EUROPEAN COURT OF AUDITORS

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Opinion 08/2022

(pursuant to Article 322(1), TFEU)

concerning the proposal for a Regulation of the European Parliament and of the Council establishing a Social Climate Fund as revised by the Council [Interinstitutional File 2021/0206 (COD) of 30 June 2022, 10775 2022]

Contents

Introduction

01 On 14 July 2021, the Commission published a proposal to establish a Social Climate Fund[1], as part of the Fit-for-55 package, issued to support the achievement of reducing EU greenhouse gas (GHG) emissions by at least 55 % by 2030 compared to 1990 levels, as agreed in the EU Climate Law[2].

02 The EU Emissions Trading System (ETS)[3] puts a price on carbon by setting a cap on emissions from certain economic sectors, which is lowered every year. In the revision of the EU ETS, also included in the Fit-for-55 package, the Commission proposes to set up a separate ETS for road transport and buildings[4], which would lead to an expected rise in the cost of heating and transport. To address the social impact of the new ETS, the Social Climate Fund ("the Fund") would provide financial support to vulnerable households, micro-enterprises and transport users affected. ***Figure 1*** shows the main features of the Fund, providing up to €59 billion for the period from 2027 to 2032.

03 The Commission based its proposal on Article 91(1)(d), Article 192(1) and Article 194(1)(c) of the Treaty on the Functioning of the European Union (TFEU). On 28 June 2022, the Council decided to add Article 322 of the TFEU to the legal basis, as the Council's amended proposal included a derogation from Article 22(2) of the Financial Regulation[5]. On 22 November 2022, the Council asked the ECA for an opinion on its text revising the Commission's proposal (General approach reached by the Environment Council, hereinafter "the proposal")[6].

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1 Proposal for a Regulation of the European Parliament and of the Council establishing a Social Climate Fund (COM(2021) 568).

2 Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality.

3 Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union.

4 Proposal amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757 (COM(2021) 551 final).

5 Appropriations for assigned revenues.

6 Interinstitutional File 2021/0206 (COD) of 30 June 2022, 10775 2022.

Figure 1 – Main elements of the Social Climate Fund

General objective

To contribute to the **transition towards climate neutrality** by addressing the social impact of including GHG emissions from buildings and road transport in the scope of the EU ETS

Specific objective

Direct support and measures or investments to increase **energy efficiency** of buildings, increase **decarbonisation** of heating and cooling of buildings, and improve access **to zero- or low-emission mobility and transport**

Financing

Maximum **€59 billion** for 2027-2032, generated from auctioning ETS allowances, mainly in the buildings and road transport sector

Source: ECA based on the proposal.
Icons: This figure has been designed using resources from Flaticon.com. © Freepik Company S.L. All rights reserved.

04 However, in issuing this opinion, we faced the following external challenges, which limited our ability to provide a more comprehensive view on several issues covered by the proposal:

- The Council only asked the ECA for its opinion on 22 November 2022, to be received preferably by mid-December for the last political trilogue. This left us very little time to carry out our work. For example, we did not check the accuracy of calculations of the Member States' allocation of fund financing.

- This proposal is closely interlinked with the legislative proposals on the revision of the EU ETS, also currently under negotiation. Significant decisions on the revision of the ETS could change key elements of the proposal on the Social Climate Fund (timing, sectors, etc.).

- The proposal does not include the annexes with the list of common indicators or the template for the Social Climate Plans, limiting our scope.

General observations

General comments: key points

The proposal:

- aims to address the investment gap and social impact of the estimated increase of energy and fuel prices
- introduces uncertainty over revenues and the adequacy of funding
- raises the risk of double funding and overlaps with other public funds
- was issued without a specific impact assessment
- may increase administrative burden associated with management, reporting and audit requirements

05 The Social Climate Fund aims to narrow the investment gap for transition towards climate neutrality, addressing the social consequences of rising energy bills due to the creation of a new EU carbon market for emissions from the buildings and road transport sectors.

