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COVER NOTE

From:	Ms Christa SCHWENG, President of the European Economic and Social Committee
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Subject:	Proposal for a Regulation of the European Parliament and of the Council on European green bonds [COM(2021) 391 final - 2021/0191 (COD)] - Opinion of the Economic and Social Committee

Delegations will find attached the opinion of the European Economic and Social Committee.

Encl.: ECO/560



OPINION

European Economic and Social Committee

EU green bond standard

Proposal for a Regulation of the European Parliament and of the Council
on European green bonds
[COM(2021) 391 final - 2021/0191 (COD)]

ECO/560

Rapporteur: **Philip VON BROCKDORFF**

Referrals	Council, 12/08/2021 European Parliament, 13/09/2021
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	23/11/2021
Adopted at plenary	08/12/2021
Plenary session No	565
Outcome of vote (for/against/abstentions)	123/1/4

1. Conclusions and recommendations

- 1.1 The "voluntary" EU green bond standard creates a regime underpinned by transparency and supervision. Under such a regime, projects that are in line with the EU taxonomy of sustainable activities would be eligible for funding, and issuers would need to provide additional information at the time of issuance, and subsequently through regular reporting on the use of proceeds and project impact.
- 1.2 The EESC believes that the EU green bond standard also has the potential to yield significant economic benefits for both issuers and investors alike. This is possible because the proposal aims to create a universal, credible and streamlined mechanism for the issuance of green bonds, minimising informational asymmetries while conveying significant reputational benefits to issuers under this standard.
- 1.3 The EESC considers that the alignment of such bonds with the EU Taxonomy Regulation also makes them suited to funding economic activities that support the transition towards more sustainable and decarbonised economies.
- 1.4 The proposed standard would also assist in significantly reducing existing levels of uncertainty regarding the types of assets or expenditures that can be reasonably classified as being a green use of capital. However, because of the aforementioned alignment with the EU Taxonomy, the EESC is of the view that clear guidance on the part of the Commission is needed to direct investors towards EU green bonds and projects that positively impact the environment.
- 1.5 The EESC is of the view that in further developing green bonds as an asset class, it is necessary to apply a uniform standard across Member States and applicable to issuers. However, one should not underestimate the challenge of issuers complying with the standards in the EU Taxonomy. In all likelihood, they would weigh the costs of an external review against the benefits of accessing a wider investor base. A situation where private issuers may prefer alternative green bonds and less onerous certification processes needs to be avoided.
- 1.6 The proposed reporting and compliance procedures may also have a disproportionate financial impact on SMEs, who may find the EU green standard to be too punitive, and thus discourage further growth. This too needs to be avoided and hence the EESC recommends a pragmatic approach in terms of the supervision and reporting requirements. Avoiding over prescription and over regulation, including in the case of corporate issuers, would facilitate the adoption of the EU green bond standard across capital markets. In decarbonising economies, corporate issuers are deemed as equally important as the Commission's issue of green bonds, and the EESC is of the view that standards applied for green bonds issued by public sector and corporate issuers need to converge.
- 1.7 Insofar as non-EU issuers of green bonds are concerned, the EESC is of the opinion that access to EU capital markets and vice versa should be based on the alignment of taxonomies across jurisdictions globally. In the view of the EESC this is of particular relevance since environmental challenges such as climate change cannot be addressed by the EU alone. Unless there is some common ground on taxonomy alignment with third countries, the Commission's

proposed regulation on a voluntary green bond standard is unlikely to become a standard for the global green bond market. The International Platform on Sustainable Finance (IPSF) should play a key role in providing this common ground by acting as a forum for dialogue between policy makers.

- 1.8 Finally, the EESC welcomes the requirement under the EU taxonomy for investments to meet the do-no-significant-harm (DNSH) and minimum safeguards, given the continued need to prioritise the green transformation alongside social protection and safeguarding of human and workers' rights. This may nonetheless limit the scope of taxonomy alignment with third countries, particularly if such jurisdictions do not fulfil DNSH criteria such as the recognition of collective bargaining rights. For this purpose, the EESC proposes a dedicated monitoring committee to supervise the dynamics of the green bond market, with the involvement of social partners.

