cepInput

03 | 2019

The EU Green Bond Standard (GBS)

An analysis of the TEG's draft

Philipp Eckhardt, Anne-Carine Pierrat & Bert Van Roosebeke

As part of the EU action plan on sustainable finance, the EU-Commission intends to adopt an EU green bond standard. The Commission's Technical Expert Group (TEG) is set to adopt final recommendations on 18 June 2019. This cepInput gives an overview of the EU green bond market, analyses the TEG's ideas for the EU green bond standard and assesses its proposals for incentivising its use.

- Given that there are two widely accepted private standards for green bonds, there is no convincing reason for the EU to introduce an EU green bond standard.
- It is in the best interest of investors to maintain competition between standards for green bonds. Therefore, it is of utmost importance that the use of the EU green bond standard remains voluntary. Neither should its use become mandatory through the backdoor, by making the use of the EU taxonomy (defining "sustainability") mandatory for all "green" products.
- Some of the TEG's proposals for incentivising the use of the EU green bond standard carry serious risks: they may have a detrimental effect on investor protection, the ECB's ability to target inflation, financial market stability and taxpayers' interest. Incentivising measures should not discriminate against private green bond standards.

Philipp Eckhardt and Anne-Carine Pierrat are policy analysts at the financial markets department of cep.
Bert Van Roosebeke is head of the financial markets department of cep.
cep | Kaiser-Joseph-Straße 266 | 79098 Freiburg | Telefon 0761 38693-107 | cep@cep.eu | www.cep.eu

Content

1 Introduction

In March 2018, the EU Commission issued a Communication on an Action Plan on Sustainable Finance [COM (2018) 97, see cepPolicyBrief]. As part of the Action Plan, the Commission declared that “an EU [Green Bond] Standard [“drawing on current best practices”] accessible to market participants would facilitate channelling more investments into green projects”. Thus, it declared that the technical expert group (TEG) on sustainable finance[1] set up by the Commission would, “on the basis of the results of a public consultation”, prepare a report on an EU green bond standard by the second quarter of 2019.[2]

“Green bonds” are usually fixed-income securities. They are typically issued by governments, multilateral development banks and corporate banks, and by private companies. Proceeds of such bond emissions are used to finance or refinance environmentally friendly projects, assets or activities, e.g. in the field of renewable energy, biodiversity or sustainable farming.[3,4]

On 6 March 2019, the TEG issued a first draft of the EU Green Bond Standard[5] and an interim report[6], which outlines the state of play on the development of the said standard. The publication of the two documents was accompanied by a consultation that offered the interested public the possibility to comment on the ideas of the TEG. The consultation ended on 7 April 2019. The TEG indicated that it was planning to adopt its final recommendation on an EU Green Bond Standard by 18 June 2019.[7]

This cepInput first provides an overview of the green bond markets (Section 2). It then looks at why the EU Commission/TEG wants to introduce a Green Bond Standard in the EU (Section 3). Section 4 introduces the two main existing market standards, the Green Bond Principles and the Climate Bonds Standard. Section 5 provides an overview and assessment of the draft of the EU Green Bond Standard (EU GBS), as proposed by the TEG. Section 6 deals with several proposals by the TEG to incentivise the use of the new EU standard and the cepInput rounds off with a conclusion in Section 7.

2 Green bond markets in a nutshell

Green bond markets are still niche markets. They currently represent only 0.4% of the global bond markets.[8] However, they have grown steadily in recent years. In 2007, the European Investment Bank (EIB) issued the first green bonds.[9] In subsequent years, the market was mainly dominated by multilateral development banks and public development agencies. Only later did corporates (in 2013)

---

1 The TEG started its work in July 2018. It consists of 35 members from civil society, academia, business and the finance sector. A list of members may be found here: https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-teg-members_en.pdf.

2 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, COM (2018) 97, Action Plan: Financing Sustainable Growth, p. 4 and 5.

3 Stephan King Park, Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution, 54 Stan. J. Int’l L. 1 (2018), p. 8.

4 Antje Schneeweiß, Große Erwartungen: Glaubwürdigkeit und Zusätzlichkeit von Green Bonds, SÜDWIND e.V. Institut für Ökonomie und Ökumene, Berlin, Januar 2019, p. 7.

5 https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190306-sustainable-finance-teg-interim-report-green-bond-standard-annex_en.pdf

6 https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190306-sustainable-finance-teg-interim-report-green-bond-standard_en_0.pdf

7 https://ec.europa.eu/info/publications/190306-sustainable-finance-interim-teg-report-green-bond-standard_en

8 Sustainable Finance in Focus: Green Bonds Take Root, Institute of International Finance, April 9 2019.

9 https://www.eib.org/de/investor_relations/cab/

and governments (2016) step in and issued green bonds.[10] Global cumulative issuances since 2007 amount to 521 billion USD and nearly one third of that amount was raised in 2018 alone (167.6 billion USD).[11] In 2017 and 2018, green bond issuances already constituted more than 2% of global new bond issuances. While volume-based market growth on a year-to-year basis was high in 2017 (70-80%), it lost momentum last year (3-5%).[12] Projections for 2019, however, show that this decline in growth rates is likely to be short-lived. Data for the first quarter show an upward trend[13] and projections for the whole year see the green bond markets grow to "hit $200 billion in 2019" (rise of 20%)[14] or even $250 billion (rise of 50%)[15].

