

## **Amendments to the European Green Bond Standard Regulation: An Analysis**

Inappropriate costs and liability risk should be avoided

## Introduction

On 6 July 2021, the European Commission published its draft proposal for a Regulation on European green bonds (EU GBS). Deutsches Aktieninstitut welcomed the proposed voluntary nature for the EU GBS and the Commission's intention to ensure its co-existence with other green bond standards, e.g. the ICMA Green Bond Principles. We otherwise highlighted areas of concern notably the absence of any flexibility provisions and the lack of full grandfathering for the case that the relevant delegated acts regarding the Taxonomy are amended.

The proposal is currently being discussed by the co-legislators. On 2 December 2021 the Rapporteur of the EU GBS Regulation at the European Parliament released his report on the file. Subsequently, numerous amendments were tabled by members of the Committee on Economic and Monetary Affairs (ECON) in January 2022. In addition, the European Council's working group agreed in January 2022 to a compromise paper.

Although there are many amendments which would increase attractiveness of the EU GBS from an issuer perspective, a lot of amendments would lead to an inappropriate level of additional costs and liability risk. As a consequence, we believe that issuers would refrain from applying the EU GBS which would in turn contradict the aim of the legislator "to further increase investment opportunities and facilitate the identification of environmentally sustainable investments through a clear label".

## 1 Areas of Concern

The European Commission proposes a **voluntary** green bond standard with the EU GBS as a benchmark for the most "**high-quality**" green bonds in the European bond market. Deutsches Aktieninstitut welcomed the proposed voluntary nature for the EU GBS and the Commission's intention to ensure its co-existence with other green bond standards

In contrast, it is proposed by some Members of ECON **to extend the EU GBS to all types of sustainable bonds** (including social bonds, sustainability bonds and sustainability-linked bonds – see amendment No. 8) and make the **EU GBS mandatory for all bonds marketed as environmentally sustainable** (see e.g. amendments No. 152, 242 or 248).

Furthermore, many amendments propose **additional requirements regarding the entire business model** of the issuer (see e.g. amendments No. 60, 248 or 308), in particular compliance with the "do no significant harm" principle on corporate/ issuer level. It is not clear whether that adherence relates to the individual activities (or related financings), being the subject matter of the green bond issuance, or to the issuer as a legal entity in the entirety of its activities. Additionally, the do no significant harm principal has been established with the EU Taxonomy as one of several key criteria to define sustainable or green economic activities, not entities. **This goes far beyond the European Commission's proposal**, which envisages that the proceeds of an EU green bond should be aligned with the EU Taxonomy.

We believe that these amendments would have the following consequences:

- **The majority of companies would not be eligible to issue EU GBS:** In the case of mandatory application of the EU GBS for all sustainable bonds, many companies could be cut off from the entire sustainable bond market. This would particularly affect issuers that are currently transforming their business model or whose activities are not yet covered by the EU taxonomy. For example, a possible extension of the scope of the EU GBS would require a fully developed European social taxonomy to define social activities, which does not yet exist. This contradicts the legislator's goal of accelerating the transition to more sustainable business models and would jeopardize the entire sustainable finance market.
- **Unlevel-playing-field on the global bond market:** Extending the scope of the EU GBS to all types of sustainability bonds would lead to an unlevel-playing-field for EU issuers compared to issuers from other jurisdictions. We are not aware of any important bond market restricting the issue of green bonds to a specific standard. All of them provide flexibility for other standards, e.g. the ICMA principles. Restricting green bonds to the EU GBS

would put potential green bond issuers in the European Union at a competitive disadvantage, forcing them to issue green bonds in other jurisdictions or switch to other financing instruments such as bank loans. Thus, lower volumes and liquidity of the EU green bond market would be the result. The political determination of one standard would also undermine a competition of standards and would also ignore that investors have very specific ideas about what is green and what is not green.

Furthermore, **the use of proceeds approach of green or sustainable bonds differs significantly from the general-purpose approach** taken e.g. by sustainability linked bonds which have no relation with the individual assets or activities finance. A sustainability-linked bond demonstrates the path issuers will take to achieve predefined environmental or sustainable objectives expressed by specific key performance indicators (KPI). These KPIs measure the progress of the company towards green or sustainable activities. The coupon, the repayment amount and other structural bond features depend on the ability of the issuer to reach these objectives. **These fundamental differences should be carefully considered by the legislator** when proposing to extend the EU GBS to all existing green financing instruments.

In addition, many amendments impose a number of additional obligations on the European sustainable bond market in terms of disclosure, reporting and external review, that should not be introduced in this form.

- **Mandatory incorporation of an extended factsheet into prospectus for all sustainable bond issuers:** Since the main risk, the loss of the designation “green”, is already incorporated among the risk factors in the prospectus, we do not see the necessity for the mandatory incorporation of further details. Nevertheless, the issuer may also incorporate the pre-issuance fact sheet published on the website by reference on a voluntary basis. While investors will appreciate the additional transparency created, for the incorporation into the prospectus, it is important to keep it simple and transparent. Additional requests, as suggested in the amendments, with regard to including transition plans would make the fact sheet overburdened and hence make the prospectus overly complex, increase liability risk for the issuer and hence reduce the acceptance of the standard. Information on the transition strategy and a related transition plan would rather fit into the issuer’s general non-financial disclosure (see amendment No. 90).
- **De facto exclusion of a portfolio approach** if fact sheet, allocation reporting and impact reporting had to be prepared for each bond (see e.g. amendments No. 67 or 73). This would negatively impact common market practice. Many 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 on a bond by bond basis. This is especially relevant for frequent green bond issuers with eligible green projects from different Taxonomy compliant economic activities. Furthermore, this is relevant as in situations when eligible projects need to be replaced, this generally can be handled more efficient within a bigger portfolio than on a bond by bond basis.

