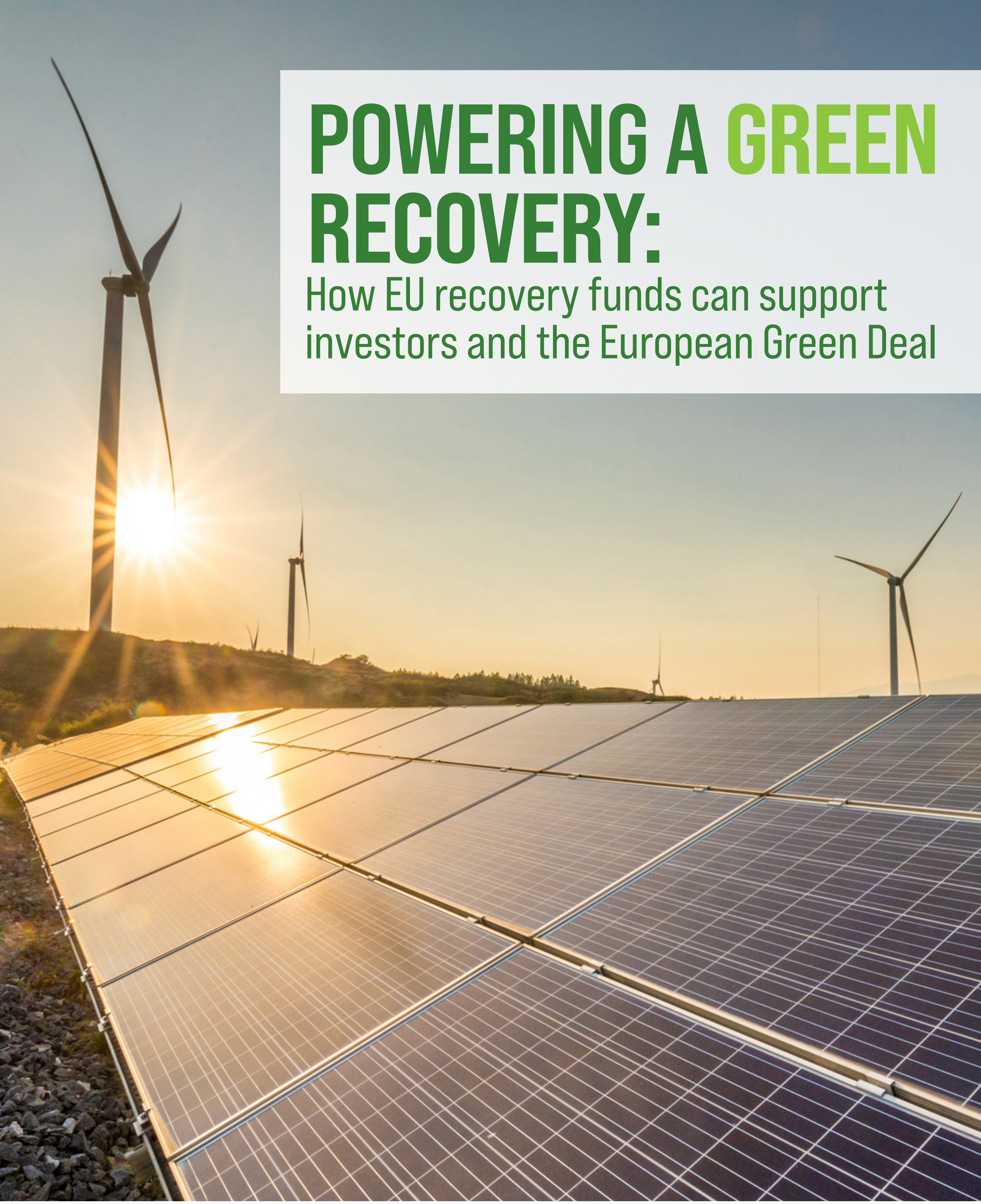
POWERING A GREEN RECOVERY:

How EU recovery funds can support investors and the European Green Deal



THE INVESTOR AGENDA
ACCELERATING ACTION FOR A NET-ZERO EMISSIONS ECONOMY

CDP
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About

The Institutional Investors Group on Climate Change (IIGCC), The Principles for Responsible Investment (PRI), and CDP, under the auspices of The Investor Agenda, a common leadership agenda on the climate crisis that is unifying, comprehensive, and focused on accelerating investor action for a net zero emissions economy, commissioned Chronos Sustainability to produce this report on the EU Recovery Funds and the European Green Deal.

The report provides an overview of the long-term EU budget and EU recovery funds, and how these are targeted to promote a green and resilient future. The purpose of the report is to highlight the opportunity for investors to become involved in facilitating the green transition and considerations for both investors and policymakers in sustainability linked public funding programmes.

Disclaimer

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Glossary

CPR	Common Provisions Regulation
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
EU	European Union
MFF	Multiannual Financial Framework
NGEU	NextGenerationEU
RRF	Recovery and Resilience Facility
RRP	Recovery and Resilience Plan

Foreword

Stephanie Pfeifer, CEO of IIGCC and Chair of The Investor Agenda Steering Committee

Private capital is crucial in the fight to tackle the climate crisis. In light of this, responsible investors have been stepping up their climate action on a range of fronts. This includes setting net zero targets and engaging with the highest emitting companies in their capacity as shareholders. A central element has been policy engagement, calling on governments to implement effective, 1.5ºC-aligned policies that are essential for accelerating and scaling up the private capital flows needed for a climate resilient, net-zero transition.

Such policies are critical and urgent, given investors' long-term perspectives and the need to be able to invest through economic, financial and environmental crises. The situation has been particularly acute over the last three years, as the world grappled with responding to the Covid-19 pandemic and is now dealing with an energy security crisis brought about by the Russian war in Ukraine, among others. Following the most severe initial waves of the pandemic, the European Union responded swiftly by developing a number of public funds to support economic recovery across its Member States.

Sustainability is placed at the heart of these policy reforms, sending a strong and welcome political signal to investors on the critical importance of achieving a net zero and climate resilient society by 2050 at the latest, while navigating separate but interrelated crises. But this is not just a political statement. The EU has established a programme of measures that enable and accelerate financing and – in turn – action. As a result of these measures, larger public and private financial flows are directed into the EU's green recovery, with the opportunities afforded by the new funds proving popular in Member States. Several resultant projects are already at implementation stage.

As we brace for a challenging winter in terms of energy supply, the wisdom of the EU's approach is becoming apparent. By creating the conditions for a sustainable recovery, it is providing a vital underpinning to the acceleration of climate solutions across the energy sector. These will not only reduce emissions, but also bolster the EU's move to energy independence and provide a wide range of economic benefits, shared in a just and equitable manner among society.

The EU has demonstrated how private capital can be harnessed in support of sustainability, in the face of unprecedented global challenges. Nevertheless, a significant financing gap for the transition remains. It is critical that the EU and its member states continue to maintain net zero as a cornerstone of their economic recovery decisions while attracting private capital for necessary investments, demonstrating that green stimulus projects can be developed and successfully implemented in harmony with wider fiscal policy commitments.

As we move forwards in tackling the trilemma of emissions reduction, energy affordability and security of supply, the most obvious solution to address all three challenges is a rapid transition towards a net zero European economy.

Investors need to prepare to make best use of the recovery funds and turbo-charge a sustainable response to the energy security crisis, just as EU institutions need to continue to provide the necessary strong long-term policy signals to incentivize private capital flowing into green solutions.

Only then can we count on a clean, secure, and equitable future for all.

Executive summary

Breakdown of EU Budget

The 2021 EU budget is the largest stimulus package ever financed in Europe, totalling €2.018 trillion. It comprises (a) the long-term budget for the next 7 years, the **Multiannual Financial Framework** (or MFF, totalling €1.211 trillion) and (b) a temporary recovery instrument, **NextGenerationEU** (NGEU, totalling €806.9 billion). The MFF supports 40 spending projects across 7 policy headings. The cornerstone of the NGEU is the **Recovery and Resilience Facility** (RRF), worth €723.8 billion, which makes up nearly 90% of the NGEU and is disbursed directly to Member States. Together, these funds are designed to boost EU Member States' recovery from the coronavirus pandemic and build a greener, more resilient Europe.

The RRF is also at the heart of **REPowerEU**, an initiative proposed in May 2022 to curb the EU's dependence on Russian fossil fuels. The REPowerEU initiative contains a combination of Member State projects that save energy, diversify energy supplies, and accelerate the renewable energy transition.

Focus of recovery funds on climate

The funds form a key component of the European Green Deal, the EU's strategy to become net zero by 2050, and will support the Fit for 55 package focused on decreasing European Union emissions by 55% by 2030. Roughly one third of the funds are directed at climate change; there is a 30% target for climate spending across the entire 2021 EU budget, while the RRF requires 37% of funds allocated to each Member State to be used to support climate action. These targets are significant for climate action as the MFF represents the last full investment cycle before 2030, by when the Fit for 55 package's objectives are supposed to be achieved.

Together, the MMF, NGEU and REPowerEU packages represent over €600 billion of climate funding, or €86 billion per year across 7 years. The European Court of Auditors estimates that the EU can provide a total of €200 billion per year, however, this is not sufficient to finance the €1 trillion needed per year for the green transition. Therefore, significant private sector investment is also required to bridge the **funding gap** to implement a green transition and sustainable recovery from the coronavirus pandemic.

