AFME response to Consultation on Establishment of EU Green Bond Standard

2 October 2020

AFME welcomes the opportunity to comment on the EU Green Bond Standard ('GBS'), which will constitute an additional milestone in the implementation of a harmonised and consistent European framework for sustainable finance, in line with the objectives established by the EU Action Plan on Financing Sustainable Growth and by the European Green Deal.

Overall, AFME believes that the GBS is well designed and is generally aligned with other market standards. We have provided our detailed responses to questions raised by the consultation in **Appendix A** herein but would like to draw attention of the policymakers to our key messages.

- **EU GBS should remain a voluntary standard**, allowing EU issuers to offer green bonds in line with other international market standards to support the integrity and efficiency of the global green bond market.
- We support the alignment of the GBS with the EU Taxonomy as a principle. However, we believe that **flexibility should be granted for those activities which are not yet covered by the Taxonomy or for which technical screening criteria have not yet been developed**. Furthermore, we highlight that the Taxonomy itself, as designed to date, might limit the number of projects that can qualify for financing under the EU GBS. For example, the EU Taxonomy sets restrictions to the **eligibility of operating expenditures**. Industries that have business models heavily reliant on operating expenditure or on supply chains would rarely be able to issue green bonds under the EU GBS.
- We support the concept of **'do-no-significant-harm'** ('DNSH'). However, this requirement might create problems for assets particularly outside the EU potentially creating a disproportionate barrier and a non-level playing field for non-EU assets. Therefore, **additional guidance would be needed on the scope and application of the DNSH criteria** to understand how the DNSH requirement will be satisfied and verified in practice.
- We would favour **additional clarity regarding the application of the EU GBS to 'sustainable bonds'**, specifically whether an issuer will be required to comply with the GBS in respect of the 'green' component and whether it would be expected to apply existing market guidance/principles to the 'social' element of such bonds.
- **We support the inclusion of R&D as an eligible expenditure for the use of proceeds** as it plays a crucial role in the transition to a more sustainable economy. **We do not believe that the Commission should further define R&D**, given that it has been properly and adequately defined in the final report by the Commission's Technical Expert group on Taxonomy. We also think that issuers should commit, where possible, to providing meaningful impact and outcome reporting on those R&D expenditures, at least in cases where they represent a significant portion of the use of proceeds.
- **EU green bonds should maintain their status for the entire term to maturity regardless of newly updated taxonomy criteria, provided compliance with the eligibility criteria at the point of issuance.** The possibility that a green bond might no longer be classified as green in the future might deter both issuers and investors from issuing and investing in green bonds, given the risk of having to exit the investment when it is no longer qualified as green under the updated criteria. Additionally,

tracking the eligibility of green issuances on a continuous basis to ensure they maintain their status would constitute an unfeasible operational challenge. However, additional disclosure should be provided to indicate the version of the Taxonomy that the bonds were compliant with at the moment when they were issued and qualified as green.

- We believe that **incentives for smaller issuers and investors would be helpful to support the uptake of EU green bonds**. In particular, such initial incentive and support mechanisms (fiscal, risk sharing (e.g. government guarantees), technical assistance) could help smaller issuers to step into the green bond market by being able to provide a competitive risk and return profile on their issuances.
- Social bonds are an important instrument for financial markets to achieve social objectives and have been playing an important role in helping fund public and private response to the socio-economic impacts of the Covid-19 pandemic. AFME believes the **existing market standards already provide sufficient guidance for issuers and investors, therefore creating a separate EU social bond standard would be premature.** The Commission has a number of sustainable finance initiatives on its agenda and should prioritise and address ongoing initiatives before taking on more.

Conclusion

Green bonds play an increasingly important role in financing assets needed for the low-carbon transition. The EU GBS, as a common EU framework, will help create a strong foundation to accelerate capital flows towards the EU's environmental objectives. The Standard will help boost the market for the 'best in class' green bonds, which will foster the credibility and integrity of such a market, subject to the EU Taxonomy being fully developed and implemented.

We would like to thank the EU policymakers for the vital work accomplished so far and we look forward to continued engagement and dialogue on this important matter. We stand ready to discuss the content our response or to provide any further clarity regarding the statements made.

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About AFME

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: www.afme.eu.

Consultation on Establishment of EU Green Bond Standard

Appendix A

I. Questions on the EU Green Bond Standard

About the TEG proposed EU GBS

The EU GBS aims to address several barriers identified in the current market. Firstly, by reducing uncertainty about what constitutes green investment by linking it to the EU taxonomy. Secondly, by standardising costly and complex verification and reporting processes, and thirdly, by establishing an official standard to which potential incentives could be linked.

The EU GBS as proposed by the TEG is intended to finance both physical and financial assets and includes the use of the latter as security (i.e. as a covered bonds or asset- backed securities).

The key components of such a standard – as recommended by the TEG and building on best market practices such as the Green Bond Principles and the Climate Bonds Initiative labelling scheme – should be:

(1) alignment of the use of the proceeds from the bond with the EU Taxonomy;

(2) the publication of a Green Bond Framework

(3) mandatory reporting on the use of proceeds (allocation reports) and on environmental impact (impact report); and

(4) verification of compliance with the Green Bond Framework and the final allocation report by an external registered/authorised verifier.

