REPLIES OF THE EUROPEAN COMMISSION TO THE EUROPEAN COURT OF AUDITORS SPECIAL REPORT:

"SUSTAINABLE FINANCE: MORE CONSISTENT EU ACTION NEEDED TO REDIRECT FINANCE TOWARDS SUSTAINABLE INVESTMENT"

EXECUTIVE SUMMARY

I. Replies from the Commission and the European Investment Bank on the Executive summary (paragraph I-IX):

Sustainable finance plays a key role in delivering on the European Green Deal objectives as well as on the EU's international climate and sustainability commitments. It does this by channelling private investment into the transition to a climate-neutral, climate-resilient, resource-efficient and sustainable economy, as a complement to public financing.

The Commission has focused its efforts on legislating in the area of sustainable finance, which has become even more vital, given the need for sustainable recovery from the COVID-19 crisis.

The Strategy for financing the transition to a sustainable economy, published on 6 July 2021, identifies areas for further action to support the transition of the financial system towards sustainability. The Strategy's initiatives highlight the EU's global leadership in setting international standards for sustainable finance. The Commission will work closely with all international partners, including through the International Platform on Sustainable Finance, to cooperate on building a robust international sustainable finance system.

The strategy is accompanied by a Staff Working Document that informs on progress in the implementation of measures under the 2018 Action Plan. The 2018 Action Plan included ten key actions that can be divided into three categories: reorienting capital flows towards a more sustainable economy, mainstreaming sustainability into risk management, and fostering transparency and durability.

Moreover, to reduce emissions by at least 55% by 2030 and achieve a climate-neutral Europe by 2050, the Commission has proposed a Fit for 55 package (July 2021) which covers wide-ranging policy areas.

Most of the 2018 actions have been completed. They have resulted in the adoption of the Sustainable Finance Disclosure Regulation (SFDR), the EU Taxonomy Regulation, a Climate Delegated Act under the EU Taxonomy (June 2021) and the delegated act providing reporting requirements on the economic activities of financial and non-financial companies (July 2021). The obligatory disclosure under the said delegated act on reporting requirements shall provide uniform and transparent information about the environmental performance of the companies and assets they finance. It will help investors and the public to understand the companies' trajectory towards environmental sustainability and take informed decisions. In addition, the 2018 Action Plan will lead to the adoption of the taxonomy delegated act on the remaining four environmental objectives.

In April 2021 the Commission adopted a proposal on Corporate Sustainability Reporting Directive (CSRD). Subject to adoption by the Council and the Parliament, the Directive will extend the reporting scope to all large companies and all companies listed on regulated markets (except listed micro-enterprises); require the audit (assurance) of reported information; introduce more detailed reporting requirements, and a requirement to report according to mandatory EU sustainability reporting standards; require companies to digitally 'tag' the reported information, so it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan.

The Commission has integrated, wherever possible, aspects of the Taxonomy Regulation into the EU budget. The 'do no significant harm' principle is largely applied across the EU budget through a number of tools and regulatory provisions. It has been transposed in the Recovery and Resilience

Facility (RRF), which is the largest programme under the 2021-2027 Multiannual Financial Framework (MFF). It needs to be taken into account in the implementation of all programmes covered by the Common Provisions Regulation. Broadly equivalent criteria, such as sustainability proofing, climate proofing and exclusion lists are envisaged in the legal acts underpinning other spending programmes to ensure that EU-funding does not lead to environmental harm. In the case of the future Common Agricultural Policy (CAP), adherence to social and enhanced conditionality will ensure the implementation of "do no significant harm" principle in an appropriate manner.

The EU climate coefficients, which are used to measure climate expenditure in the 2021-2027 MFF and Next Generation EU, are aligned to the maximum extent possible with the technical screening criteria under the EU Taxonomy's first delegated act. The EU climate coefficients and climate tracking methodology for the EU budget also recognise efforts and investments that are not covered by the Taxonomy or not entirely in line with it if they nevertheless produce a beneficial climate effect or are relevant for the green transition.

INTRODUCTION

03. The Commission agrees that it is challenging to organise the financing of a socially just and environmentally sustainable transition towards a climate neutral and resilient economy. Therefore the European Green Deal is crucial in achieving this objective, including through the circular economy action plan and the biodiversity strategy.

