EXECUTIVE SUMMARY

For ECON committee

European Parliament

Green Bonds: An assessment of the proposed EU Green Bond Standards and its potential to prevent greenwashing

Background

The fast growing market of green bonds in the EU is not yet harmonised. Thus far, only private standards exist. In July 2021, the Commission issued a proposal for a Regulation on European Green Bonds (EuGBR proposal)[i]. It is part of a broader EU legislative focus on sustainable finance that has resulted in the adoption of the Taxonomy Regulation[ii] and the Sustainable Finance Disclosure Regulation[iii]. This study analyses the fundamental aspects of the EuGBR proposal in the context of the EU green bond market and existing EU legislation in the area of sustainable finance and financial regulation.

Aim

This study assesses to what extent the EuGBR proposal can achieve its key regulatory goals and how it can be modified to better achieve them.

The key regulatory goals of the EuGBR proposal (Chap. 2) are to:

- foster the uptake of green bonds by issuers;
- enhance the transparency, comparability and credibility of the EU green bond market;
- prevent greenwashing;
- help prevent climate change; and
- create a 'gold standard' for green bonds globally.

As with any EU legislation on financial services, the co-legislators have to decide how they want to regulate and influence the currently free market of green bonds in the EU, which has grown significantly in recent years. For the European Green Bond Standard (EuGBS) to succeed, in addition to achieving its goals, it needs to counter three dangers. The first of these is that the EuGBS makes green fundraising more expensive, cumbersome and bureaucratic, especially for small and medium-sized enterprises (SMEs). The second is over-regulation, i.e. a scenario in which the regulatory requirements of the EuGBS suffocate entrepreneurial inventiveness. The third is that the EuGBS reduces the competitiveness of the EU financial markets by setting the wrong incentives, which would result in capital flight and reputational damage. If the EuGBS is well designed, it can counter all these risks and achieve its key regulatory goals. This study puts a particular focus on strengthening the prevention of greenwashing and fostering market growth.

Key Findings

The EuGBR proposal is a good starting point for the co-legislators to adopt an effective and reliable EuGBS. In light of the current EU green bond market (Chap. 1), this study analyses the main regulatory aspects for a successful EuGBS.

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The co-legislators will mainly have to decide on:

- whether to adopt a voluntary or a mandatory standard (Chap. 3);
- whether to focus on green bonds or to include social and sustainability bonds (Chap. 4);
- alignment with the Taxonomy Regulation (Chap. 5);
- whether and how to create a single standard for corporate and sovereign bonds (Chap. 6);
- transparency requirements (Chap. 7);
- review and supervision (Chap. 8);
- enforcement and sanctions (Chap. 9); and
- international aspects (Chap. 10).

All these regulatory aspects are interrelated. A policy choice on one aspect will impact other regulatory aspects. This study intends to view the EuGBS holistically and to highlight the most important consequences of specific policy choices.

The EuGBR proposal chooses a voluntary standard for issuers to use the label 'European green bond' or 'EuGB' (Chap. 3.1). Such a voluntary standard would add a public standard to the existing market of voluntary private standards. It relies on the quality of the EuGBS, the appeal of the 'European green bond' label and the good reputation of the EU as a standard-setter (Chap. 3.2.1). There are several options on the spectrum of voluntariness, ranging from voluntary to mandatory (Figure 3). This study considers a mandatory standard for all bonds labelled 'green' or 'environmentally sustainable' most appropriate as it would most effectively prevent greenwashing and create a regulatory level playing field (Chap. 3.3, 3.4 and 3.5). Yet, if the co-legislators prefer a voluntary standard, this study recommends that they consider making the transparency requirements under the EuGBS mandatory for all bonds that are labelled 'green' and issued or marketed in the EU (Chap. 7.5).

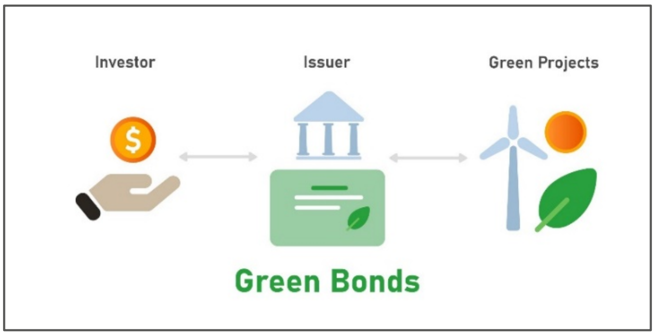
The scope of application under the EuGBR proposal is limited to green bonds, i.e. bonds financing environmental objectives. The EuGBS could follow market trends and include social and sustainability bonds, i.e. bonds financing social objectives or a combination of social and environmental objectives (Chap. 4.1). This would create a 'sustainable bond standard'. In theory, this is appealing (Chap. 4.2), but in practice, clear guidance on social criteria is still missing (Chap. 4.3). Therefore, this study recommends that the co-legislators mainly focus on green bonds (Chap. 4.5).

