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EBF ON THE PROPOSAL FOR A REGULATION ON EUROPEAN GREEN BONDS

Introduction

The European Banking Federation (EBF) welcomes the European Commission's proposal for the development of a voluntary EU Bond Standard (EU GBS). The development of a coherent and uniform framework that is available for different types of issuers both inside and outside the EU (i.e. non-financial undertakings, financial institutions, sovereign issuers, public bodies) will significantly facilitate the ability to raise large-scale financing that will encourage economic activity contributing to the achievement of the European Green Deal.

In particular, the EBF would reiterate support for the following provisions of the proposed EU GBS:

- the voluntary nature of the standard;
- the requirement for the publication of a pre-issuance "green bond factsheet", subject to a "pre-issuance review", as well as a "post-issuance review" once proceeds have been allocated before the bond matures;
- the requirement for the publication of an annual allocation report, as well as the environmental impact report;
- the designation of ESMA as the supervisor of the external reviewers and their methodology;
- the definition of 'sovereign' provided in the proposal;
- the mandatory 3-year look-back period for green OPEX, which is a more ambitious measure than current market practice;
- the requirement to provide information on how the bond aligns with the broader environmental strategy of the issuer.

Nonetheless, for the EU GBS to be taken up by the market, especially in its initial phases, the EBF would underline the importance of additional flexibility to be imparted into the framework from the outset.

Specifically, the EBF would emphasize the need to re-evaluate three provisions of the proposal:

- The five-year transitional period, which should evolve into a full grandfathering provision guaranteeing that despite evolving Taxonomy Technical Screening Criteria (TSC) a bond may maintain the EU GBS designation until maturity;
- the requirement for 100% of the proceeds to be directed to Taxonomy-aligned activities, which should be amended to include a temporary flexibility to facilitate the initial uptake of the standard;
- The provision for which proceeds are to be fully allocated without deducting costs. Considering the costs associated with issuance we believe that the Regulation should allow a use of "net" proceeds after the deduction of costs.

In addition, the EBF would encourage further consideration on how the risk-sharing mechanisms under the InvestEU programme can be applied to incentivize the uptake of the EU GBS, especially by SMEs.

Specific Comments

Ensuring that the bond remains eligible for the voluntary designation until maturity

As outlined by Recital 11 of the proposed Regulation, the delegated acts adopted as part of the Taxonomy Regulation will be reviewed and amended – reflecting a welcome dynamic approach which would allow for technological and scientific advances to be reflected in the framework's TSC.

While the dynamic nature of the Taxonomy is merited, the implications of evolving TSC on the attractiveness of the proposed EU GBS must be carefully considered, as the current provisions of the proposal would require the issuer to reallocate proceeds to assets meeting the evolving TSC within a five-year period. Such a reallocation is hardly practical. In addition, this could become particularly burdensome for financial institutions, in the capacity of issuers, when handling their portfolios as they will have to face the additional challenge of screening their portfolio against the new taxonomy criteria on a regular basis (e.g. once a year) as proceeds are to be reallocated. This could result in an overburdensome practice in the case of large portfolios.

For the EU GBS to benefit from wide market uptake, it is important that the EU GBS designation be secured for all outstanding bonds until maturity – independently of the evolution of the corresponding TSC. This is in line with the EU TEG on Sustainable Finance's recommendation that '*Technical Screening Criteria be grandfathered for their entire tenor, as there would otherwise be unpredictability for both issuers and investors*'[1].

The possibility to lose the EU GBS designation before the bond matures would, indeed, create uncertainty and unpredictability for all parties: the original borrower, the bond issuer, and investors. The market value of outstanding EU GBS might decrease following the taxonomy TSC reviews, a risk that may be priced into the bond from the beginning. Since the EU GBS is a voluntary label, market participants might thus avoid it.

In addition, any reallocation of the funds may be difficult, especially if the issuer has a limited business focus and may therefore struggle to find meaningful alternative "green" uses within its own business. Moreover, the refinancing process might result burdensome in terms of costs.