04. Concerning the 2021-2050 estimate (1 tillion p.a.), the Commission notes that the cited report refers to 28 trillion euros over the next 30 years, about 80% of which (23 trillion in total or 0.8 trillion p.a.) would come from redirecting investments that would otherwise have funded carbon-intensive technologies, and the EU would have to allocate an additional 5.4 trillion euros, i.e. an average gap of 180 billion euros p.a., to clean technologies and techniques, which latter coincides with the 2018 Commission's estimations.

05. **- Markets do not reflect the full social and environmental cost of economic activities**

The Commission agrees that current pricing in financial markets does not integrate environmental externalities. While taking ambitious action in climate policy, the Commission also recognises that financial market structures also play an important role in the transition, and these are currently not fit for embedding sustainability considerations.

At the same time, the Commission set up a staged approach, where focused on the climate and environmental risks, which should be followed by other actions which might include also social aspects.

- Lack of sufficient transparency and disclosure on sustainable activities

Transparency and disclosure requirements are addressed in the EU Taxonomy Regulation, and is being further supported by the Delegated Acts, as laid down by the EU Taxonomy.

The adoption of the Corporate Sustainability Reporting Directive (improving upon the previous Non-Financial Reporting Directive) and other measures increasingly applied across the economy (even having an impact in updating environmental statistical accounts) will also work against greenwashing, providing robust reference to what extent economic activities are green.

- Some sustainable investments face potentially higher risks and costs of financing

The Commission acknowledges that sustainable investment needs estimates might change over time, and that public support in financing and catalysing is vital. Therefore, the Commission supports Member States in many ways, through the EU Budget and the EU recovery instrument (Next Generation EU), through dedicated technical support projects (for instance those on green budgeting and green taxation) and other tools.

06. Based on comprehensive discussions with Member States and different European bodies as well as inputs from a public consultation, the Commission adopted the Strategy for financing the transition to a sustainable economy in July 2021. The Strategy follows on actions under the 2018 Action Plan and will develop the area of sustainable finance further. The Strategy provides a cross-cutting roadmap with new actions to redirect private investment towards sustainable projects and activities to support the different actions set out in the European Green Deal. The Commission recognises that for an orderly transition, full transparency is needed on the exposure of climate risks, including possible stranded assets, and the financial stability implications of these. This Strategy is another important piece for the future sustainable finance framework.

09. The target of 30% climate expenditure applies to the EU budget together with Next Generation EU, resulting in €625 billion climate expenditure for the period 2021-2027. The Recovery and Resilience Facility, with its 37% sectorial target, falls under this.

Apart from climate allocations in the EU budget, further resources will be dedicated to environmental issues, such as the annual 7.5% of EU budget in 2024 and 10% in 2026 and 2027 supporting biodiversity, as well as national co-financing, and private investment leveraged to provide the necessary financial pool to sustainability investments.

Beyond that, improving estimates on and in support of Zero Pollution Action and on Circular Economy actions (under the Green Deal) will provide further financing opportunities to address environmental objectives. In many cases investments also generate synergies across multiple environmental objectives e.g. contributing to climate and biodiversity simultaneously.

OBSERVATIONS

22. The Platform on Sustainable Finance set up by the EU Taxonomy, which formally started its work in autumn 2020, is tasked to report on the remaining four environmental objectives laid down by the EU Taxonomy and on a possible extension of the EU Taxonomy to social objectives, as well as on the development of the taxonomy with regard to economic activities that do not have a significant impact on environmental sustainability, and economic activities that significantly harm environmental sustainability.

At the same time, the Commission is working on prudential rules that will integrate climate risks.

23. *Common reply to paragraphs 23-24:*

The Commission acknowledges that the EU Emissions Trading System (ETS) and other measures need to be further developed. Within the ongoing EU ETS reform, the Commission considers to extend the EU ETS to transport and buildings, and to complement it with a carbon-border adjustment mechanism (CBAM), and with supporting environmental tax reforms (ETR). At the same time, the Commission underlines that other sector-specific regulations further integrate climate considerations. The “Fit For 55” legislative package further strengthen the economic signal.