The US, China, France, Germany and the Netherlands were the top 5 issuers in 2018. Their issuances amounted to 94 billion USD in total (see Table 1) and accounted for more than 55% of global issuances.[16]

Top 5 in 2018	Total issues size in bn USD	Market share	Number of issuers
USA	34,0	20	63
China	31,0	18	69
France	14,0	8	12
Germany	7,6	5	14
Netherlands	7,4	4	6
In total	**94,0**	**55**	**164**

Table 1: Top 5 green bond countries in 2018

Issuers of green bonds from Europe lead the ranks for the amounts issued since 2007. They have raised a total of 190 billion USD since then, compared to 120 billion USD for the Asia-Pacific region, which includes e.g. China, Australia and Japan, and North America with 137 billion USD (see Table 2).[17]

Bonds issuance since 2007	Amount issued in bn USD	Market share	Number of Issuers
Europe	190	36	193
Asia-Pacific	120	23	222
North America	137	26	167

Table 2: Green bond issuances since 2007 by region

Sovereigns play a big role in the green bonds market in Europe. After Poland issued the first sovereign green bond in 2017, other EU Member States followed suit.[18] By the end of 2018, in addition to Poland,

[10] Stephan King Park, Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution, 54 Stan. J. Int'l L. 1 (2018), p. 14 and 15.
[11] Green bonds: The state of the market 2018, Climate Bonds Imitative, p. 2.
[12] EU Green Bond Standard – Interim Report – March 2019, p. 11.
[13] Sustainable Finance in Focus: Green Bonds Take Root, Institute of International Finance, April 9 2019.
[14] 2019 Global Green Bond Outlook, Moody's Investor Services, 31 January 2019.
[15] https://www.climatebonds.net/
[16] Green bonds: The state of the market 2018, Climate Bonds Imitative, p. 3.
[17] Green bonds: The state of the market 2018, Climate Bonds Imitative, p. 5.
[18] Stephan King Park, Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution, 54 Stan. J. Int'l L. 1 (2018), p. 16.

France, Belgium, Ireland and Lithuania had also issued sovereign green bonds (see Table 3).[19] On 21 May 2019, the Netherlands issued their first sovereign bonds with an allocated size of almost 6 billion Euro.[20] Recently, Spain and Germany also declared their willingness to enter the market.[21,22]

Sovereign green bonds issuers in Europe	Until End 2018 (in USD)
Belgium	5500 million
France	16700 million
Ireland	3500 million
Lithuania	24 million
Poland	2000 million

Table 3: Sovereign green bonds issuers in Europe until end 2018

3 Why an EU green bond standard?

The TEG provides several reasons for the establishment of an EU Green Bond Standard. Although the market for green bonds has grown over the last few years and several market standards (e.g. the Green Bond Principles and the Climate Bonds Standard) and procedures have evolved, the TEG identifies various issues that inhibit further development of the market.

First, it argues that in the current market setting there seem to be "no clear economic benefits for issuers" to issue green bonds compared to standard bonds. This is because there is no clear evidence of a pricing advantage for green bonds. Furthermore, the issuance of green bonds regularly produces higher costs, e.g. for external reviews and for reporting tasks.[23]

Second, it states that issuers often refrain from issuing green bonds due to reputational risks. As long as there is no common understanding in the market as to which projects, assets or activities are actually "green", issuers do not want to take the risk of being labelled as "greenwashers" – i.e. declaring their investments to be green, while the wider public takes a different view. Thus, without clear definitions, the issuance of green bonds is inhibited since they involve additional risks and liabilities.[24]

Third, the TEG identifies different approaches and different market actors (e.g. rating agencies, auditing firms, certification bodies) being used for external reviews of green bonds.[25] It fears that such variety creates uncertainty for potential issuers and investors, and hints at conflicts of interest and quality control issues with such verification bodies.[26]

Fourth, it states that there is often uncertainty about "what can constitute an eligible green use of

19 Green bonds: The state of the market 2018, Climate Bonds Imitative, p. 5.
20 https://english.dsta.nl/subjects/g/green-bonds/news/2019/05/21/%E2%82%AC-5.98-billion-issued-in-new-20-year-greendsl-2040
21 https://uk.reuters.com/article/us-spain-economy/spain-may-issue-green-bonds-to-finance-environmental-plan-minister-says-idUKKCN1R81XT
22 https://www.boersen-zeitung.de/index.php?li=1&artid=2019089006
23 EU Green Bond Standard – Interim Report – March 2019, p. 15.
24 EU Green Bond Standard – Interim Report – March 2019, p. 15.
25 External reviews include, in particular, second party opinions, verification, certification and ratings [EU Green Bond Standard – Interim Report – March 2019, p. 23].
26 EU Green Bond Standard – Interim Report – March 2019, p. 15.

capital", so the question arises as to what kind of assets and expenses (e.g. capital or operating expenditure) may be financed via the issuance of a green bond. Furthermore, various models have evolved for tracking proceeds, with varying degrees of reliability.[27] They range from simple tracking – where proceeds have to be equal to the allocations to green projects – to dedicated accounts set up for the green bond issuance.[28]

4 Main existing green bond standards

Two private standards are widely accepted in the market for green bonds: The Green Bond Principles (GBP) were developed by the International Capital Market Association (ICMA) and the Climate Bonds Standard (CBS) were developed by the Climate Bonds Initiative (CBI).

