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From:	Presidency
To:	Financial Services Attachés Working Party on Financial Services and the Banking Union (Sustainable Finance)
Subject:	Presidency Steering Note on sovereigns for the Working Party on Financial Services (EuGB) meeting on 19 October 2021

Presidency Steering Note on sovereigns

I. Introduction

The Presidency would like to dedicate a part of the morning session of the Council Working Party (CWP) on 19 October 2021 to further discuss the EuGB proposal from the sovereigns' perspective. The CWP members believe that such important topics as the definition of sovereign and sovereign flexibilities need to be examined thoroughly. These issues are about finding a balance between harmonization of rules, promotion, and actual applicability of the EuGB standard.

Based on the discussions at the previous CWP meetings, written comments and consultations with Member States, the Presidency considers the following issues related to the treatment of sovereign EU green bond issuers as the main open issues:

- 1) Definition of sovereign (Article 2)**
- 2) Alignment with the EU Taxonomy¹ (Articles 6 and 7)**
- 3) Reviewers of sovereign issuers /State auditors and other public entities (Article 11)**

II. Main open issues

1. Definition of sovereign (Article 2(3))

There are three main reasons which underpin the importance of this discussion:

1. the potential inclusion of private law companies in the scope of sovereigns can be controversial and needs to be well justified in terms of market distortions.
2. the definition of sovereign as currently included in the EuGB proposal does not fully reflect:

¹ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13).

- a. the exemptions in the Prospectus Regulation² (Article 1(2)), whereby not all sovereign entities are subsequently exempt from NCA supervision.
 - b. the scope of the Taxonomy Regulation, whereby not all sovereign entities may be subject to the expected flexibilities in relation to the use of the EU Taxonomy.
3. the different views of Member States on private law companies (Article 2(f)).

Therefore, the Presidency seeks the opinion of Member States on the following 3 options:

- a) **Option 1** – maintain the Commission proposal (a company of private law fully owned by other sovereigns shall count as a sovereign).
- b) **Option 2** – delete Article 2(3) (f) (a company of private law 100% owned by other sovereigns is not one of the sovereigns).
- c) **Option 3** – a private law company 100% owned by other sovereigns is classified as a sovereign only to the extent it exercises public utility services in accordance with the applicable law.

In the discussions so far, Member States have expressed different views on the options presented, with a slight majority leaning towards the containment of private law companies. Member States prefer Options 2 and 3 over Option 1 due to the unjustifiable preferential treatment compared with those companies that are not state-owned. Quite a few Member States did not have a strong position and showed readiness to discuss further with the aim to reach a final decision. For those Member States the most important element is to cover all public law entities.

Question 1.1: Would Member States support to move towards a compromise based on Option 2?

And if not, what are the main concerns?

Question 1.2: Do Member States have any other concerns about the definition of sovereign?

² Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (OJ L 168, 30.6.2017, p. 1).

2. Alignment with the EU Taxonomy (Articles 6 and 7)

The alignment of the EU Taxonomy is seen as the most important pillar of the EuGB proposal, aimed at reducing uncertainty and prevent greenwashing, and ensuring that the EuGB becomes an international gold standard. However, the EU Taxonomy is not yet fully finalized, green projects are still relatively rare, and certain specificities of issuers are appearing on the market. On this basis, and recognizing the importance of balancing the benefits of harmonization with the broad applicability and usage of the standard, the Presidency is therefore considering the following options:

- a) **Option 1** – maintain the Commission proposal (a sovereign EuGB should be fully aligned with the Taxonomy).
- b) **Option 2** – sovereigns should be allowed, as far as they are not covered by Article 4³ of the Taxonomy Regulation, to allocate EuGB proceeds for innovative activities or basic research contributing to the environmental objectives set out in Article 9 of the Taxonomy Regulation or for activities enabling the transformation of other activities to become environmentally sustainable activities but not covered by the Technical Screening Criteria (TSC) referred to in Article 3 (d) of the Taxonomy Regulation.
- c) **Option 3** – the flexibility in Option 2 should be limited to 20% of the EuGB proceeds (the so-called flexibility pocket).

