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European Union Green Bonds Regulation

Nicholas P. Pellicani, Vera Losonci, and John Young*

In this article, the authors discuss the EU's Green Bonds Regulation and its use for bonds made available to investors in the European Union.

The EU's Green Bonds Regulation[1] (the Regulation) entered into force in November 2023 and will apply from December 21, 2024. The Regulation is a voluntary standard for issuers of bonds that wish to use the designation "European Green Bond" or "EuGB" for bonds that are made available to investors in the European Union. The Regulation sets out eligibility criteria for investing the proceeds of bonds in environmentally sustainable projects, standards for pre-issue and post-issue sustainability reporting, and a new framework for external review of those reports, and supervision of the reviewers.

Bonds that are used to finance environmentally sustainable technologies, energy, and resource efficiency, as well as environmentally sustainable transport infrastructure and research infrastructure, subject to certain reporting and requirements under the Regulation, will be eligible under the Regulation to be designated as "European Green Bonds" or "EuGB." Issuers may only use the "European Green Bond" or "EuGB" label if they publish a prospectus under the EU Prospectus Regulation. The Regulation covers financial issuers (which may "on-lend" the proceeds of their bonds to finance other companies' projects) as well as issuers raising finance for commercial projects.

The proceeds of EU Green Bonds are primarily expected to be invested in economic activities that are aligned to the EU Taxonomy Regulation, either directly (through the financing of "real economy" assets and expenditure) or indirectly (through the creation of equity or debt instruments that finance) in Taxonomy Regulation–aligned economic activities. The Taxonomy Regulation is the EU's classification system for environmentally sustainable activities. The Regulation includes an option for bonds that are marketed with a broad commitment to invest in environmentally

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sustainable activities, but are not aligned with the Taxonomy Regulation, voluntarily to opt-in to a number of the Regulation's disclosure requirements.

The Regulation introduces standard forms of disclosure and reporting for European Green Bond issues, requiring disclosure of methodologies and key assumptions used when preparing reports and external review of the information on the use of proceeds of the European Green Bond, in order to facilitate comparability of European Green Bonds issues.

Finally, the Regulation includes specific provisions for European Green Bonds issued by sovereigns, regional or local authorities, and EEA supranationals and introduces a separate regime for bonds issued by securitization vehicles. These provisions are not discussed in this article.

Ways Issuers May Invest the Proceeds of a European Green Bond

The Regulation provides for two ways for an issuer to invest the proceeds of a European Green Bond. Under the "gradual approach," the issuer of European Green Bonds must allocate, before the bond's maturity, the proceeds of the bonds in full to one more of the following:

1. Fixed assets (other than financial assets) that relate to Taxonomy Regulation–aligned economic activities;
2. Financing capital or operating expenditure that meets conditions in the Taxonomy-Delegated Regulation[2] (for CapEx, part of a plan for activities to become Taxonomy Regulation-aligned);
3. Acquiring financial assets that are created no more than five years after the date of issue of the bond, subject to the conditions described below; and
4. Financing assets and expenditure of households.

Where the use of proceeds is for capital or operational expenditure, the issuer must publish a CapEx plan, which must specify a deadline, before the European Green Bond reaches maturity, by when the capital and operating expenditure funded by the Green Bond will be Taxonomy aligned. An external reviewer must assess the Taxonomy alignment of the capital and operating expenditure that is included in the CapEx plan and funded by the proceeds of the bond.

Recognizing that certain issuers may not be able to link the proceeds of an issue to specific assets on their balance sheet, the Regulation also allows for a "portfolio approach." Under the portfolio approach, issuers must allocate proceeds from the issuance of European Green Bonds to a portfolio of environmentally sustainable assets on their balance sheet that meet the Taxonomy technical screening criteria,[3] provided that the value of the environmentally sustainable assets exceeds the total value of the portfolio of the issued outstanding European Green Bonds.

The Taxonomy Regulation defines six environmental objectives and sets out the general criteria for activities to contribute to those objectives. The Taxonomy technical screening criteria set out the detailed technical standards for an activity to contribute to a given environmental objective, and the "do no significant harm" tests for each activity. For flexibility, an issuer may allocate up to 15 percent of the proceeds from the issuance of a European Green Bond toward activities that contribute to environmental objectives that meet the general criteria in the Taxonomy Regulation, but not the separate technical screening criteria, so long as it is in an activity for which no technical screening criteria are yet available. The issuer will need to comply with the generic "do no significant harm" criteria in the Appendices to the Taxonomy technical screening criteria. Issuers may also allocate, up to the 15 percent limit, proceeds to activities in the context of international support reported in accordance with internationally agreed guidelines, criteria, and reporting cycles.

Financial Assets

The Regulation applies specific rules to bonds where the proceeds are applied to "financial assets." These provisions are directed at issuers that on-lend issuance proceeds to borrowers, or invest issuance proceeds in equity of another entity, with the debt or equity termed "financial assets." Any such financial assets must be allocated in accordance with the rules for allocation of the proceeds of European Green Bonds (summarized above) and must be created within five years of the issue of such bond. While financial assets can be allocated to subsequent financial assets, this is subject to a maximum limit of three consecutive financial assets. Issuers must also ensure that external reviewers review the final allocation of proceeds, which may be challenging in practice.