2. General comments

- 2.1 On 6 July 2021, the European Commission proposed a new Regulation on a voluntary European Green Bond Standard. The proposed Regulation aims to make the EU's financial system more sustainable by creating a "gold standard" for green bonds that can be compared to, and potentially aligned with, other market standards.
- 2.2 The green bond standard would be open to all issuers of green bonds, including private, public and sovereign issuers, and includes issuers located outside of the EU.
- 2.3 The proposed framework would set a voluntary standard for how companies and public authorities can use green bonds to raise funds on capital markets to finance projects.
- 2.4 The standard requires that issuers allocate all of the issue proceeds to activities that meet the EU Taxonomy Regulation EU/2020/852 requirements by the date of maturity of the bond. It sets out environmental objectives, screening criteria and performance thresholds for economic activities. An economic activity will be considered compliant if it: (a) contributes substantially to one or more of the environmental objectives; (b) does no significant harm to other environmental objectives; and (c) complies with social and governance safeguards.
- 2.5 EU green bonds would help address funding of long-term projects (of up to 10 years) as long as such projects are aligned with the Taxonomy Regulation's environmental objectives.
- 2.6 EU green bonds would be subject to external review to ensure that they are compliant with the requirements referred to above, in particular the taxonomy alignment of projects. Under the proposal, external reviewers would be registered with the European Securities and Markets Authority and will need to meet the conditions for registration on a regular basis.
- 2.7 In the event of a change in the EU Taxonomy Technical Screening Criteria (TSC) under the Taxonomy Regulation after a bond issuance, the proposal allows issuers to continue to qualify under pre-existing criteria for a further five years. However, the EESC is of the view that once a bond qualifies as "green" at issuance, the rules for allocating the proceeds should not be

changed. In practice, though the taxonomy screening criteria change and the bond no longer meets the new criteria, it should remain "green" for the entire term to maturity. This should contribute to stable green bond markets.

- 2.8 The proposal also aims to enhance investor confidence and safeguards, and to reduce risks of green bonds-funded projects not achieving the target environmental objectives. Issuers of such bonds would be required to undertake regular reporting.
- 2.9 A "green bond factsheet" setting out the definitive funding objectives of the issue would be obligatory and this factsheet will be subject to a "pre-issuance review" by a registered external reviewer to ensure that the bond meets the green bond standard requirements.
- 2.10 Green bond issuers would also be required to publish annual reports showing how the proceeds of the bond issue are aligned with the EU taxonomy.
- 2.11 Once all of the proceeds from the sale of green bonds have been allocated (which must happen prior to bond maturity), the issuer will be required to obtain a "post-issuance review". For certain issuers (such as some financial institutions), this will be an annual requirement.
- 2.12 There will also be a requirement to publish at least one report on the overall environmental impact of the bond.

3. **Specific comments**

- 3.1 The European Commission's proposal for a European Union green bond standard comes at a time when the demand for green bonds is on the increase within the EU. However, current green bond issuance in the EU still only represents 2.6% of total EU bond issuance, so there remains a significant opportunity for growth. For example, in the second quarter of 2021 green bond issuance in the EU grew by around 30% relative to the same period in 2020, reflecting the growth trajectory within this area¹.
- 3.2 Despite this, there is increasing concern about the true extent of environmental benefits arising from projects funded by the issue of such bonds. The term to describe these concerns is "greenwashing", reflecting the at times uncertain environmental credentials of projects financed via green bonds. This creates a credibility problem for issuers seeking to establish their environmental reputation, and an information asymmetry for investors who *ex-ante* may struggle with identifying genuine environmentally sustainable projects.
- 3.3 The problem lies with the fact that green bonds are the same as all other bonds: the difference being that the proceeds from green bonds issue being used for a project that meets certain pre-established environmental criteria. In the event of a default, and as in any bond issue, the investor typically has recourse to the issuer's entire balance sheet. The additional value to the investor is derived from holding a bond that meets sustainable or environmental objectives. However, the issue here is that definitions of sustainable activities vary across jurisdictions

¹ Climate Bonds Initiative (2021). Regional breakdown of green bond issuance, by volume of issuance.

within the EU. Hence, comparing the impacts of projects across jurisdictions and often across regions within a Member State is quite impossible.