26. The Commission recognises that the phasing-out of environmentally harmful subsidies is an important lever to meet its environmental objectives. The Commission is actively working on it through support to best practices and building engagement across Member States (e.g. through technical support instrument projects, greening budgets and reforming taxation).

27. *Common reply to paragraphs 27-28:*

A stocktake on the progress on the 2018 Action Plan is provided in the Staff Working Document accompanying the Strategy for financing the transition to a sustainable economy that the Commission adopted in July 2021. The Commission acknowledges that the implementation of the Action Plan suffers from some delays. However, it has to be noted that setting up a classification of green activities (including energy measures) is a complex exercise that has required extensive engagement with experts, stakeholders and EU Members States in particular.

29. The Commission acknowledged that the results of the Action Plan measures may be better monitored. However, the transformation of the financial system, including the increasing use of Taxonomy rules, the incorporation of long-term environmental risks and improved sustainability reporting will also manifest itself in the financing practice, through improved sustainability and environmental reporting and proofing practice, with observable effects on sustainable financing.

32. The EU Taxonomy requires to measure the greenness of investments according to EU rules, improving transparency and fostering responsible decision making.

Financial and non-financial companies will disclose information on the basis of the technical screening criteria laid down by the EU Taxonomy.

35. *Common reply to paragraphs 35-36:*

Complementary legislative proposals will further clarify the sustainability of certain activities under the taxonomy regulation, including agriculture, nuclear energy and natural gas.

In addition, to provide relevant criteria to the market, the sectors mentioned (electricity production from gas and nuclear energy) will be subject to further analysis.

42. EU Ecolabel framework is a voluntary third party verified scheme established in 1992 (Regulation (EC) No 66/2010).

The development of the criteria in order for financial products to be awarded the EU Ecolabel and the requirements for the verification are set in the EU Ecolabel Regulation (EC) No 66/2010.

According to the EU Ecolabel Regulation, each Member States will appoint a Competent Body (which can be a private or public entity) in charge of verifying that financial products applying for the EU Ecolabel comply with the EU Ecolabel criteria, before awarding them the EU Ecolabel. The Commission will draft a user manual for the competent bodies with instructions and guidance on how to check compliance with the EU Ecolabel criteria.

It is the responsibility of Member States to appoint the competent bodies, but Annex V of the EU Ecolabel Regulation sets the general requirements for them. As per Article 13 of the EU Ecolabel Regulation, the Commission shall set up a working group of competent bodies ("CB Forum") for the purpose of fostering consistent implementation of the EU Ecolabel Regulation among competent bodies. Moreover, the EU Ecolabel products are under the remit of market surveillance authorities. In terms of verifying compliance of the underlying investments with the EU Taxonomy criteria, this information will be disclosed in accordance with the CSRD and will be reviewed by auditors. Competent bodies in charge of verifying compliance of underlying investments of financial products that apply for the EU Ecolabel, with the EU Taxonomy, will rely on this information as reviewed by the auditors.

47. The regular frequency and the extent of the checks to be carried out by the national competent authorities are set out in the relevant sectoral rules referred to in the SFDR. In fact, the SFDR adds sustainability disclosure requirements to the already existing product disclosure/information required under these sectoral rules.

The Q&As (that will be published in summer 2021) and the regulatory technical standards that will be adopted by the end of 2021 will provide further guidance aiming at harmonising and clarifying the supervision of the SFDR application.

65. The climate tracking system and criteria for the InvestEU programme had to be devised and adopted before the final adoption of the EU Taxonomy delegated acts.

In line with the InvestEU Regulation, climate and environmental tracking for InvestEU funds is to be done through the Union's tracking methodology, which is informed by the criteria of the EU Taxonomy.

The InvestEU climate and environmental tracking guidance foresees an ex-ante indication of expected contribution to climate and environmental objectives at approval phase. It also foresees ex-post reporting for each supported financing or investment operation. Implementing partners shall indicate divergences of results from initial expectations in their ex-post reporting.