4.1 The Green Bond Principles (GBP)

The International Capital Market Association (ICMA), mainly representing investors, issuers and underwriters, developed the Green Bond Principles (GBP) in 2014 and has updated them every year since.[29] The GBP are voluntary process guidelines for the issuance of green bonds.[30] They are currently the "most important and widely accepted initiative at the international level".[31] The GBP set non-binding standards to encourage "transparency, disclosure and reporting" on green bonds issuances. According to the Principles, "green bonds" are defined as "any type of bond instrument where the proceeds will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible green projects". The GBP are built around four basic components:[32]

- **Use of proceeds**: Proceeds of green bonds issuances should be dedicated solely to projects with environmental objectives, such as "climate change mitigation, climate change adaptation, natural resource conservation, biodiversity conservation, and pollution prevention and control". Thereby, issuers will be encouraged to refer to international and national green taxonomies for identifying these projects. Furthermore, they should prescribe the use of proceeds in the legal documents for the bond.
- **Process evaluation and selection**: Issuers should inform investors about the "environmental sustainability objectives" of a green bond, about how they determine the projects and about the criteria used to identify eligible projects. The latter may also include e.g. exclusion criteria.[33] Furthermore, issuers are encouraged to use external reviewers – providers of second opinions, verifications, certifications, or ratings – to increase credibility.
- **Management of proceeds**: As proceeds of green bond issuances should be solely used to finance eligible green projects, issuers are encouraged to credit the proceeds to specific sub-accounts, move them to a sub-portfolio or otherwise track them. Net proceeds should match allocations to eligible green projects as long as a green bond is outstanding. In this regard, issuers are encouraged to use external reviewers such as auditors to verify their tracking method.

[27] The tracking of proceeds is needed to ensure that the proceeds of issuances are in fact allocated to green projects.
[28] EU Green Bond Standard – Interim Report – March 2019, p. 15 and 16.
[29] Kathrin Berensmann, Upscaling Green Bond Markets: The Need for Harmonised Green Bond Standards, Briefing Paper 12/2017, German Development Institute.
[30] Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds, June 2018, ICMA.
[31] Maria Jua Bachelet & Leonardo Becchetti & Stefano Manfredonia, 2019. "The Green Bonds Premium Puzzle: The Role of Issuer Characteristics and Third-Party Verification," Sustainability, MDPI, Open Access Journal, vol. 11(4), page 4, February.
[32] Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds, June 2018, ICMA.
[33] "Exclusion" means that issuers may state that they definitely exclude certain projects ex ante, e.g. nuclear power projects.

- **Reporting**: Issuers are encouraged to report annually about the use of proceeds until full allocation. Such reports shall include a list of (re-)financed projects, a description of the projects, the amounts allocated to them and their expected environmental impact. For the latter, issuers should use “qualitative performance indicators and, where feasible, quantitative performance measures”.

The GBP are thus based on a “market participant-led governance” structure, which is mainly industry driven. The GBP do not use any “mandatory language”. Instead, they have a rather “permissive rulemaking orientation”.[34]

4.2 The Climate Bonds Standard (CBS)

The Climate Bonds Initiative (CBI) has established the voluntary Climate Bonds Standard (CBS).[35] The Climate Bonds Standard Board at the CBI, which consists mainly of investor entities, is the responsible body that governs the CBS. Thus, it is seen as an investor-oriented standard.[36] The Standard builds upon the Green Bonds Principles (GBP). It makes them “more prescriptive”[37], couples them with a Climate Bonds Taxonomy and with sector-specific eligibility criteria and adds a compulsory certification regime.[38]

Issuers that want to issue green bonds by referring to the CBS and use its label (the “Climate Bonds Certification Mark”) have to fulfil requirements both before and after the issuance.

At the pre-issuance stage, the CBS focuses on:

- **Selection of eligible projects and assets:** The CBS sets out a “two step-approach”. First, a dedicated taxonomy signals the areas into which funds may flow in general terms, e.g. solar and wind energy.[39] Some areas, such as nuclear energy or fossil fuels, are generally excluded.[40] Second, the CBI has developed detailed sector-specific criteria for the eligibility of projects and assets. The criteria are currently only available for certain sectors, whilst for others they are still under development.[41] CBI certification is still only possible for those sectors in which the criteria have been finalised.
- **Readiness of the issuer’s internal processes to track and report on the use of proceeds.**

Furthermore, issuers have to engage a verifier – third-party assurance providers or auditors accredited by the CBI – to certify the eligibility of the selected projects and assets and their “readiness”.[42]

At the post-issuance stage, the CBS focuses on the **actual use of proceeds**, the ongoing eligibility of the projects & assets, the use of funds not yet allocated […], and the adequacy of and output from the

---

34 Stephan King Park, Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution, 54 Stan. J. Int’l L. 1 (2018), p. 23.

35 https://www.climatebonds.net/standard

36 Stephan King Park, Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution, 54 Stan. J. Int’l L. 1 (2018), pp. 25-26.

37 Stephan King Park, Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution, 54 Stan. J. Int’l L. 1 (2018), pp. 25.

38 Introduction to the Climate Bonds Standards & Certification Scheme, Climate Bonds Initiative, December 2015.

39 Introduction to the Climate Bonds Standards & Certification Scheme, Climate Bonds Initiative, December 2015.

40 Antje Schneeweiß, Green Bonds – Black Box mit grünem Etikett? Grüne Anleihen – ein neuer Weg zur Finanzierung von Umweltschutz und Entwicklung?, p. 15.

