diesel fuelled vehicles, we expect them to be slightly more expensive to purchase, and slightly cheaper to run. Further detail on monetised impacts is included in the cost benefit analysis.

9.3 DfT's analysis indicates that implementation of this instrument results in a minor reduction in the overall carbon savings expected to be delivered by the 2023 Order, as amended, potentially resulting in slightly greater carbon emissions being emitted into the environment.

9.4 However, the VETS Order remains the single largest carbon saving measure across the United Kingdom economy between 2024-2050. The VETS Order is a world-leading zero emission vehicle regulation, as recognised by the International Council on Clean Transportation in 2024 and 2025. Further detail on the carbon impact is included within the cost benefit analysis.

9.5 This instrument impacts small or micro businesses, but to no greater or lesser degree than any other business. To minimise the impact of the overall regulatory requirements on small or micro businesses, derogations and exemptions from aspects of the regulatory requirements are offered. Under the VETS Order, manufacturers registering fewer than 1,000 non-zero emission cars or vans are exempt from the CO_2 standard schemes. Manufacturers registering fewer than 2,500 cars or vans (of any drivetrain type) are either automatically derogated from ZEV targets, or may apply for a derogation from ZEV targets.

9.6 There is no, or no significant, impact on the public sector. Whilst this instrument may indirectly impact people with protected characteristics in the short-term, the impacts are not expected to be significant, especially when considered alongside existing regulatory mitigations already in place.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 In accordance with Article 118 of the VETS Order, the Secretary of State for Transport is under an existing duty to review the regulatory provisions contained in

[6] https://www.theccc.org.uk/publication/letter-ccc-response-to-secretary-of-state-for-transport-vets-order/

the VETS Order and publish reports setting out the conclusions of the review. Reports must be published at intervals not exceeding five years. The first such review shall be in 2029.

10.2 Additionally, the administrator will also conduct a non-statutory mid-point review in 2027, and will continuously monitor the vehicle data to safeguard against any potential adverse effects.

10.3 Therefore, this instrument does not include a statutory review clause and, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, The Rt Hon Heidi Alexander MP, Secretary of State for Transport, has made the following statement: “A further review provision would be disproportionate when taking into account the existing regulatory review provisions already included within the VETS Order.”

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 This instrument corrects defects in the VETS Order: in Schedule 3 an erroneous bracket has been removed; in article 36(2) and 68(2) "or" is amended to "and" for clarity; and Schedule 4(10) is amended to remove a reference to the certificate of conformity. DfT has consulted with the SI Registrar. Therefore, it is appropriate to apply the free issue procedure to this instrument.

12. European Convention on Human Rights

12.1 As the instrument is subject to negative procedure and does not amend primary legislation, no statement is required.

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").