It is worth noting that the Invest EU climate and environmental tracking guidance foresees the possibility for implementing partners to track climate and environmental operations using EU Taxonomy criteria (when adopted). It is therefore also possible for less experienced implementing partners to use a simpler Union tracking system initially and to fully transition to the EU Taxonomy when ready.

66. The Commission recalls that the European Fund for Strategic Investments (EFSI) is demand driven and can support financially viable project with higher risk profiles. Many climate adaptation projects are not economically viable, are often done by public authorities and are thus not always suitable for repayable support. Therefore, the observation that most sustainable projects relate to climate mitigation is in line with what could be expected for an instrument targeting financially viable and higher risk-projects aiming at mobilising private financing.

71. As noted by the ECA Special Report on the European Investment Advisory Hub (EIAH), the EIAH should be **additional** with regard to other EU programmes, including JASPERS, which has Central and Eastern Europe as its main geographical area of operation, as well as covering the sectors indicated for the provision of technical assistance support to prepare and develop projects to be funded via ESI Funds grants. The EIAH is a **demand driven initiative** created with the objective of improving the quality of investment projects by offering tailored advisory support to European project promoters. Defining priorities for services for different sectors and Member States for EIAH goes against the demand driven essence of the EFSI Initiative.

The EIAH has developed a robust cooperation platform with national promotional banks and institutions, with direct funding and expert support to a number of them in the central and Eastern European countries, and with the aim of building their capacity to provide more local advisory services including for sustainable infrastructure. The structure of the InvestEU Advisory Hub is well-positioned to build on the groundwork provided by EIAH, and addressing certain concerns raised by the High-Level Expert Group on sustainable finance in respect of generating sustainable investment projects.

72. The mission and added value of the portal is to publicise and increase visibility of potential investment opportunities for project promoters who wish to use the portal. The Commission does not have the mandate to perform technical and financial due diligence of published project proposals and direct investors to specific projects. Neither does Commission have the resources or competences to perform project due-diligence. This is a responsibility and competence of potential investors.

However, in accordance with Article 26(3) of the InvestEU Regulation, the Commission will transmit published projects on the InvestEU Portal to the relevant implementing partners and where appropriate to the InvestEU Advisory Hub.

73. The Commission agrees that some of the plans lack detailed quantifications of investment needs, which also complicates comparability among Member States. The Commission continues to provide support to Member States, and under the Technical Support Instrument has launched a new flagship initiative entitled “Greening of public finances - evaluating budgetary and fiscal policies’ impacts on the delivery of national and international commitments” that notably aims to help build Member State capacities to quantify investment needs, identify gaps and develop policy to bridge them.

76. The Recovery and Resilience Facility (RRF), the largest programme under Next Generation EU, requires a “do no significant harm” (DNSH) assessment based on Article 17 of the Taxonomy Regulation, while the application of the detailed DNSH criteria as adopted in the delegated acts is

optional. Similarly to the RRF, broadly equivalent criteria (e.g. sustainability proofing, climate proofing, exclusion list) are envisaged in the legal acts underpinning other spending programmes to ensure that EU funding does not lead to environmental harms. Moreover, the inter-institutional agreement between the European Parliament, the Council and the Commission that accompanies the 2021-2027 MFF foresees a horizontal "do-no harm" principle that applies to the entire 2021-2027 MFF.

A one-size fit-all formulation of the "do no harm" principle across the different policy areas of the EU budget is not possible, considering the different implementation cycles, management modes and activities funded

The Commission considers that the future CAP will ensure the implementation of "do no significant harm" principle through social and enhanced conditionality.

77. The "do-no-significant harm" principle has been incorporated in the RRF and has to be taken into account in the implementation of all Funds subject to the Common Provisions Regulation (CPR).

As explained in the reply to paragraph 75, the different implementation cycles, management modes and activities funded by the EU are not consistent with a one-size fits-all approach to determining whether significant harm is being done to the environment.

78. Under the European Regional Development Fund (ERDF) and the Cohesion Fund, investment in gas infrastructures is not permitted with the exceptions of replacing solid fuel fired heating systems and boilers under specific conditions and of other infrastructures where this supports the transition to renewable energy and can be used for renewable and low-carbon sources, as stipulated in 7(1)(h) of the ERDF and the Cohesion Fund Regulation. Such limited investments related to natural gas should be well-justified and contribute to reducing greenhouse gas emissions in a way that supports the transition towards climate neutrality.