41 https://www.climatebonds.net/standard/taxonomy

42 Introduction to the Climate Bonds Standards & Certification Scheme, Climate Bonds Initiative, December 2015

issuer's internal systems". Verifiers are again compulsory. They have to provide assurance that the green bond and its issuer sticks to all post-issuance requirements. For such assessment, verifiers have to follow certain assurance standards.

Where verifiers certify that a green bond fulfils the pre-issuance requirements, the CBI **may grant a certificate** to the issuer allowing the issuer to use the CBS label. Since the bond is also tested post-issuance, the certificate requires confirmation.

Furthermore, each green bond issuer must provide **a "Green Bond Framework"**. This document lays down, i. a., the environmental objectives of the bonds, information about the selection process and the internal processes that the issuer has established to meet the Standard's requirements.

Finally, **reporting requirements** complement the CBS. The CBS sets "minimum requirements" for issuers on when, what and to whom they have to report. Reports must be made available pre-issuance to the Standard's board and post-issuance to bond holders. Post-issuance, the CBS calls for annual reporting, i.a. about the funded projects and assets and their eligibility. Furthermore, the CBS recommends making reports publicly available.[43]

5 The TEG's draft for an EU Green Bond Standard (GBS): Main features and assessment

The TEG has developed a draft for a EU Green Bond Standard (GBS).[44] The key features of the draft EU GBS proposed by the TEG are dealt with and analysed below.

5.1 The main features of the TEG's draft

5.1.1 Voluntary tool (at first)

The EU GBS is meant to be a voluntary standard, i.e. issuers of bonds or other capital market debt instruments[45] can choose whether or not to align with the standard. Both European and international issuers can use it.[46]

The TEG proposes that the Commission should adopt a recommendation in the form of a Communication or other type of non-binding EU act to implement the EU GBS. This EU act would provide for the requirements which issuers and other parties involved have to comply with when using the EU GBS. The TEG also proposes that the Commission should adopt incentive measures to support the use of the EU GBS and hence to support the EU green bond market (see more in part 7).

The TEG does not exclude the adoption of a binding EU act in the future – a Regulation or a Directive – to "support the implementation of the EU GBS". The Commission should consider this possibility and other further measures after a period of 3 years in order to evaluate the implementation and impact of the standard.[47]

[43] Introduction to the Climate Bonds Standards & Certification Scheme, Climate Bonds Initiative, December 2015
[44] EU Green Bond Standard – Interim Report – March 2019, Annex 1 pp. 38-41
[45] Other debt instruments than bonds can include inter alia commercial papers or sukuk – securities complying with the Sharia.
[46] EU Green Bond Standard – Interim Report – March 2019, Annex 1 p. 38
[47] EU Green Bond Standard – Interim Report – March 2019, pp. 22-23.

5.1.2 Allocation to Green Projects

According to the TEG, the first core component of the EU GBS is the allocation of the proceeds from green bonds to "green projects".[48]

In order to qualify as "green", these projects must comply with three criteria:

- They must contribute significantly to at least one of the EU's six environmental objectives – i.e. (1) climate change mitigation, (2) climate change adaptation, (3) sustainable use and protection of water and marine resources, (4) transition to a circular economy, waste prevention and recycling, (5) pollution prevention and control, (6) protection of healthy ecosystems.
- They must not significantly harm any of these environmental objectives.
- They must comply with minimum social safeguards – i.e. principles and rights identified in the eight fundamental conventions of the International Labour Organisation's declaration on Fundamental Rights and Principles at Work. [49]

These criteria correspond to those set out in the proposed EU taxonomy to determine if an economic activity is "environmentally sustainable".[50] As of May 2019, the EP adopted its first-reading position on the taxonomy (see cep**Adhoc**). It affirmed the six environmental objectives but raised the standard regarding minimum social safeguards. The Council has not yet adopted a position and is fundamentally questioning the set-up of the taxonomy. When adopted, the projects financed or refinanced by EU green bonds will have to respect the EU taxonomy framework with external reviewers verifying that green projects align with it.

In exceptional cases, green projects do not have to meet the taxonomy because of "the innovative nature, the complexity and/or the location of green projects".[51]

According to EU GBS, proceeds of green bonds can be used for the (re)financing of:[52]

- both tangible and intangible green assets;
- green capital expenditure, i.e. the funds used by a company to acquire or maintain physical assets such as a low carbon building or an electric car;
- green operating expenditure, i.e. the costs of a company's normal business such as rents or machine repairs;
- green expenditure by public entities.

Under the EU GBS, green bonds can only refinance green capital, operating and public expenditure incurred within 3 years before the issuance year of the bond.