Implications for policymakers

To draw in private investment to EU fund projects, there is an impetus on policymakers to create transparent, lucrative, and actionable green projects that are "investor-ready" for capital allocation from the private sector. EU policymakers can do this by (1) increasing consultation with external stakeholders, (2) improving data on monitoring, implementation, and climate effects, and (3) ensuring private investment in these sectors is not "crowded out" by public investment. Other governments can also implement ambitious, green infrastructure projects and recovery packages that signal to investors that they are ready to make significant investments for a green transition, by learning from and adapting design features of the EU recovery funds to their own specific contexts. In doing so, they can provide a clear policy signal to financial markets about significant investment opportunities provided by the urgently needed green transition.

Opportunity for investors

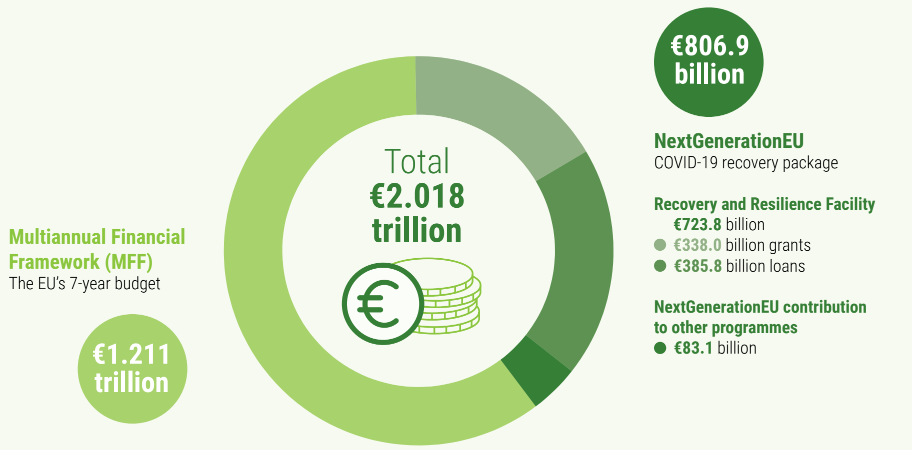
Investors will benefit from an ambitious European Green Deal and Fit for 55 package that represents long-term investment in climate transition projects. EU recovery funds provide a key opportunity to participate in such projects that prioritize energy efficiency, boost renewable energy deployment, and incentivize industry innovation. Although risks remain, the unprecedented **scale** of the funds allocated to climate action under the EU budget, **interaction** between Member States and relatively **swift implementation** of projects avoids pitfalls traditionally associated with large public stimulus funds. Further, characteristics of the RRF in particular, such as the conditionality of fund disbursement and a clear administrative structure also benefit investors. Policymakers need to create the right conditions for investment by signalling these characteristics to investors and creating structures that enable investment.

PART 1:
Current landscape of the EU Recovery Funds and European Green Deal

The 2021-2027 EU budget, the largest stimulus package ever financed in Europe, is a collection of funds worth €2.018 trillion designed to promote Member States' social and economic recovery from the coronavirus pandemic and enable them to transition to a modern, green, and resilient future. The Multiannual Financial Framework (MFF), the latest iteration of the EU's long-term financial perspective that delineates its annual budget for the next seven years, constitutes the largest share of the package. The remainder of the funds are derived from NextGenerationEU (NGEU), a recovery instrument to support Member States by directly financing their own national recovery plans coming out of the coronavirus pandemic (Figure 1).[1]

The funds are primarily focused on modernization, decarbonization and digitalization,[2] providing funding to EU Member States to promote research and innovation, build economic resilience and facilitate recovery, accelerate energy transitions and biodiversity protection, and improve policies around agriculture and economic, social and territorial cohesion. Through REPowerEU, some funding can also be directed towards energy security.

Figure 1: EU budget overview[3]



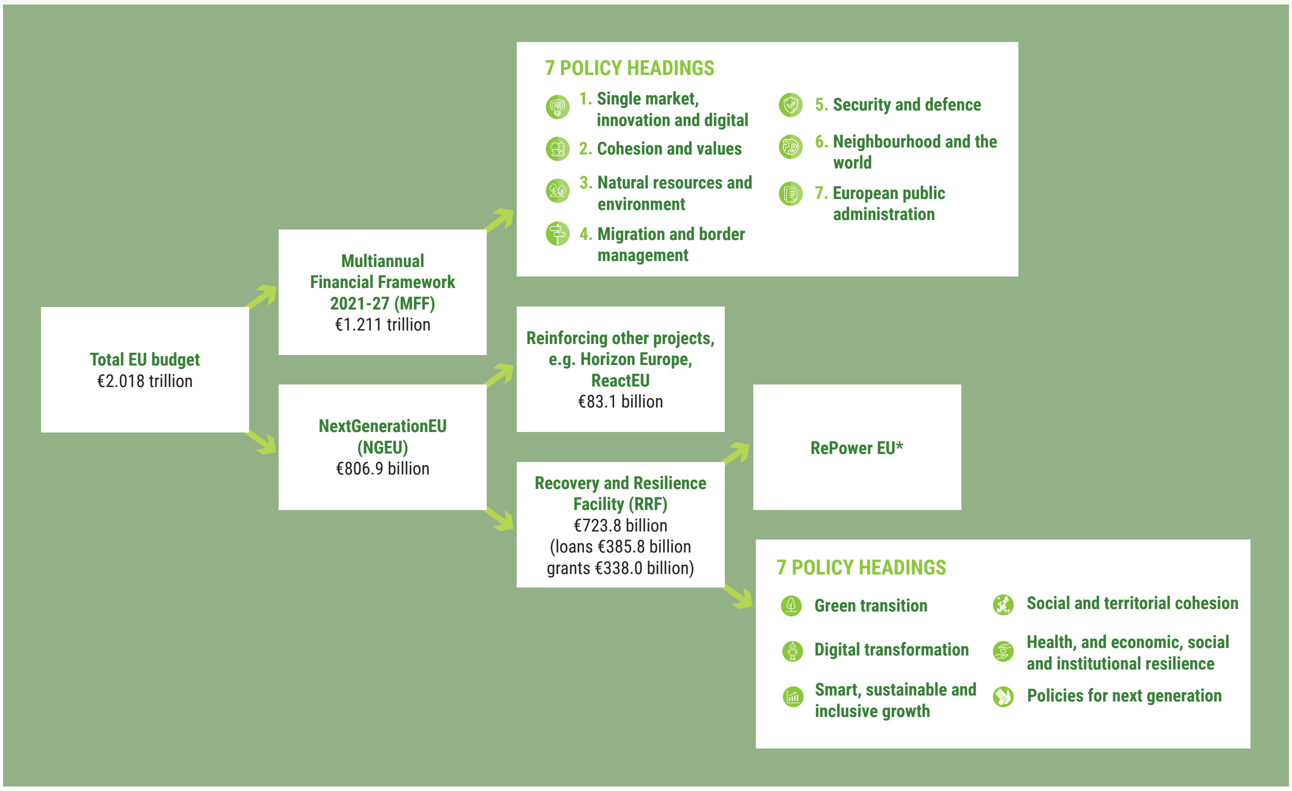
The European Commission has also set a target for 30% of the EU budget to contribute to climate change mitigation and adaptation. Within NGEU, 37% of funds must support climate action and 20% must support the digital transformation.[4] This focus provides support for the EU's overarching 'Fit for 55' climate policy, enshrined by the European Climate Law in 2021, which sets the goal of reducing net greenhouse gas emissions across the EU by 55% to 2030 as compared to 1990 levels.

Breakdown of funds

The MFF budget of €1.211 trillion represents 7% of the EU's estimated 2021 GDP of €17.3 trillion.[5] The MFF will be used to finance 40 new and existing EU spending projects, categorized under 7 key policy headings: Single Market, Innovation and Digital; Cohesion, Resilience and Values; Natural Resources and Environment; Migration and Border Management; Security and Defence; Neighborhood and the World; and the European Public Administration (Figure 2).[6]

The recovery instrument NGEU has a budget of €806.9 billion, the majority of which is allocated to the Recovery and Resilience Facility (RRF) (€723.8 billion). The RRF will, upon the submission and approval of National Recovery and Resilience Plans (RRPs) by Member States, directly distribute funds to Member States undertaking reforms and investments. Funds allocated to Member States under the RRF must be categorized under six policy pillars that are specific to the RRF: green transition; digital transformation; smart, sustainable and inclusive growth; social and territorial cohesion; health, and economic, social and institutional resilience; and policies for the next generation. The remainder of the NGEU funds (€83.1 billion) will be allocated to other EU projects deemed necessary for Member States' recovery, including the Just Transition Fund, Horizon Europe and REACT-EU. These projects are otherwise primarily funded by the EU's 7-year budget (MMF).

Figure 2: EU budget breakdown.[7]



*The RRF is one of several sources of funding for REPowerEU.