- 3.4 There is also an issue relating to the reporting on the use of proceeds. Problems with issuer disclosure and communicating information on the use of proceeds to investors tend to be more pronounced in Member States where the bulk of low-carbon investment will be needed in the future.
- 3.5 The EU green bond standard aims to address these problems by creating a regime underlined by transparency and supervision. Under such a regime only projects that are in line with the EU taxonomy of sustainable activities would be eligible for funding, and issuers would need to provide additional information at the time of issuance, and subsequently through regular reporting on the use of proceeds and its impact. In addition, only external reviewers supervised by the European Securities and Markets Authority (ESMA) will be allowed to sign off on an EU green bond. However, the EESC cautions against market concentrations to keep the cost of external reviewers under control. For example, a simple and smooth registration process can encourage competition in this area – this would not compromise the knowledge or quality of the reviewers.
- 3.6 The EU green bond standard also has the potential to yield significant economic benefits for both issuers and investors alike. At present, the issues surrounding credibility and informational asymmetries create additional costs for all parties involved, with issuers seeking to establish their credentials through various costly efforts, including costly external review procedures and increased reporting, while investors may undertake additional search efforts in order to adequately identify suitable sustainable investment opportunities. The proposed EU green bond would create a universal, credible and streamlined mechanism for the issuance of green bonds, minimising informational asymmetries while conveying significant reputational benefits to issuers under this standard.
- 3.7 European green bonds aligned with the EU Taxonomy Regulation are well suited for funding economic activities that support the transition towards more sustainable and decarbonised economies. Green bonds should be seen as a primary preference, and appropriate incentives should be created in order to actually 'green' the EU financial system.
- 3.8 The proposal would also allow EU-based companies to issue a European green bond to acquire or construct an EU taxonomy-aligned asset, such as a new energy efficient building. Hence, this would allow companies to increase their share of taxonomy-aligned assets. However, this should also consider associated social costs, including collective redundancies.
- 3.9 The proposed standard would also assist in significantly reducing existing levels of uncertainty regarding the types of assets or expenditures that can be reasonably classified as being a green use of capital, due to the aforementioned alignment with the EU taxonomy, thereby creating increased confidence in the green bond market and thus helping to further boost growth and investment within this emerging field and the mainstreaming of green finance. In time, the EU green bond standard may become effective, but guidance on the part of the Commission is needed to direct investors into higher-quality bonds and projects that really impact positively the

environment, as well as creating a new asset class in the capital market within the EU. The prospect of such guidance is another reason why this proposal is welcome.

- 3.10 Against this background, green bonds would become a fundamental component for financing the low-carbon transition across the EU. Green bonds typically have long durations with capital being repaid when the bond matures, as is required for large infrastructure projects. While the use of the EU green bond label would be voluntary, investors have every incentive to use it in their efforts to mobilise capital for projects with visible environmental benefits. That in itself is already an important advantage but the main advantage is the standard itself, which provides a benchmark for green assets in the capital market. This is expected to further develop green bonds as an asset class, enabling investors to identify a yield curve specific to green debt instruments. Assuming a uniform standard across Member States and applicable to issuers, green bond funds and the provision of green bank loans could help mobilise additional funds to facilitate the low-carbon transition. This would be further facilitated also on the assumption that the pricing of green loans is sufficiently reasonable.
- 3.11 The EU green bond could also result in a benchmark for green bonds in markets outside the EU, as has been the case for retail investment funds. The EU has in fact established itself as a global leader in the area (with 51% of global issuance in 2020 from EU companies and public bodies) and the green bond standard would generate further opportunities for sustainable finance for the EU investors from across international markets.
- 3.12 Setting a standard for green bonds is important. However, one should not underestimate the challenge of issuers complying with the standards in the EU taxonomy. In all likelihood, they would weigh the costs and complications of a lengthy process of an ESMA-approved and supervised external review against the benefits of accessing a wider investor base. Private issuers may thus prefer alternative green bonds and less onerous certification processes. These reporting and compliance processes may also have a disproportionate financial impact on SMEs, who may find the EU green standard to be too punitive, and thus discourage further growth. The experience of EU-wide capital market products, where take-up has been not so encouraging, may shed light on the potential interest in EU green bonds.
- 3.13 Hence, it is necessary for the EU supervisor to implement the green bond standard as pragmatically as possible. Though the Commission will be the main issuer of green bonds with EUR 250 billion over the next three years under NextGenerationEU) with Member States issuing a total of around EUR 80 billion green bonds, the role of the private sector in issuing green bonds cannot be downplayed. Avoiding over prescription and over regulation in the case of corporate issuers would facilitate the adoption of the green bond standard across capital markets in the EU. However, a note of caution is warranted. Under the proposal, green bonds issued by the public sector in Member States would not be subject to external review as envisaged in this proposal. Though public sector issuers would still need to account to bond investors, given the commitments on the part of Member States towards a low carbon transition, applying the EU green bond standard across the board would guarantee that commitment. On the other hand, allowing two types of green bonds (one for public sector and one for corporate issuers) could result in at least two different standards.