48 EU Green Bond Standard – Interim Report – March 2019, Annex 1 pp. 38-39.
49 More information on the declaration and the eight fundamental conventions can be found under: http://libguides.ilo.org/c.php?g=657806&p=4649148
50 Proposal of 24 May 2018 for a Regulation on the establishment of a framework to facilitate sustainable investment, COM(2018) 353, see cep**PolicyBrief.**
51 EU Green Bond Standard – Interim Report – March 2019, Annex 1 p. 39.
52 *Idem.*

5.1.3 Green Bond Framework

Under the EU GBS, issuers of green bonds must publish a Green Bond Framework (GBF). The GBF is a document stating the alignment of the green bond with the EU GBS. It provides information on the use of proceeds and the green bond strategy in general.[53]

The following information must be included in the GBF:

- The environmental objective(s) of the green bond, the alignment of the issuer's strategy with the objective(s), and the reasons for issuing.
- The issuer's process for determining how green projects align with the EU taxonomy, and possibly any green standard or certification followed to select projects.
- A description of the identified or potential green projects financed or refinanced by the green bond.
- The process for linking the amount lent for or invested in green projects to the EU green bond issued.
- A description of the reporting process, including details on the frequency, methodology and assumptions used for the calculation of impact metrics.

The issuer must publish the GBF on its website or via another communication channel before or at the time the green bond is issued.

5.1.4 Reporting

As long as the bond proceeds are not fully allocated to the green projects, issuers have to report at least once a year. After that, reporting is necessary upon any material change in the allocation.[54]

Reporting is standardised and includes:

- a statement of compliance with the EU GBS.
- the amount allocated to green projects, whether proceeds cover assets or expenditure, the distribution between financing and refinancing, their "actual or estimated environmental impact" based on the metrics detailed in the GBF, and their regional distribution.
- the Green Bond Ratio, i.e. the "total amount of green bonds outstanding divided by the total amount of bonds outstanding at the end of the reporting period".[55]

5.1.5 Verification

For the EU GBS, the TEG proposes mandatory verification, which should be conducted by accredited external reviewers.[56] Verification should cover ex-ante compliance with the Green Bond Framework and ex-post compliance with the EU GBS rules regarding the use of proceeds and impact reporting[57]. The external reviewers are appointed by the issuers.[58]

---

53 *Idem*.
54 EU Green Bond Standard – Interim Report – March 2019, Annex 1 p. 40.
55 Report on Climate-Related Disclosures, TEG on Sustainable Finance, January 2019, p. 32.
56 EU Green Bond Standard – Interim Report – March 2019, p. 22.
57 Impact reporting refer to the Green Projects' "actual or estimated environmental impact" that issuers have to report on until bond proceeds are fully allocated. The impact will be determined or estimated with metrics precised in the GBF.
58 EU Green Bond Standard – Interim Report – March 2019, Annex 1 p. 41.

Issuers publish the external review on their website or via another communication channel accessible to the public.

External reviewers must be formally accredited. The TEG recommends establishing a centralised accreditation regime for external reviewers led by the European Securities and Markets Authority (ESMA). As is already the case for credit rating agencies, ESMA would be the single competent body in charge of authorising and supervising external review providers across the EU.[59]

Until the ESMA-operated centralised regime is set up, an interim accreditation scheme will be established for about 2-3 years by a market initiative. This market-led interim accreditation will be open to all interested firms that provide verification services. An accreditation committee will verify that external review providers comply with ethical and professional principles (e.g. objectivity or confidentiality) and professional qualifications (e.g. competence and experience in environmental projects assessment) proposed by the TEG[60] and apply existing practices and international standards on external review. [61]

5.2 A general assessment of the TEG's draft

According to the TEG, the "green bond market […] is not faced with any major market dysfunction".[62] Green bond standards such as the GBS and the CBS already exist in the market and are widely used and accepted. A number of firms are active in the market for the external review of green bond issuances.

Consequently, from an economic point of view, there is no convincing reason for the EU to introduce a public standard for green bonds. In fact, there is a serious risk that the public EU green bond standard will distort competition, even though it is set to be voluntary.

First, bond issuers might have an incentive to adhere to a public standard – instead of private standards such as the GBP or the CBS – as they may reasonably expect this to minimise liability risks. As a consequence, without any competing standard remaining, it is likely that the incentive to improve the EU GBS over time and adapt it to market developments and the changing needs of market players will shrink due to the lack of competitive pressure. This should be avoided.

Second, one of the main differences between the EU-GBS and the existing standards is that the EU-GBS only allows for the (re)financing of projects which meet the criteria of the EU taxonomy defining "sustainability" (see cep**Adhoc** and cep**PolicyBrief**). This is problematic in three ways:

- Linking the EU-GBS to the EU green taxonomy makes it more likely that the EU-GBS will not remain voluntary but will be compulsory in the market for green bonds. This is so as the taxonomy itself may become a binding standard for all financial products pursuing sustainable objectives.
- There is no guarantee that the EU green taxonomy will meet market players' expectations on "greenness" any better than other – private or public – taxonomies do, especially since there is no common understanding of "sustainability". The EU-GBS thus risks ignoring the sustainability

[59] EU Green Bond Standard – Interim Report – March 2019, pp. 26-29.
[60] EU Green Bond Standard – Interim Report – March 2019, Annex 2 pp. 45-47.
[61] The accreditation criteria shall be drawn in particular from the CBI approved verifiers system, the ICMA's Guidelines for External Reviewers and standard from the International Organization for Standardization on general principles and requirements for validation and verification bodies [ISO 17029].
[62] EU Green Bond Standard – Interim Report – March 2019, p. 14.

preferences of investors, which may hinder the development of an EU-market for green bonds.