Questions on the potential need for an official / formalised EU GBS

(1) In your view, which of the problems mentioned below is negatively affecting the EU green bond market today? How important are they? Please select and rate the extent of the impact on a scale of 1 to 5 (1 no impact, 5 very strong impact). Multiple answers are possible.

a) Absence of economic benefits associated with the issuance of green bonds [1] [**2**] [3] [4] [5]

b) Lack of available green projects and assets [1] [2] [3] [**4**] [5]

c) Uncertainty regarding green definitions [1] [2] [3] [**4**] [5]

d) Complexity of the external review procedure(s) [1] [2] [**3**] [4] [5]

e) Cost of the external review procedure(s) [1] [2] [**3**] [4] [5]

f) Costly and burdensome reporting processes [1] [2] [**3**] [4] [5]

g) Uncertainty with regards to the eligibility of certain types of assets (physical and financial) and expenditure (capital and operating expenditure) [1] [2] [3] [**4**] [5]

h) Lack of clarity concerning the practice for the tracking of proceeds [1] [**2**] [3] [4] [5]

i) Lack of transparency and comparability in the market for green bonds [1] [**2**] [3] [4] [5]

j) Doubts about the green quality of green bonds and risk of green washing [1] [2] [3] [**4**] [5]

k) **Other (if so, please specify) [BOX]**

Regarding the complexity of the external review procedures, cost of the external review procedures as well as costs and operational burden associated with reporting processes (items (d), (e) and (f) above), we think that, whilst these factors are present to a certain degree when issuing green bonds compared to a conventional bond, they are not seen as major impediments to the issuance of such green instruments. We note however that for smaller issuers these factors can bear more weight, and that is why some initial incentive and support mechanisms (fiscal, risk sharing (e.g. government guarantees), technical assistance) could help such issuers to step into the green bond market.

(2) To what extent do you agree that an EU GBS as proposed by the TEG would address the problems and barriers mentioned above in question 1? Please indicate which specific barriers it would address on a scale of 1 to 5 (1 negative impact, 3 no impact, 5 positive impact). Multiple answers are possible.

a) Absence of economic benefits associated with the issuance of green bonds [1] [2] [**3**] [4] [5]

b) Lack of available green projects and assets [1] [**2**] [3] [4] [5]

c) Uncertainty regarding green definitions [1] [2] [3] [**4**] [5]

d) Complexity of the external review procedure(s) [1] [2] [**3**] [4] [5]

e) Cost of the external review procedure(s) [1] [2] [**3**] [4] [5]

f) Costly and burdensome reporting processes [1] [2] [**3**] [4] [5]

g) Uncertainty with regards to the type of assets (physical and financial) and expenditure (capital and operating expenditure) [1] [2] [3] [**4**] [5]

h) Lack of clarity concerning the practice for the tracking of proceeds [1] [2] [3] [**4**] [5]

i) Lack of transparency and comparability in the market for green bonds [1] [2] [3] [**4**] [5]

j) Doubts about the green quality of green bonds and risk of green washing [1] [2] [3] [**4**] [5]

k) **Other (if so, please specify) [BOX]**

The EU GBS, as a voluntary standard, is well designed and is generally aligned with other market standards. On the one hand, it is meant to provide clarity on the types of assets and expenditures that would be eligible for green financing via linking them to the EU Taxonomy. However, at the same time the need for the EU green bonds to be referenced back to the Taxonomy has added a degree of complexity and restrictions, which might further limit the pipeline of available projects that can qualify for financing under the EU GBS[1].

Specifically, the Taxonomy, as currently recommended by the TEG, provides for a relatively narrow scope of eligible expenditures and in particular sets restrictions to the eligibility of

[1] According to Green Bond Treasurer Survey by CBI, a lack of suitable projects for financing remains an issue https://www.climatebonds.net/system/tdf/reports/climate-bonds-gb-treasurer-survey-2020-14042020final.pdf?file=1&type=node&id=47035&force=0

operating expenditures. As noted in the TEG report, "TEG recommends to include any capital expenditure and **selected** operating expenditures such as maintenance costs related to green assets that either increase the lifetime or the value of the assets, and research and development costs. Operating costs such as purchasing costs and leasing costs would not though normally be eligible except in specific and/or exceptional cases as may be identified in the EU Taxonomy and future related guidance."[2] Effectively, unless there is an underlying Taxonomy-aligned green asset, it would be very hard for projects to qualify under the EU GBS. Industries that have business models heavily reliant on operating expenditure or on supply chains, such as IT and technology, apparel, pharmaceuticals, retail, would rarely be able to issue green bonds under the EU GBS. However, as indicated by the below examples, a number of such companies have now issued sustainability bonds that would not qualify under the proposed EU framework in respect of the environmental component.