06 The Fund will be financed by auctioning allowances under the EU ETS[7]. However, the revision of the EU ETS to cover emissions from road transport and from buildings has not yet been finalised. It is unclear when the revenues will be available and whether they will be commensurate with the Fund's ambitious objectives and corresponding investment needs.

07 The proposal provides further funding for energy efficiency and decarbonisation of transport. This comes in addition to the various other EU funds, such as the Modernisation Fund, Just Transition Fund, European Structural and Investment Funds, Recovery and Resilience Facility, or InvestEU, as well as national or regional funding. It is important that the Member States address the issue of coordination and complementarity of the various funding sources, as well as the risk of double funding[8]. We did not find a comprehensive analysis by the Commission of what these funds have achieved so far, or of what is still needed in order to achieve the EU's climate objectives. Such analysis would ensure a better targeting and management of the Fund.

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[7] Article 9 of the proposal.

[8] Opinion 06/2020 on establishing the Recovery and Resilience Facility.

08 The Commission has not carried out a specific impact assessment for the proposal. It instead used the impact assessment from September 2020, "Stepping up Europe's 2030 climate ambition"[9]. The estimated financial allocation of €59 billion for 2027-2032[10] for the Fund was based on the ETS impact assessment[11] concluded in July 2021. These impact assessments could not take into account the significant impact of the war in Ukraine on the energy market, raising questions on whether they provided an appropriate and sufficient basis for the proposal.

09 The potential benefits of a separate instrument like the Social Climate Fund are unclear, and the multiplication of instruments financing the same types of projects will add complexity to EU funding. The new resources provided by the Fund are likely to add to the pressure on Member States' ability to spend, many of them already facing delays in absorption of EU funds. This could result in insufficient attention being paid to performance and value for money considerations[12]. The new framework and the resulting programming work is also likely to add to Member States' administrative workload, involving additional reporting and monitoring, audit and discharge processes.

[9] COM (2020) 562 final.

[10] The Commission initially proposed €72.2 billion for the 2025-2032 period.

[11] SWD (2021) 602 final.

[12] Special report 17/2018: Commission's and Member States' actions in the last years of the 2007-2013 programmes tackled low absorption but had insufficient focus on results.

Specific comments

Social Climate Plans

Social Climate Plans: key points

The proposal should, in line with our previous audit observation on the RRF:

- ensure consistency and complementarity with other national plans
- clarify what qualifies as satisfactory fulfilment of milestones and targets
- set clear milestones and targets as well as procedures for suspended payments
- ensure payments are linked to cost of achieving milestones and targets

10 The Social Climate Plans ("the plans") will be the basis for disbursement of financial contribution of the Fund. The plans lay out the **measures and investments** available to households, micro-enterprises and transport users affected by the inclusion in the ETS of greenhouse gas emissions from buildings and transport. It would be useful to clarify the difference between the concepts of "measures" and "investments", which is not explained in the proposal. In addition, the definition of "energy poverty" has not yet been adopted[13], although the term is used throughout the proposal.

11 The Social Climate Plans should be consistent with and **complementary** to other national strategic plans and programmes, such as the national energy and climate plans, recovery and resilience plans, cohesion policy operational programmes, territorial just transition plans, and Common Agricultural Policy strategic plans. These plans may also need to be updated in line with the Social Climate Plans. This adds significantly to the administrative burden of the national authorities. The proposal does not specify a deadline for Member States to submit their Social Climate Plans.

12 Support from the Fund should not replace recurring **national budgetary expenditure**[14]. Member States providing income support to low-income households, e.g. subsidising their heating and electricity costs, is not new. The direct income support provided by the Fund could be used for the same kind of costs, at the risk of

[13] See proposal for a directive on energy efficiency (recast), COM(2021) 558 final.

[14] Article 12 of the proposal.

replacing existing national expenditure. The proposal should clarify the concept of recurring national budgetary expenditure, to avoid double funding and overlaps.

