



Proposal for a Regulation on European green bonds. International Bulletin of November 2021.

On 6 July 2021, the European Commission (EC) published its proposal for a Regulation on European green bonds (the Regulation), the purpose of which is to establish a common regulatory framework for the use of the designation “European green bond” or “EuGB” and a system for registering and supervising the companies that act as external reviewers for green bonds. The proposal establishes a framework that can be used by all issuers of green bonds, in the public and private sectors, for financial and non-financial undertakings, which can also be used by issuers of covered bonds and securitisations, the securities of which are issued by a special purpose vehicle. It may also be used by issuers from within and outside the European Union (EU).

Currently, there are proprietary market frameworks for green bonds commonly accepted that are widely used. These existing standards set out high-level process-based guidelines or recommendations, but the underlying definitions of green projects are insufficiently standardised, rigorous, and comprehensive. Therefore, they can be costly to use and difficult for investors to determine the positive environmental impact of bond-based investments and compare different green bonds on the market. This can also create uncertainty about which economic activities can be considered to be legitimately green and issuers may face reputational risks from potential accusations of greenwashing, especially in transitional sectors. This proposal seeks to address these obstacles and establish a high-quality green bond standard anchored to Regulation (EU) 2020/852 (the Taxonomy Regulation) as a framework that can be used to determine whether an economic activity and the assets or projects related to it are environmentally sustainable, which in turn helps to reduce the potential risks of greenwashing.

As an example of potential uses of these green bonds, the proposal mentions cases such as a bank issuing a European green bond to finance green mortgages, a steel manufacturer issuing a European green bond to finance a new lower emitting production technology or a sovereign issuing a European green bond to finance a subsidy scheme for renewable energy installation.

In regard to the review system for green bonds, which the proposed Regulation addresses by establishing a system for the registration and supervision of companies that act as external reviewers, the preamble refers to the fragmentation of external review practices that may generate additional costs. The current standards do not adequately ensure transparency and accountability of external reviewers, and there is no ongoing supervision of companies acting as external reviewers. The proposal also seeks to standardise the external review practice and increase trust in external reviewers by introducing a voluntary registration and supervision system.

Thus, the proposal establishes: 1) the creation of a voluntary standard for green bonds requiring that the use of proceeds is aligned with the requirements of the Taxonomy Regulation, and 2) the requirement for issuers of European green bonds to obtain a pre- and post- issuance review from an external reviewer registered and supervised in line with the requirements of this Regulation. A degree of flexibility is also afforded to sovereign issuers who wish to issue EuGBs and their external reviewers.

The standard has been developed using the recommendations of experts from the financial sector, environmental NGOs, green bond issuers and representatives of existing green bond standard-setting bodies. The EC also consulted the European Securities and Markets Authority (ESMA), in particular regarding a possible registration and supervision regime for external reviewers at European Union level.

Proposed regulation

The different titles of the proposed Regulation set out the conditions for the use of the designation “European green bond” or “EuGB”, bond-related, transparency and external review requirements, conditions for taking up the activity of external reviewer of European green bonds, as well as the powers of the national competent authorities for the supervision of bond issuers, and ESMA, for the supervision of external reviewers. The European Commission is also awarded powers to implement the corresponding delegated acts. Lastly, the final provisions set out a transitional provision for external reviewers in the first 30 months following the entry into force of the Regulation.

Requirements for European green bonds

Bonds designated "European green bonds" or "EuGB" must comply with the requirements established in the Regulation until their maturity.

Proceeds from EuGB must be used exclusively to finance economic activities that are environmentally sustainable or contribute to the transition of activities to a more environmentally sustainable model in a period that does not exceed five years (or ten years under certain circumstances). This can be done directly through the financing of assets and expenditures that relate to economic activities that meet the requirements set out in Article 3 of the Taxonomy Regulation⁽¹⁾, or indirectly, through financial assets that finance economic activities that meet those requirements.

Due to the foreseeable technological advances in the area of environmental sustainability, it is possible that over time the EC will review and modify the technical screening criteria for environmentally sustainable economic activities and the delegated acts that govern them. Therefore, on allocating the proceeds of the bonds, issuers must apply the delegated acts in force at the time of issuance. When the delegated acts are subsequently amended, the issuer will have five years from their entry into force to apply the amendments made.

Transparency and external review requirements

The bond may only be offered to the public in the Union after prior publication of the European green bond factsheet on the issuer’s website, which must be previously reviewed by an external reviewer.

The issuer must draw up European green bond annual allocation reports yearly until the full allocation of the proceeds of the bond, and publish them no later than three months following the end of the reference year. The issuer is also required to obtain a post-issuance review by an external reviewer of the first allocation report following full allocation of bond proceeds.

The issuer must draw up an impact report after the full allocation of the proceeds at least once during the lifetime of the bond.

Issuers must keep on their websites, until the maturity of the bonds, all documents drawn up by the issuer in accordance with the Regulation, including the corresponding pre- and post-issuance reviews. Where the EuGB are offered to the public or are listed on a market in only one Member State, the information will be provided in a language accepted by the competent authority of that Member State and when they are offered to the public or listed in two or more Member States, the information will either be provided in a language accepted by the

competent authority of each Member State, or in a language customary in the sphere of international finance, at the choice of the issuer.

Issuers of EuGB shall notify the publication of the documents to the relevant national competent authority without undue delay and to ESMA within 30 days.

