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CLIENT ALERT

EU Green Bond Standard Proposal Has Been Adopted

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AUTHORS

Jean-Quentin De Cuyper | Zoé Janssen

Being a sustainable company is no longer a question of choice, but more and more an obligation[1]. But to implement a sustainable strategy and invest in green projects, your company might need to raise financing. In that respect, the issuance of green bonds might be an accurate tool.

Background

Green bonds already exist and are growing more and more popular. However, the lack of a clear definition of what constitutes "*green projects*" creates uncertainty and added costs for issuers and investors alike. It can be difficult for investors to determine the environmental impact of bond-based investments and compare different green bonds on the market, while the lack of common definitions of environmentally sustainable economic activities creates uncertainty about which economic activities can be considered to be legitimately "green"[2].

Accordingly, the European Commission wishes to set the standard for how companies and governments can issue green bonds to raise money in the capital markets to finance investments, while meeting strict sustainability requirements and protecting investors from the risk of greenwashing.

1 See our previous client alert, available here.

2 Explanatory Memorandum of the Proposal for a Regulation on European Green Bonds.

On July 6, 2021, as part of its broader agenda on sustainable finance, the European Commission adopted a regulation proposal on European Bonds with a view to creating the "*European Green Bond Standard*" (EUGBS). The proposal lays the foundation for a common framework of rules regarding the use of the label "*European Green Bond*" or "*EUGB*" for bonds that pursue environmentally sustainable objectives within the meaning of the EU Taxonomy Regulation[3]. The objective pursued by the Commission is to make it easier for investors and companies to identify environmentally sustainable investments and ensure that they are credible, and to reorient capital flow towards sustainable investments. This could be done via clear labels for retail investment products and by developing a European green bond standard.

Overview of the Proposal

The European Green Bond Standard is a voluntary standard available to all issuers, EU as well as non-EU, private as well as sovereign.

This standard is based on best practice and is compatible with existing market standards for green bonds (for instance, ICMA's Green Bonds Principles), but goes further in certain aspects, such as a full alignment with the EU Taxonomy Regulation and a strict regime of external review.

The standard sets out uniform requirements for any bond to be qualified as a "*European Green Bond*".

There are four key requirements:

1) The proceeds of the bonds shall be exclusively and fully allocated to projects aligned with the EU Taxonomy requirements[4] before their maturity, and shall be allocated to financing eligible fixed assets, expenditures or financial assets, or a combination thereof, with the issuers not being allowed to deduct costs from the collected proceeds for the purpose of this allocation.

The EU Taxonomy sets out four conditions that an economic activity has to meet to be recognized as "Taxonomy-aligned":

- making a substantial contribution to at least one environmental objective (i.e. climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; and protection and restoration of biodiversity and ecosystems);
- doing no significant harm to any other environmental objective;

[3] Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment.

[4] The EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities, which is established by Taxonomy Regulation and its delegated acts.

- complying with minimum social safeguards; and
- complying with the technical screening criteria (i.e. technical screening criteria developed in delegated acts, which for each economic activity considered specify environmental performance requirements that ensure the activity makes a substantial contribution to the environmental objective in question and does no significant harm to the other environmental objectives).

2) The allocation of proceeds must be fully transparent, with detailed reporting requirements.

Before issuing the bonds, issuers will have to publish a "*green bond factsheet*" describing the concrete funding goals and environmental objectives of the bonds. This factsheet will be reviewed by external reviewers (see below) to ensure that the bonds are compliant with the European Green Bond Regulation.

After the issuance of the bonds, issuers will be required to publish yearly reports to demonstrate how they are allocating the proceeds of the bonds to economic activities that meet the EU Taxonomy requirements.

Once all the proceeds have been allocated (such allocation being required in full prior to the maturity date of the bonds), the issuer shall have to obtain a "*post issuance review*" from an external reviewer (see below). Such post issuance review may be required on a more frequent basis for certain issuers (such as banks).

Issuers are also required to publish at least one report on the overall environmental impact of the bonds.

Issuers shall publish these reports on their website, in a distinct section titled "*European green bonds*".

3) All EU green bond issuance must be monitored by an external reviewer, who ensures compliance with the proposed regulation and the alignment of the projects financed with the EU Taxonomy criteria. Limited specific flexibility is provided in this respect for sovereign issuers.

4) These external reviewers play a crucial role in maintaining the integrity of the green bond market by assessing the greenness of each bond and of the activities it funds. That is why the external reviewers offering their services to EU green bond issuers must be registered with and supervised by the European Securities and Markets Authority (ESMA) and will need to meet the conditions for registration on an ongoing basis. Such conditions cover qualifications, experience, recordkeeping, transparency, and conflict of interest management. The requirement to use external reviewers aims at ensuring the quality of the reviewer's services and reviews and, in so doing, the protection of investors and the integrity of the market. Limited specific flexibility is provided in this respect for sovereign issuers.

Following its adoption, the Commission's proposal will be submitted to the European Parliament and the Council under the ordinary legislative procedure.

Final Observation

The Regulation, once adopted, will set a standard for how companies, but also public authorities, can use green bonds to raise funds to finance their green investments, while meeting tough sustainability requirements.

European green bonds are well suited for supporting any kind of issuers in their transition to more sustainability: funding of long-term sustainable projects (building of a new energy-efficient facility, resource-efficient buildings, low-carbon transport infrastructure, …), replacement of "brown" assets by "green" assets, emissions offsetting (reforestation), decarbonization of core activities, … These issuers will be able to easily demonstrate that they are financing legitimate green projects aligned with the EU Taxonomy, while investors buying the bonds shall be able to compare bonds available on the financial markets and trust that their investments are actually sustainable.

Should you need funds to implement your sustainable strategy, it's time to think of issuing green bonds, to benefit from the currently low OLO-rate (in particular with the stricter credit conditions applied by the banks) and the possibility of raising sizeable amounts. There is no reason to wait for the entering into force of the EU Regulation on European Green Bonds. Prepare your next bond issuance meeting within the EU Regulation's requirements and your company will demonstrate its willingness to be sustainable.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

Jean-Quentin De Cuyper	**Zoé Janssen**
+32 2 290 18 20	+32 2 290 18 20
jdecuyper@willkie.com	zjanssen@willkie.com