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The European Green Bond Standard — The New Green Bond "Gold Standard"?

The inter-institutional political agreement seeks to be the "gold standard" for green bonds and reinforce the EU's position as the leading market for sustainable finance.

With the unveiling of the EU green bond standard (the EU GBS), the European Commission (the Commission) takes another important step towards implementing its Sustainable Finance Action Plan[1] to support the growth of sustainable finance and direct capital towards sustainable growth. The EU GBS has been much anticipated, having been announced in concept by the Commission on January 14, 2020 as part of the "European Green Deal Investment Plan"[2], and then first proposed[3] in substance on July 6, 2021, setting out requirements for environmentally sustainable bonds marketed in the European Union as "European green bonds" (EuGB). The EU GBS establishes a new voluntary regime for green bonds that seeks to cement the EU's position as the leading market for sustainable finance, combat greenwashing risks associated with sustainable finance products, and provide greater investor protections through regulating the use of the EuGB label.

In April 2022, the European Council[4] (the Council) published its initial negotiating position, followed subsequently by a report of the European Parliament's Committee for Economic and Monetary Affairs (the ECON Committee)[5] in May 2022, both including certain significant deviations from the Commission's initial proposal. In February 2023, after tripartite negotiations, the co-legislators reached a "provisional agreement on European green bonds"[6], subject to confirmation and adoption by the Council and the European Parliament. On May 10, 2023, a draft overall compromise was agreed by the Council's permanent representatives' committee. In a letter to the chair of the ECON Committee[7], the Council confirmed adoption of the final compromise text[8] should the European Parliament adopt its position at first reading[9]. The Compromise Text constitutes the basis for the below analysis.[10] It remains subject to change during the final steps of the legislative procedures. However, given that a political agreement has now been reached, substantive changes to the final version are not expected.

Characteristics of the EU GBS

The EU GBS is intended as the "gold standard" for green bonds, underlying the European Union's leadership ambition in the area of sustainable finance. In essence, the EU GBS requires that all bond net proceeds are allocated in alignment with the EU Taxonomy[11] (the Taxonomy) and that EuGBs are subject to supervision by competent authorities under the EU prospectus regulation (the EU Prospectus Regulation)[12]. The EU GBS further establishes a registration and supervisory regime for external reviewers supervised by the European Securities Markets Authority (ESMA). Issuers from inside and outside the EU may issue and market their bonds as EuGBs if they comply with the requirements of the EU GBS.

The summary below sets out the key characteristics of the EU GBS:

1. **Scope/Prospectus:** Issuers that wish to issue an EuGB (except for (quasi-)sovereigns) will be required to publish a prospectus in compliance with the EU Prospectus Regulation. Under the EU GBS, the prospectus must state that (i) the bonds are designated as "European Green bonds" or "EuGB" throughout the prospectus, and (ii) the EuGBs are issued in accordance with the EU GBS. If the issuer is required to publish a Capex Plan (as defined below), a summary thereof must also be included in the prospectus. Under applicable securities law, a prospectus is required if the securities are being offered to the public (i.e., open to retail subscribers) and/or if a listing on a regulated market is being requested. Currently, most green bonds issued by investment grade companies in euros and/or in the European market are executed on the basis of a prospectus, whereas most issuances by private, non-investment grade companies are not.

2. **Use of Proceeds:** The net proceeds of an EuGB must be allocated in accordance with the Taxonomy. The Taxonomy is a European framework that facilitates sustainable investment and which is used by other European directives and regulations as a means to identify activities that qualify as "environmentally sustainable". Under the Taxonomy, an economic activity is environmentally sustainable if it contributes substantially towards an enumerated environmental objective,[13] "does not significantly harm" any of the other environmental objectives, is carried out in compliance with minimum social safeguards, and complies with certain technical screening criteria (TSC) (collectively, the Taxonomy requirements). The EuGB proceeds must be allocated towards any of: (i) fixed assets that are not financial assets, capital expenditures (Capex), operating expenditures (Opex), (ii) financial assets created no later than five years after the issuance, and/or (iii) assets and expenditures of households that will meet the Taxonomy requirements before the EuGB reaches maturity. In the case of Capex and/or Opex use of proceeds, the issuer is additionally required to publish a Capex plan (as defined below) on its website.