Requirements for taking up activities of external reviewers

External reviewers for European green bonds must be registered with ESMA and permanently meet the established registration conditions. Implementing technical standards will be drawn up to specify the standard forms, templates and procedures required to submit the information for the registration application.

ESMA will only register an applicant as an external reviewer if: 1) the senior management of the application is of sufficiently good repute; is sufficiently skilled to ensure that the applicant can perform the tasks required of external reviewers pursuant to this Regulation; has sufficient professional qualifications and is experienced in quality assurance, quality control, the performance of pre- and post-issuance reviews and financial service; 2) the number of analysts, employees and other persons directly involved in assessment activities, and their level of experience and training, are sufficient; and 3) the internal arrangements implemented to ensure compliance with the requirements for organisation, processes and governance, established in the Regulation are appropriate and effective. Regulatory technical standards will be developed to specify the requirements set out in points 1) and 2).

Once registered, the external reviewer will be able to carry out its activities throughout the European Union and must inform ESMA of any significant changes in the conditions of its initial registration before they take effect.

ESMA may deny or withdraw registration under certain conditions and will keep a database on its website containing all registered external reviewers, including those who have been temporarily prohibited from pursuing their activities and whose registration has been withdrawn.

In regard to organisational requirements, processes and documents concerning the governance of external reviewers, the Regulation establishes some provisions for senior management, analysts, employees and others directly involved in review activities, the compliance review function, internal policies and procedures, assessment methodologies and the information used and the outsourcing of activities, for which it indicates that regulatory technical standards will be drawn up to provide greater details of the criteria needed to assess the adequacy and compliance with requirements. Requirements for record-keeping, preventing conflicts of interest and confidentiality of information are also established to ensure that the provision of other services does not create conflicts of interest and advise how to act if errors are detected in assessment methodologies or in their application.

At least once a year, the external review must assess the suitability and effectiveness of its systems, internal control mechanisms and provisions, and adopt the necessary measures to correct any deficiencies.

The Regulation expressly mentions that pre- and post-issuance reviews must not refer to ESMA or to any competent authority in a way that could indicate or suggest that they endorse or approve the document in question or any assessment activities of the external reviewer.

The Regulation also establishes requirements for the information that external reviewers must provide free of charge on their websites, which includes all pre- and post-issuance reviews.

In regard to third-country external reviewers, the proposal includes three possible access routes to the EU: a third-country regime on the basis of an equivalence assessment, recognition, or endorsement under which third country external reviewers may provide external review services.

ESMA will register third-country external reviewers that request access provided that: 1) the Commission has adopted an equivalence decision, 2) the third-country external reviewer is registered or authorised to provide external review services and is subject to supervision and compliance control in its home country, and 3) cooperation agreements have been arranged between ESMA and the home authority, as set out in the Regulation. However, to allow third-country external reviewers to take up their activities until an equivalence decision has been adopted, a process for the recognition by ESMA of external reviewers located in a third country has been established. Additionally, an endorsement system has been put in place, allowing, under certain conditions, registered external reviewers located in the Union to endorse services provided by a third country external reviewer (in this case, the EU external reviewer must be fully responsible for the endorsed services and for ensuring that the third-country external reviewer meets the requirements established in the Regulation).

EuGB of sovereign issuers and their external review

Unlike other issuers, sovereign issuers can use the proceeds of European green bonds to indirectly finance economic activities that meet taxonomy requirements through the use of programmes of tax expenditures or programmes of transfers, including subsidies. In such cases, Member States will have to ensure that the activities financed by these programmes comply with the required conditions. For that reason, when providing pre- and post-issuance reviews of EuGB issued by sovereigns and the proceeds of which are allocated to tax expenditures or subsidies in accordance with terms and conditions that are aligned with taxonomy requirements, external reviewers should not be required to assess the taxonomy-alignment of each economic activity funded by such programmes. In this case, it would be sufficient for external reviewers to assess the alignment of the terms and conditions of the funding programmes concerned with the taxonomy requirements. State auditors, or any other public entity that is mandated by a sovereign to assess whether the proceeds of the EuGB are indeed allocated to eligible fixed assets, expenditures and financial assets, are statutory entities with responsibility for and expertise in the oversight over public spending, and typically have legally guaranteed independence. Therefore, sovereign issuers that issue EuGB should therefore be allowed to make use of these state auditors or entities for the purposes of the external review of bonds issued.

Supervisory powers of the NCAs and ESMA

The Regulation establishes the powers of the national competent authorities to supervise bond issuers in order to guarantee the application of the Regulation, as well as the cooperation regime between competent authorities, and includes several provisions that specify the administrative sanctions and other administrative measures that the competent authorities may impose, in addition to rules on the publication and notification of these sanctions to ESMA.

The powers entrusted to ESMA with respect to the supervision of external reviewers established by the Regulation include the power to require information by simple request (in which case there is no obligation to respond) or by decision (where a response is mandatory, although it can also be appealed), the power to carry out general investigations and on-site inspections (the conditions under which ESMA can exercise these supervisory powers are also established). Various provisions specify the supervisory measures, fines and periodic sanctions that ESMA may impose, and the authority is also empowered to charge registration and supervision fees.

[1] (1) Make a substantial contribution to one or more of the environmental objectives set out in Article 9 of that Regulation, (2) do no significant harm to any of these environmental objectives, (3) be carried out in compliance with the minimum safeguards laid down in Article 18 of that Regulation, and (4) comply with the technical screening criteria established by the EC.

Useful links:

Proposal for a regulation on European green bonds and its annexes

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