The Commission recalls that under the Recovery and Resilience Facility, measures related to power and/or heat generation using fossil fuels, as well as related transmission and distribution infrastructure, as a general rule should not be deemed compliant under the "do no significant harm" principle.

From a climate change mitigation perspective, exceptional measures related to power and/or heat generation using natural gas, as well as related transmission and distribution infrastructure, can be made on a case-by-case basis (following Annex III of the DNSH guidance), and provided that this support would contribute to the EU's decarbonisation objectives for 2030 and 2050. No investments in coal or oil power and/or heat generation will pass DNSH assessment.

79. The Commission notes that the climate tracking methodology underpinning the 2021-2027 MFF has addressed several of the shortcomings of the methodology underpinning the 2014-2020 MFF, which were identified by the previous ECA reports.

The 2021-2027 climate tracking methodology, as enshrined for example in the RRF Regulation, builds on the 2014-2020 CPR methodology but has been modified to take into account aspects of the EU Taxonomy criteria and provides the basis for climate tracking across the budget.

The 2021-2027 climate tracking methodology allows for the recognition of both major climate contribution with a 100% climate coefficient based on criteria that are inspired by the EU taxonomy and of more limited climate contributions (with a 40% coefficient), as well as to assess in a more granular way the contribution to climate objectives of different actions and speed of implementation, for example concerning different energy efficiency actions.

80. The Commission recalls that the methodology for climate tracking has been significantly strengthened in the run-up to the 2021-2027 MFF. In particular the attribution of the 100% weight is

now guided by substantially stricter criteria, which are informed to the extent possible by the EU Taxonomy technical criteria and weigh not just the intent but also the effects of the various activities.

The 40% EU climate coefficient is attributed to activities that, while not fulfilling the integrated technical criteria of the EU taxonomy, nevertheless contribute to environmental and climate objectives. Such economic activities may, for example, be on a transition pathway towards reaching the significant contribution level.

For the green bonds that the Commission will issue to finance the climate part of the RRF, the Commission will put forward a green bond framework, which will be as much as possible aligned with the proposed Green Bond Standard. The EU green bond framework will be based on well-known and established market standards while catering to the specific structure of the RRF where, inter alia, spending authorities are separate from the issuing institution. It will provide the necessary guarantees to investors that the proceeds have truly been used for green investments.

In line with this best-in-class approach, the Commission will seek verification of its green bond framework by an independent party.

Box 5 - The Commission draws attention to the fundamental difference between the EU Taxonomy criteria currently only focusing on activities performing above the substantial contribution criteria and other EU policies, such as the CAP, which covers a broader eligibility spectrum for financial support with not necessarily lower level of ambition than the Taxonomy. Hence, this diversity is reflected in the climate tracking of expenditure.

81. The Commission recalls that the EU budget has already integrated wherever possible aspects of the Taxonomy into the EU climate coefficients, which are used to measure climate expenditure in the 2021-2027 MFF and Next Generation EU. Moreover, the EU climate coefficients and climate methodology in general for the EU budget also have to recognise efforts and investments that are not covered or not entirely in line with the Taxonomy as these may nevertheless also produce a beneficial climate effect or be relevant for the green transition.

As regards the risk of potential harm from EU spending, the Commission refers to its response to paragraph 75.

The Commission considers the rules set out in EU legislation covering the funding programmes to be appropriate for addressing the policy objectives, and underlines that the roles of public and private finance differ. The Commission reiterates that the use of the Taxonomy for EU funding decisions, or in other pieces of EU policy, should be assessed on a case-by-case basis and will be discussed with the other EU institutions in accordance with the relevant legislative procedures.

CONCLUSIONS AND RECOMMENDATIONS

82. The Platform on Sustainable Finance is currently working on their advice to the Commission on the possible extension of the EU Taxonomy, among others, to social activities. However, transforming pricing mechanisms in the economy, to reflect true costs of environmental pollution and other environmental degradation is a process, on which the Commission is constantly working.

Recommendation 1 **– Complete the measures of the Action Plan and clarify compliance and audit arrangements**

a) The Commission accepts recommendation 1 a).