3. **Limited Grandfathering:** The EuGB proceeds must be allocated in accordance with the relevant TSC applicable on the issue date of the EuGB. However, in case of a change in such TSC during the lifetime of the bond, proceeds allocated pursuant to a Capex plan as well as any unallocated proceeds must be (re-)allocated in alignment with the respective amended TSC within seven years after their entry into application.

4. **"Flexibility Pocket":** The EU GBS provides for a "flexibility pocket" allowing up to 15% of the net proceeds of an EuGB to be earmarked towards economic activities that comply with all requirements of the Taxonomy other than the TSC if (i) no TSC are in place[14] for the relevant environmental objective, or (ii) the proceeds are being allocated towards activities in the context of certain international support in accordance with certain internationally agreed guidelines[15] (in case of (ii), issuers shall comply with the TSC on a "best effort" basis).

5. **"Capex Plan":** If the proceeds are be allocated towards Capex and Opex that will meet the Taxonomy requirements, issuers must publish a "Capex plan" in accordance with Annex I to Commission Delegated Regulation (EU) 2021/2178[16]. The Capex plan needs to specify a timeline by which all Capex and Opex shall be Taxonomy-aligned before the EuGB reaches maturity. Issuers shall obtain an assessment by an external verifier about the Taxonomy-alignment of the Capex plan[17]

and include a summary of the Capex plan in the prospectus. If allocated proceeds subject to a Capex plan are "at risk" of not being aligned with the amended TSC, issuers need to prepare an "alignment plan" which, in turn, is also subject to external review.

6. **Factsheet:** Prior to issuing an EuGB, issuers must publish a "European green bond factsheet" (the Factsheet) which is subject to pre-issuance review by an external reviewer. Key items include the following information:

    a. How the EuGB is expected to contribute to the broader environmental strategy of the issuer, including the environmental objectives under the Taxonomy

    b. If the issuer is subject to Art 8 of the Taxonomy, a description of how and to what extent bond proceeds are expected to contribute to the issuer's Taxonomy-aligned assets, turnover, Capex, and Opex

    c. To the extent available at the time of issuance and in case the issuer publishes a transition plan[18], how the proceeds are intended to contribute to such transition plan and a link to where such plan is published

    d. The intended allocation of bond proceeds to EU taxonomy-aligned economic activities

    e. Information on reporting

    A template for the Factsheet will be provided in an annex to the EU GBS.

7. **Allocation and Impact Reports:** Under the EU GBS, issuers must publish annual allocation reports until full allocation and must obtain a post-issuance review after full allocation which will require close interaction with the external reviewer. After full allocation and at least once during the lifetime of the bond, issuers must publish an impact report.[19] Templates for the impact report as well as the annual allocation report will be set out in annexes to the EU GBS.

8. **Optional Disclosure Requirements for Other Green Bonds and SLBs:** The EU GBS will provide for voluntary templates for pre- and post-issuance disclosure for all bonds "marketed as environmentally sustainable" and sustainability-linked bonds with environmental sustainability objectives (SLB). Although disclosure using the templates will be on a voluntary basis only, it will be interesting to see the extent to which investors come to expect issuers to adopt such disclosure format. Within one year after the entry into force of the EU GBS, the Commission shall publish guidelines for the pre-issuance disclosure and, with respect to the post-issuance disclosure, a delegated act establishing content, methodologies, and presentation of the relevant information. By five years after the entry into force and every three years thereafter, the Commission shall submit a report on the application of the EU GBS, including a legislative proposal on disclosure requirements for other green bonds and SLBs. Within three years after the EU GBS enters into force, the Commission shall publish a report about the need to regulate SLBs, accompanied with a legislative proposal.

9. **Supervisory Regime for Issuers:** EuGB issuers will be supervised by the "competent authority" that reviews and approves the relevant prospectus under the EU Prospectus Regulation in the relevant Member State. This authority will have various powers and sanctions to enforce compliance. For example, the competent authority may suspend an offer or admission to trading for up to 10 days if there are reasonable grounds to suspect that the issuer has failed to comply with an obligation under

the transparency and external review requirements (e.g., the Factsheet). The competent authority may even prohibit an offer or admission to trading if there are reasonable grounds to believe that the issuer continues to fail to comply. Further administrative powers shall include prohibition of further issuances for up to one year, removal of designation as "EU Green Bond," fines[20] and, relevant from a reputational perspective, to make public the fact of non-compliance and to require the issuer to publish the same on its website. Furthermore, disclosure of a decision imposing an administrative sanction or other administrative measure shall be published by competent authorities on their official websites immediately after the subject person has been informed of that decision.