The purpose of the EU GBS is to reorient capital flows towards a more sustainable economy. However, a 5-year grandfathering would create significant problems of legal uncertainty for asset managers. Asset managers aim to use EU Green Bonds in investment products, such as sustainable financial products under Art. 9 of the SFDR or in UCITS to receive the Ecolabel. Any changes to the status of the EU Green Bond risks however to impact the status of the asset manager's product,

The complexity of this provision would, moreover, disadvantage EU Green Bonds with a term exceeding five years. The discouragement of EU Green Bonds as a tool for long-term funding would contradict the Commission action plan on financing sustainable growth, according to which '*Sustainability and long-termism go hand in hand*'.

There are no guarantees that, according to the evolving TSC, enough new Taxonomy-aligned assets would be available, nor can the issuer trust that it would find a buyer for the old bonds that are no longer Taxonomy-aligned. In case of project finance, where the idea is to make an asset Taxonomy-aligned within a pre-determined timeframe (the current provision is for a 5-10 year period), it would be unrealistic to expect the EU GBS issuer to change its investment programme after a project has been initiated due to the amendment of the relevant TSC.

In conclusion, we believe that the requirement to reallocate bond proceeds following new technical screening criteria (TSC) would have a negative impact on issuers, the price of European green bonds, as well as investors. In order to provide legal certainty to issuers and investors and prevent any negative

1 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

impact on the price of already issued EuGBs, it should be made clear that issuers may allocate bond proceeds under the delegated act applicable at the point in time the bond is issued, and that these do not need to be replaced until their maturity.

Providing for flexibility in the use-of-proceeds with Taxonomy-aligned activities

As outlined under Action 1 of the Strategy for Financing the Transition to a Sustainable Economy, the European Commission and EU Platform on Sustainable Finance are focusing on better defining how activities that do not yet meet the requirements for full Taxonomy-alignment can be increasingly included in the Taxonomy frameworks. As also outlined in response to the recent Draft Report on the Extension of the Taxonomy to NSI/Harmful economic activities[2], the EBF considers the increasing focus on financing "greening" activities pivotal as to allow the channelling of investment flows towards activities that are credibly transitioning towards Taxonomy-alignment.

The proposal under scrutiny highlights that '*the use of proceeds shall relate to economic activities that meet the Taxonomy requirements or that will meet such requirements within a defined period of time as set out in a taxonomy-alignment plan'.* Such period '*shall not exceed 5 years from bond issuance, unless a longer period of up to 10 years is justified by the specific features of the economic activities concerned as documented in the taxonomy-alignment plan*'. Considering the difficulties linked to the proper application of the overall framework, we deem appropriate to develop additional guidance for certain elements of Taxonomy-alignment also considering that both financial and non-financial companies are still adjusting to the operational requirements for full Taxonomy-alignment.

The EBF supports the creation of the standard as it will provide a common language and serve as a 'gold standard' for green bonds. However, due to the significant difficulties expected to be encountered in the initial period, in particular with regards to satisfying the technical screening criteria and 'do no significant harm' criteria of the EU Taxonomy, to facilitate the initial broad and successful uptake of the standard, we believe there would be benefit in allowing additional and temporary flexibility concerning the requirement that proceeds be fully aligned with the Taxonomy. Any initial and temporary flexibility should be granted to all issuers, both sovereign and corporate, as to ensure a level playing field and avoid that the standard result in two qualitatively different categories of EU Green Bonds. Finally, the EBF strongly supports the voluntary nature of the standard as it will ensure that stakeholders be provided the opportunity to choose between existing standards available in the market and that the European market continue leading in terms of volume of green bond issuance. Restricting the issuance of green bonds to solely taxonomy aligned bonds would risk suddenly shrinking the offer of green bonds in the EU altogether.