The Taxonomy Regulation was adopted and entered into application. The EU Taxonomy Climate Delegated Act (adopted in June 2021) and the forthcoming delegated act on the taxonomy of the remaining four environmental objectives will complete the Action Plan.

The Commission is following up on the analytical and consultative work carried out under the Action Plan in the area of corporate governance in accordance with the Commission Work Programme 2021, which envisages a legislative proposal on sustainable corporate governance to foster long-term sustainable and responsible corporate behaviour. The aim is to present a proposal by the end of 2021.

b) The Commission accepts recommendation 1 b).

c) The Commission accepts recommendation 1 c).

Common Commission reply to recommendations 1 b and 1 c:

Article 8 of the Taxonomy Regulation requires financial and non-financial undertakings to disclose on how and to what extent are their activities aligned with the Taxonomy Regulation.

This disclosure obligation falls under company law (Accounting Directive as amended by the Non-Financial Reporting Directive).

Currently, the Commission proposed the CSDR, which amends the provisions of the Non-Financial Reporting Directive (subject to adoption by the co-legislators expected by mid-2022), and will require auditors to verify and express an opinion on sustainability reporting's compliance with requirements (including taxonomy reporting under Article 8 of the Taxonomy Regulation). Sustainability reporting standards will be developed for all companies that will fall under the scope of the future CSRD obligations, i.e. large companies (listed and non-listed), and SME reporting standards will be developed for listed SMEs.

Regarding the financial products, Article 8 of the Taxonomy Regulation (its delegated act) and the regulatory technical standards under the SFDR (to be adopted by end 2021) require to disclose the alignment of underlying investments to the Taxonomy Regulation.

In the context of the SFDR, Member States should rely on the competent authorities already designated under the sectoral rules referred to in the SFDR for the supervision and monitoring of such disclosures (that is the financial markets authorities of Member States). These authorities will rely on the information that will be disclosed by financial and non-financial undertakings as explained above.

Recommendation 2 – Better contributing to sustainable finance by pricing greenhouse gas emissions

The Commission accepts this recommendation.

As recognised in this report, the EU climate policy uses a range of tools to achieve our objectives. The "Fit for 55" package further increases the ambition.

For example, as part of the package, the Commission proposes to strengthen the EU Emissions Trading System in its current scope, and to amend the Market Stability Reserve. These reforms would translate into lower supply of allowances and potentially higher carbon price – although, the market is, according to most market analysts, already anticipating future legislative changes in line with the increased EU climate ambition of at least 55% net emissions reductions in 2030 compared to 1990, as enshrined in the proposed European Climate Law.

Furthermore, as part of the Fit for 55 package, the Commission put forward a proposal for the establishment of a Carbon Border Adjustment Mechanism (or CBAM).

Likewise, for the financial sector, the Strategy for financing the transition to a sustainable economy puts forward proposals to embed sustainability risk in the financial system framework.

87. The Commission recalls that EFSI is demand driven and can support financially viable project with higher risk profiles. Many climate adaptation projects are not economically viable, are often done by public authorities and are thus not suitable for repayable support. Therefore, the observation that most sustainable projects relate to climate mitigation is in line with what can be expected for an instrument targeting financially viable and higher risk-projects aiming at mobilising private financing.

In line with the InvestEU Regulation, InvestEU climate and environmental tracking is to be done through Union tracking system appropriately using the criteria of the EU Taxonomy. Relevant draft EU Taxonomy criteria are reflected in the Union tracking system and in addition, implementing partners can fully track climate and environmental operations using EU Taxonomy substantial contribution criteria (when adopted). This system provides flexibility for less experienced implementing partners to use a simpler Union tracking system and to align with the EU Taxonomy when ready. InvestEU climate and environmental tracking guidance foresees reporting of climate and environmental results ex ante as well as ex post based on results.

Recommendation 3 – Reporting on climate and environment related results of InvestEU

The Commission accepts this recommendation.

Recommendation 4 – Generating a pipeline of sustainable projects

a) The Commission accepts recommendation 4 a).