Examples:

- Burberry: **Sustainability bond**
- Starbucks: **Sustainability bond**
- Barry Calleabaut: **Sustainability bond**
- Ahold Delhaize: **Sustainability Bond**
- Pepsi: **Green Bond**

We acknowledge that uncertainty around green definitions (b) and doubts about the green quality of green bonds and risk of green washing (j) pose significant issues for investor confidence, and therefore, the EU Taxonomy is helpful in mitigating these issues. At the same time, we note that a very restrictive taxonomy would also be problematic and counter-productive, as explained above. Additionally, the overly strict metrics and thresholds set by the Taxonomy technical screening criteria (TSC), in the context of EU GBS, could also deter issuers from issuing green bonds under the Standard and thus impede growth in the green bond market in the short- to medium term.

Example: the criteria for Construction and Real Estate activities within the EU Taxonomy states that for properties built from 2021 to be eligible, they must be at least '20% lower in terms of carbon emissions than the primary energy demand resulting from the relevant Near Zero-Energy Building (NZEB) requirements'. However, this one-size-fits-all approach would be potentially problematic, as many EU member states have different building regulations in place. There is also a lack of consistent and comparable data across countries for benchmarking building stock performance and setting suitable thresholds for the top performing buildings within the respective national stock. In order for the Taxonomy, and consequently the EU GBS to be more inclusive and not deter issuance, country specific building criteria may need to be developed, which would take into account the carbon emissions performance of the local market.

Additionally, the fact that technical screening criteria are still to be developed for environmental objectives besides climate change mitigation and adaptation restrict the usability of the GBS in

[2] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf

the short term, if the latter is fully linked to the EU Taxonomy (refer to our response to Question 6).

We strongly support the TEG's proposal to grant flexibility around the alignment of the use of proceeds to the Taxonomy in cases where either the TSC are not directly applicable or have not yet been developed. However, it has yet to be seen in practice whether and how external verifiers will become comfortable to confirm the alignment of the projects with the EU GBS in such cases.

Regarding the cost of external review procedures, we think it might increase due to the additional requirements under the GBS, including verification (i) after full allocation of proceeds and (ii) for alignment with the DNSH and minimum safeguard components of the EU Taxonomy. Furthermore, a change in costs may result from the requirement that verification providers be registered/authorised/supervised by a regulatory authority and subject to professional codes of conduct and minimum qualification standards.

Questions on the proposed content of the standard

(3) To what extent do you agree with the proposed core components of the EU GBS as recommended by the TEG? Please express your views using the scale from 1-5 (1 strongly disagree, 3 neutral, 5 strongly agree). Multiple answers are possible.

a) Alignment of eligible green projects with the EU Taxonomy [1] [2] [3] [**4**] [5]

b) Requirement to publish a Green Bond Framework before issuance [1] [2] [3] [4] [**5**]

c) Requirement to publish an annual allocation report [1] [2] [3] [4] [**5**]

d) Requirement to publish an environmental impact report at least once before final allocation

[1] [2] [3] [**4**] [5]

e) Requirement to have the (final) allocation report and the Green Bond framework verified

[1] [2] [3] [**4**] [5]

Please specify the reasons for your answer [BOX]

We find that generally the proposed core components of the EU GBS represent a common industry practice and produce a credible green bond standard. Please refer to our comments to Question 2 for some additional considerations.

We would favour additional clarity regarding the application of EU GBS to 'sustainable bonds', specifically whether an issuer will be required to comply with the GBS in respect of the 'green' component and whether it would be expected to apply existing market guidance/principles to the 'social' element of such bonds.

Additionally, in reference to a recent report by BIS[3], we see a merit in exploring how the EU GBS can be potentially amended in the future (when the existing ESG data availability issues have been resolved) to be used outside of project financing linked to economic activities under the EU Taxonomy and where financing can be classified as 'green' subject to the issuer meeting

[3] https://www.bis.org/publ/qtrpdf/r_qt2009c.htm

established criteria/KPIs (such as measure of emissions intensity at corporate level as proposed by BIS).

(4) Do you agree with the proposed content of the (a) Green Bond Framework, (b) Green Bond allocation report, and (c) Green Bond impact report as recommended by the TEG? Select which elements you agree with. Multiple answers are possible.

a) **I agree with the proposed content of the Green Bond Framework.**

b) **I agree with the proposed content of the Green Bond Allocation Report.**

c) **I agree with the proposed content of the Green Bond Impact Report.**

d) None

e) Do not know

If you disagree with the proposed content for some or all of these documents by the TEG, please specify the reasons for your answer [BOX]

We support the proposed content of the Green Bond Framework, Green Bond allocation report, and Green Bond impact report as recommended by the TEG. However, we reiterate that the Taxonomy is still under development, which, in the short-term, is likely to complicate the preparation of the Impact Report for issuers based on the quantitative metrics and thresholds prescribed by the technical screening criteria.

(5) Do you expect that the requirement to have the Green Bond Framework and the Final Allocation report verified (instead of alternatives such as a second-party opinion) will create a disproportionate market barrier for third party opinion providers that currently assess the alignment of EU green bonds with current market standards or other evaluation criteria?

a) Yes

b) No

c) **Do not know**

If yes, please specify the reasons for your answer [BOX]

There is a view that the verification requirement will not create a disproportionate barrier for third party verifiers. On the contrary, the EU GBS provides clearer guidelines than those existing under the current market standards/practices where third party verifiers do not have a uniform reference against which to make their opinion.