Disclosure and Reporting

The Regulation includes standardized disclosure and reporting requirements.

The European Green Bond fact sheet is a template fact sheet that gives the key facts about the bond, including information on the intended allocation of European Green Bond proceeds. The fact sheet requires a pre-issuance review by an external reviewer, which includes a statement by the reviewer on alignment of the use of proceeds of the European Green Bond with the Taxonomy Regulation.

Until the proceeds of a European Green Bond issuance have been fully allocated, the issuer must disclose annually a European Green Bond allocation report, demonstrating that the proceeds of the European Green Bond have, to date, been allocated in accordance with the criteria summarized above, including, if applicable, information on the progress made in implementation of the CapEx plan. Once the proceeds have been fully allocated, the external reviewer must perform an annual post-issuance review to confirm that the proceeds have been allocated in accordance with the criteria. Where the proceeds are allocated to a portfolio of assets, the external reviewer must review each allocation report on an ongoing basis. The allocation reports are published on the issuer's website.

Issuers of European Green Bonds must also, after the full allocation of the proceeds and at least once during the lifetime of those bonds, publish a European Green Bond impact report on the environmental impact of the use of the bond proceeds. This covers an assessment of whether the bond issuance aligns with the broader environmental strategy of the issuer and an assessment of the indicated environmental impact of the bond proceeds. The issuer may seek an external review of this report.

Prospectus

Importantly, in order to use the designation "European Green Bond" or "EuGB," issuers must publish a prospectus under the EU

Prospectus Regulation. The prospectus must state that the bond is a European Green Bond and include a statement in the use of proceeds section that such bond is issued in compliance with the Regulation. The requirement for a Prospectus Regulation–compliant prospectus will ensure that the bond issue is supervised by the national competent authority in line with their existing powers. However, this requirement potentially reduces the usefulness of the designation, given that many companies issue bonds in reliance on an exemption from the Prospectus Regulation, such as where the bond is only offered to professional investors or where the bond is admitted to trading on an exchange-regulated market as opposed to an EU-"regulated market," which tends to have lighter requirements. It is to be seen whether issuers will be willing to issue European Green Bonds if such issuance requires the publication of a prospectus.

The Optional Disclosure Regime

The Regulation includes a disclosure regime for bonds that are marketed as "environmentally sustainable" or sustainability linked and where the proceeds are not intended to be invested in projects aligned with the Taxonomy Regulation or would otherwise not be designated as European Green Bonds. The Regulation calls this regime "optional," in that issuers are not required to adopt the regime, but may do so for comparability with other environmentally sustainable or sustainability linked and bond issues and to demonstrate steps they have taken to address greenwashing risk.

Bonds marketed as environmentally sustainable are bonds where "the issuer provides investors with a commitment or any form of pre-contractual claim that the bond proceeds are allocated to economic activities that contributed to an environmental objective." This would, for example, include bonds issued in accordance with the ICMA Green Bond Principles. The optional disclosure regime includes pre-issuance and post-issuance disclosure templates, to be developed by the European Commission. These templates will include disclosure on how bond proceeds contribute to the issuer's climate transition plan, the manner in which bond proceeds are expected to contribute to the issuer's Taxonomy Regulation–aligned turnover, CapEx or OpEx and the minimum proportion of proceeds to be applied to environmentally sustainable activities under the criteria in the Taxonomy Regulation. For sustainability-linked bonds, there are requirements to include the rationale, level of ambition and materiality on the relevant KPIs and a description of the bond structure.

If an issuer opts to use the templates described above, it will be supervised by the relevant national competent authority in relation to its obligations under that part of the Regulation.

External Reviewers

External reviewers will be responsible for assessing the pre- and post-issuance reports relating to European Green Bonds. The requirement for standardized external reporting represents a significant change as compared to current market practice, where issuers use different types of external consultants to provide a degree of assurance to the reporting.

External reviewers based in the EEA will be required to apply for registration with ESMA, with prescribed information in their application, covering their ownership, management, and resources and methodologies to be used to issue reviews. External reviewers based outside the EEA are similarly required to be registered or recognized by ESMA (where recognition is achieved by having a responsible legal representative in the EEA) or to have their reports endorsed by an EEA-registered external reviewer.

There is an 18-month transition period when both EEA and third-country external reviewers can provide services to issuers of European Green Bonds without being registered, recognized, or having their reports endorsed, provided that they have notified ESMA of their intention to provide such services.

Supervision

The national competent authority that reviews the prospectus for a European Green Bond will be responsible for supervising the issuer's compliance with the Regulation's disclosure and reporting requirements. In line with their powers under the Prospectus Regulation, competent authorities have a range of enforcement powers, including suspension of a bond offer or admission to trading, and to make public the fact of an issuer's default.

Notes

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1. Regulation (EU) 2023/2631.
2. Regulation (EU) 2021/2178.
3. Delegated Regulation (EU) 2021/2139, Delegated Regulation (EU) 2021/2178, Delegated Regulation (EU) 2022/1214, and Delegated Regulation (EU) 2023/2486.