The InvestEU Advisory Hub will aim at increasing its focus on projects that could eventually be supported by the InvestEU Fund. Where possible, and depending on project promoters' interest, areas and sectors that have the greatest need for climate and environmental investment will be prioritised, including climate change adaptation, natural capital, energy efficiency, circular economy. Additionally, the EIB is actively developing new advisory support as well as support through existing mandates such as EIAH and JASPERS, for both public and private clients, as outlined in its Climate Bank Roadmap, by engaging upstream in Member States where proactive support can help develop a bigger pipeline of climate action and environmental sustainability investments. Several lines of advisory support are ongoing or being developed in 2021, including, but not limited to, the Member State Energy Finance Workshops, with a focus on central and Eastern Europe, the Green Portal for intermediary banks, and EIB's upcoming 2021 Adaptation Plan.

b) The Commission accepts recommendation 4 b).

89. A one-size fit-all formulation of the "do no harm" principle across the different policy areas of the EU budget is neither necessary nor appropriate, considering the different implementation cycles, management modes and activities funded. This does not mean that there are no safeguards against environmental harm in Union policies.

The Commission considers that the future CAP will ensure the implementation of "do no significant harm" principle through social and enhanced conditionality.

The application of the "do no significant harm" (DNSH) principle within the meaning of Article 17 of the EU Taxonomy is mandatory under the RRF Regulation. Member States must show for every reform and investment that the DNSH principle is complied with for all included environmental objectives. No national recovery and resilience plan will be accepted if this is not shown. The Commission has provided guidance for Member States on how compliance with the DNSH principle can be shown. This guidance is, to a large part, based on the EU Taxonomy but leaves flexibility. This allows Member States for example to show compliance with the principle also for investments that do not fall under the Taxonomy.

90. The EU budget funds a very large spectre of activities, through different cycles and methodologies. Moreover, the EU budget finances activities, which are not covered by the EU Taxonomy, or activities that, while not meeting the strict technical criteria of the EU Taxonomy, nevertheless contribute to the EU climate objectives. This is why the EU applies the EU climate tracking methodology for the 2021-2027 MFF, which takes into account EU Taxonomy criteria, where possible and appropriate.

The contribution of the EU budget to climate action is being estimated ex-ante and will be calculated ex-post based on this public and transparent methodology, which has by now been enshrined in several legal acts. This methodology aims at factoring in all the activities that contribute to the EU climate objectives. The weighting system used is informed by, and aligned to the maximum possible extent, with, the EU Taxonomy technical criteria. The commitment to devote the equivalent of at least 30% of the 2021-2027 MFF to climate objectives is based on this methodology.

Some investments under the RRF are not covered by the EU Taxonomy. Others do not meet all the EU Taxonomy criteria. Both types of investments can however contribute to the EU's efforts to fight climate change. The EU green bond framework, also discussed in our reply to paragraph 79, will provide investors with all the relevant information.

Recommendation 5 – Applying the "do no significant harm principle" and the EU Taxonomy criteria consistently across the EU budget

a) The Commission partially accepts recommendation 5 a).

The Commission committed in the EU Green Deal Communication to the implementation of the "do no harm" principle as an underpinning principle of its actions, in line with its Paris agreement commitments.

In practice, this has been translated into the commitment in the Inter-institutional Agreement accompanying the 2021-2027 MFF to apply the "do no harm" principle when designing climate and biodiversity mainstreaming.

To ensure the uptake of this principle, the EU budget includes several safeguards that work in synergy with the primary objectives of the individual funds. This translates, for instance, into sustainability proofing for the programmes investing in infrastructures, into social and enhanced conditionality in the future CAP, or lists of investments that cannot be financed by the EU budget.

Where relevant and applicable, on the basis of Commission proposals, this principle has been included in the relevant legislation, such as the Common Provision Regulation and the Recovery and Resilience Facility, with a direct link to the EU Taxonomy.

The Commission considers that a uniform application of the EU Taxonomy 'do no significant harm' principle across the entire EU budget is neither feasible nor appropriate due to the diversity of the EU spending programmes, in terms of cycles, management modes, activities covered and ultimate objectives.

b) The Commission partially accepts recommendation 5 b).