Additionally, the requirement to have verifiers externally certified is welcomed because it should help address potential conflicts of interest of current SPO providers who might provide other professional services to issuers (e.g. where verifiers would need to ensure that processes and procedures are put in place to prevent any conflicts of interest).

There is a view that the requirement to have the GBF verified, as required by the EU GBS, will require experience in providing assurance services in line with standards such as ISAE 3000 or DIS ISO 17029. This could disqualify many of the leading SPO providers, as their mandate has never been to provide such assurance services. Nevertheless, SPO providers have played a key role in shaping and developing the green bond market and have developed deep expertise in this space. We note that it would be important to define clearly the scope of information subject to the verification procedures as certain elements might be of qualitative nature and involve significant judgement, and thus can be hard to opine on (e.g. the issuer's overall strategy, determination of compliance with the DNSH principles and social safeguard criteria).

It might be that the market will naturally evolve from second-party opinion providers to verified third-party providers. We believe that the requirement is likely to drive current providers to obtain accreditation by a designated competent authority. Therefore, the pool of providers is likely to remain relatively the same and that additional accreditation requirements should not create major barriers to entry.

Questions on the use of proceeds and the link to the EU Taxonomy

The EU Taxonomy Regulation[2] specifies that the Union shall apply the EU Taxonomy when setting out the requirements for the marketing of corporate bonds that are categorised as environmentally sustainable. Given that the EU Green Bonds initiative will pursue, as its core objective, the aim of delineating the boundaries of what shall constitute an 'environmentally sustainable' bond, the Taxonomy will need to be applied to determine the eligibility of the proceeds of the bond issuance. However, there may be reasons to provide a degree of flexibility with regard to its application, or its application in specific cases.

Building on market practice, the proposed EU GBS by the TEG recommends a use-of- proceeds approach, where 100% of the proceeds of an EU Green Bond should be aligned with the EU Taxonomy (with some limited flexibility).

The below questions aim to gather stakeholder input on the application of the taxonomy in the context of EU Green Bonds.

(6) Do you agree that 100% of the use of proceeds of green bonds should be used to finance or refinance physical or financial assets or green expenditures that are green as defined by the Taxonomy?

a) Yes, with no flexibility

b) Yes, but with some flexibility (i.e. <100% alignment)

c) No

d) Do not know

Please specify the reasons for your answer. If you selected b., please indicate what thresholds you would suggest, and why. [BOX]

As noted in our response to Question 2, we think that the EU GBS is well designed and is generally aligned with other market standards. The "use-of-proceeds approach" is a well-established concept. It promotes transparency around capital allocation and provides all companies with the opportunity to issue green bonds regardless of their main business activity, as long as they finance eligible green projects. These factors strengthen the role of bond markets in growing sustainable finance to help issuers transition to environmentally sustainable business models.

We agree that 100% of the use of proceeds of green bonds should be used to finance or refinance green physical or financial assets or green expenditures, which would be consistent with existing frameworks governing the issuance of green bonds. However, we think that 100% alignment of the definition of green projects with the EU taxonomy in the context of the EU GBS might not be practical at this stage for the following reasons:

- Taxonomy is still at an early stage of its development and implementation. The TSC for climate change mitigation and adaptation environmental objectives are expected to be formally enshrined into law only by 31 December 2020. TSC for the rest of environmental objectives[4] are still to be developed and adopted, which is expected by 31 December 2021. This would limit the number of Sustainable Development Goals (SDGs) to which investors could contribute through the issuance of green bonds under the EU GBS. Therefore, we think it is **important for market participants to implement the taxonomy first and let the market upscale its use before 100% alignment with the Taxonomy can be codified in other EU standards.** Additionally, the latter can restrict the use and uptake of such standards (i.e. issuers will be inclined to continue using other frameworks to facilitate green bond issuance).
- From initial voluntary assessments conducted by some corporate issuers, it appears that only a limited proportion of their total business activities is aligned with the Taxonomy at this stage. This means that **restricting green bond issuance to those activities that are fully aligned with the Taxonomy would reduce the eligible universe compared to the current regime,** e.g. under the ICMA Green Bond Principles, potentially causing a slowdown in this market.
- To this end, we fully support the approach proposed by the TEG (consistent with our response to Question 7) to recognise the need for the flexibility in cases where *(1) the technical screening criteria have not yet been developed for a specific sector or a specific environmental objective or (2) where the developed technical screening criteria are considered not directly applicable due to the innovative nature, complexity, and/or the location of the green projects to verify the alignment of their green projects with the Taxonomy*, **provided that it can be demonstrated that the activities being financed clearly follow the spirit of the Taxonomy and that appropriate disclosure is made** around the proportion of financed activities that are aligned with the EU taxonomy and the proportion of activities that are not covered by the EU Taxonomy (but which are aligned with other green bond frameworks).
- Ensuring a degree of **flexibility would be conducive to the alignment of international green bond frameworks** to help prevent any fragmentation in this market, which could impede its growth.