- The **obligation for EU GBS issuers to develop transition plans** to reach net zero by 2050, especially in terms of annual, verifiable targets, is so far not common among companies and countries (federal/state level) as well as their authorities (e.g. state owned banks like in Germany the “KfW”). Also, our understanding of the future regulation is that Green Bonds follow the so called “use of proceeds” approach, i.e. is linked to specific environmental projects, which corresponds to current market standards. Against this background any transition plan which delivers information on a general issuer basis would not deliver any supplemental information for investments in Green Bonds. Furthermore due to the long time horizon, which is difficult to predict and partly subject to limited influence (e.g., political support, Scope 3 emissions) **such plans offer no added value for investors**. We therefore think that this would reduce the uptake of the standard, as these requests relate to the corporate strategy and not the economic activities financed by the bond (see amendments No. 86 or 408).
- **Requirements for Taxonomy alignment plans for EU GBS** to be based on annual intermediate targets and subject to annual external review (see amendment No. 20). The failure to achieve these targets twice would lead to the loss of the EU GBS designation, which is an inappropriate punishment (see amendment No. 52).
- A potential **exclusive application of the EU GBS only for new projects or exclusion of refinancing would limit options for follow-up funding**. As new issuances always require alignment to the latest version of the Technical Screening Criteria of the Taxonomy there is no reason to exclude to re-finance an existing, Taxonomy-aligned activity with a EU GBS, especially as green bonds often support long term projects, e.g. wind parks, which require long-term financing beyond the normal tenor of the green bond and have a positive impact throughout their ~25-year lifetime (see amendments No. 351 or 255).
- It has been also suggested that issuers which use other formats than the EU GBS need to i.) **disclose their taxonomy aligned proportion of proceeds** and ii.) **allocate proceeds in compliance with the DNSH principle**. This would force issuers of green bonds e.g. under ICMA GBP

into elements of the Taxonomy rules and reduce the attractiveness of ICMA GBP as a key format for transition finance. Also, with the absence of grandfathering rules available to EU GB, it is unclear how any future changes of DNSH rules would affect such instruments issued under other standards. On their transition pathways issuers should have access to the stricter EU GBS, but also to formats defined more widely like ICMA GBP, formally independent from the Taxonomy, to foster further innovation, e.g. in fields of agriculture. Issuers could then assign green bonds proceeds to activities or a specific technology, which are not yet covered under the Taxonomy, provided that investors share the view that such activities contribute to the protection of climate and the environment (see amendment No. 407).

- **Excluding transitional activities** (see amendments No. 386, 395) from the taxonomy alignment plan which we interpret as excluding not yet allocated or aligned proceeds for transition finance makes the standard less attractive. Given that the transition taxonomy is not yet developed, issuers should have the chance to use the proportion for this purpose. In case the final standard will provide for the currently discussed flexibility pocket, this could be a chance to use the not-taxonomy aligned proportion of the proceeds for transitional activities which are not yet deemed green under the taxonomy, e.g. sustainable fishery.
- **Mandatory external reviews** for impact reports and taxonomy alignment plans for all sustainable bonds (at both pre- and post-issuance phase – see amendments No. 85, 86) would confront issuers and auditors with an enormous difficulty of practical implementation in connection with the uniform definition of the criteria for measuring the impact, the methodological approach as well as documentability and verifiability. This is particularly important for issuers with a wide variety of eligible green projects, some of which are quite complex and involve a diverse range of activities.

## 2 Welcome Improvements

However, as mentioned above, we also welcome many ECON proposals and the EU Council compromise. These adequately reflect recent funding practices.

The EU GBS should provide more flexibility for issuers to deviate from the Taxonomy requirements. 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. Although we are aware that the acceptance of the EU GBS among investors would be highest by providing a strong link to the Taxonomy, 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. In this context we support the proposal of the EU Council to grant 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 (see proposed Art. 7 para. 1a). Some ECON amendments point in the same direction (see e.g. amendments No. 252 or 254).

Furthermore, one of the most problematic issues – the lack of **full grandfathering** rights of issued green bonds – **is addressed by many amendments** (see e.g. amendments No. 279 or 282) and the EU Council's compromise paper (see proposed Recital 11). **We welcome a full grandfathering for existing bonds** as they provide issuers the legal clarity that they should not have to re-allocate their bond proceeds in the case of changes to the delegated acts under the Taxonomy Regulation.

Finally, we welcome the proposals to extend the **reporting deadlines** as is foreseen in the EU Council's compromise (see Art. 9 para. 6) and many amendments (see e.g. amendment No. 419). In addition, we also appreciate proposals stating that the issuer is allowed to settle the **issuance costs** from the proceeds of the issuance (see e.g. amendments No. 260, 360 and 346; Art. 4 para. 1 Council's compromise).

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