13 The proposal establishes that the Commission will make payments to Member States based on the satisfactory fulfilment of the **milestones and targets** in the Social Climate Plans[15]. The meaning of "satisfactory fulfilment" is not explained in the proposal, which allows the Commission a considerable margin of discretion. In order to ensure transparency and equal treatment, the key principles applied when assessing "satisfactory fulfilment" should be specified in more detail.

14 The overall arrangements for disbursing funds based on achieving milestones and targets are similar to those used for the Recovery and Resilience Facility (RRF)[16]. A number of our previous audit observations on the RRF's milestones and targets could also be relevant for the Fund, as follows:

- Certain milestones and targets were unclear, which increased the risk of undue payments. We therefore highlighted the importance of adequately defining milestones and targets to cover all key implementation stages[17].

- The amount paid in a given instalment was not necessarily based on the estimated costs of achieving the milestones and targets included in the payment request, but rather a result of the negotiations with the Member State in question[18]. For partially fulfilled milestones and targets, it was not clear how the Commission and Member States would determine the amounts of the partial payments. As a result, we recommended that the Commission develop a clear methodology to determine the amount to be suspended from payments[19].

- Milestones and targets were output-oriented or included input indicators, generally referring to spending of a certain amount of funds. Avoiding impact indicators, focusing on output indicators and including input indicators for

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[15] Article 19 of the proposal.

[16] Article 5 of the proposal and articles 2 and 4 of the Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility.

[17] Special report 21/2022: The Commission's assessment of national recovery and resilience plans – Overall appropriate but implementation risks remain.

[18] Special report 21/2022: The Commission's assessment of national recovery and resilience plans – Overall appropriate but implementation risks remain.

[19] Annual report on the implementation of the EU budget for the 2021 financial year, Chapter 10.

milestones and targets considerably limits the flexibility needed during implementation and the possibility of measuring the performance and the impact of the Fund.

Eligible funding

Eligible funding: key points

- direct payments could delay energy transition, better targeting is needed
- transfers from shared management programmes could potentially undermine established safeguards

15 Increasing **energy efficiency** is a key action to be financed by the Social Climate Plans. Investments in energy efficiency face certain barriers, such as incentives being split between the owners and tenants of buildings, large upfront costs, and often long payback periods. We consider that our previous audit observations on energy efficiency projects can be relevant to the Fund (see ***Figure 2***).

Figure 2 – Audit observations for EU energy efficiency

In our report on energy efficiency **in buildings**:

- We found that, in most cases, Member States allocated the budget to projects on a first-come, first-served basis, which did not allow them to assess their relative costs and benefits. This meant they rarely prioritised projects delivering energy savings or other benefits at lower costs. We recommended improving project selection procedures.
- We mentioned that using energy audits as a primary selection requirement was a good practice. Such audits, combined with a post-works energy performance certificate, make it possible to estimate the energy saved due to the project. We also considered the installation of individual meters in households as another good practice.

In our report on energy efficiency **in enterprises**:

- We showed that some energy efficiency projects had payback times longer than their lifetime, meaning that they were not efficient.
- We highlighted that some projects would have likely taken place even in the absence of an EU grant and could have been funded through loans.
- We recommended the Commission verify whether the choice of funding instrument was reasonably justified by the Member States and that grants were not used where financial instruments would have been more appropriate.

Source: Special report 11/2020: Energy efficiency in buildings: greater focus on cost-effectiveness still needed; Special report 02/2022: Energy efficiency in enterprises – Some energy savings but weaknesses in planning and project selection.
Icons: This figure has been designed using resources from Flaticon.com.

16 Regarding **zero- and low-emission mobility**, our report on EU support for vehicle-charging infrastructure highlighted the need for harmonised payment systems, adequate user information on real-time availability and billing details for charging stations, and equitable access for all electric vehicle users. We also noted that funding for charging stations was not made conditional on a minimum period of operation[20]. Urban mobility projects were not always based on sound urban mobility strategies and often lacked coordination with neighbouring municipalities[21]. Addressing these issues would make the funding more effective.