10. **Standalone Supervisory Regime for External Reviewers:** External reviewers will play an important role in maintaining the integrity of the EU GBS as they review, for example, (i) compliance of Factsheet and Allocation Report with the requirements of the EU GBS, including alignment with the TSC, (ii) whether the proceeds have actually been allocated in line with the EU GBS and the Factsheet, and (iii) the Taxonomy-alignment of Capex and Opex as set out in the Capex plan. Ultimately, the external reviewer confirms whether the EuGB is Taxonomy-aligned. The rationale of the external review requirement is to provide investors with "reliable information" on EuGB in a "cost-effective" manner. The EU GBS further establishes a standalone regulatory regime for external reviewers who must register with ESMA and who will be supervised by the same with a particular focus on avoiding actual and potential conflicts of interest.

Topics to Consider for Potential Issuers

The EU GBS is more rigorous than other existing green bond standards, such as the GBP, particularly regarding allocation of the bond proceeds. It may also require more involvement from the external reviewer to determine whether an allocation of the bond proceeds is EU GBS compliant, in particular as EU GBs will need to comply with the TSC and the "do no significant harm" requirements. This will likely require additional preparatory work prior to issuance, including enhanced technical analysis. As a consequence, preparing an EuGB may take longer and could be more expensive than issuing green bonds under other standards. How this voluntary standard will co-exist with the International Capital Market Association (ICMA) Green Bond Principles (GBP)[21], the most widely used voluntary standard, is not yet known.

Further, the prospectus publication requirement may, at least initially, limit the usage of the EU GBS, as issuers who issue green bonds in other markets (i.e., bonds offered and/or admitted to trading in the United States, Canada, Australia, or Switzerland) may be unable or unwilling to prepare an EU prospectus for such issuances and subject themselves to the regulatory scrutiny of the relevant EU competent authorities. Currently, privately-held issuers and non-investment grade issuers only rarely list on regulated markets, and therefore do not typically prepare prospectuses.

While issuers that would not normally elect to conduct bond transactions requiring the preparation of a prospectus may not be inclined to prepare a prospectus going forward in order to enable their bonds to qualify as EuGBs, we anticipate that elements of the EU GBS will diffuse into and be adopted by the wider green bond issuer market and that best practices will evolve towards embracing some of the elements in the EU GBS, such as Taxonomy-alignment, voluntary disclosure templates, the Factsheet and Capex plan. More robust disclosure for green bond issuances in euro and/or by European companies with regards to the use of proceeds and broader issuer transition plans will likely become mainstreamed and further develop as investment grade companies issue EuGBs.

As the market develops, to the extent EU competent authorities elect to commence administrative or enforcement actions against EU GB issuers, issuers may also further strengthen and develop their sustainability and green bonds disclosure in general, and generally subject such disclosure to a similar level of scrutiny as financial disclosure[22].

Institutional investors are coming under increasing pressure to monitor and report on the sustainable characteristics of their debt portfolios. The introduction of the EU GBS is, in part, intended to assist them in this challenge. Indeed, the recitals to the EU GBS note that the voluntary templates for sustainability-linked bonds and non-EU GBS green bonds are intended to address the lack of standardized methodologies for disclosure of Taxonomy-alignment and the resulting difficulties faced by bond investors that report under the Sustainable Finance Disclosure Regulation (SFDR).[23] In this context, whether investors will expect issuers of green bonds to comply with the EU GBS and/or expect issuers of sustainability-linked bonds and non-EU GBS green bonds to disclose in accordance with the voluntary disclosure templates remains to be seen.