Focus on climate

The EU budget is a key part of the EU's wider climate policy landscape and supports the EU's goal of achieving carbon neutrality by 2050. The budget contributes to this goal through programmes supporting energy efficiency, renewables and diversification, sustainable transport, and fair climate transitions. Thirty percent of the total funds, amounting to €605 billion in current prices, must tackle climate change, marking the highest ever share of the European budget allocated to climate action.[8] Member States accessing the RRF are required to allocate 37% of spending in their RRPs to activities supporting climate action as a condition of receiving funds.[9]

Furthermore, the packages are designed to remain flexible, with several special instruments allowing funds to be reallocated if unforeseen needs arise in the future.[10] The recently devised REPowerEU plan is one such example; it will contribute to the energy transition by accelerating renewable energy production to lessen the EU's dependence on Russian fossil fuels.

Current use of recovery funds

Currently, all EU Member States have completed the first step of utilizing the RRF by submitting national Recovery and Resilience Plans (RRPs) to the European Commission. Of the 25 RRPs approved by the EC, 21 Member States have received disbursements: 14 Member States have received pre-financing, a small initial disbursement worth 13% of their total allocation, allowing them to begin implementing the initial milestones and targets set out in the RRP, and 7 have received further payments.[a] So far, the RRF has dispersed €112.7 billion, 15% of its total budget of €723.8 billion under the NGEU.[11] Several initiatives under REPowerEU, such as import agreements with international partners to diversify energy supplies and new hydrogen production plans, are also underway.[12]

The current use of MFF funds is not tracked in the same way as it is spread across various established EU-wide sectors and programmes.

a Figures as of 18 August 2022.

PART 2:
How are the funds being dispersed?

The 7-year budget (MFF), along with the €83.1 billion of the NGEU recovery funds that are not allocated directly to Member States through the RRF, are used to finance a range of European Commission-led spending programmes that include funding pre-existing projects, modernizing longstanding EU policies, covering administrative costs, and introducing new programmes.[13]

Figure 3: Flowchart showing the general EU Budget (MFF) management process[14]

Step 1. Proposing and financing
Rules for managing funds are proposed by the European Commission (EC) ahead of budgetary period (every 7 years) to determine eligible projects. Funds are negotiated and agreed by Council of the EU and European Parliament. EC and Member States discuss how funds will be spent.

Step 2. Programming
Member States negotiate the rules that apply to European Parliament. They then propose a Partnership Agreement to the Commission, a reference document explaining their strategy and investment priorities, along with a list of operational programmes that will be funded.

Step 3. Implementing
Implementation of EU funds is carried out by managing authorities. These can be national or regional authorities, local councils, or any public or private body nominated and approved by a Member State. Each operational programme is discussed with the EC to ensure projects match EU priorities and respect EU rules.

Step 4. Overseeing
Monitoring committees ensure programmes are properly implemented. These include civil society, regional authorities, and social partners. Committees can directly access up-to-date information on programmes. They can challenge evaluation, propose revisions and changes, and question harmful programmes.

Unlike the MFF process (Figure 3), access to RRF funds is granted through a process of approval of national Recovery and Resilience Plans (RRPs). RRF fund disbursements can occur from 2021 to 2024 and investments and reforms outlined in RRPs are required to be fully implemented by August 2026.[15] The RRF funding allocation process consists of 7 steps, and the 27 EU Member States are at varying stages of progress (Figure 4).

Figure 4: Flowchart showing the assessment and disbursement process of the Recovery and Resilience Facility[16 b]

1. Member state submits national RRP outlining reforms and investments with clear milestones and targets

2 Member States currently at this stage

2. EC assesses and endorses RRP after checking alignment with country-specific recommendations EU's priorities (e.g., digitalization and climate targets)

3. Council of the European Union approves RRP

4 Member States

4. EU disburses pre-financing, an upfront payment of up to 13% of the total funding available to that member state

6 Member States

5. EU and member state sign legally binding Operational Arrangements that further specify conditions of payment, monitoring and cooperation between the two parties

5 Member States

6. Member state requests first payment after implementing investments and reforms

3 Member States

7. Within 2 months, the EC assesses request for payment, which is contingent on reaching previous milestones and targets. Commission disburses amount requested after consulting expert committee

2 Member States

Steps 6-7 are repeated for further payments. Up to 2 payments may be disbursed to each member state per year

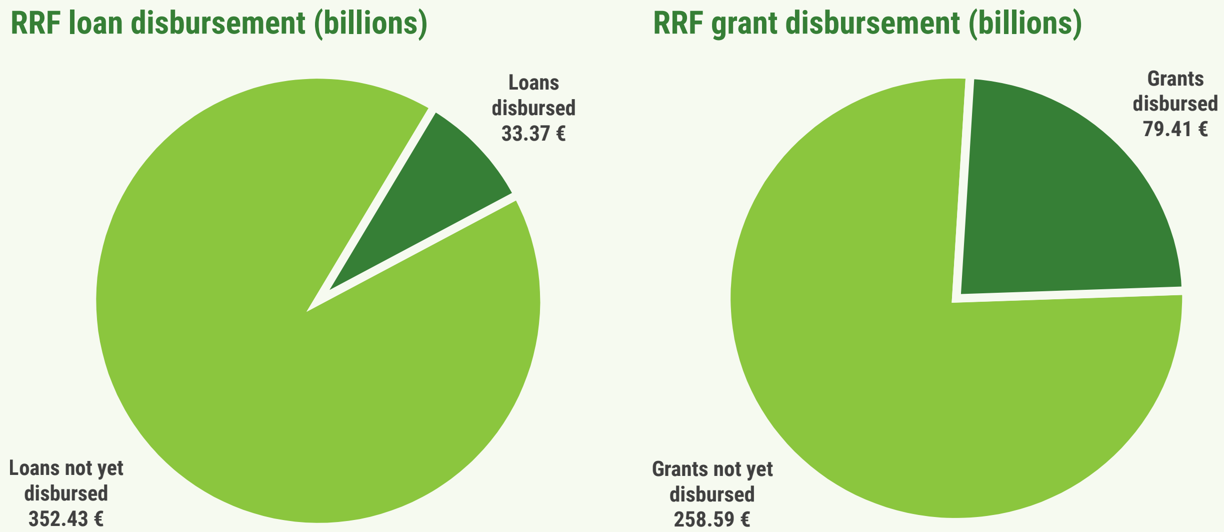
2 Member States have requested or received their 2nd payment

The RRF uses both grants and loans to disperse funds to Member States. The €723.8 billion from the RRF is comprised of €338 billion in grants and €385.8 billion in loans (Figure 5). Each Member State may request up to a specified maximum amount of funding for their RRP. For grants, the maximum allocation is calculated in two parts; for 70% of the total grants available, allocation is calculated by taking into account population, GDP per capita, and the relative unemployment rate. The remaining 30% is calculated using the loss in GDP over the pandemic period (2020-21) in place of the unemployment rate. For loans, the maximum loan allocation is capped at 6.8% of the 2019 GNI (Gross National Income) of each Member State, to be repaid to the EU under favorable conditions.[17]

This allocation mechanism allows for the worst affected and most economically vulnerable Member States to receive more grant funding. While grants are expected to be used by Member States in full, it is unclear whether stronger economies will request larger loans to supplement their smaller grant allocations, or if they will opt out of loans entirely (for example, if they have higher credit ratings and thus find it inefficient to borrow from the EU).[18]

b Data as of 18 August 2022.

Figure 5: Charts showing grants and loans disbursed so far[19] (data correct as of 18 August 2022).



Flexibility is a key characteristic of the EU budget. For MFF, a variety of special instruments worth €21 billion[20] are built into the budget to allow flexibility. These operate above the budget's expenditure ceilings and will be used to help manage specific events that may occur, such as political disturbances or natural disasters. Instruments are divided into (a) thematic instruments, allocated to specific events (e.g., the Brexit Adjustment Reserve designed to help countries hardest hit by the UK's exit from the EU) and (b) non-thematic instruments (which address emerging and unforeseen issues).

NGEU has already demonstrated flexibility under unforeseen geopolitical conditions, with the European Commission introducing new legislation allowing Member States to amend their RRPs to include a chapter on REPowerEU. Member States are also able to transfer up to 12.5% of funds from their Cohesion Policy and European Agricultural Fund for Rural Development allocations to the RRF to accelerate their contribution to REPowerEU objectives.[21]

Box 1: How is the stimulus financed?

The financing of the MMF follows that of the previous EU budget. Funds are raised through traditional 'own resources' collected from Member States. These are collected primarily through a) customs duties, b) VAT, c) national contributions determined by GNI, and d) a new tax determined by Member States' proportion of unrecycled plastic packaging.[22]

The financing of the NGEU is the responsibility of the European Commission which raises the NGEU budget by issuing long-term securities on international capital markets, to be repaid by 2058.[23] Around 30% of this financing, or €250 billion, comes from the issuance of NextGenerationEU green bonds. These bonds will finance green projects in line with the 37% climate financing target of the RFF. The first of these was issued in October 2021 to raise €12 billion,[24] marking the largest green bond transaction yet. Borrowing is expected to peak in 2023-2024.[25]

Mechanisms exist within the EU and partner organizations to facilitate combining private-public financing. Programmes funded by the EU budget fall under one of three types of implementation modes depending on the nature of the funding:[26]

- **Direct management:** EU funding is managed directly by the European Commission (EC)
- **Shared management:** the EC and national authorities jointly manage the funding
- **Indirect management:** funding is managed by partner organizations (such as international organizations or banks) or other authorities inside or outside the EU

The application process for funding depends on the implementation mode.[27] Whilst the RRF is implemented through direct management (with its own specific procedures due to its exceptional nature) a third of the EU budget uses shared management. This is a significant delivery mechanism for accessing green transition funds. The Common Provisions Regulation (CPR)[28] for the 2021-2027 programming period allows for the combination of financial instruments and grants[29] where delivery is shared management.

