European Union institutions agree on a standard for EU Green Bonds - Current developments

NEW UNIFORM STANDARD FOR HIGH-QUALITY EUROPEAN GREEN BONDS

Executive Summary

- Legislators struke a deal on the EU regulation for European Green Bonds on 28 February 2023.
- For the first time, the regulation defines binding uniform requirements for issuers of bonds that have to be fulfilled in order for them to be designated as "European Green Bonds" ("***EUGB***").
- The EUGB standard remains a voluntary quality label.
- 15 % of the proceeds from an EUGB can be invested in sectors not yet covered by the EU taxonomy.
- A registration system and supervisory framework for external auditors of European Green Bonds is to be established.
- High transparency and disclosure requirements to be laid down in the form of templates.

A. Background

With the EU Action Plan on Sustainable Finance, the EU Commission had already developed a plan on 8 March 2018 (last updated on 6 July 2021) that includes a series of measures aimed at creating a framework for sustainable finance and accelerating the transition to a low-carbon economy. These include, for example, the revision of existing frameworks such as the Benchmark Regulation[1], the CSRD[2] or the IDD[3], but also entirely new regulatory instruments such as the Disclosure Regulation[4] or the Taxonomy Regulation[5].

This also applies at least in part to another measure that was intended to create the basis for using the designation "European Green Bond" to pursue environmentally sustainable goals within the meaning of the Taxonomy Regulation: the envisaged regulation for EU Green Bonds.

The latter is based on a development that has been emerging for quite some time, as a number of companies - also in the SME sector - have already issued green bonds or bonds that are closely linked to sustainable characteristics (so-called "sustainability-linked bonds"). However, up to now there has been no uniform regulatory framework or a sound classification as a "green bond" to refer to and which could also serve as a point of reference for investors. The intended regulations now aim to create a uniform framework for this practice for the first time and thus also reduce greenwashing.

Recent issuance volumes of green bonds have shown the importance of the green bonds topic for financial market players. For example, a green bond with a volume of up to EUR 25 million was listed in February 2023, a CHF 175 million green bond in January 2023, an up to EUR 77.5 million green bond in November 2022 and a green bond with a volume of EUR 1.8 billion was issued in September 2022. Another example is the Luxembourg Green Exchange, launched in 2016 by the Luxembourg Stock Exchange, the world's first and leading platform dedicated exclusively to sustainable financing, which now houses around 3,100 securities and has contributed to making Luxembourg the leading centre for green, social and sustainable bonds. The change was therefore already taking place, but there was a lack of uniform specifications and a binding classification seal.

The first proposal for a regulation on European Green Bonds was published by the EU Commission on 6 July 2021[6].

The EU Green Bond Standard is a voluntary standard whose designation "European Green Bond" shall be available to all issuers - both inside and outside the EU - that meet the requirements of the proposal. But in the further course, political differences became apparent. European legislators disagreed on several details of the proposal.

B. Innovations in the political agreement on the EU regulation

After lengthy and difficult negotiations, the Council of the European Union and the European Parliament reached a political agreement on 28 February 2023. The publication of provisional agreement is expected shortly. Nevertheless, the following details of the provisional agreement are already known, which at least partially deviate decisively from the previous proposal:

- The EUGB issuance proceeds are to be used for investments in projects that comply with the taxonomy. But a flexibility reserve of 15 % is provided for government and corporate issuers. This can be used for activities for which criteria have not yet been established to determine whether the activity contributes to a green objective. But it is a prerequisite that the activity financed by the EU Green Bond meets environmental standards and does not cause significant harm to the environment (DNSH). The DNSH assessment includes a thorough evaluation of the impact of the activity on various aspects of the environment, including climate change, air quality, water conservation, biodiversity and waste management. In general, only ecological ("E") indicators apply. However, any social aspects were not taken into account.

- A special feature was also defined in the event of changes to the Technical Screening Criteria of the Taxonomy Regulation ("*EU Taxonomy Technical Screening* Criteria" - "*TSCs*"). These are a list of assessment criteria developed by the EU to support companies in assessing the sustainability of their economic activities. If these should change after the issuance of bonds, issuers can fall back on already existing criteria for another five years. However, this general grandfathering only applies to EU Green Bonds that have already been issued, i.e. only after the future regulation comes into force.