The Commission will reflect how to include an appropriate reference to the "do no significant harm" principle in the forthcoming proposal for a revised Financial Regulation, taking into account its scope of application and the differentiated nature of the Union budget. However, the Commission cannot, at this stage, give commitments on the exact content of the future legislative proposal.

The Commission also recalls that it is committed to implement the "do no harm" principle in the Inter-institutional Agreement accompanying the 2021-2027 MFF, which applies to all MFF programmes. The Commission has full faith in the Partners' commitment to this agreement.

c) The Commission partially accepts recommendation 5 c).

As explained most recently in the June 2021 "Communication on the Performance Framework for the EU budget", the Commission has strengthened its climate tracking methodology for the 2021-2027 MFF. In particular, it has implemented a substantial enhancement, moving from the "OECD Rio markers" used in the 2014-2020 MFF to the "EU Climate coefficients" used in the 2021-2027 MFF. These EU climate coefficients, which have been enshrined in several basic acts, are aligned to the maximum extent possible with the technical screening criteria under the EU Taxonomy's first delegated act.

The Commission's tracking methodology also ensures that climate coefficients are attributed in a consistent manner across all EU spending programmes.

The 30% climate mainstreaming target was set in respect of these coefficients and progress to this target needs to be established on this basis. The EU Taxonomy is not final and likely to evolve in the legislative procedure, therefore using it to measure the contribution of the EU budget to the EU climate efforts would render it impossible to have a stable time series.

It should also be noted that the detailed information needed to fully apply the EU Taxonomy requirements is neither available, nor required to be delivered by the Member States or the implementing partners, for the spending programmes in indirect and shared management. Information is also incomplete for some direct management spending programmes.

d) The Commission accepts this recommendation 5 d).

The Commission will use the EU climate methodology in order to report on progress towards the achievement of the 30% climate target. This data will be complemented by information about the amount of expenditure falling under intervention fields of the EU climate methodology that receive a 100% coefficient by virtue of meeting the technical screening criteria of the EU Taxonomy concerning climate mitigation or adaptation.

This reporting will, by design, provide a partial picture of the contribution of the EU budget to the EC climate objectives. In the case of shared management, it will be based on existing data as reported by the Member States.

91. This report was part of the Staff Working Document accompanying the newly adopted Strategy for financing the transition to a sustainable economy.

The newly adopted Strategy and the proposed legislative package set out the next steps towards achieving Commission's ambitious goals.

In particular, financial institutions shall disclose their own sustainability transition and decarbonisation plans, including intermediate and long-term targets, and how they plan to reduce their environmental footprint. This greater transparency on targets, indicators, definitions and methodologies will in turn enable monitoring the effectiveness of actions over time.

Subject to adoption by the Council and the Parliament, the CSRD proposal will require large EU companies and listed companies including banks, insurers and investors to disclose their sustainability targets and the progress made towards their achievement.

In addition, and building on the regulatory technical standard under the SFDR, the Commission will strengthen the disclosure and effectiveness of decarbonisation action by financial market participants for all investment products.

Moreover, Article 20 of the Taxonomy Regulation tasks the Platform on Sustainable Finance to monitor and regularly report to the Commission on trends at Union and Member State level regarding capital flows into sustainable investment. This work will already start in 2021.

Recommendation 6 – Monitoring and reporting of the Sustainable Finance Action Plan and future strategy

a) The Commission accepts recommendation 6 a).

Article 20 of the Taxonomy Regulation tasks the Platform on Sustainable Finance to monitor and regularly report to the Commission on trends at Union and Member State level regarding capital flows into sustainable investment. This work will start in 2021.

As of June 2021, an indicator capturing developments in the green bond markets has been already included in a recently launched Capital Markets Union toolkit and discussions regarding inclusion in other indicators sets are ongoing.

In addition, the Commission will explore possible actions on assisting Member States to assess the alignment of their financial sector with sustainability targets;

The European Supervisory Authorities and the European Central Bank, in their respective areas, follow latest market developments in sustainable investment.

b) The Commission accepts recommendation 6 b).

The Commission will continue to regularly take stock of progress and review its actions. The Commission will report on the implementation of the Strategy by the end of 2023 and will actively support Member States in their implementation efforts.