17 Member States may fund **temporary direct income support**, limited to the direct impact of emissions trading for buildings and road transport, of up to 35 % of the estimated total cost of their plans. Direct support needs to be appropriately calculated and well targeted to the most vulnerable people who are disproportionally affected by the increase in fuel and energy price, and provided temporarily while investments measures reduce the related costs. But such support could help vulnerable households absorb the higher cost of operating coal or gas-fired heating systems and driving cars with combustion engines. The impact could therefore be to postpone the energy transition for these households and maintain their dependency on fossil fuels. We consider that the funding should better target relevant actions on energy efficiency or greening transport to address the Fund's objectives, as direct payments may to some extent impact compliance with the "do no significant harm" principle and may not align with the "lasting impact" noted in article 15 of the proposal.

18 Article 10 provides for the possibility of **transferring funds from and to the shared management programmes**[22]. On this topic:

- The proposal provides for the possibility for Member States to transfer part of the Fund's financial allocation (up to 15 %) to funds under shared management. Such programmes offer additional safeguards and national authorities have long experience of implementation.

[20] Special report 05/2021: Infrastructure for charging electric vehicles: more charging stations but uneven deployment makes travel across the EU complicated.

[21] Special report 06/2020: Sustainable Urban Mobility in the EU: No substantial improvement is possible without Member States' commitment.

[22] Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund.

- The proposal also provides for transfers from shared management programmes to the Fund. These are limited by the Common Provisions Regulation[23]. We previously pointed out that these transfers might reduce the availability of funding for other cohesion and rural development objectives[24] and might affect their primary strategic goals. We also noted that the possibility of transfers might result in the shifting of funds to programmes that are considered to have fewer conditions or be more advantageous in terms of costs[25]. In particular, the transfer of funds could potentially undermine the safeguards inherent in operational programmes subject to shared management, or open up the possibility of avoiding the co-financing that is otherwise required from Member States[26]. Therefore, we support introducing specific conditions in the proposal for such transfers of funds.

19 The proposal provides for **support of public and private entities** developing and providing affordable energy efficiency solutions and affordable zero- and low-emissions mobility services. Member States are responsible for providing safeguards to ensure that the entire benefit is passed on to households, micro-enterprises and transport users. We note that the proposal does not refer to any such safeguards, for example capping the funds available for this type of support.

Financing the Fund

Financing the Fund: key points

- further ETS allowances on top of 200 million allowances will likely be needed
- price volatility and uncertainty of available revenue can pose financing risks
- formula allocation also based on rural population is not explained in the proposal

[23] Article 26 of the Regulation (EU) 2021/1060 on common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund.

[24] Opinion 04/2022 RePowerEU.

[25] Annual report on the implementation of the EU budget for the 2020 financial year, Chapter 2.

[26] Opinion 06/2020 on establishing the Recovery and Resilience Facility.

20 The financing of the Fund, to a maximum of €59 billion for the 2027-2032 period, should be covered by external assigned revenue[27]. Revenues will be generated by auctioning allowances under the EU ETS. The proposal revising the EU ETS[28] refers to two types of allowances to be made available for the Fund:

- 50 million allowances auctioned from stationary installations (power generation and industry). These revenues are not linked to buildings or road transport, so will not impact energy price increases in the buildings or road transport sectors;
- 150 million allowances initially auctioned from the ETS for buildings and road transport, plus an undetermined number of allowances auctioned in these two sectors to bring revenues up to the required €59 billion.

21 Auctioning 200 million allowances would require a price of €295 per allowance to generate €59 billion, while in November 2022 the price of the allowances in the auction platform averaged around €80 per allowance[29]. The Commission worked on the assumption of €45 per allowance (2020 prices), which translate into €9 billion in revenues from the 200 million allowances detailed above. To generate revenues of €59 billion, the Commission will most likely need to auction significantly more ETS buildings and road transport allowances.