- A registration system and supervisory framework for external auditors of European Green Bonds, i.e. independent bodies responsible for assessing whether a bond is green, will continue to be established, as also foreseen in the original proposal for the EUGB Regulation. This should properly identify, eliminate or manage actual or potential conflicts of interest and disclose them in a transparent manner.

- All companies that choose to use the EUGB standard when marketing a green bond are expected to disclose a wide range of information about how the bond proceeds are used, while also outlining how these investments feed into the company's overall transition plans. The disclosure requirements, which would be set out in templates, would also be available to companies issuing bonds that cannot meet all the requirements to qualify for the EUGB standard. These companies would thus subject themselves to ambitious transparency requirements and, as a result, benefit from greater investor confidence.

- Until the agreement, it was still uncertain to what extent the taxonomy should apply to other green and sustainability-related bonds in order to prevent greenwashing in the market in general. The agreement now reached provides for voluntary disclosures before and after issuance.

C. Outlook and challenges in practice

The agreement reached between the European Council and the European Parliament is provisional and still has to be confirmed by the Council of the European Union and the European Parliament and also adopted by both institutions to become final. Eventually, the final regulation will enter into force twelve months after its publication..

PRACTICE NOTES:

For market participants, the following challenges arise from these plans:

1) Green bonds wishing to comply with the draft EU Green Bond Standard must include a description of the green projects to be financed or refinanced in their Green Bond Factsheet.

2) The bond may only be offered to the public within the EU after the factsheet has been published on the issuer's website together with a pre-issue evaluation of this factsheet by an external reviewer.

3) The issuer is required to prepare annual reports on the use of proceeds of the EUGB until the proceeds of the bond have been fully allocated. Furthermore, these proceeds must be published no later than three months after the end of the reference year. In addition, once the proceeds have been fully allocated, an impact report must be prepared at least once during the life of the bond.

4) Firms wishing to act as external auditors for issuers of European Green Bonds will be registered with the European Securities and Markets Authority (ESMA) and comply with existing requirements on qualifications, experience, record keeping, transparency and management of conflicts of interest accordingly.

Contact Capital Markets:

Dr. Alexander J. Thomas
Lawyer, Location: Munich
alexander.thomas@gsk.de
+49 89 288174-98

Contacts Sustainable Finance:

Philippe Lorenz
Lawyer, Location: Munich
Philippe.Lorenz@gsk.de
+49 89 288174-662

Dr. Dominik Stolz
Lawyer, Location: Munich
Dominik.Stolz@gsk.de
+49 89 288174-273

Contacts in Luxembourg:

Andreas Heinzmann, LL.M. eur.
Partner, Location: Luxembourg
andreas.heinzmann@gsk-lux.com
+352 271802-30

Katharina Schramm
Senior Associate, Location: Luxembourg
katharina.schramm@gsk-lux.com
+352 271802-34

STOCKMANN

Disclaimer
This client briefing exclusively contains general information which is not suitable to be used in the specific circumstances of a certain situation. It is not the purpose of the client briefing to serve as the basis of a commercial or other decision of whatever nature. The client briefing does not qualify as advice or a binding offer to provide advice or information and it is not suitable as a substitute for personal advice. Any decision taken on the basis of the content of this client briefing or of parts thereof is at the exclusive risk of the user.

GSK Stockmann as well as the partners and employees mentioned in this client briefing do not give any guarantee nor do GSK Stockmann or any of its partners or employees assume any liability for whatever reason regarding the content of this client briefing. For that reason we recommend you to request personal advice.

www.gsk.de

GSK Stockmann

BERLIN
Mohrenstrasse 42
10117 Berlin
T +49 30 203907-0
F +49 30 203907-44
berlin@gsk.de

HEIDELBERG
Mittermaierstrasse 31
69115 Heidelberg
T +49 6221 4566-0
F +49 6221 4566-44
heidelberg@gsk.de

FRANKFURT / M.
Bockenheimer Landstr. 24
60323 Frankfurt am Main
T +49 69 710003-0
F +49 69 710003-144
frankfurt@gsk.de

MUNICH
Karl-Scharnagl-Ring 8
80539 Munich
T +49 89 288174-0
F +49 89 288174-44
muenchen@gsk.de

HAMBURG
Neuer Wall 69
20354 Hamburg
T +49 40 369703-0
F +49 40 369703-44
hamburg@gsk.de

LUXEMBOURG
GSK Stockmann SA
44, Avenue John F. Kennedy
L-1855 Luxembourg
T +352 271802-00
F +352 271802-11
luxembourg@gsk-lux.com