Further, once companies that are subject to applicable EU sustainability regulation (such as the Taxonomy and the Corporate Sustainability Reporting Directive[24]) are consistently monitoring, reporting, and disclosing in accordance therewith, they may feel more capable (and hence may be more inclined) to elect to align their green bonds with the EU GBS. The market might then experience an increase in the number of bonds being issued under the EU GBS. Conversely, issuers that are not subject to such European regulation — such as certain emerging market issuers or US issuers offering securities in Europe ("reverse Yankee") — may fail to develop such internal capabilities and hence may be less inclined to use the EU GBS. The extent to which the EU GBS will be adopted outside the EU investment grade market is difficult to predict. However, issuers will still be able to issue green bonds under the GBPs, set up a green financing framework in accordance with the Taxonomy, and/or opt-in for the voluntary disclosure templates under the EU GBS.

Latham & Watkins will continue to monitor developments on the EU GBS, the GBPs, and other sustainable finance frameworks.

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Endnotes

[1] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, and the Committee of the Regions Action Plan: Financing Sustainable Growth (COM/2018/097 final) (Link).

[2] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions, Sustainable Investment Plan, European Green Deal Investment Plan (COM/2020/21 final) (Link).

[3] Proposal for a Regulation of the European Parliament and of the Council on European green bonds (COM/2021/391 final) (Link) (Commission Proposal).

[4] ST 7379 2022 INIT - NOTE (2021/0191 (COD)) (Link); ST 7379 2022 ADD 1 – NOTE (2021/0191 (COD)) (Link).

[5] Report on the proposal for a regulation of the European Parliament and of the Council on European green bonds (COM(2021)0391 – C9-0311/2021 – 2021/0191(COD)), A9-0156/2022 (Link).

[6] Council of the EU, Sustainable finance: Provisional agreement reached on European green bonds (Link).

[7] Council of the EU, Proposal for a Regulation of the European Parliament and of the Council on European green bonds - Letter to the Chair of the European Parliament Committee on Economic and Monetary Affairs, Interinstitutional File 2021/0191 (COD), 9074/23.

[8] Which is attached as Annex I to the letter mentioned in footnote 8 above (the Compromise Text). References to the "EU GBS" refer to the Compromise Text.

[9] Which is currently expected to be scheduled for H2 2023.

[10] The Compromise Text also provides for provisions for securitization bonds designated as EuGB.

[11] 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 (Link).

[12] 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, and repealing Directive 2003/71/EC.

[13] The six environmental objectives are: (i) climate change mitigation, (ii) climate change adaptation, (iii) the sustainable use and protection of water and marine resources, (iv) the transition to a circular economy, (v) pollution prevention and control, and (vi) the protection and restoration of biodiversity and ecosystem.

[14] The TSC for the environmental objectives climate "change mitigation" and "climate change adaption" have been adopted as Commission Delegated Act in 2021 and in May 2022, the European Commission further adopted a "Complementary Delegated Act", laying out the (narrow) scope under which nuclear and natural gas energy activities can be considered as environmentally sustainable. On June 27, 2023, the Commission adopted a Delegated Act on the TSC for (i) sustainable use and protection of water and marine resources, (ii) transition to a circular economy, (iii) transition to a circular economy, (iv) pollution prevention and control, and (v) protection and restoration of biodiversity and ecosystems. On the same day, the Commission further adopted a Delegated Act with certain amendments to the TSC for the environmental objectives "change mitigation" and "climate change adaption". Both Delegated Acts will enter into force on the 20th day following its publication in the Official Journal of the European Union.

[15] For example, official development assistance reported to the OECD Development Assistance Committee.

[16] Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation.

[17] Within 60 days after the deadline specified by the issuer in the Capex plan.

[18] Either voluntarily or if the issuer is subject to an obligation to publish plans pursuant to Article 19a(2)(a)(iii) or, if applicable, Article 29a(2)(a)(iii) of Directive 2013/34/EU.

[19] With respect to the impact report, external review is not required, but the EU GBS states that issuers "may" obtain external review.

[20] See Art 41: (a) for legal persons: max admin. penalty of at least €500 thousand; (b) for natural persons: max admin. penalty of at least €50 thousand. Member States also have the right to impose criminal sanctions. However, this does not prejudice pre-existing rights of public authorities.

[21] International Capital Markets Association, The Green Bond Principles (GBP) 2021 (with June 2022 Appendix I) (Link).

[22] Under current market practice, there is no contractual liability for misuse of green bond proceeds and enforcement by regulators and civil actions have been rare (though in some cases, issuers damage their standing in the market if they do not allocate green bond proceeds appropriately).

[23] 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.

[24] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.