New unified standard for EU Green Bonds – Current developments

NEW VOLUNTARY STANDARD FOR THE USE OF THE LABEL AS AN EU GREEN BOND

Executive Summary

- On 5 October 2023, members of the European Parliament approved an EU regulation on European green bonds.
- 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" (in short: "***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.
- Issuers intending to use the proceeds of the issue to finance investments or expenses must publish an investment plan.
- There will be high transparency and disclosure requirements to be verified by external auditors.
- The EuGB regulation creates a high quality and transparency standard for green bonds and is therefore to be welcomed from investors' point of view.

A. Background

With the so-called 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 in the sense 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 which one could refer 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 the risk of 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 even a green

[1] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

[2] Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, COM (2021) 189 final.

[3] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

[4] 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 (SFDR).

[5] 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 (Taxonomy-Regulation).

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] In this respect, the Council of the European Union and the European Parliament reached a political agreement on 28 February 2023. In terms of content, the preliminary agreement resulted in a number of changes compared to the first proposal of the EU Commission. These related in particular to the use of issue proceeds and the grandfathering of EU Green Bonds already issued.

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 very requirements of the proposal. Generally, the proceeds of the issue should be used in accordance with the taxonomy and comprehensive transparency should be ensured prior to the issue and during its term.

B. New requirements for EU Green Bonds due to the regulation

On 5 October 2023, the European Parliament finalized and approved an EU regulation on European green bonds. The Members of the European Parliament adopted the regulation for EU Green Bonds with 418 votes in favor, 79 against as well as 72 abstentions.

The following elements of the EU financial framework are particularly relevant:

- The EuGB issuance proceeds are to be used for the financing of activities that comply with the taxonomy. But a flexibility reserve of 15 %is provided for government and corporate issuers. This can be used for activities that do not meet the technical review criteria at Level 2 of the Taxonomy Regulation, if they are activities for which technical criteria have not yet been developed, or if they are development assistance activities. 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" – in short: "*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 criteria change after bonds have been issued, issuers can use the existing criteria for a further seven years. This applies as long as the proceeds have not yet been allocated to specific uses, are not covered by the investment plan and do not yet

[6] Proposal for a Regulation of the European Parliament and of the Council on European green bonds, COM (2021) 391.

meet the taxonomy requirements. 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.

- Issuers wishing to use the proceeds of the issue to finance new investments or expenditures (CapEx/OpEx) must publish an investment plan. This specifies a deadline before which all investments or expenditures financed by the EuGB must be taxonomy-compliant; this deadline must occur before the maturity date of the EuGB

- Issuers of EuGBs must prepare a fact sheet prior to issuance. Once a year until the maturity of the EuGB, they are required to prepare an allocation report on the allocation of proceeds and, if applicable, the progress of the investment plan. Both documents are to be verified by an external auditor. At least once during the term and after the full allocation of proceeds, EuGB issuers shall publish an impact report.

- Special features apply to EuGBs issued as securitized bonds. Bonds issued for the purpose of synthetic securitization are not entitled to use the designation as EuGBs. The EU Regulation, however, contains a green true sale securitisation chapter, focusing on asset-backed securities involving a prospectus and thereby excluding private securitisations not entailing a prospectus from the scope of the EuGB Regulation.

- For other green bonds that are not marketed as environmentally sustainable, as well as for sustainability-linked bonds, the EU Commission is to develop guidelines with standardized templates that can be used voluntarily for pre-issuance information twelve months after the EuGB Regulation enters into force.

C. Outlook and challenges in practice

The EU Regulation on European Green Bonds, which was finally adopted and approved by the EU Parliament, is provisional and still has to be confirmed and adopted by the Council of the European Union. Only then will it become final and be published in the EU Official Journal. The final regulation will finally come into force 20 days after its publication and is to be applied in practice twelve months later.

However, it is still unclear whether the EuGB standard will prevail in the market. It would be important for the attractiveness of EuGBs that fund companies and other investors can comprehensively classify investments in EuGBs as taxonomie compliant, even if the issuer makes use of the 15 percent flexibility quota.

ESSENTIAL POINTS FOR PRACTICAL IMPLEMENTATION

For market participants, the following challenges arise from these plans in relation to EuGBs:

1) Green bonds wishing to comply with the draft EU Green Bond Standard 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 valuation of this factsheet by an external valuer.

3) A prospectus compliant with the EU Prospectus Regulation[7] shall be prepared for an EuGB, which has to be approved by the competent national authority and published before the issuance.

[7] 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.

4) 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.

5) 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.

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

CONTACT CAPITAL MARKETS

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

CONTACTS SUSTAINABLE FINANCE

Philippe Lorenz
Local Partner, Location: Munich
philippe.lorenz@gsk.de
+49 89 288174-662

Dr. Dominik Stolz
Senior Associate, Location: Munich
dominik.stolz@gsk.de
+49 89 288174-273

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GSK Stockmann
Rechtsanwälte Steuerberater Partnerschaftsgesellschaft mbB

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

LONDON
GSK Stockmann International
Rechtsanwaltsgesellschaft mbH,
London branch
Queens House, 8-9 Queen Street
London EC4N 1SP
United Kingdom
T +44 20 4512687-0
london@gsk-uk.com

Registered office: Munich
Munich Local Court
HRB 281930
Managing directors:
Dr Mark Butt, Andreas Dimmling