- 3.14 Another issue that needs to be addressed is how to allow non-EU issuers of green bonds to access EU capital markets and vice versa – hence, the need for the alignment of taxonomies across jurisdictions globally. In this context, it is relevant to refer to the International Platform on Sustainable Finance (IPSF), which is a forum for dialogue between policymakers, with the overall aim of increasing the amount of private capital being invested in environmentally sustainable investments. The end objective of the IPSF is to facilitate the mobilisation of private capital towards environmentally sustainable investments. The IPSF therefore offers a multilateral forum of dialogue between policymakers to help investors identify and seize sustainable investment opportunities that truly contribute to climate and environmental objectives. The alignment of taxonomies should be debated and agreed upon within this forum.
- 3.15 As stated earlier, ESMA, as the EU's capital market supervisor, would play a critical role in ensuring that the proposed standards are applied as pragmatically as possible. This would require developing the skills and building its capacity as supervisor of EU green bond reviewers. The Commission sets the criteria for qualifications and transparency and these represent a solid basis for ESMA. In our view, as ESMA builds its capacity it could in time support its counterparts outside the EU to apply similar standards and hence facilitate access to EU investors in emerging markets.
- 3.16 Another point to consider is that the transition towards a low-carbon EU economy will require funding well beyond what is available under NextGenerationEU. The private sector is already playing a role in this transition but much more is required. Hence, the proposed EU green bond standard would further develop a fledgling green bond market and mobilise additional issuers besides facilitating cross-border funding in capital markets. In the final analysis, the proposed standard for green bonds would enhance the reputation of potential issuers and investors and their commitment to sustainable development and environmental goals, namely: climate change mitigation, climate change adaptation, the sustainable use and protection of water and marine resources, the transition to a circular economy, recycling, waste prevention, pollution prevention and control, and the protection of healthy ecosystems. The relevant environmental and social objectives would thus form part of any corporate strategy. Furthermore, promoting an EU eco-label for financial products, whilst minimising bureaucracy, would help support private business adopting such a strategy.
- 3.17 Over time the EESC expects investors to opt for EU green bond standards, as this would ensure funds are used according to the taxonomy, which in turn eases investor-reporting requirements. Hence, adopting the proposed standard for green bonds across the EU, be it in the private or public sector, should be the goal.
- 3.18 And in this connection the EESC would welcome existing green bonds being "grandfathered" under the proposed standard, as well as the eventual application of such standards for NextGenerationEU bonds. The EESC firmly believes that taxonomy-aligned green bonds would help achieve environmental goals. Moreover, our expectation is that the EU green bond standard will increase investors' interest in such investments, further developing the green bond market. While this is good news for issuers and investors, the EESC cautions about the challenges referred to earlier.

- 3.19 Going forward and assuming the proposal is adopted as is, it would be interesting to assess (i) the extent to which investors, both inside and outside of the EU, would demand that issuers align with the proposed standards or whether the proposal would result in divergence in the green bond market between the EU and the rest of the world, and (ii) how the proposed implementation of the EU green bond standard would affect developments in the green bond market inside and outside the EU.
- 3.20 In the view of the EESC this is of particular relevance since environmental challenges such as climate change cannot be addressed by the EU alone. Unless there is some common ground on taxonomy alignment with third countries, the Commission's proposed regulation on a voluntary green bond standard is unlikely to become a standard for the global green bond market. This would result in fragmented capital markets, with third country issuers quite possibly not adopting the Commission's proposed standards. This could hold back the flow of funds required to address huge environmental challenges, particularly climate change.
- 3.21 Finally, the EESC welcomes the requirement under the EU taxonomy for investments to meet the do-no-significant-harm (DNSH) and minimum safeguards, given the continued need to prioritise the green transformation alongside social protection and safeguarding of human and workers' rights. This may nonetheless limit the scope of taxonomy alignment with third countries, particularly if such jurisdictions do not fulfil DNSH criteria like the recognition of collective bargaining rights. For this purpose, the EESC proposes a dedicated monitoring committee to supervise the dynamics of the green bond market with the involvement of social partners.

Brussels, 8 December 2021

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The president of the European Economic and Social Committee
