Deutsches Aktieninstitut

Helping the European Green Bond Standard Achieve Global Relevance

Companies need legal certainty and more flexibility

Response of Deutsches Aktieninstitut to the public consultation on the establishment of an EU Green Bond Standard, 16 September 2021

Introduction

Deutsches Aktieninstitut welcomes the proposed voluntary nature for the Regulation on European green bonds (EU GBS) and the intention to ensure its co-existence with existing green bond standards. Furthermore, we support the alignment of the EU GBS with the EU Taxonomy. This is a distinctive feature of the planned EU GBS and a major difference from the previous market standards for green bonds.

However, there is still room for improvement in three notable areas

1. The EU GBS needs flexibility in the provisions for the green bond alignment with the Taxonomy where the Technical Screening Criteria may not be directly applicable or the criteria have not yet been developed.

2. Grandfathering provisions are needed: EU green bonds should maintain their status until maturity, provided they met the eligibility criteria at the time of issuance. Newly updated taxonomy criteria should not be relevant for the status of the bond in order to provide legal and economic certainty for both issuers and investors as well as to make the EU label attractive.

3. The required reporting deadlines are too difficult to meet in practice. The initial 30 days period for the preparation of the allocation report is too ambitious in comparison to the deadlines of financial reporting according to Art. 4 para. 1 Directive 2004/109 allowing 120 days for the preparation of an annual financial report. The EU GBS should be brought in line with existing rules and market practice.

The EU GBS needs flexibility provisions

Generally, we support the alignment of the EU GBS with the EU Taxonomy. Nevertheless, as the Taxonomy does not yet cover all relevant activities, a certain degree of flexibility should be granted in terms of eligible activities/projects to be financed. Limiting the use of proceeds to only those currently listed in the Taxonomy would significantly lower the opportunities for many potential issuers to become active in the market. For example, the EU Taxonomy sets restrictions to the eligibility of operating expenditures. Industries that have business models heavily reliant on operating expenditure or on supply chains would rarely be able to issue green bonds under the EU GBS.

In this context we strongly support the proposal of the Technical expert group on sustainable finance to grant explicit flexibility around the alignment of the use of proceeds to the Taxonomy in cases where either the technical screening criteria are not directly applicable or have not yet been developed.[1]

Lack of grandfathering rights may create mistrust and legal uncertainty

Indeed, one of the most problematic issues is that EU GBS designation will not be fully grandfathered for the full maturity of the bond. Under the proposed EU GBS regulation, issuers who have already issued a green bond must apply new rules retroactively within five years. This introduces unnecessary uncertainty and practical challenges into a product and market that requires certainty, transparency and comparability from an issuer's perspective. The possibility that a green bond might no longer be classified as green in the future might deter both issuers and investors from issuing and investing in green bonds.

EU green bonds should therefore maintain their status for the entire term regardless of eventually updated taxonomy criteria, provided they met the eligibility criteria at the time of issuance.

Without such provisions the following practical and legal problems may arise, the consequences of which are hard to fully anticipate.

- The lack of grandfathering rights will make issuers reluctant to issue EU Green Bonds with a term exceeding a certain maturity, e.g. five years. As a result, the EU GBS could be perceived as less flexible and, hence, less attractive. It discourages long-term EU green bond issuance and sets an

[1] See Technical Expert Group on sustainable finance (TEG) (2020): EU green bond standard usability guide, p. 14

incentive to use other green bond standards instead. This should not be in the interest of the co-legislators.

- It is unclear how the grace period will work in practice. Questions arise in particular for EU green bonds with a maturity of less than five years at the moment of amendment of technical screening criteria (TSC). Furthermore, it is also unclear whether issuers will for example need to: (i) reallocate the proceeds in line with the amended TSC if the proceeds have been already invested into fixed assets or modify such fixed assets in line with the TSC.

- It would be an unmanageable operational challenge for issuers to constantly review and track the eligibility of green issuances to ensure compliance with the current requirements. Apart from that, the organisational effort required in case the proceeds generated by the EU green bond no longer meet the updated requirements would be very high. A potential re-allocation of the funds may be difficult for companies from the real economy, especially if the issuer has a limited business focus and therefore may struggle to find meaningful alternative “green” uses within his own business.

- One additional challenge is linked to the so-called portfolio approach. Many green bond issuers do not allocate projects to each bond individually, but have a large portfolio of projects, which is matched by all issued green bonds rather than being linked directly to specific projects. In this case, it is conceivable that individual projects within the portfolio could be affected by a change in the EU taxonomy. In this case, issuers would not only have to remove the project from the portfolio, but there is also a risk that the entire portfolio would have to be revalued for alignment with the Taxonomy. This is associated with high costs and effort.