The case studies in this section provide example of frameworks for combining public and private financing to support green transition projects under the EU budget.

Box 2: Case study on fi-compass models: combining public and private finance through new financial instruments

Fi-compass is an EU platform for advisory services on shared management financial instruments. It has developed financial instrument models to meet challenges private investors have faced in financing public policy objectives. These models also provide exemplars of how Member States could promote private investment to implement their RRF funds.

REPowerEU and New European Bauhaus public-private financial instrument models

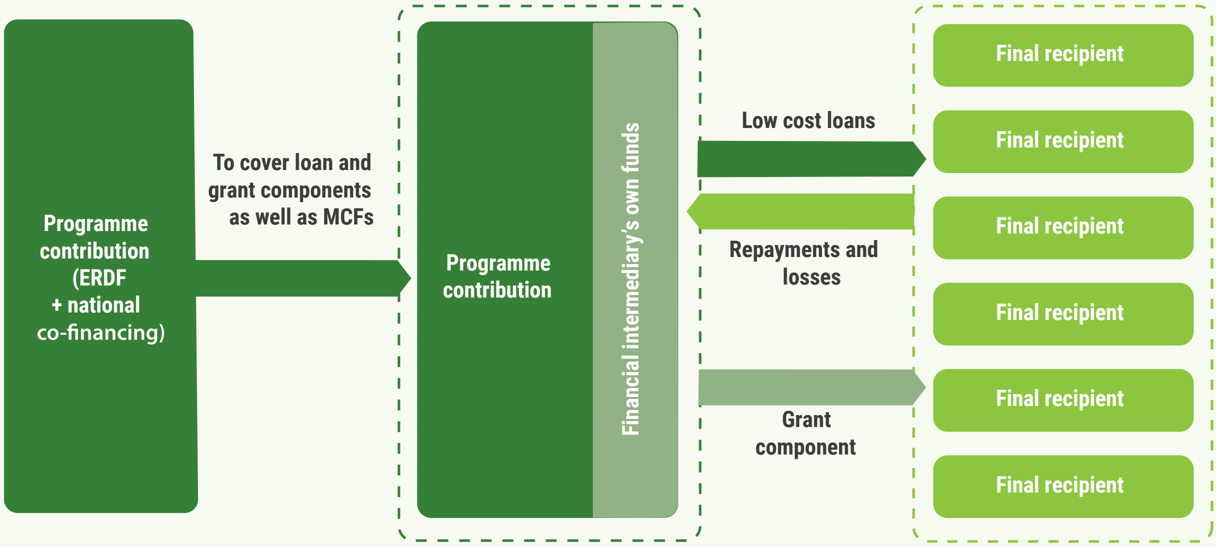
Based on the Common Provisions Regulation (CPR) and acknowledging the funding gap for green transition, the EC and European Investment Bank (EIB) have launched two new models for setting up financial instruments available through fi-compass. The models give options on how to combine EU grants with loans on favorable terms, to finance investments in support of REPowerEU's objectives on energy efficient buildings[30] and the New European Bauhaus' objectives on sustainable, inclusive, and aesthetical territorial development.[31]

The EC and EIB intend for the models to be *"…a practical "how to" guide to easily set up financial instruments, to provide funding and advisory support to investments… [The menu of options] provide tangible and practical solutions to common challenges encountered by financial instrument practitioners. Crucially, the models offer a path to leverage the funds available through the EU budget as well as EIB co-financing, to mobilize additional resources from commercial banks and private investors for such schemes"*.[32]

Example: Energy efficiency financial instrument (EEFI)

The EEFI is made available within the framework of a programme co-financed by the European Regional Development Fund (ERDF) or the Cohesion Fund (CF), prioritised under Policy Objective 2: a greener, low-carbon transitioning towards a net zero carbon economy and resilient Europe. The co-financing may be provided through national financing at programme level, finance provided by the financial intermediary and other investors, or finance paid by third parties at project level.[33]

Figure 6: EEFI framework[34]



This financial instrument is a **combined loan and grant financial instrument** that is managed by a financial intermediary on behalf of a Member State elected managing authority (MA), acting either directly or through a holding fund. Managing authorities award the contract (this process will differ by Member State) for implementation to eligible financial intermediary bodies, defined as: public and private bodies established and operating in a Member State which are legally authorized to provide loans to the types of final recipients targeted by the Programme. Financial intermediaries' role will include the marketing of the products, identification of final recipients, appraisal of applications for support and disbursement of the grant and loan products in line with State aid rules.

The aims of the combined financial instrument are:

- To use programme resources to **mobilize additional investment to provide low-cost loans** to finance the renovation of eligible buildings to make them more energy efficient.
- To deploy **grants in combination with the loan to fund technical support** to building owners, and/or provide an interest rate subsidy to reduce the cost of borrowing, and/or support a capital rebate that repays part of the loan on achievement of specified energy efficiency outcomes, and/or in order to extend financing to low-income individuals.

Box 3: Case study on EBRD's Greek RRF Co-Financing Framework

The European Bank for Reconstruction and Development (EBRD)[35] signed an agreement with the Greek government in 2021 to develop a Greek RRF Co-financing Framework to help implement the country's Recovery and Resilience Plan (RRP). Under this plan, the EBRD will combine up to €500 million of Greece's concessional loans from the RRF under its management with €500 million in loans from its private investors and commercial loans.[36]

The framework allows private companies implementing recovery projects in Greece to borrow from public and private co-lenders as long as projects are eligible under the RRF's criteria in terms of adhering to its policy pillars and digitalization / green targets. This co-financing framework creates a multiplier effect in the amount of investment available to implement Greece's recovery plan.[37]

Example project: Hellenic Telecommunications Organization[38]

- EBRD has loaned €150 million to the Hellenic Telecommunications Organization (OTE), for the telecommunications company to roll out fibre broadband infrastructure to over 300,000 households and businesses outside of Greece's major urban regions.
- The project fully satisfies RRF's digitalization goal. 'Fibre-to-the-home' (FTTH) broadband is 40% more energy efficient than traditional copper wiring broadband.
- The loan combines €56 million from ERBD's private resources and €94 million from Greece's RRF funds, with an additional €73 million of OTE's own resources.

PART 3:
Where are the funds being directed?

Sectors and themes

MFF and NGEU funding is categorized into seven policy headings (see Figure 2). The MFF, as the long-term 2021-2027 EU spending budget, comprises the majority of funding under each heading, though some headings also receive funding from NGEU or other EU funding sources (Table 1).[39] The headings are broad, thematic categories under which 40 new or longstanding spending programs with a mix of local, national, and EU-level implementation are funded. Most NGEU funding, including all of RFF, is categorized under Heading 2: Cohesion and Values.[40]

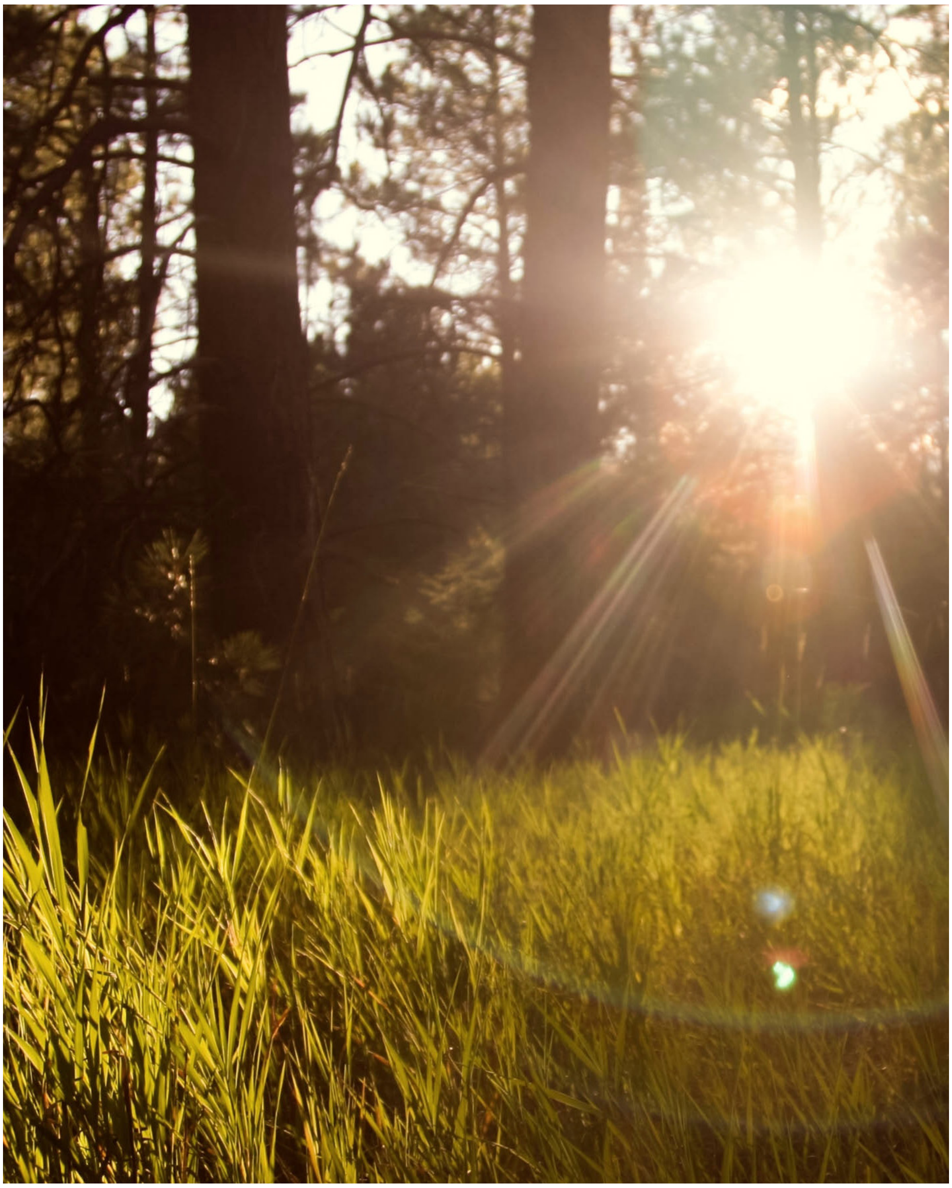


Table 1: Spending categories under the MFF and NGEU[41]