The EuGBR proposal requires issuers to allocate the proceeds from 'European green bonds' to economic activities that comply with the Taxonomy Regulation (Chap. 5.1). This entails that they contribute substantially to an environmental objective, do not significantly harm another environmental objective, fulfil minimum social safeguards and comply with the technical screening criteria (Chap. 5.2). The technical screening criteria are specified by the Commission in delegated acts. Thus far, only the two objectives of climate change mitigation and climate change adaptation have been specified in the Taxonomy Climate Delegated Act[iv] and the recent Taxonomy Complementary Climate Delegated Act[v], which conditionally includes nuclear power and natural gas among the economic activities contributing substantially to climate change mitigation (Chap. 5.2.4). The latter is highly controversial and currently under the scrutiny of the co-legislators. Aligning the EuGBS with the Taxonomy Regulation is recommended because the Taxonomy Regulation provides solid and clear technical guidance for issuers and enhances the comparability for investors. To make transitional elements transparent to investors, this study recommends that the co-legislators consider introducing the category of 'transition bonds' covering transitional economic activities and economic activities in transition towards taxonomy alignment (Chap. 5.4).

A single standard for corporate and sovereign issuers is the best way to ensure a level playing field for both issuer types that compete on the same market and for the same investors (Chap. 6). The peculiarities of sovereign issuers can be addressed by modifying the use of proceeds (Chap. 6.3) and review requirements (Chap. 8.5).

Transparency duties are a very important tool for the success of the EuGBS (Chap. 7). The EuGBR proposal requires issuers to disclose before the issuance a factsheet on the 'European green bond' and a pre-issuance review by an external reviewer. After issuance, issuers have to disclose annual allocation reports, post-issuance reviews and impact reports (Chap. 7.1). The disclosures give information to investors. Together with the substantive requirements under the Taxonomy Regulation, they enhance the transparency, comparability and credibility of the EU green bond market and help prevent greenwashing. The impact reports could be merged into the allocation reports (Chap. 7.1.3). The transparency duties under the EuGBR proposal consistently relate to other transparency duties under EU law (Chap. 7.3). While extending the disclosure obligations under the EuGBR proposal to social and governance matters at entity-level is not recommended (Chap. 7.4.1), this study recommends that the co-legislators consider requiring transparency for 'social bonds', 'sustainability bonds' and 'sustainability-linked bonds' (Chap. 7.4.2).

External review and supervision operate in three layers under the EuGBR proposal (Chap. 8.1). First, private external reviewers assess a bond's substantive compliance with the Taxonomy Regulation (Chap. 8.1.1). Second, national competent authorities (NCAs) supervise the issuers' compliance with the disclosure obligations (Chap. 8.1.2). Third, the European Securities and Markets Association (ESMA) registers and supervises the private external reviewers (Chap. 8.1.3). This three-pronged approach is complicated and runs the risk of supervisory diffusion (Chap. 8.2). It could be simplified by giving the NCAs the powers to supervise issuers regarding their substantive and disclosure compliance with the EuGBS. Also, under a mandatory standard, external reviewers could operate voluntarily if issuers choose to have their second opinion. The heavy organisational and governance requirements for external reviewers could then be reduced (Chap. 8.4.2).



The enforcement and sanctions regime under the EuGBR proposal follows the three layers of review and supervision (Chap. 9.1). It is based on the deterrent effect of negative opinions by private external reviewers (Chap. 9.1.1), the supervisory and sanctioning powers of NCAs regarding disclosure infringements (Chap. 9.1.2), and the supervisory and sanctioning powers of ESMA regarding external reviewers, including withdrawal of registration and imposing fees (Chap. 9.1.3). This mechanism does not enforce issuers' compliance with the Taxonomy Regulation effectively. It could be strengthened by giving the NCAs supervisory and sanctioning powers regarding issuers' substantive compliance (Chap. 9.2). Furthermore, this study recommends that the co-legislators consider adding a civil liability mechanism for issuers and/or external reviewers. Such private law enforcement could follow the models of the Prospectus Regulation [vi] and the Credit Rating Agencies Regulation [vii] and would strengthen the overall enforcement level (Chap. 9.3).

The EuGBR proposal addresses international issuers and external reviewers located outside the EU (Chap. 10). Along the EU's general open market philosophy, it gives third-country corporate and sovereign issuers the possibility to opt for the EuGBS (Chap. 10.1). It also opens the EuGBS market for external review to third-country external reviewers by way of a Commission equivalence decision on a third country (Chap. 10.2.1), an individual recognition by ESMA (Chap. 10.2.2) or the endorsement of their services by EU external reviewers (Chap. 10.2.3). The EuGBS is likely to influence third-country legislators to some extent. This influence will probably be stronger in the case of a mandatory standard applicable to all green bonds marketed in the EU as this would de facto bind third-country issuers seeking investment from within the EU (Chap. 10.3).

[i] European Commission, proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (COM(2021) 391 final). https://eur-lex.europa.eu/resource.html?uri=cellar:e77212e8-df07-11eb-895a-01aa75ed71a1.0001.02/DOC_1&format=PDF

[ii] 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 [2020] OJ L 198/13. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

[iii] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector [2019] OJ L 317/1. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN.

[iv] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives [2021] OJ L 442/1. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R2139&qid=1643891065831&from=EN

[v] Commission Delegated Regulation (EU) .../... of 9.3.2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities [C(2022) 631 final]. https://ec.europa.eu/transparency/documents-register/api/files/C(2022)631_0/090166e5e98cca4f?rendition=false

[vi] Article 11(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 [2017] OJ L 168/12. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1129&from=EN

[vii] Article 35a Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009R1060&from=EN

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