- Through the link with the EU green taxonomy, there is a risk that the public EU green bond standard will become an instrument of industrial policy because the standard will only be available for the financing of activities found to be "sustainable" according to the EU taxonomy. As of May 2019, the criteria for these decisions are still being negotiated and it is unclear how technical or political this process will be. Depending on the outcome of the negotiations on the EU-taxonomy, there is a significant risk that decisions will be guided by industrial policy considerations and not exclusively by sustainability arguments. This may negatively impact on the acceptance of the EU-GBS, making it all the more important that it remains voluntary. That is the only way that alternative private standards stand a chance of offering a more credible alternative for the green bond market.

Third, it is likely that once an EU-standard for green bonds is set, public measures to encourage its use are likely to distort competition (see section 6). This is true irrespective of whether the standard is voluntary or compulsory.

6 The TEG's proposals for incentivising the use of the EU GBS: Main features and assessment

6.1 Encouragement for investors to adopt EU GBS requirements

6.1.1 Main features

The TEG wants investors to invest more of their funds in EU green bonds. Thus, the TEG "encourages" institutional investors to incorporate the requirements of the EU GBS into their "green fixed-income investment strategies" in order to promote the Standard. Furthermore, investors should inform issuers and underwriters about their commitment to the EU GBS.[63]

6.1.2 Assessment

The EU GBS is just one of several different market standards currently available, but it is one that is established not by the market but by politics. Thus, investors have multiple options. It is not appropriate to push institutional investors to use the EU GBS instead of using other standards. It should be their sovereign decision. If investors feel that the EU GBS has advantages as compared to the other standards, it will prevail. If not, the existing standards will.

6.2 Disclosure regime for institutional investors

6.2.1 Main features

The TEG recommends that the EU puts in place an ambitious 'comply or explain' type regime for periodic disclosure of holdings by institutional investors of green bonds according to the EU green bond standard.[64] In this regard, the TEG views the French Energy Transition for Green Growth Act from 2015

[64] This means that investors either decide to disclose on their EU green bonds holdings ('comply') or decide not to disclose them. In the latter case, they must explain, why they do not disclose such information ('explain').

with its Article 173(vi)[65] as a lead example for such a disclosure regime.[66]

6.2.2 Assessment

Institutional investors typically work in a principal-agent relationship: they invest the funds of their clients. In competing with other institutional investors, they have a self-interest in convincing their clients that their sustainability preferences are being respected. The need for regulatory intervention – e.g. by prescribing disclosure – is therefore very limited.

Nevertheless, in early 2019, the European Parliament and the Council agreed on new sustainability-related disclosure rules for financial market participants and financial advisors (Disclosure Regulation, see cep**Adhoc**). the Regulation includes a comply or explain regime for sustainability-related disclosure on websites and in pre-contractual documents.

There is no apparent added value of an additional comply or explain-disclosure rule, aimed specifically at EU-GBS-holdings. Bonds are only one of many possible financial instruments available to a sustainability-based investment policy. The level of EU-GBS-exposure does not say much about the sustainability quality of an investment policy. In fact, a comply or explain-disclosure rule may falsely set incentives to increase investment in bonds according to the EU-GBS, at the expense of investments in equally sustainable instruments with equal or higher return. This is not in the interest of investors.

6.3 Role of the European Central Bank (ECB)

6.3.1 Main features

The TEG wants the ECB to integrate climate-related criteria especially in their “management of own funds, pension funds and official reserves”. It further recommends that the ECB, when purchasing green bonds, should give priority to EU green bonds. However, such preferential treatment should be “without prejudice to the principle of market neutrality”.[67]

6.3.2 Assessment

It is important to distinguish between the ECB’s monetary policy activity (where it enjoys independence as guaranteed by the EU Treaties) and other activities:

- Regarding the latter, the ECB often acts in a principle-agent relationship (e.g. when managing the pension funds of its employees) and should thus be bound by the preferences of its agents (here: the employees). If they value sustainable investments or prefer the EU GBS over other green bond standards, the ECB should respect this.
- Regarding monetary policy, the ECB’s independence should be respected, meaning that it is up to the ECB alone to decide upon bond purchases or collateral eligibility. Moreover, any

[65] Article 173(vi) of the “Loi n° 2015-992 du 17 août 2015 relative à la transition énergétique pour la croissance verte“ provides for an obligation for institutional investors to report on the integration of ESG parameters in their investment policies and on the means to contribute to the energy and ecological transition. To bring more flexibility, the reporting is based on the “comply or explain” principle – i.e. comply with the duty to inform on ESG integration or explain why they did not or not completely.

[66] EU Green Bond Standard – Interim Report – March 2019, p. 31.

[67] EU Green Bond Standard – Interim Report – March 2019, pp. 31 and 32.

preferential treatment of green bonds under the EU GBS – and hence discrimination against green bonds governed by other standards – would not be compatible with the ECB's own principle of "equal treatment", which aims for "neutral" market behaviour. Instead, such preferential treatment is of a selective nature and addressed only at a specific part of the market. This can be problematic from a legal point of view, given that Article 127(1) and 282(1) TFEU require the ESCB to act in accordance with the principle of an open market economy with free competition, unless price stability dictates otherwise. The economic argument for central banks to act neutrally, by treating counterparties and market participants equally, relates to the unlimited resources this lender of last resort possesses. Whereas all central banks' activities naturally have an impact on prices, it is in the central bank's own interest not to distort market prices. Without a properly functioning price building mechanism on capital markets, the transmission mechanism cannot function adequately; and therefore the central bank cannot effectively measure or steer "real" inflation. A central bank that distorts prices, e.g. by targeted purchases of bonds in certain sectors, would be measuring prices which do not reflect genuine scarcity.