Name	Objectives	MFF budget	NGEU budget (if applicable)	Example programmes
Heading 1: Single market, innovation and digital	Unlocking future growth through research and innovation, digital transformation, strategic infrastructure, decarbonization, competitive of enterprises and the single market	€149.51 billion	€11.49 billion	• Connecting Europe Facility • Digital Europe programme • EU anti-fraud programme • European space programme
Heading 2: Cohesion, resilience and values	Strengthening resilience and cohesion between EU Member States, by reducing disparities, investing in future growth through promoting young people, health green and digital transitions	€426.69 billion	€776.5 billion	• Recovery and Resilience Facility • European Regional Development Fund • Cohesion Fund • REACT-EU • EU4Health
Heading 3: Natural resources and environment	Drive sustainability and competition with reforms in maritime and agricultural sectors, climate action, rural development, and food security	€401 billion	€18.94 billion	• European Agricultural Guarantee Fund • Just Transition Fund • Programme for environment and climate action (LIFE)
Heading 4: Migration and border management	Management of EU's external borders, safeguarding asylum system, and helping Member States manage migration into the EU	€25.7 billion	–	• Asylum, Migration and Integration Fund, Integrated Border Management Fund
Heading 5: Security and defence	Improve safety and security of EU citizens, strengthen defence and prepare for internal and external security challenges	€14.92 billion	–	• Internal Security Fund • Nuclear decommissioning • European Defence Fund
Heading 6: Neighborhood and the world	Reinforce the EU's impact on developing countries, assist accession into EU by new members, humanitarian aid	€110.6 billion	–	• Neighborhood, Development and International Cooperation Instrument – Global Europe • European Instrument for International Nuclear Safety Cooperation
Heading 7: European public administration	Cover administrative expenditures of all EU institutions and pensions	€82.47 billion	–	–

The RRF uses a different set of headings, six policy pillars, to categorize funding (Table 2). Unlike the MFF, the RRF does not allocate specific amounts of funding to each of its six policy pillars, with the exception of green transition and digital transformation targets. Since RRF disbursement is performance-based, Member States must provide proof to the EC that key steps have been achieved towards the implementation of investments and reforms described in the RRP.[42] Key implementation steps under the RRF are described as milestones (qualitative measures) and targets (quantitative measures).

The REPowerEU Plan to decrease dependence on Russian fossil fuels, with a thematic focus on energy security, has also been incorporated into the RRF in 2022. This allows Member States to receive additional funding by dedicating chapters of their RRPs to REPowerEU.[43]

Table 2: Six policy pillars of the RRF[44]

Name	Description	Number of milestones and targets (all countries)	Examples of expenditure areas
Green transition	Measures contributing to a green transition. **Overlaps with the requirement that at least 37% of funds are dedicated to this climate action**	2,432	Sustainable mobility; energy efficiency; renewable energy and networks; climate change adaptation
Digital transformation	Investments in digital technologies, infrastructures, and processes to modernize and increase the EU's resilience. **At least 20% of funds must be dedicated to digitalization under this pillar**	2,182	E-government, digital public services (including digitalization of transport) and local digital ecosystems; human capital digitalization; digitalization of businesses; connectivity
Smart, sustainable, and inclusive growth	Measures to make economies more sustainable, resilient, and inclusive. Includes economic cohesion, jobs, productivity, competitiveness, research, development and innovation, and a well-functioning internal market with strong SMEs	2,639	Building renovation and construction; support to SMEs; research, development, and innovation; business environment / entrepreneurship
Social and territorial cohesion	Measure to mitigate the social impact of the pandemic, including tackling unemployment and poverty and integration of disadvantaged groups	2,429	Territorial infrastructure and services; adult learning including vocational education, recognition and validation of skills; social housing and other social infrastructure; development of rural and remote areas
Health, economic, social, and institutional resilience	Measures increasing quality and accessibility of healthcare, and improving public administration and systems, with the aim of increasing crisis preparedness and crisis response capacity	2,130	Healthcare: resilience, sustainability; adequacy, availability etc; effectiveness of public administration; long-term care; effectiveness of judicial systems; crisis preparedness
Policies for the next generation	Measures aimed at improving access to education, employment and inclusion for children and youth	583	General, vocational and higher education; early childhood education and care; youth employment support and job creation

Climate change and the green transition

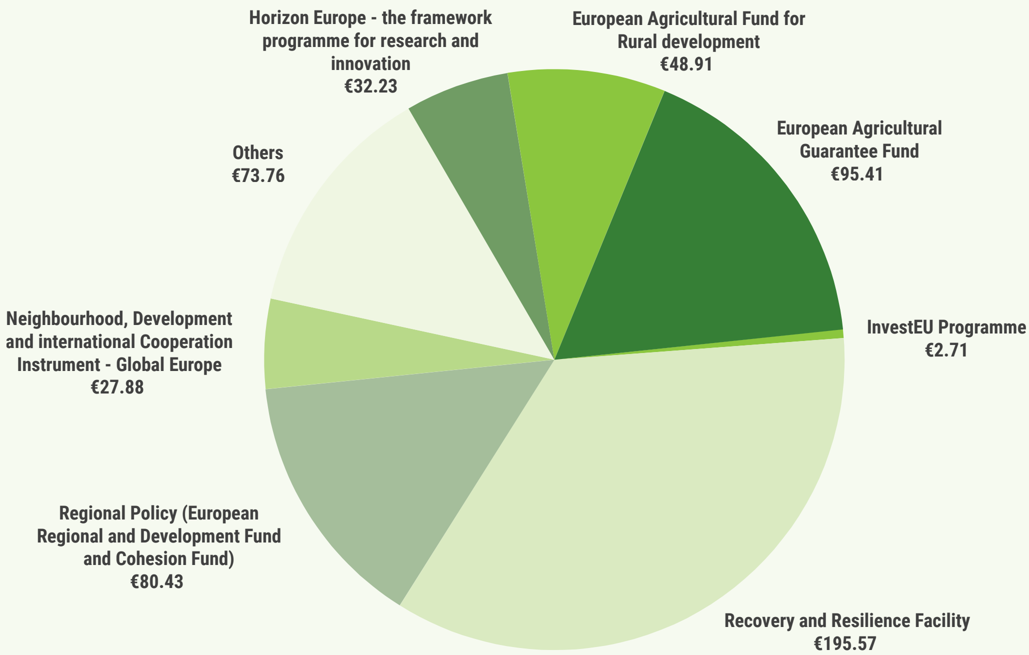
Climate change and the green transition is the key focus of post-pandemic EU spending with planned spending highest within this area. As already discussed, 30% of the total budget and 37% of the RRF is directed at climate action projects contributing to the EU 2050 carbon neutral goal and interim 2030 goal to reduce emissions by 55%. Multiple policy headings from the MFF contribute to this. Heading 3 (Natural resources and the environment) funds climate action programmes and projects across the EU, including the Programme for Environment and Climate Action (LIFE), and the Just Transition Fund. Decarbonization and sustainability transitions are key climate-related objectives under Headings 1 and 2.

The LIFE programme, distributing €5.43 billion from the MFF in grants, procurements and prizes across Member States, supports national and local authorities to implement actions around nature conservation, implementation of climate plans, coordination and capacity building across four sub-programmes: circular economy, biodiversity, clean energy transition and climate change adaptation and mitigation.

The Just Transition Fund, distributing €8.45 billion from MFF and €10.87 billion from NGEU, aims to alleviate the socioeconomic impacts of the climate transition on localities and businesses in the most negatively affected regions. Actions include economic diversification, upskilling and reskilling, clean energy projects and jobseekers' assistance.