[4] sustainable use and protection of water and marine resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control; protection of healthy ecosystems.

On the other hand, we fully recognise a need for a 'best in class' label that could require that 100% of the use of proceeds for a green bond would be fully aligned with the EU Taxonomy. This would help to set a clear benchmark that industries would ultimately need to transition to in order to support the achievement of carbon emission targets outlined in the EU 2030 Climate Target Plan and EU Green Deal. We therefore envision and support the EU GBS to become a standard to facilitate the creation of such a label in the near future, once the Taxonomy is developed in a more complete way.

We note that the above view is representative of the majority but is not unanimous. Some members support a view that 100% of the use of proceeds of green bonds should be used to finance green projects as defined by the Taxonomy. According to this view, provided the EU GBS remains voluntary and whilst it is widely agreed that at this stage issuers may not have enough eligible assets, it is important to maintain the highest credibility of the EU GBS to ensure it can become the 'gold standard' from the outset. The 100% alignment with the EU Taxonomy would help boost issuers' ambition towards accelerating the transition of their activities to next zero carbon, although it might take time for the "best in class" market to grow. Issuers should not be prevented from issuing green bonds under other frameworks if the projects cannot meet the Taxonomy eligibility requirements. Further, the basis of the mandatory verification can be compromised if there is no solid reference point, where currently the Taxonomy is the only one.

(7) The TEG proposes that in cases where (1) the technical screening criteria have not yet been developed for a specific sector or a specific environmental objective or (2) where the developed technical screening criteria are considered not directly applicable due to the innovative nature, complexity, and/or the location of the green projects, the issuer should be allowed to rely on the fundamentals of the Taxonomy to verify the alignment of their green projects with the Taxonomy. This would mean that the verifier confirms that the green projects would nevertheless (i) substantially contribute to one of the six environmental objectives as set out in the Taxonomy Regulation, (ii) do no significant harm to any of these objectives, and (iii) meet the minimum safeguards of the Taxonomy Regulation.

Do you agree with this approach?

a) Yes, both (1) and (2)

b) Yes, but only for (1)

c) Yes, but only for (2)

d) No

e) Do not know

Please specify the reasons for your answer. Do you see any other reasons to deviate from the technical screening criteria when devising the conditions that Green Bond eligible projects or assets need to meet? If so, please clearly specify the reason for your answer and, where applicable, the respective area or (taxonomy-defined) activity. [BOX]

As the EU Taxonomy does not yet cover all relevant activities, a certain degree of flexibility should be granted, as long as it can be demonstrated that the activities clearly follow the spirit of the Taxonomy. Therefore, AFME supports the solution offered by the TEG Usability Guide. This will allow more projects to qualify under the EU GBS. It is important to consider how the Taxonomy Regulation and technical criteria also interact with other regulations and standards both at the European level and at national levels too. Technical screening criteria will often differ across jurisdictions, which would create difficulties in certain sectors e.g. various construction standards (refer to an example noted in our response to Question 2).

(8) As part of the alignment with the EU Taxonomy, issuers of EU Green Bonds would need to demonstrate that the investments funded by the bond meet the requirements on do-no-significant-harm (DNSH) and minimum safeguards. The TEG has provided guidance in both its Taxonomy Final Report and the EU GBS user guide on how issuers could show this alignment. Do you foresee any problems in the practical application of the DNSH and minimum safeguards for the purpose of issuing EU green bonds?

a) Yes

b) No

c) Do not know

Please specify the reasons for your answer [BOX]

DNSH criteria is a valid concept in principle, that AFME is supportive of. However, the DNSH requirements might create problems for assets both inside and particularly outside the EU due to its complexity. Although issuers may be able to demonstrate DNSH alignment for assets within the EU due to numerous EU standards relating to this principle, issuers will most probably face difficulties in demonstrating DNSH alignment for assets outside the EU. Therefore, AFME finds that this requirement might create a disproportionate barrier and a non-level playing field for non-EU assets. Furthermore, although the requirements established for many economic activities appear clear to follow, there are some obligations, such as those concerning water provisions for green buildings, that would be extremely difficult to comply with. Finally, it remains to be seen how the DNSH requirement will be satisfied in practice with a potential for different interpretations of the qualitative criteria amongst issuers as well as external verifiers and also noting that the internal due diligence systems and procedural approach to DNSH and minimum safeguards could vary significantly among issuers. Therefore, additional guidance would be needed on the scope and application of the DNSH criteria, in order to clarify and assess them, together with the creation of tools to facilitate coherent data collection and analysis.

Ideally, we would recommend that the EU GBS be introduced in the market only after the Taxonomy has become applicable (1 Jan 2022) at least in relation to climate change mitigation and adaptation environmental objectives. We expect that companies might not be able to complete a thorough DNSH assessment of their activities until that time. We also believe that the DNSH test can require a more complex analysis than that for the Technical Screening Criteria. Therefore, in the interim period, we would recommend an application of the DNSH principle to be embedded into the bond verification process – with external verifiers identifying and flagging any potential deficiencies in the use of proceeds – rather than as a strict eligibility criterion. This would allow to smoothen the process until issuers will have sufficient data to include the DNSH test in their project selection process.