22 The Commission proposed that 25 % of ETS revenues become new own resources[30], to be used among others to repay the Next Generation EU grants or reduce the share of Member States' gross national income-based contribution to the financing of the EU's annual budget[31]. The Commission estimated that 25 % of the ETS revenue generated by including buildings and road transport in the ETS would suffice

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[27] Article 9 of the proposal. External assigned revenue is used to finance specific items of expenditure, as defined in article of the Financial Regulation. On assigned revenue, the European Parliament is excluded from the decision-making process.

[28] Council's General Approach of 30 June 2022, Interinstitutional File: 2021/0211 (COD) 10796/22.

[29] https://www.eex.com/en/market-data/environmental-markets/eua-primary-auction-spot-download.

[30] Commission Proposal (COM(2021) 570) of 22 December 2021 amending Decision (EU, Euratom) 2020/2053 on the system of own resources of the European Union.

[31] Interinstitutional agreement on budgetary discipline (…) including a roadmap towards the introduction of new own resources.

to address the financing needs of the Fund[32]. The ETS has been operating since 2005 and prices for emissions allowances have fluctuated significantly (between €5 and €55 from 2005 to 2021)[33], which makes it a relatively volatile source of EU revenue.

23 Upon approval of the Social Climate Plans, the Commission will sign legal commitments with the Member States to pay up to the maximum financial allocation until the duration of the Fund ends. The proposal provides for the possibility of **proportionally reducing payments** in case of insufficient assigned revenues in a given year, with the balance to be paid when revenues become available[34].

24 The formula for allocating funds to Member States takes into account population, including the proportion of rural areas, poverty levels, CO_2 emissions from fuel combustion by households, and gross national income per capita. These criteria are consistent with the objectives of the Fund. However, the proposal does not detail why the population in rural areas receives a higher weighting in the allocation formula.

Control and performance framework

Control and performance framework: key points

- Commission assessment of the plans needs to be well documented
- compliance with applicable EU and national law should be detailed
- cases of suspected fraud need to be reported at national and EU level
- common indicators should be relevant, accepted, credible, easy and robust

25 We welcome the fact that the proposal expressly authorises the Commission, OLAF, the European Court of Auditors and, where relevant, the EPPO to exert their access, audit and investigation rights.

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32 Proposal amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757 (COM(2021) 551 final).

33 EU Carbon Market Report (COM(2021) 962): Clearing prices for auctions of general allowances between January 2013-30 June 2021.

34 Article 19.9 and Article 18 of the proposal.

26 Article 15 sets out a list of criteria for the **Commission's assessment** of the national Social Climate Plans, which have a similar structure to those of the Recovery and Resilience Plans (RRPs). We found that the documentation trail was generally fragmented and that the analyses appeared in multiple working papers of the Commission for different components of the RRPs. We also found that the Commission had applied a qualitative assessment of each RRP against the standards of the RRF regulation rather than a comparative assessment[35]. The proposal explicitly refers to the identification of best practices across Member States in article 4.3.

27 Member States are required to provide assurance in their management declarations that the financial allocations are managed in accordance with all applicable rules, in particular rules on the avoidance of conflicts of interest, fraud prevention, corruption and double funding[36]. However, there is no direct obligation for the Commission to verify whether Member State control systems provide the necessary assurance, and this poses risks of assurance and accountability gaps, and ultimately risks with regard to protecting the financial interest of the Union. We therefore consider that the proposal should clarify and strengthen the Commission's responsibility for compliance with national and EU rules.

28 We previously reported cases of non-compliance with EU and national rules, such as procurement, state aid and eligibility rules. As a consequence, given the coverage of the control framework for the Fund and the limited responsibility defined for the Commission, there may be limited verified information at EU level on whether and how Member States' systems adequately cover the significant risk of **non-compliance with EU and national rules**.

29 Article 20.5 of the proposal suggests that the Commission's responsibility is limited to fraud, corruption, conflict of interest and breach of obligations stemming from the financing agreement. In particular, the proposal addresses **anti-fraud measures** in a more detailed manner than the RRF regulation, although it is unclear how and at what level (national and/or EU) cases of suspected fraud should be reported.