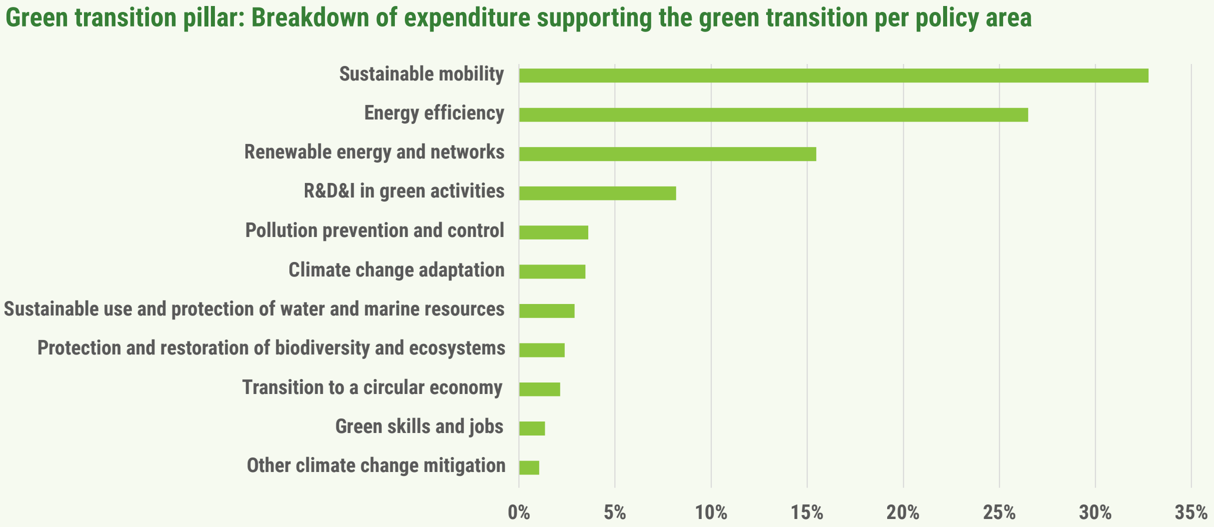
Within the RRF, members must collectively allocate at least 37% of their funding towards climate-resilient measures (and 20% to digital transitions)[45]. In practice, approximately 40% of Member States' plans relate to climate action, exceeding the EU's target.[46] The target exists beyond a general requirement to design projects under the green transition pillar, which encompasses a variety of climate-related policy areas (Figure 8). The RRF also requires that all projects presented in RRPs "do no significant harm" to any of the 6 pillars.[47]

Figure 7: Estimated climate contribution of the 2021-2027 EU budget (in billion Euros)[48 c]



c We note that this figure is looking specifically at climate mitigation and climate adaptation spending aspects of the EU 'green budget'.

Figure 8: Breakdown of areas of expenditure by all EU Member States under the RRF's green transition policy pillar.[49] [d]



This chart shows a breakdown of the estimated contribution to the policy pillar according to a list of policy areas established by the European Commission. The percentage relates to the overall share of the plan tagged under this policy pillar.

Box 4: RRF case study: thematic analysis on clean power

As energy use and production account for over 75% of GHGs, clean power is necessary for achieving net zero emissions by 2050. To this end, in 2021 the European Commission increased the EU's renewable energy target to 40% by 2030 under the Fit for 55 package, recently proposing a further increase to 45% as a response to concerns around the energy crisis and dependence on Russian fossil fuels.[50] For Member States, this involves significantly accelerating renewable energy transitions by front-loading clean technologies and enhancing their connectivity and networks.

Low-carbon hydrogen, produced using clean energy from wind and solar, is expected to be a key technology for the transition. The EU's Hydrogen Strategy (2020) highlighted the potential for hydrogen as an energy source in sectors that are hard to electrify. Industrial production of hydrogen has the potential to increase investment, research and jobs and is a key action under REPowerEU. REPowerEU increases the 2020 Hydrogen Strategy's goal of 5.6 million tonnes of hydrogen to 20 million tonnes (10 million tonnes from domestic renewables and 10 million tonnes from imports).[51] It also introduces Hy2Tech, the EU's first hydrogen-related Important Project of Common Interest (IPCEI) involving 41 projects to be implemented by 35 companies across 15 Member States.[52]

Many countries have included investments in clean power generation and networks in their RRPs, totaling €26.7 billion as of December 2021. Across the EU, proposed investments in hydrogen total at least €9.3 billion. Notable examples include:[53]

- Italy's RRP contains reforms for simplifying authorisation procedures in renewable plants, an extension of support schemes, and a new legal framework to sustain production.
- The RRF will finance infrastructure connecting Greece and Cyprus, increasing electricity interconnection and storage through submarine cables and strengthening energy solidarity.
- In cooperation with other states and in line with its national renewable strategy, Austria's RRP will support the development of hydrogen production and storage facilities as part of IPCEI Hy2Tech.

d Figures as of 18 August 2022.

Box 5: Case study on REPowerEU funding

Background

European taxpayers spend nearly €100 billion annually on Russian fossil fuels.[54] The ongoing energy crisis has highlighted dependency on Russian oil and gas, building on previous concerns around energy security, including recent interruptions to gas supply in Poland and Bulgaria. In light of these concerns, the REPowerEU initiative was put forward by the Commission in March 2022 to reduce the EU's dependence on Russian fossil fuels.[55] REPowerEU will also promote diversification of energy supply towards renewables, further contributing to the EU's sustainability goals, and the end of dependence on Russian gas and oil imports by 2027.[56]

Actions[57]

Short-term (2022)

- Common purchases gas, hydrogen and LNG via EU Energy Platform by Member States
- New energy partnerships with international partners
- Rapid rollout of wind, hydrogen and solar projects including 50 billion cubic metres (bcm) of gas
- Increasing biomethane production to save 17 bcm of gas
- Approving new EU-wide hydrogen projects by summer
- Publishing EU Save Energy Communication with recommendations for citizens and businesses (saving 13 bcm of gas)
- Filling gas storage capacities to 80% by November
- Coordinated EU-wide energy demand reduction plans to prepare for potential gas supply disruption

Medium-term (by 2027)

- National REPowerEU Plans under modified Recovery and Resilience Fund
- €3 billion under Innovation Fund to boost industrial decarbonization
- Introducing legislation and recommendations for faster renewables transition in areas with low environmental risk
- Investing in an integrated and adapted gas and electricity infrastructure network
- Raising the EU-wide target on energy efficiency for 2030 from 9% to 13%
- Raising EU renewables target for 2030 from 40% to 45%
- New proposals to ensure industry has access to critical raw materials
- Regulatory measures to increase energy efficiency in the transport sector
- A hydrogen accelerator for homegrown production of 10 million tonnes renewable hydrogen
- A new regulatory framework for hydrogen

Investment

RRF funds are at the heart of REPowerEU's short-term funding. Other sources include MMF funds, (including but not limited to Horizon Europe and InvestEU), as well as national fiscal measures and private investment.[58] Estimates suggest that reducing dependence on Russian imports to zero would require a €300 billion investment by 2030 to develop the required technologies and infrastructure changes. This means additional investments of €210 billion between now and 2027, much of which can be facilitated through access to the remaining RRF funds of €225 billion under new amendments to the RRF,[59] acknowledging that this shift might affect progress on other RRF policy pillars.

Implementation

Achieving the objectives outlined in REPowerEU requires significant investment in renewable energy production, infrastructure and networks. RRPs under the RRF can contribute greatly, combining investments and reforms to accelerate the energy transition. A swift amendment to the RRF was implemented to this end, allowing Member States to include a chapter in their RRPs dedicated to REPowerEU.[60] New RRF grants, funded by the auctioning of Emission Trading System (ETS) allowances, have also been introduced for this purpose. In addition, Member States may make voluntary transfers from other funds to the RRF to speed up implementation of REPowerEU related targets within their plans.

Drawbacks

While renewables and energy efficiency are crucial components of REPowerEU, the EC acknowledges that a fast rollout of the plan requires some investment in EU gas infrastructure including new international gas pipeline contracts, diversification of oil supply, and potentially increased domestic gas use and longer-term use of current coal capacities (including for hydrogen production). Due to the expedited rollout of REPowerEU, projects such as these risk locking in fossil fuels and creating stranded assets, and undermining the EU's sustainability goals,[61] particularly as they may not be adequately priced in as detrimental to the climate financing targets.[62]

Member States

Funding allocation and dispersal varies by Member State and by the EU projects that receive these funds. Within the RRF, the European Commission must approve submitted RRPs and ensure they meet country-specific recommendations and common targets. However, it is national authorities that write RRPs and are therefore the key decision-makers regarding how the funding is spent. As of July 2022, all 27 Member States had submitted their RRPs, the majority of which had been endorsed by the European Commission (see Figure 4 for the status of Member State plans).