Given all reasons stated above, we urge the Commission to allow for flexibility in relation to the DNSH principle.

We would also recommend the following:

a) Although being aware of potential challenges, we would encourage the Platform on Sustainable Finance to develop an equivalence table between DNSH based on qualitative criteria – particularly when referring to EU regulation – and international standards to facilitate its use.

b) For the EU authorities to clarify the expectations on investor (and verifier) assessment of taxonomy-alignment particularly in relation to qualitative criteria and DNSH. We favour the approach taken by the TEG in the EU Taxonomy report that recommends conducting due diligence based on good faith and the principle of proportionality.

(9) Research and Development (R&D) plays a crucial role in the transition to a more sustainable economy, and the proposed EU GBS by the TEG explicitly includes such expenditure as eligible use of proceeds. Do you think the EU GBS should provide further guidance on these types of activities, to either solve specific issues with green R&D or further boost investment in green R&D? If so, please identity the relevant issues or incentives.

a) Yes, as there are specific issues related to R&D that should be clarified.

b) Yes, the proposed EU GBS by the TEG should be changed to boost R&D.

c) No, the proposed EU GBS by the TEG is sufficiently clear on this point.

d) Do not know

Please specify the reasons for your answer [BOX]

We support the inclusion of R&D as an eligible expenditure for the use of proceeds as it plays a crucial role in the transition to a more sustainable economy. We think that if the Commission were to further define R&D, this would have little or no impact on the current market. R&D has been properly and adequately defined in *Taxonomy: Final Report of the TEG*[5] in support of the six environmental objectives. The current definitions of R&D within the scope of the EU GBS do not prevent sustainable investments towards EU Green Bonds where their proceeds go towards R&D. In addition, there are already several EU funding programmes that strongly support R&D in ESG. Whilst we think that verifiers may struggle to confirm R&D compatibility with the Taxonomy in some cases where the R&D is in very early stages and where it is difficult to provide sufficient detail as to what economic activities the R&D is enabling, the publication of TSC for all environmental objectives might help bring more clarity for verifiers.

[5] https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf

We also think that, where possible, the issuer should commit to providing meaningful impact and ideally outcome reporting on those R&D expenditures, at least in cases where they represent a significant portion of the use of proceeds. In fact, from an investor perspective, it might be challenging to assess the impact of R&D expenditures only based on output indicators (e.g. number of patents or new products developed). The fact that an R&D project is completed does not necessarily mean it is impactful. Investors would need to have information such as "avoided emissions thanks to a new low carbon technology developed", or "substitution rates in favour of a new low carbon product", for example. If this information is not available on a yearly basis, the issuer should provide it at least after 3 years from issuance or at maturity of the bond, whichever is shortest.

Questions on grandfathering and new investments

(10) Should specific changes be made to the TEG's proposed standard to ensure that green bonds lead to more new green investments?

a) Yes

b) No

c) Do not know

Please specify the reasons for your answer. If you are in favour of changes, please explain what changes should be made [BOX]

We are, overall, satisfied with the current EU GBS framework. We have highlighted our concerns regarding the EU Taxonomy itself as the basis for the GBS in our responses to Questions 2 and 6.

We recommend however that further clarification be provided in the EU GBS regarding the look-back period for eligible expenditures. The text (section 4.1 of Annex 1) mentions that no look-back period applies to assets and Capex, while a maximum look-back period of 3 years applies to Opex (which we interpret as also applying to R&D). It is unclear, however, whether expenditures for acquisitions (e.g. wind farm acquisition) should be exempted from the look-back period as considered Capex. Our interpretation is that they are indeed exempt. On the other hand, we interpret maintenance costs for Capex as being subject to the 3-year rule. A more detailed table mapping each specific expenditure type to its look-back period would be helpful.

Given the complexity involved in identifying and reconciling multiple types of eligible assets and expenditures across different financial statements over several years, we recommend that independent audit and legal experts provide a thorough review of the eligible project definitions and relative look-back periods in order to ensure that the process for verification and assurance of the proceeds allocations under the EU GBS will be based on clear, well-defined accounting rules applied consistently by all external verifiers. This will help enhance transparency and market confidence. Further guidance should also be provided around whether the rules would be the same for different host instruments (senior unsecured, covered bonds, subordinated debt, bank capital or convertible bonds).

(11) The EU Taxonomy technical screening criteria will be periodically reviewed. This may cause a change in the status of issued green bonds if the projects or assets that they finance are no longer eligible under the recalibrated taxonomy. In your opinion, should an EU Green Bond maintain its status for the entire term to maturity regardless of newly adapted taxonomy criteria?

a) **Yes, green at issuance should be green for the entire term to maturity of the bond.**

b) No, but there should be some grandfathering.

c) No, there should be no grandfathering at all. If you no longer meet the updated criteria, the bond can no longer be considered green.

d) Do not know

Please specify the reasons for your answer [BOX]

The EU Taxonomy TSC are expected to be reviewed periodically. Whereas we consider this as a positive element, the risk that a green bond might no longer be classified as green in the future might disincentivise many issuers from issuing such bonds. Furthermore, such a risk would also affect investors' decisions, as they would be more reluctant to invest in green bonds, given the risk of having to exit the investment (if failing the terms of the investment mandate) when it is no longer qualified as green under the updated criteria. Finally, tracking the updates to the Taxonomy on a continuous basis and assessing whether the bond could have lost its status according to the updated criteria, would present a significant operational burden and legal risks both to issuers and investors.