In the discussions so far, a group of Member States would be willing to support the Commission proposal, as the EU Taxonomy alignment is the backbone of the whole sustainable finance framework. Member States supporting this view believe that there should be one standard for all, without distinguishing between sovereigns and corporates. The EuGB standard should create a level playing field for the market participants and double standards should be avoided. Another group of Member States favors Option 2 and/or Option 3, which allow some flexibility for sovereigns to comply with the EU Taxonomy. Views on the form and degree of flexibility among them however differ and some Member States would allow it for a transitional period only. In order to get more clarity on the Member States' concerns and possible way forward, the Presidency sees the need for more granular discussion on various aspects related to flexibility, including in particular:

- (i) the proportion of EuGB use of proceeds that are not aligned with Technical Screening Criteria (TSC),
- (ii) areas and criteria that projects not aligned with TSC must meet,

³ In relation to Article 1(2).

- (iii) disclosure requirements in case of TSC non-compliant projects,
- (iv) permanent versus temporary flexibility,
- (v) grandfathering for green bonds issued before the entry into force of the EuGB Regulation.

The arguments for flexibility concern mainly the lack of green projects and green assets, the time needed to adapt to the EU Taxonomy and the sovereign specificities.

Question 2.1: What is the view of Member States on the desirable flexibility pocket composition and size?

Question 2.2: Should there be additional safeguards if flexibility pocket is enhanced?

If yes, which ones?

Question 2.3: What is the position of Member States regarding permanent and temporary flexibilities?

Question 2.4: What is the position of Member States regarding grandfathering for sovereign green bonds issued before the introduction of the EuGB?

3. Reviewers of sovereign issuers (Article 11)

An in-depth discussion is foreseen to elaborate on concerns expressed by a few Member States regarding a lack of criteria for state auditors and other public entities, and possible consequent shortcomings in relation to using an external reviewer to obtain pre-issuance and post-issuance reviews.

The Presidency is exploring the following options:

- a) **Option 1** – to maintain the Commission proposal (a sovereign may have a pre-issuance and post-issuance review conducted by an external reviewer or by a state auditor or any other public entity mandated by the sovereign to assess compliance).
- b) **Option 2** – to delete sovereign flexibility under Article 11.
- c) **Option 3** – sovereign flexibility only in case of the review of the allocation report.

Most of the Member States do not have strong opinions regarding the options of the review process for sovereigns. Member States asked for more clarity and justification for the proposed flexibility for sovereigns, as this flexibility needs to be justified. Some Member States argued that provided there is flexibility regarding the EU Taxonomy alignment, the flexibility in Article 11 could be dropped (Option 2). Other Member States supported Option 2 as they believe that review criteria should be developed to allow for state auditors and other public entities to ensure a level playing field. Member

States need further clarification on what is meant by ‘other public entity that is mandated by the sovereign’. In order to maintain the credibility of the standard, it is necessary to ensure that the review is as credible as possible.

Question 3.1: Would Member States support deleting the sovereign flexibility under Article 11?

Question 3.2: What criteria state auditors and other public entities should meet in order for the Member States to support Option 1?

III. Other topics

The Commission proposal on the EuGB also provides for the following flexibility for sovereigns:

1. that sovereigns may allocate proceeds to one or more of the items listed in Article 4(2) of the EuGB proposal, taken from the European System of National and Regional Accounts (ESA 2010) in the EU Regulation.
2. an exemption from the requirement to demonstrate alignment with the EU Taxonomy at the project level for certain public expenditure programmes, such as funding or subsidy programmes and tax relief schemes (Article 9(8)).

Question 1: Do Member States see the need to further specify the provisions in Articles 4(2) and 9(8)?