6.4 Credit enhancement guarantees for sub-investment grade green bonds

6.4.1 Main features

The TEG wants the EU institutions involved in the Investment Plan for Europe[68] – especially the European Investment Bank (EIB) – to play a role in promoting EU green bonds. They should enhance the risk profile of EU green bonds. Consequently, the TEG recommends "credit enhancement guarantees for sub-investment grade green bonds" in the form of public guarantee schemes or guaranteed public buying at the moment of issuance ("anchor investments").[69]

6.4.2 Assessment

The proposals by the TEG should be rejected. First, they would lead to a situation where taxpayers ultimately take on risks that should be carried by private investors. Secondly, they would distort prices making it more attractive for investors to invest in green bonds that are marketed under the label of the EU Standard as compared with green bonds that follow no or other standards or as compared with other financial instruments, even when the fundamental data of the latter are more convincing. This would therefore result in a misallocation of capital and may cause financial market stability risks. Thirdly, they would favour EU green bonds according to the EU GBS vis-à-vis other financial products that may have a similar – or even better – environmental impact. Consequently, credit enhancement guarantees, and anchor investments, do not necessarily promote green investments.

6.5 Encouragement for issuers to use EU GBS

6.5.1 Main features

The TEG wants all issuers, both from the public and private sector, to stick to the EU GBS when they

[68] More about the Investment Plan for Europe may be found here: https://ec.europa.eu/commission/priorities/jobs-growth-and-investment/investment-plan-europe-juncker-plan_en

[69] EU Green Bond Standard – Interim Report – March 2019, pp. 32 and 33.

issue a Green Bond in the future. This will enhance the credibility of the GBS.[70]

6.5.2 Assessment

The TEG may encourage issuers to use the EU GBS. However, it should by no means force them to use it. It should be left to the issuers to decide whether they see the EU GBS as an attractive standard in comparison to other standards. Whether issuers stick to the EU GBS or not will also depend on the final design of the standard.

6.6 Grant scheme for external verification

6.6.1 Main features

As the issuance of green bonds under the EU GBS is associated with extra costs for external verification, the TEG recommends that a "grant scheme" be set up by the European Commission to provide subsidies for issuers. This could "totally or partially" compensate for the extra costs involved as compared with mainstream bonds issuance. The TEG proposes a grant-scheme that will elapse by the end of 2022, when the EU taxonomy on sustainable investments is finally in place ('sunset clause').[71]

6.6.2 Assessment

The TEG should refrain from setting up a grant scheme to subsidise external verification. It is clear that the verification process associated with issuing green bonds generally causes additional costs as compared to issuing mainstream bonds. The TEG emphasises that i. a. given higher internal (i. e. reporting duties) and external costs (i.e. third-party verification) there are actually no "clear economic benefits" for issuers to issue green bonds as compared with mainstream bonds. The "pricing advantage […], if any, appears to be small"[72]. In essence, this means that investors are not willing to pay for these additional costs. Their preference for sustainable investments does not appear to cover the acceptance of lower returns on green bonds. Public subsidies for external verification would therefore be inefficient and a waste of public money. Moreover, they would distort prices to the detriment of both green bond issuers not using the EU-GBS, as well as issuers of other financial instruments.

Moreover, from a practical point of view, it does not make sense to subsidise an activity such as external verification until the EU taxonomy, which is to be the basis for that activity, is adopted.

Setting up a grant scheme to subsidise the extra costs of external verification may also be problematic from a legal perspective. According to the financial rules applicable to the EU budget[73], every expenditure committed under the EU budget needs the adoption of a "basic act" – defined as "a legal act, other than a recommendation or an opinion" – to be implemented. [74] The Commission is therefore not allowed to set up a grant based on a voluntary standard established by a

[70] EU Green Bond Standard – Interim Report – March 2019, p. 33.
[71] EU Green Bond Standard – Interim Report – March 2019, p. 34.
[72] EU Green Bond Standard – Interim Report – March 2019, p. 15.
[73] Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012 ("financial rules of the EU budget").
[74] Articles 2 (4) and 58 (1) of the financial rules of the EU budget.

recommendation, and not via mandatory legislation.

6.7 EU eco-label for financial products

6.7.1 Main features

The European Commission is currently developing an EU ecolabel for financial products[75] for retail investors.[76] The TEG recommends that disclosures on the use of proceeds from green bond issuances and impact reporting be used to establish the ecolabel. Concretely, the EU GBS should be referred to in the "technical criteria" for the EU ecolabel for financial products.[77] The sub-group on the Ecolabel[78] is also considering a requirement "that the EU Ecolabel could only be obtained if portfolios are invested in 'green bonds', as defined by the EU GBS"[79].

6.7.2 Assessment

It is to be welcomed that the TEG wants to use the EU GBS as a reference for the EU ecolabel for financial products since the EU GBS already sets out criteria for eligible green projects and will in future be linked to the EU green taxonomy. However, it is not appropriate to allow only EU green bonds to obtain the Ecolabel. Other green bonds, which do not fall under the EU brand, may be no less "green" than EU green bonds. Allowing only the latter to use the label discriminates against the former and distorts competition. Furthermore, if the market does not – for whatever reason – make use of the EU GBS, potentially only a few green bond issuers may benefit from the Ecolabel, which certainly goes against what the TEG/Commission is advocating.