Therefore, we think that subsequent changes to the Taxonomy should not apply to outstanding EU green bonds every time the TSC become updated. However, we believe that additional disclosure should be provided in order to indicate what version of the Taxonomy bonds were compliant with at the moment when they were issued and qualified as green (or alternatively a different label can be defined to mark the bonds that complied with previous versions of the Taxonomy).

If you select b, what should the maximum amount of years for grandfathering?

a) 3 years

b) 5 years

c) 10 years

d) 20 years

e) Different approach all together, please specify reasons for your answer [BOX]

Question on incentives

(12) Stakeholders have noted that the issuance process for a green bond is often more costly than for a corresponding plain vanilla bond. Which elements of issuing green bonds do you believe

lead to extra costs, if any? Please use the scale from 1 (no additional costs) to 5 (very high extra cost) – multiple answers possible:

a) Verification [1] [2] [**3**] [4] [5]

b) Reporting [1] [2] [**3**] [4] [5]

c) More internal planning and preparation [1] [2] [**3**] [4] [5]

d) Other

Increased communication efforts

Please explain and specify the reasons for your answer. [BOX]

We confirm that the issuance process for a green bond is often more costly than for a plain vanilla bond of the same risk and return profile. All of the above (verification and reporting requirements, additional internal planning and preparation) generally lead to higher costs. For example, issuers incur additional costs to identify eligible assets, perform the pre-assessment project by project (for Corporate Banking) or at a portfolio level (for Retail Activity), collect required information for reporting, set up a dedicated governance (frameworks, committees), flag assets in databases and others.

However, consistent with our response to Question 1, we think that whilst these costs are present, they are not seen as major impediments to the issuance of green bonds. We reiterate that for smaller issuers these factors can bear more weight, that is why some initial incentive and support mechanisms (fiscal, risk sharing (e.g. government guarantees), technical assistance) could help such issuers to step into the green bond market.

If possible, please provide the estimated percentage and monetary increase in costs from issuing using the EU GBS, or – ideally – the costs (or cost ranges) for issuing green bonds under the current market regimes and the estimated costs (or cost range) for issuing under the EU GBS. [BOX]

(13) In your view, how would the costs of an official standard as proposed by the TEG compare to existing market standards? Please rate on a scale of 1 to 5 (1 substantially smaller, 3 approximately the same, 5 substantially higher). [1] [2] [3] [**4**] [5]

Please specify the reasons for your answer [BOX]

We find that the cost of an official standard as proposed by the TEG is approximately equivalent to other existing market standards. The EU GBS is generally aligned with existing practises. However, the EU GBS could result in higher costs in the future due to the following:

- Mandatory verification can drive the cost up (due to the demand for such service and potentially more regulation to be introduced around verifiers' activity and service quality standards).
- Demonstrating/verifying compliance with Taxonomy is usually more time-consuming and hence cost intensive.

(14) Do you believe that specific financial or alternative incentives are necessary to support the

uptake of EU green bonds (green bonds following the EU GBS), and at which level should such incentives be applied (issuer and/or investor)? Please express your view on the potential impact by using the scale from 1 (not strong at all) to 5 (extremely strong) – multiple answers possible:

a) Public guarantee schemes provided at EU level, as e.g. InvestEU [1] [2] [**3**] [4] [5]

b) Alleviations from prudential requirements [**1**] [2] [3] [4] [5]

c) Other financial incentives or alternative incentives for investors [1] [2] [**3**] [4] [5]

d) Other Incentives or alternative incentives for issuers? [1] [2] [**3**] [4] [5]

e) None

Please specify the reasons for your answer, in particular if you have chosen "other incentives or alternative incentives" [BOX].

We believe that incentives would be helpful to support the uptake of EU green bonds by smaller issuers and investors. For example, public guarantee schemes provided at the EU level would help improve a credit rating of EU green bonds issued by small issuers (who often have a higher risk profile). If the EU is willing to intervene and guarantee investments, this would result in investors accessing funds more cheaply and increasing the demand for EU green bonds. Finally, we think that a fund enabling issuers to cover the costs of verification would help incentivise small market participants (at least as a temporary mechanism for the time until green investing becomes more mainstream and grows in volume). A wide range of tax incentives could be considered, which could act as simple and appealing incentives, e.g. to investors with green bond incomes; and tax incentives to issuers that would allow faster amortization of green expenditures.

Other questions related to the EU GBS

The EU GBS as recommended by the TEG is intended to apply to any type of issuer: listed or non-listed, public or private, European or international.