Deduction of costs from the use of proceeds

The current proposal foresees, as per Article 4(1), that '*the proceeds of European green bonds shall be exclusively and fully allocated, without deducting costs*'. It should be considered that the issuance process entails significant costs, including, but not limited to, fees for underwriting, prospectus approval, listing, external reviews, and legal advisors. In addition to this, and specifically in the case of EU green bonds, there will be additional costs resulting from the need to analyse the assets and collect data that is often not readily available. It is currently normal market practice that these costs be allocated to the individual bond issuance and that there be a 'net' use of proceeds from which costs of issuance are deducted. For these reasons, we would propose re-elaborating the provision as to foresee the use of proceeds after the deduction of commissions and costs related to the issuance and offering of the bonds at hand.

2 https://www.ebf.eu/financing-growth/draft-report-on-taxonomy-extension-options-linked-to-environmental-objectives-ebf-response/

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The provision of incentives for the uptake of the standard

The issuance of green bonds entails additional costs, particularly during the initial phase of the application of the standard. This will especially be the case for SMEs.

To help offset some of these costs, we encourage the European Commission to carefully consider the use of private-public guarantee schemes as well as fiscal incentives as supporting tools in the context of the EU GBS. The dedicated use of the InvestEU programme is suitable for this purpose, especially through the €6.9 billion "SME window"[3].

The above-mentioned incentives would be in line with Action 2 of the Strategy for Financing the Transition to a Sustainable Economy. The EBF agrees with the European Commission's assessment that this will be a key component in creating a more inclusive sustainable finance framework, while promoting the development and standardisation of practices under the EU GBS.

The creation of tax incentives for investors, aimed to attract medium/long term investors, such as investment funds (equity and fixed income), and the reduction of the haircut for the ECB eligibility of EU Green Bonds (10%) would help the EU green bond market grow on the buy side, while incentives for issuers of EuGBs would counterbalance increased costs (extra investments in terms of selection, monitoring and reporting; increased cost of external reviews). It would, moreover, be useful to have guidance on fiscal incentives from the EU in this context, although we do recognise that such incentives are within the competences of member states.

3 https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2344

Annex – Additional points to be considered

Feasibility concerns

- The document proposed by the EC, (the "Factsheet") does not follow current green bond frameworks which are aligned to ICMA GBP four core components. Such a significant deviation could possibly result in more costs than benefits for market participants.
- Goodwill is excluded from eligible assets while often considered as current value of the assets.
- The timeframe to provide the allocation report to the external reviewer within 30 days following the end of the year the report refers to, is very ambitious especially because issuers may try to produce a joint allocation and impact report.
  In this context, the initial 30-day period for the preparation of the allocation report not only appears quite ambitious in comparison to the financial reporting according to Art. 4(1) of Directive 2004/109, which allows four months (i.e. 120 days) for the preparation of an annual financial report (including the management report with non-financial information pursuant to Art. 19a, 29a of Directive 2013/34/EU). From a merely practical perspective, the preparation of the allocation report would also interfere with the preparation of the annual financial report.
  Moreover, the period for the preparation of the allocation report appears disproportionately short in comparison to the 90 days the external reviewer may take for their review. Firstly, the split of the 120 days period in total, calculated from the end of a business year, appears counterintuitive. We would assume that the compilation of the allocation report will take longer than its review. Also, we believe it is absolutely sufficient to set a maximum period for the publication of the package (allocation report and post-issuance review report) without allocating fractions of that period to each of the two related documents – just as it is today for the publication of annual financial statements and the auditor's opinion.
- Allocation reporting on portfolio basis based on yearly average of quarter-end values; vs half-year end values is often used in the market currently.
- Guidance on alignment with EU Taxonomy DNSH would be appreciated. DNSH is viewed as the most complex part of the EU Taxonomy and without targeted guidance there would be a risk that issuers may initially only align with the SC criteria, falling short of the EuGB standard. A practical suggestion to facilitate application would be to establish equivalence tables between DNSH based on qualitative criteria – particularly when referring to EU regulation – and international standards.