Spain and Italy are most advanced in their uptake of RRF funding; both have requested their 2nd payment, with Spain receiving its disbursement in July 2022. All Member States submitted their RRPs to the EU between April and July 2021, with the exception of Bulgaria (submitted in October 2021) and the Netherlands (July 2022). The majority of plans progressed quickly, most have been endorsed by the European Commission and then approved by the Council within two to three months after submission and had received pre-financing by the end of the year.[63] Spain and Italy received the two highest grant allocations, while Greece has the highest grant allocation as percentage of GDP, given the serious economic effects of the pandemic on their economies.[64]

Box 6: RRF country case study on Spain

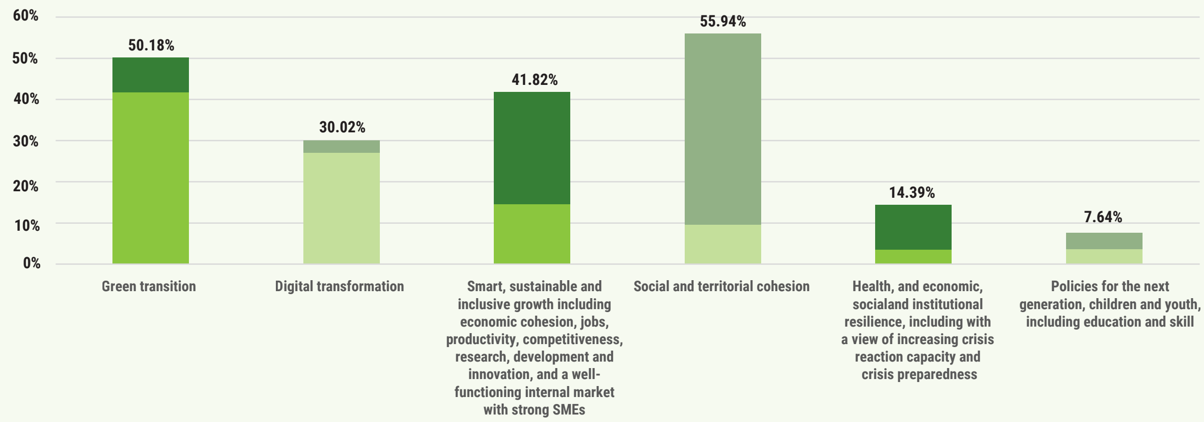
Spain's funding allocation and disbursements so far:[65]

- €69.5bn in grants (the highest RRF grant allocation). €31bn dispersed so far.
- RRP allocation as a share of GDP: 5.77%.

Spain's RRP consists of 112 investments and 102 reforms. 40% of the plan will support climate objectives and 28% will support the digital transition.[66] The implementation of the plan is expected to foster economic growth by creating 250,000 jobs by 2026. It is estimated to increase GDP by 1.8% to 2.5% by 2024, with a further 0.4% increase from spillover effects from other Member States.[67]

The plan categorizes half its spending as supporting the green transition, with 41% contributing to it as a primary pillar. A majority (55%) of investments and reforms support social and territorial cohesion, mainly as a secondary pillar.

Figure 9: Share of Spain's estimated expenditure contributing to each policy pillar[68]



This graph displays the share of the recovery and resilience plan's estimated contribution to each policy pillar. As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments) the total contribution to all pillars displayed in this graph amounts to 200% of the RRF funds allocated to the Member State.

Some examples of investments and reforms receiving funding are:[69]

- €7.8 billion invested to support efficiency renovations in buildings and €13.2 billion on sustainable mobility in urban and long-distance transport as part of securing the **green transition**.
- €4.6 billion to digitize industry and SMEs, and €3.2 billion to digitize public administration as part of the **digital transition**.
- €2.1 billion in upskilling, reskilling and teacher training to support **economic and social resilience**.

Example green transition project: Residential building energy renovations.

- €3.4 billion worth of investments amounting to more than half a million actions on residential building reforms. These are designed to achieve a reduction in demand for primary energy by at least 30%. They will be implemented using a package of reforms that include tax incentives and renovation offices ("one-stop-shops") to facilitate renovations.
- As well as contributing to longer-term EU climate goals, these measures will contribute to the goals of Spain's National Energy and Climate Plan which aim for, among other aims, a 39.5% increase in energy efficiency by 2030.

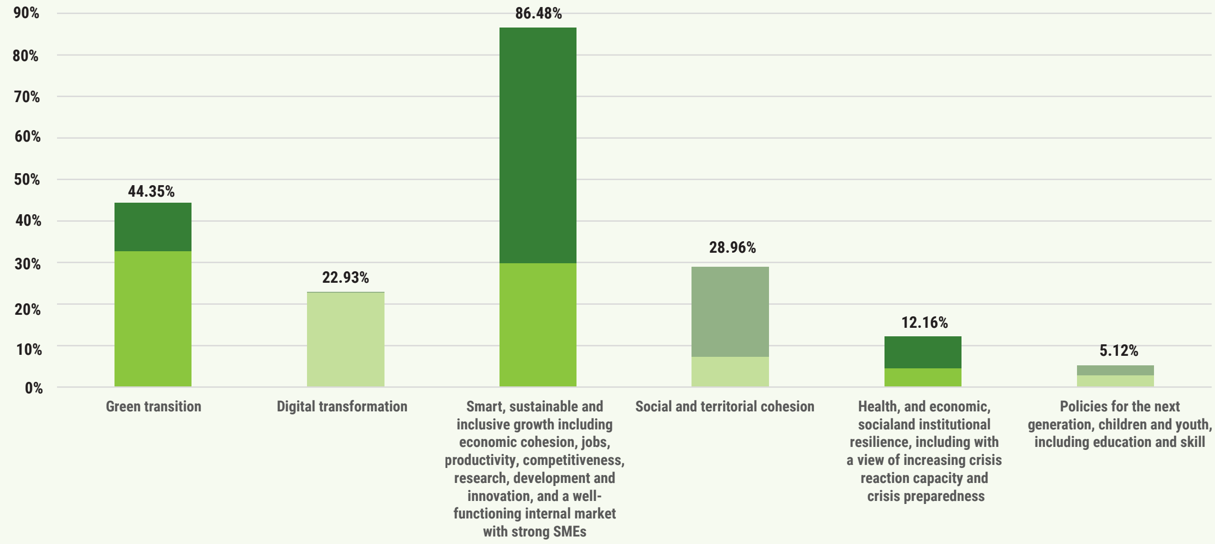
Box 7: RRF country case study on Greece

Greece's funding allocation and disbursements so far:[70]

- **€17.7** billion in grants. €4 billion disbursed so far.
- **€12.7** billion in loans. €3.5 billion disbursed so far.
- RRP allocation as share of GDP: **9.72%**.

Greece's RRP is expected to increase the country's GDP by 2.1% to 3.3% by 2026, with a further 0.3% in spillover benefits. It will boost the economy by creating 62,000 jobs by 2026.[71] The RRP prioritises smart, sustainable, and inclusive growth with 86% of its expenditure contributing to this pillar, mainly as a secondary pillar.[72]

Figure 10: Share of Greece's estimated expenditure contributing to each policy pillar[73]



This graph displays the share of the recovery and resilience plan's estimated contribution to each policy pillar. As each measure contributes towards two policy areas of the six pillars (primary and secondary assignments) the total contribution to all pillars displayed in this graph amounts to 200% of the RRF funds allocated to the Member State.

Some examples of investments and reforms receiving funding are:[74]

- €1.3 billion in the energy-efficient renovation of more than 100,000 residences, and €600 million to reforestation, biodiversity, flood mitigation and irrigation network upgrades, waste management reform to support the **green transition**.
- €1.3 billion for the digital transformation of the public sector and €375 million to boost digitisation of businesses, particularly of SMEs, supporting the **digital transition**.
- €12.7 billion to support private investments in the form of loans, and €740 million to strengthen labour market policies and increase full-time employment, and support long-term unemployed and disadvantaged people, supporting **economic and social resilience**.

Example green transition project: Electric vehicles.

- Greece's RRP includes the promotion of electro-mobility to make mobility cleaner, safer and fairer.
- Reforms include establishing a conducive legal framework to organise the emerging electric vehicle market. This includes subsidising and incentivising electric vehicle purchases, greening taxi fleets, and installing more than 8,000 charging stations for electric vehicles in key urban and rural locations across the country, such as motorways and airports.

PART 4: What does this mean for investors?

The scale of the EU budget's funding packages and the rapid uptake of RRF by nearly all EU Member States demonstrate the seriousness with which the EU is approaching a green recovery, both in terms of setting policy and strategy and in driving implementation and action. Whilst the scale of funding is historic, private finance is needed to overcome the funding gap for an effective green transition. However, concerns remain around the EU's ability to persuade private investment towards its goals, given that its public climate funding (including 30% minimum of climate funding in MFF and 37% in RRF) is not sufficiently high enough to usher in and maintain the green transition envisioned in the European Green Deal and Fit for 55 targets.

A need to bridge the green funding gap

Current estimates show that nearly €1 trillion is needed annually between 2021-2050 to achieve the goal of the European Green Deal to reduce emissions to net zero by 2050.[75] The EU budget 2021-2027 allocates around €605 billion towards this goal, across the 7 years this amounts to €86 billion per year. The European Court of Auditors (ECA) estimates that the EU can afford total climate financing of €200 billion per year between 2021-2027, or 20% of the €1 trillion necessary. This figure combines the €86 billion from the EU budget with other EU financing such as InvestEU and the European Investment Bank (EIB), additional public and private financing associated with these institutions, and member-state co-financing.[76] This leaves a shortfall of 80% or €800 billion of additional finance needed per year for the green transition, which is currently not being met and can be provided by private investment.

Significant opportunities for investors

Investors will benefit from an ambitious European Green Deal and Fit for 55 package. These policy initiatives provide support for long-term investment in sustainable projects, and focus on prioritising energy efficiency, boosting renewable energy deployment, and incentivising industry innovation through carbon pricing. Previous public funding projects within the EU have been criticized for slow bureaucratic rollout, lack of co-ordination, and absorption capacity.[77] In contrast, the current recovery scheme shows unprecedented scale and fast implementation. It presents a window of significant policy reform through public funding into projects with desirable sustainability characteristics that private investors are encouraged to be a part of. The historic scale of funding signals a long-term commitment to green investment. Some features of the funds mitigate risks traditionally associated with public stimulus packages; for example, the technology risk associated with ambitious sustainability projects like REPowerEU is reduced by the size of the funding as well as coordination and policy convergence between Member States. These features provide an opportunity for investors to increase their sustainable finance flows while reducing their respective risk.