(15) Do you foresee any issues for public sector issuers in following the Standard as proposed by the TEG?

a) Yes

b) No

c) Do not know

Please specify the reasons for your answer. [BOX]

Technically, we believe that public issuers can follow the Standard assuming they can find eligible projects under the EU Taxonomy. However, the public sector would likely to face the same issues as the private sector currently does in terms of finding eligible assets. Therefore, we think that the same principles of flexibility outlined in our response to Question 6 would need to be allowed for the public sector to apply. Additionally, the public sector may be more sensitive to costs (compared to corporate issuers) and 'project justification' in cases when there is a lack of clarity around the financial incentives for the taxpayer.

Finally, public issuers often finance a particularly large number of activities/projects which they do not own themselves. Obtaining the necessary data to demonstrate Taxonomy compliance is likely to be burdensome. For example, there are several uses and types of activities that have not been studied by the TEG from the perspective of a sovereign issuer (e.g. academic research).

Overall, we think that the public sector should lead by example and strive to apply EU GBS, however we do not think it should be required across all projects.

(16) Do you consider that green bonds considerably increase the overall funding available to or improve the cost of financing for green projects or assets?

a) Yes

b) No

c) Do not know

Please specify the reasons for your answer. If possible, please provide estimates as to additional funds raised or current preferential funding conditions. [BOX]

At this stage it is difficult to foresee the impact of green bonds on the overall funding availability and cost of financing. We believe that at this stage the EU GBS is not enabling new money flows to the green market. We find that it replaces current streams and provides an alternative investment opportunity. However, we note that in the long term, marginal improvements will incrementally lower the cost of financing for the issuer, essentially resulting in an improvement to the cost of financing green projects. There is initial evidence suggesting that green bonds benefit from better investor demand (new investors, long term investors, increasing proportion holding to maturity), enabling improved execution.

II. QUESTIONS ON SOCIAL BONDS AND COVID19

During the ongoing COVID-19, financial markets have so far responded with significantly increased issuance of social bonds responding to the impact of COVID19. These social bonds often follow established market-based Social Bond Principles. The Commission is seeking the input of stakeholders on the lessons learned from this new development, including whether the Commission can play an even greater supportive role in building resilience to address future potential crises.

(17) To what extent do you agree with the following statements? Please use the scale from 1 (strongly disagreeing) to 5 (strongly agreeing) – multiple answers possible:

a) Social bonds are an important instrument for financial markets to achieve social objectives. [1] [2] [3] [**4**] [5]

b) Social bonds targeting COVID19 are an important instrument for financial markets in particular to help fund public and private response to the socio- economic impacts of the pandemic. [1] [2] [3] [**4**] [5]

c) Social bonds targeting COVID19 are mostly a marketing tool with limited impact on funding public and private responses to the socio-economic impact of the pandemic. [1] [**2**] [3] [4] [5]

d) Social bonds in general are mostly a marketing tool with limited impact on social objectives. [1] [**2**] [3] [4] [5]

e) Social bonds in general require greater transparency and market integrity if the market is to grow. [1] [2] [3] [**4**] [5]

(18) The Commission is keen on supporting financial markets in meeting social investment needs. Please select one option below and explain your choice:

a) The Commission should develop separate non-binding social bond guidance, drawing on the lessons from the ongoing COVID19, to ensure adequate transparency and integrity.

b) The Commission should develop an official EU Social Bond Standard, targeting social objectives.

c) The Commission should develop an official "Sustainability Bond Standard", covering both environmental and social objectives.

d) Other Commission action is needed.

e) **No Commission action is needed in terms of social bonds and COVID19.**

Please specify the reasons for your answer. [BOX]

The impact of Covid-19 has resulted in a steady increase in the issuance of social bonds, which has been playing an important role in helping fund public and private response to the socio-economic impacts of the pandemic. We remain hopeful, however, that regulators, policy makers and financial participants can address those challenges through monetary and fiscal policies. The Commission has a number of sustainable finance initiatives on its agenda and should prioritise and address ongoing initiatives before taking on more. Furthermore, and due to the hopefully temporary nature of COVID-19, by the time that the Commission is at the stage to formally address social bonds and COVID-19 bonds, COVID-19 will not be a social emergency.

AFME believes the ICMA Social Bond Principles already provide useful guidance for issuers and investors, therefore creating a separate EU social bond standard would be premature. We believe that defining 'social benefits', a requirement for social bonds, can be a highly political process, and there would be greater difficulties in defining and measuring social objectives via prescriptive metrics and thresholds, if similar in concept to those embedded in the EU Green Taxonomy.

(19) In your view, to what extent would financial incentives for issuing a social bond help increase the issuance of such bonds? Please use the scale from 1 (very strong increase) to 5 (no increase at all). [1] [2] [**3**] [4] [5]

Please explain what kind of financial incentives would be needed, if any. [BOX]

Financial incentives for issuing social bonds would help increase bond issuance by smaller companies. In addition to the proposed incentives mentioned above (refer to our response to Question 14), which can be equally helpful in relation to social bonds, a fund that would cover additional costs of establishing the social bond label would be helpful.