Taxonomy-alignment plan

According with Article 6(1) of the Proposal "*The use of proceeds referred to in Article 4 shall relate to economic activities that meet the taxonomy criteria, or that will meet the taxonomy criteria within a defined period of time as set out in a taxonomy-alignment plan*." Is that taxonomy-alignment plan going to be verified by the external reviewers? Moreover, the same article states that such period "*shall not exceed 5 years from bond issuance, unless a longer period of up to 10 years is justified by the specific features of the economic activities concerned as documented in the taxonomy-alignment plan*". Further clarity is needed on which '*specific features*' would justify a longer period.

Financial assets – debt and equity

The proposal sets the use of proceeds as financial assets include debt and equity, while the TEG recommendations did not include equity. We would ask for clarification on two aspects:

- under the proposal, does equity mean for instance convertible bonds or payments in kind bonds (those instruments could indeed be considered as equity or equity-like)?
- how can equity finance be ringfenced to fixed assets?

Designation for failing EuGB

Sanctions are foreseen for issuers which breach the rules set in the Proposal and the designation 'European green bond' or 'EuGB' shall only be used for bonds that comply with the requirements set out in the Proposal until their maturity. Firstly, the EBF suggests that, when it is found that an issuer does not comply with the rules set in the Proposal, said issuer be sent a statement of objections and be granted the possibility to address the authorities' concerns within a set timeframe. In addition, in those cases where the issuer fails to address the authorities' concerns, it is not clear whether and how the denomination of the failing 'European green bond' status shall be modified after notification of the infringement. The EBF suggests that the issuer is offered a period to change the designation of the bond in the public documentation and notify key stakeholders such as Exchanges where the bond is listed, In addition, it should be clarified that the loss of the 'EU Green Bond' designation does not prevent the same bond from having the status of "green bond", provided that it classifies as such in compliance with other existing standards.

Publication

Under Article 13(1) of the Proposal, "Issuers of European green bonds shall publish on their website, in a distinct section titled 'European green bonds' and make available free of charge until at least the maturity of the bonds concerned" the documentation related to the EuGB. Regarding securities which are admitted to trading, we suggest aligning the publication regime with Article 21(2) of the Prospectus Regulation, giving issuers the chance to publish all EuGB related documentation on different websites, including on the website of trading venues where the admission to trading is sought.

In addition, the provision in Art. 30(2), which requires the pre-issuance review to be made publicly available "*within a reasonable period of time prior to the beginning of the offer*" and "*without delay following the assessment*" appears vague, ambiguous and impracticable. In particular, it is unclear what is meant by "*within a reasonable period*". It would appear preferable to align the requirement with Art. 21(1) of the Prospectus Regulation (Regulation (EU) 2017/1129). The latter stipulates: "*Once approved, the prospectus shall be made available to the public […] at a reasonable time in advance of, and at the latest at the beginning of, the offer to the public or the admission to trading of the securities involved*." This should be sufficient and add both clarity and consistency to the documentation requirements for green bonds.

European green bond impact report

According to Article 10, "*Issuers of European green bonds shall, after the full allocation of the proceeds of EU GBs and at least once during the lifetime of the bond, draw up a European green bond impact report on the environmental impact of the use of the bond proceeds by using the template laid down in Annex III*". It should be clarified that no external review will be required for such impact reports.

Private placements

In the context of a private placement, can the EuGB designation be used? In that case, which national competent authority would be competent to verify the documentation of the bond and the factsheet, and their alignment with the Proposal?

About EBF

The European Banking Federation is the voice of the European banking sector, bringing together national banking associations from across Europe. The federation is committed to a thriving European economy that is underpinned by a stable, secure, and inclusive financial ecosystem, and to a flourishing society where financing is available to fund the dreams of citizens, businesses and innovators everywhere.

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