- From the perspective of an investor a lack of grandfathering rights also comes with additional hurdles. Investors may find themselves having financed activities incompatible with their objectives or legal investment mandate, even though they originally invested in a green-labelled product. This could affect investors’ decisions, as they would be more reluctant to invest in EU green bonds, given the risk of having to exit the investment when it is no longer qualified as green under the updated criteria. Finally, tracking the updates to the Taxonomy on a continuous basis and assessing whether the bond could have lost its status according to the updated criteria, would present a significant operational burden and legal risks to investors.

Reporting deadlines are too difficult to meet in practice

Art. 9 para. 6 in conjunction with Art. 13 para. 1 EU GBS Regulation seems to require the preparation of an allocation report within 30 days after the end of the financial year and the preparation and subsequent publication of the post-issuance review report within 90 days after receipt of the allocation report.

In this context the initial 30 days period for the preparation of the allocation report appears quite ambitious in comparison to the financial reporting according to Art. 4 para. 1 Directive 2004/109/EU allowing four months (i.e. 120 days) for the preparation of an annual financial report (including the management report with non-financial information pursuant to Article 19a, 29a of Directive 2013/34/EU), while the period for the external review of 90 days is much longer.

Therefore, it is absolutely sufficient to a set maximum period of 120 days including both, the publication of the allocation report and the post-issuance review report, without differentiation between both phases of the bond documentation. Thus, the EU GBS should be aligned with this proven practice.

The cost of the issuance of an EU green bond should be allowed to be settled from the proceeds of the issuance

It contradicts common market practice that the cost of the issuance of an EU green bond (such as underwriting commissions, fees for prospectus approval, listing, the external reviewer, legal advisors, auditors or cost for the printing of a prospectus) cannot be settled out of the proceeds. The fact that these costs cannot be allocated to the individual bond issue could have accounting implications and raise questions as to whether these costs can be included as costs in determining the issuer's tax liability.

Compatibility with other standards must be established

We welcome that the EU GBS is voluntary so that the EU GBS will coexist with other established market standards (e.g. the ICMA Principles). However, there are already a large number of European green bond issuers that have based their documentation on the ICMA green bond standards. If these issuers were interested in additional issuance under the EU GBS, they would have to comply with several standards. This must be avoided as this will increase costs, restrictions and compliance burdens. For example, the question arises whether the “Green Bond Framework” required by the ICMA standard can also be used as the mandatory “Factsheet” for the EU GBS, or whether issuers have to set up a completely new framework which entails additional efforts and cots for issuers.

We therefore think that it is important that already existing documentation and reporting of other standards should also be allowed to be used for the EU GBS and vice versa.

Rules for external reviewers are a step into the right direction

The draft Regulation provides rules for registration and supervision of external reviewers. Deutsches Aktieninstitut welcomes the intention to regulate the market for external reviewers. This could have a positive effect as this will lead to a more common methodologies, improve the reliability, comparability, and transparency.

However, it is important to note, that due to the complexity of the EU Taxonomy, we expect review costs for issuers to rather increase than decrease in the future. Furthermore, small and specialized external reviewers could be deterred by the EU regulation and registration obligations. In this context, it is important to ensure that the final regime will not result in market concentration of external reviewers which may disadvantage issuers as well as smaller external reviewers, while still ensuring that the market develops in a properly regulated and supervised way.

Create a level playing field between sovereign and private issuers

Under the proposed EU GBS regulation there are two main flexibilities for sovereign issuers: (i) Taxonomy-alignment of the terms and conditions of the funding programs is sufficient (i.e., there is no need for an external reviewer to confirm the Taxonomy alignment of each economic activity funded by such programs) and (ii) state auditor/any other public entity can issue external reviews without being subject to the registration and supervision requirements of the draft Regulation. In Art. 2 para. 3 (f) EU GBS Regulation the definition of a “sovereign” is, however, quite far-reaching. It could also include private companies that are state owned, but are competing with pure-play private companies.

We therefore believe that the definition should be more precise. Apart from the definition, however, the question arises as to why simpler rules should apply to sovereigns but not to private companies? This not only creates an unlevel playing field but also shows that a standard with fewer reporting requirements and simpler handling of ESG ratings is possible. The regulator should therefore consider making the standard easier for private companies as well, so that more EU green bonds could be issued and the market as a whole could grow.

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