6.8 Additional considerations

6.8.1 Main features

The TEG also provides some thoughts about further policy options that could promote the EU GBS, going beyond the proposals mentioned above. It points out that those additional policy options would need further analysis due to their complexity.

One proposal is to provide tax incentives, granted either at issuer or investor level. Given the EU's lack of competence in this field, these incentives would have to be implemented at national level.

A second proposal is to provide preferential prudential treatment for EU green bonds, if assessments,

[75] Financial products entail i. a. Green Bonds [EU Ecolabel criteria for Financial Products, Preliminary report, First draft, Joint Research Centre (JRC) technical report, EU Commission, March 2019, p. 45].

[76] The Commission announced in its Action Plan on Sustainable Finance from March 2018 (see cep**PolicyBrief**) the proposition of a "voluntary EU-wide labelling scheme through the extension of the EU Ecolabel to financial products". Such label is to be applied "once the EU sustainability taxonomy is adopted". It shall "allow retail investors concerned with the environmental impact of their investment to rely on a trusted and credible (third party verified) label when investing in green financial products". [EU Ecolabel criteria for Financial Products, Preliminary report, First draft, Joint Research Centre (JRC) technical report, EU Commission, March 2019, p. 9].

[77] EU Green Bond Standard – Interim Report – March 2019, p. 35.

[78] The "EU Ecolabel for Financial Products is being developed by Unit B5 - Circular Economy and Industrial Leadership, as well as Unit B1 - Finance & Economy of the Joint Research Centre (JRC) Directorate B - Growth and Innovation for the Directorate General for the Environment in collaboration with the Directorate General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA) of the European Commission".

[79] EU Ecolabel Criteria for Financial Products, Subgroup on Criterion 1.1 - Meeting Presentation 21 May 2019, EU Commission.

e.g. by the European Banking Authority (EBA) conclude that such treatment is advisable from a risk perspective. In this regard, the TEG elaborates on findings of the Bank of England that more energy-efficient properties have a higher creditworthiness.[80]

6.8.2 Assessment

Many economic activities harm the environment. Public and private actors that perform these activities often do not pay for such harm. They externalise the costs to the wider public. Thus, policies that shift the burden from the wider public back to the responsible actors internalise those costs and are efficient. However, this target cannot be achieved by promoting the use of EU green bonds via tax incentives. In fact, it shifts financial burdens to taxpayers in general, and fails to place a financial burden upon those responsible for the environmental harm and related costs.

First, it is preferable to tackle the issue at source, e.g. by increasing the price of a harmful activity via taxes or by even prohibiting it. Second, tax incentives for EU green bond issuers or investors would distort competition as this would discriminate against the use of other green bonds, or other green financial instruments, for no legitimate reason.

The prudential treatment of EU green bonds should be risk-based in order to avoid jeopardising financial market stability. Environmental and climate factors do influence the general risk of economic projects and thus also the bonds that are issued to finance them. Thus, it may well be that transition risks or physical risks have a negative impact on the risk profile of non-green bonds. In such cases, the existing risk-based prudential treatment already enables this information to be incorporated and there is therefore no need to generally treat green bonds differently from other bonds.

7 Conclusion

Given that there are two widely accepted private standards for green bonds, there is no convincing reason for the EU to introduce a public EU green bond standard.

It is in the best interest of investors to maintain competition between standards for green bonds. Therefore, it is of utmost importance that the use of the EU green bond standard remains voluntary. Neither should its use become mandatory through the backdoor by making the use of the EU taxonomy (defining “sustainability”) mandatory for all “green” products.

Some of the TEG’s proposals for incentivising the use of the EU green bond standard carry serious risks. They may have a detrimental effect on investor protection, the ECB’s ability to target inflation, financial market stability and taxpayers’ interest. Incentivising measures should not discriminate against private green bond standards.

[80] EU Green Bond Standard – Interim Report – March 2019, pp. 35 and 36.

Recently published in this series:

2019-02: Governance of the Energy Union (May 2019)

2019-01: Renewable Energy in the EU (April 2019)

2018-05: EU Energy Efficiency Policy (December 2018)

2018-04: Climate Protection outside the EU ETS (August 2018)

2018-03: Climate Protection by way of the EU ETS (July 2018)

2018-02: French vocational training (February 2018)

2018-01: The European pillar of social rights (January 2018)

2017-07: Globalisierung des Klimaschutzes (November 2017)

2017-06: Deepening EMU in the euro area (November 2017)

2017-05: CO2 minimum price - Curse or blessing of EU climate policy? (October 2017)

The Authors:

Philipp Eckhardt and Anne-Carine Pierrat are policy analysts at the cep financial markets department. Dr. Bert Van Roosebeke is head of the financial markets department at cep.

cep | Centre for European Policy
Kaiser-Joseph-Strasse 266 | 79098 Freiburg | Germany
Telephone +49 761 38693-0 | www.cep.eu

cep is the European-policy think tank of the non-profit-making foundation Stiftung Ordnungspolitik. It is an independent centre of excellence for the examination, analysis and evaluation of EU policy.