Association for Financial Markets in Europe

AFME views on the EU Green Bond Standard (GBS) proposal in the context of the European Parliament and Council negotiations

16 December 2021

AFME welcomes the European Commission's proposal to establish an EU Green Bond Standard (GBS).[1] AFME's members are committed to supporting the transition to a sustainable economy and strongly support the further development of sustainable finance. On behalf of our members, we wish to provide practical industry input to support the establishment of an effective and successful market for EU Green Bonds.

We support the Commission's objective of establishing a voluntary, credible, "gold standard" to enhance the effectiveness, transparency, comparability and credibility of the green bond market, and to encourage further growth of the market, which plays an important role in the transition to environmental sustainability.

The sustainable bond market has been on a remarkable growth trajectory since the early part of the decade and is vital for connecting capital to sustainability objectives. During the first three quarters of 2021, green bond issuance increased by 87.3% compared to the same period of 2020,[2] confirming that the ESG debt market no longer represents a niche sector but rather a sizeable and growing component of overall debt markets.[3]

In this context, an EU GBS could contribute to the further development of the market by establishing a voluntary EU standard underpinned by the dynamic and science-based classification system for environmentally sustainable economic activities provided by the Taxonomy Regulation.

A voluntary standard will be able to encourage the growth and further development of the EU Green bond market, avoiding the risk for EU issuers being constrained by a format which would only evolve at the pace that the legislative process will allow. With a mandatory EU standard, third-country issuers would be able to adopt green bonds with much more flexibility, developing new eligible asset categories, for instance by combining them with a social element or capturing investments in activities deemed to have 'no-significant impact'. A mandatory standard thus risks slowing down the flow of capital to support the decarbonisation objectives of the real economy, while the proliferation of mandatory standards in other jurisdictions may in turn deter access of EU issuers to US or Asian capital markets.

It is therefore important that the EU GBS remains a voluntary standard, complementing existing market labels and allowing issuers to offer green bonds in line with other international standards to support the continued growth and efficiency of the green bond market.

The proportion of Taxonomy-aligned economic activities is estimated to be small at present and expected to grow over time. This has implications for the potential scale of the market for EU GBS-designated bonds, in particular in the short-term. It is therefore important to maintain the voluntary nature of the standard.

[1] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European green bonds COM/2021/391 final
[2] AFME ESG Finance Report – Q3 2021: EUR 100 billion issued over Q1-Q3 2020; EUR 187.27 billion issued over Q1-Q3 2021.
[3] Capital Markets Union: Key Performance Indicators – Fourth edition (October 2021)

The Commission's proposal provides that proceeds shall be allocated to economic activities aligned with the Taxonomy, without derogation. The Technical Expert Group (TEG) on Sustainable Finance suggested providing some flexibility for activities that are not yet covered by the Taxonomy's technical screening criteria (TSC),[4] considering that this would enhance the Standard's usability without harming its credibility.

We understand that a similar approach, supported by AFME in our feedback to the public consultation on the establishment of the EU GBS,[5] is under consideration in Council discussions. The flexibility would be conditional on activities not yet covered by TSC or on their innovative or complex nature or their location.

On the one hand, a degree of Taxonomy-alignment flexibility could support the growth in issuance, especially in the near-term while the Taxonomy is not fully developed. On the other, this approach may be perceived as reducing the credibility of the standard. The EU Green Bond designation being subject to the activities satisfying the 'substantial contribution to environmental objectives' and 'Do No Significant Harm' tests, meeting the minimum social safeguards and obtaining third party verification would provide a credible, science-based confirmation for the "green" nature of the bonds. However, this would narrow down the market in the near-term. For a balanced discussion on this topic, co-legislators may consider any flexibility alongside criteria such as minimum requirements for the allocation of proceeds and limiting any flexibility to an initial time period during which the market for Taxonomy-aligned assets will evolve and grow.

In this debate, we emphasise that an agreement on the EU GBS proposal must avoid creating different requirements across issuers and issuances. Any Taxonomy-alignment flexibility should not create different categories of "green" in the EU GBS, as this would add complexity in the framework, cause confusion among issuers and investors (especially non-European ones) and dilute its efficacy. The information presented in the allocation report should provide transparency to the market and investors on the process of allocating proceeds to Taxonomy-aligned activities and explain to what extent flexibility considerations have been applied, if at all. This would also allow financial institutions to include EU GBs in their respective KPIs according to Article 8 of the Taxonomy Regulation with the exact percentage of fully-aligned activities.

Whether or not flexibility is provided, the criteria should be the same for all issuers, without distinctions being made between sovereign and private issuers. Differential treatment would threaten the proposal's harmonisation objectives, adding complexity for issuers and confusion for investors. We also find worth noting that government bonds provide a standard against which the performance of other bonds can be measured. If they were subject to different criteria, sovereign Green Bonds could risk losing their function as a benchmark in the wider bonds markets.

It is also necessary that Green Bonds maintain their designation for the entire term to maturity regardless of updated Taxonomy criteria. The possibility that a green bond might no longer be classified as green at a certain point in time would 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 impracticable operational challenge. Similarly, for financial institutions that manage proceeds on an aggregated basis for multiple green bonds (also known as "portfolio approach", as opposed to "bond-by-bond approach"), grandfathering from origination to maturity is a necessity to support

[4] EU Green Bond Standard Usability Guide: TEG Proposal for an EU Green Bond Standard (March 2020)
[5] AFME response to Consultation on Establishment of the EU Green Bond Standard (October 2020)

green financing that requires long-term lending. Any concerns regarding continued alignment could be addressed through additional disclosure to indicate the version of the Taxonomy that the bonds were compliant with at the date of issuance or, in the case of loans, at the date of origination.

It is also important to ensure that the EU GBS supports the growth of EU securitisation markets and applies effectively to securitisation structures, taking account that the issuer may be a special purpose entity which is established solely to purchase the portfolio of assets which are securitised. AFME and its members remains highly engaged in this debate and we will be providing further feedback focusing on securitisation relevant matters within the EU GBS in due course.

Finally, there are two areas which we believe the Commission should seek to clarify further. Firstly, we would like to clarify the application of EU GBS to Third Country Issuers, in particular with respect to the supervisory role of the National Competent Authority ('NCA') under Articles 8 to 13. Our interpretation is that NCAs' responsibilities are only applicable to issuances which fall under the Prospectus Regulation 2017/1129, therefore limiting the supervisory role for NCAs exclusively to issuance from EU entities, but we would like clarity in the drafting to confirm if this is the case. If our interpretation is incorrect, we would seek further clarification on how Third Country Issuers would issue under the EU GBS given the lack of detail in the proposal regarding how third country NCAs are intended to perform some of the roles and responsibilities (in particular under Articles 8 to 13).

Secondly, we seek clarification on the requirements for completion of Green Bond Factsheet in Annex 1 of the proposed regulation, in particular whether each individual field is optional or compulsory, and if the latter if there are conflicting confidentiality clauses or similar legal restrictions which may prevent the disclosure of information listed in Annex 1 (for example the underlying green project's sector and country which may give away identifiable private information on the project) whether there is the ability to disclose information on an aggregated or anonymized basis.

In conclusion, in support of the objectives of the proposal, we trust that the co-legislators will ensure that the standard provides a credible, voluntary framework which supports the growth of the green bond market. This necessitates providing for EU Green Bonds to retain their status until maturity and to avoid diverging criteria for sovereign and private issuers when considering the introduction of any flexibility regarding Taxonomy alignment in the proposal.

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