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[35] Special report 21/2022: The Commission's assessment of national recovery and resilience plans – Overall appropriate but implementation risks remain.

[36] Article 20 and Annex III of the proposal.

30 We consider it positive that Member States will be required to collect, record and store in an electronic system data on final recipients, contractors, and sub-contractors[37]. Up-to-date information on the amount of financial support received by final recipients will also facilitate the monitoring of the absorption of funds. However, as information is only required on first-level sub-contractors receiving more than €50 000, some sub-contractors will not be reported. We also note that there is no time limit for publishing this information.

31 Article 20 requires Member States to establish an effective and efficient internal control system based on the key requirements set out in Annex III to the proposal. We consider that Member States should also be required to carry out management verifications and audits to ensure that funds have been used in line with relevant EU and national law. The Commission's assessment of the adequacy of the Member States' control systems is described in a very general manner in the proposal, which, unlike the RRF regulation, does not require the Commission to apply a rating system[38].

32 We welcome the provisions on the **monitoring and evaluation** of the Fund. However, the annex with the common indicators is missing from the proposal. We previously noted that the monitoring framework for energy efficiency did not allow the Commission to assess the EU budget's contribution to the EU energy efficiency target[39]. Such indicators should correspond to the Fund's objectives and be suitable for measuring its performance. As far as possible, they should follow the Relevant, Accepted, Credible, Easy and Robust (RACER) criteria[40].

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[37] Article 20 of the proposal.

[38] Proposal on establishing a Recovery and Resilience Facility, Annex II. Examples of a rating system are: to a high/medium/low extent; high/medium/low expected impact; contributes effectively/partially/does not contribute; adequate/minimum/insufficient arrangements.

[39] Special report 11/2020: Energy efficiency in buildings: greater focus on cost-effectiveness still needed; Special report 02/2022: Energy efficiency in enterprises – Some energy savings but weaknesses in planning and project selection.

[40] Opinion 06/2020 on establishing the Recovery and Resilience Facility.

Concluding remarks

33 The Social Climate Fund was proposed by the Commission in July 2021 and revised by the Council in June 2022. It aims to address the social consequences of rising energy prices due to the creation of a new EU Emissions Trading System (ETS) for the buildings and road transport sectors. The Fund has the opportunity to make an important contribution to the EU achieving climate-neutrality by 2050.

34 Auctioning EU ETS allowances from the buildings and road transport sectors will provide financing for the Fund of up to €59 billion for 2027-2032. The price volatility affecting EU ETS allowances and the uncertainty of available revenue may pose financing risks. As the Commission has not yet adopted procedures for managing the proposed new own resources or for calculating, establishing and recovering revenue, it is unclear when the revenues will be available and whether they will be commensurate with the Fund's ambitious objectives and corresponding investment needs. The lack of a specific impact assessment for the proposal adds to this issue.

35 The proposal builds on basic features from the Recovery and Resilience Facility (RRF), such as national plans, payments conditional on satisfactory fulfilment of milestones and targets, additionality and complementarity with other EU and national funds, and compliance with the "do no significant harm" principle. However, as for the RRF, the Commission will mainly assess the likelihood of achieving green objectives at the assessment stage of the plans, and to a lesser extent when it assesses payments requests.

36 In this context, we would like to stress the importance of drawing on lessons learned from the implementation of the RRF in further procedures and decisions on the Social Climate Fund. In particular, we believe that certain weaknesses, which we previously highlighted for the RRF, are also relevant for the Fund:

- risk of double funding and overlapping objectives with other public instruments and funds;
- insufficient attention to performance and value for money due to added complexity and administrative burden;
- potential weak link between payments and the Fund's objectives, milestones and targets;

- assurance and accountability gaps with regard to protecting the EU's financial interests;
- indicators, milestones and targets not effectively assessing performance.

This opinion was adopted by the Court of Auditors in Luxembourg at its meeting of 15 December 2022.

For the Court of Auditors

Tony Murphy
President