The design of climate-related EU recovery funds reduces risk for investors. Swift disbursement and simplified administrative processes improve accessibility for investors, reduce costs and improve returns. Lessons from green stimulus funds after the 2008 financial crisis show that simplicity is key for success in attracting private investment: the most effective energy stimulus projects, i.e., those with significant impact on economic growth, competitiveness and support for a green, low carbon future, focused on clear, targeted policy frameworks.[78] In this regard, the quick timeline and clear delineation of steps and monitoring agreements that characterize the RRF process is a clear advantage. Fast approval and deployment of funds has been the norm so far for most Member States' RRPs. The conditionality built into the RRF funds also provides a risk-reducing effect for ambitious projects, as new disbursements are contingent on successful implementation of the targets and milestones attached to previous instalments. This conditionality keeps project implementation on track, ensuring funds are effectively absorbed and not misdirected.

Continuing challenges for investors

Conversely, the MFF may also present challenges for investors, due to the complex combination of new and existing funding projects under its purview, each with different strategies and timelines for distribution and accountability.[79] The complexity of overlapping funding, differentiated monitoring, dispersal, and implementation mechanisms of the 40 projects under the long-term EU budget may present a barrier to accessing MFF and other NGEU projects.

EU recovery funds may still carry risks for investors that are common to large public stimulus funds of this nature. The previous EU budget was criticized for designing a framework that failed to deliver detailed data on climate spending, a key element of fund design for attracting private investment.[80] The 2014 – 2020 EU budget did not employ robust tracking and monitoring measures, leading to overestimating climate spending and failing to meet its 20% climate target.[81] The current budget presents similar risks regarding imprecise accounting mechanisms that may impede private investment. While the European Commission has updated its monitoring strategy for climate mainstreaming,[82] concerns remain that the methodology behind climate spending has not changed significantly[83] for the 2021 – 2027 budget. Further concerns focus on funds not adequately factoring in unsustainable activities, and how accounting of the implementation of the "do no harm" policy and the climate tagging of projects is insufficient to counteract funds being channelled into unsustainable activities. This may be counterproductive to the otherwise commendable climate spending targets.[84]

Final takeaway for investors

This stimulus package presents a window of significant policy reform for public funding of projects with desirable sustainability characteristics that offer incentives to private investors by reducing risk. Investors make essential contributions to the energy transition by allocating capital to energy infrastructure projects, often with considerable upfront costs. They also fund and engage with companies in economic sectors that have a critical role to play in the energy transition. Experience of green stimulus funds from 2008 show that private investment is suited for scaling up existing energy projects and ensuring technology readiness, particularly for projects requiring complex infrastructure.[85] This is reflected in investor commentary on current EU recovery funds, which highlights how private investors prefer to finance known technologies perceived to carry lower risks.[86] While the scale of funding helps to mitigate some risk, investor concerns in this context may remain a barrier for private investment in the most novel and ambitious of recovery projects, such as the acceleration of renewable hydrogen. This could reduce the effectiveness of the REPowerEU plan and may result in higher than anticipated fossil fuel dependence.

PART 5: How can policymakers support investments?

Investors have a crucial role to play in bridging the considerable funding gap between the EU's ambitious green policies and targets and their effective implementation, a task that must be facilitated by policymakers. The ability of investors to provide the funding needed for the net zero transition is dependent on governments' credible commitments and policies,[87] such as NDCs and other sustainability targets, and clear implementation plans.[88] To incentivize investments, all relevant parties need to show strong policy action and political will to negotiate the political framework and translate ambitious targets into action for net zero and the green transition. In this context, the EU Green Deal to reach net zero by 2050, and in particular its interim Fit for 55 package to cut emissions by 55% by 2030, is significant in terms of the scope of the policies, targets, and funding it provides.

Recommendations for policymakers within the EU

Implementation at scale is key to a sustainable recovery and requires concerted action from private investors.[89] EU policymakers, managing authorities and Member States responsible for fund implementation have a key role to play in seeking out private investment and disclosing relevant information regarding project planning, tendering, and implementation.[90]

A well-known challenge for investors has been the identification of and access to available investment opportunities contributing to EU climate and energy targets and the goals of the Paris Agreement. One of the key aspects of this challenge lies in how individual Member States present and implement their RRPs. Reforming real-economy policies to implement an accelerated, ambitious, and predictable EU Green Deal and Fit for 55 will help provide more confidence and planning security for financial markets and enable investors to identify and access opportunities to increase the size of their investments.

To attract more private investment in green transition projects, EU policymakers and Member States should:

- **Limit the risk of private finance being crowded out.** While certain sectors, for example renewable energy, have been identified as presenting significant opportunities for investors, care must be taken to avoid crowding out private finance in the deployment of recovery packages. RRPs should be assessed to identify which projects are best suited for public or private financing, or a combination of both.[91]
- **Increase consultations with stakeholders.** Private investors and other relevant financial and civil society stakeholders need to be consulted during the RRP process to maximise crowding-in of investors and increase the transparency and public acceptance of projects.[92] Increasing investor collaboration during tendering, planning and implementation stages decreases unfamiliarity risk,[93] and thus increases investment potential.
- **Ensure that the implementation of projects follows a defined process with strong monitoring mechanisms.** A comprehensive, data-driven approach to monitoring progress on climate metrics is key to attracting investment. EU policymakers and managing authorities should demonstrate how spending projects and targets are backed by strict accounting for carbon emissions, while increasing transparency on how each project and programme is contributing to climate change and net zero objectives.[94]

Additionally, policymakers and Member States can facilitate private investment by:

- **Clearly communicating eligibility criteria for recovery funds,** e.g., timelines, geographical areas, preferred sectors and activities, and any limitations on activities that may be funded, to guide investors towards the most appropriate projects.
- **Adequately pricing in carbon-intensive or otherwise unsustainable projects into targets** such as new gas imports and infrastructure within REPowerEU, and enforcing a more robust application of the "do no harm" policy.[95]
- **Aligning climate action targeted by EU recovery funds with other frameworks** within the context of European climate policy, such as integrating projects into the EU Taxonomy as it becomes applicable.[96]
- **Facilitating public-private co-financing** by developing stronger and more effective guidance, mechanisms, and frameworks to co-finance projects by public and private actors, such as the EU fi-compass model guidelines[97] and the EBRD's Greek Co-financing Framework.[98]
- **Demonstrating how funding will feed into Member States' national decarbonization plans,** for example by developing clear, sector-specific net zero pathways in National Energy and Climate Plans (NECPs) and clearly defining which aspects of these strategies will be supported by EU recovery funds, and in what way.
- **Raising ambitions by Member States to divert funds into climate projects.** Diverting RRF and other funds to REPowerEU demonstrates the adaptability of EU funds and the institutional capacity of the EU to react quickly to new challenges. Policymakers can divert funds to climate spending in a similar way to signal investors the immediacy of climate risks and the importance of bridging the climate financing gap.

Recommendations for other policymakers

Climate funding within the EU has the potential to have a ripple effect on the pandemic recovery plans of other countries and drive more ambitious net zero targets and policies. The EU funds are significant in their size and their expansive climate targets, providing a credible model for climate mainstreaming within national budgets and stimulus packages. Other public bodies can use the MFF and NGEU as examples adapted to the local context to integrate climate action into national fiscal policy and attract private investment.

There are high-level actions that other governments can take to incentivize private investment in sustainable projects, including:

- **Ensuring national climate policies are ambitious, transparent and reliable, with set deadlines aligned with the 1.5ºC goal of the Paris Agreement.**[99] Such policies can include net zero targets by 2050, development of transition pathways, just transition plans, pre-2030 action plans, robust carbon pricing, removal of fossil fuel subsidies, and the phaseout of coal.
- **Creating recovery plans to address economic and social impacts related to the coronavirus pandemic that are resilient and support the green transition** by integrating climate targets, investing in green jobs in sustainable energy, transport, and infrastructure, and avoiding new carbon-intensive recovery measures and fossil-fuel infrastructure lock-in.[100]
- **Aligning recovery packages and long-term climate spending with EU frameworks** to harmonise sustainable targets across different markets and attract a range of investors.
- **Designing a clear, informative, and administratively simple transition** to facilitate easy identification of investment opportunities by investors.

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Editor and lead authors:

Chup Priovashini, Chronos Sustainability

Rory Sullivan, Chronos Sustainability

Ella Harvey, Chronos Sustainability

Robert Black, Chronos Sustainability

Rachel Ward, Policy Consultant to IIGCC

Contributors:

Martin Stavenhagen, PRI

Jodi-Ann Wang, PRI

Hajira Kamran, IIGCC

Mona Freundt, CDP

The Investor Agenda is a common leadership agenda on the climate crisis that is unifying, comprehensive, and focused on accelerating investor action for a net zero emissions economy. The founding partners of The Investor Agenda are seven major groups working with investors: Asia Investor Group on Climate Change, CDP, Ceres, Investor Group on Climate Change, Institutional Investors Group on Climate Change, Principles for Responsible Investment and UNEP Finance Initiative. For more information, visit **theinvestoragenda.org** and follow **@InvestorAgenda** on Twitter.

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