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Updated analysis of the proposals for the EuGB Regulation

Trilogue discussions are beginning between the co-legislators to determine a final text for the Regulation on European green bonds. We strongly support the progress towards a consensus on a voluntary standard, as well as potentially on grandfathering of Technical Screening Criteria of the Taxonomy for the EuGB label.

However, we have real concerns for the success of the EuGB label if proposals for fundamental changes to its legal requirements are taken forward, as they will likely prove impractical and will significantly increase legal liability for issuers. We reiterate our view that the absence of a comprehensive solution to Taxonomy usability issues will considerably limit the potential alignment of green projects. This will also narrow the scope of the future EU GBS. Additionally, we identify unintended barriers for CapEx plan financing.

Our analysis of the European Parliament's proposals to expand the scope of the Regulation to introduce mandatory requirements for all sustainable bonds, finds them to be largely superfluous as well as raising real implementation challenges. They essentially duplicate entity-level requirements that are or will be covered by other EU sustainable finance legislation, such as the Taxonomy Regulation and the future CSRD. Such duplication will also unintentionally diminish the appeal of the European sustainable bond market considerably, by adding unnecessary complexity and costs.

Finally, we have shared this paper with the [Climate Bonds Initiative](#), which has confirmed its support for our analysis and recommendations.

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Background

As of June 2022, the negotiating positions of the Council (see [here](#)) and of the European Parliament (EP) (see [here](#)) on a Regulation for European green bonds ("Regulation" or "EuGB Regulation") creating an official European label (the "EU GBS"), have been finalised. This paper provides an update to inform the discussions around the co-legislative process and identifies several key points for attention. As background, the European Commission published its [proposal](#) for the EuGB Regulation on 6 July 2021. ICMA published a [note](#) on 8 July 2021 on this proposal, followed by a further [commentary](#) on 5 January 2022 on the proposed [amendments](#) of the Rapporteur of the file in the EP.

In this note, we underline the significant progress on the key issues of the voluntary nature of the EuGB label and grandfathering of Taxonomy alignment. We also identify concerns about remaining issues that will likely hinder the success of the EU GBS, as well as the future development of the overall sustainable bond market, most notably in the EU. These include proposals that would:

- (i) increase potential liability and costs for EuGB issuers creating significant disincentives;
- (ii) provide an only partial solution to the usability challenges of the EU Taxonomy;

- (iii) create unintended barriers to financing Taxonomy aligned CapEx plans by the EuGB issuers; and,
- (iv) duplicate organisation level disclosure requirements for almost all issuers of sustainable bonds in the EU while also raising real implementation challenges.

Support for voluntary nature of the EU GBS and grandfathering

ICMA strongly supports the shared position of the EP and the Council to make the EU GBS a voluntary standard. This is in line with the Commission's original proposal and the recommendations of the EU's Technical Expert Group. It will establish an official European label that will co-exist with the existing international market standard, represented by the [Green Bond Principles](#) ("GBP") supported by ICMA.

There has also been progress towards grandfathering¹ of alignment with the Technical Screening Criteria ("TSC") in the Council text, and to a lesser degree in the EP version as the latter may raise interpretation issues. This is fundamental, especially as the TSC for transitional activities (approximately one quarter of the climate mitigation activities listed in the Climate Delegated Act of December 2021) will be reviewed at least every three years. We reiterate our support for full grandfathering of the EU GBS designation, and generally of Taxonomy aligned allocations and commitments once made.

Increased liability and costs for EuGB issuers creating significant disincentives

The EP text includes mandatory incorporation of an extended factsheet into prospectuses compliant with the EU Prospectus Regulation (2017/1129) for the EU GBS (Article 12(2)). The proposed amended content of factsheets in Annex I of the EP text is likely to be challenging for issuers to comply with, in particular, due to forward-looking and/or subjective statements and commitments (e.g. the bond's projected contribution to an increase in Taxonomy-aligned turnover or to a credible 2050 carbon neutrality pathway as well as annual intermediate steps under a CapEx plan). This will result in increased costs and liability risk for issuers and act as a significant disincentive to the use of the EU GBS within the scope of the EU Prospectus Regulation.

The EP text has also included a civil liability provision that may further disincentivise issuers (Art.12a). It mandates Member States to ensure that civil liability attaches to the issuer or its administrative, management or supervisory bodies for any damages incurred by investors because of infringement of use-of-proceeds ("UoPs") and Taxonomy alignment rules (Art.4 to 7). This will add considerable additional and contingent liabilities for all these parties, and will create real complexity for issuers who will need to analyse and understand their potential liability across the 27 EU Member States. ICMA recommends that Article 12a of the EP text is not taken forward in the final version of the Regulation.

The Council version includes a new Article 12(4) requiring a binding provision of compliance with the EU GBS in the terms of the bond, leading to an outcomes-based approach with real negative legal implications. Under Article 12(4) an outcome failure outside of the control of the issuer (relating to the future alignment of a project with the Taxonomy under a CapEx plan for instance) could become an event of default also triggering cross-defaults in an issuer's other debt securities and loans (and

¹ Grandfathering is a provision by which an old rule continues to apply to specific existing situations while a new rule will apply to all future cases.

so potentially triggering the issuer's insolvency). We believe that this would create a powerful deterrent for green bond issuers to adopt the EU GBS. We therefore recommend the removal of the Council's proposed new Article 12(4).

The issue of increased liability and related costs could also go beyond the EU GBS, as factsheet and post-issuance disclosures under the annexes of the EuGB Regulation are referenced for the broader sustainable bond market, captured by the extended scope (see last section) under Art.7c.

Partial solution to the usability challenges of the EU Taxonomy

The Council version incorporates up to a 20% flexibility pocket only available for (i) activities for which TSC do not exist at the time of issuance, and (ii) activities in the context of international climate finance support including those reported to UNFCCC and OECD DAC (ODA) (Art.6/1a). The EP text does not provide any TSC flexibility but proposes a "Taxonomy equivalency" for international situations only (Art.7e).

We believe both proposals only offer a partial solution to the considerable usability challenges of the Taxonomy. We identify in our publication "[Ensuring the usability of the EU Taxonomy](#)" (February 2022) key usability issues of which: (i) the requirement for highly granular data for technical Screening Criteria, (ii) the reliance on EU legislation and criteria in an international market, and (iii) inconsistency in the use of estimates and third-party data. We make three key recommendations designed to address usability concerns for both product alignment and sustainable reporting, and two that are more specific to assessing the Taxonomy alignment of green and sustainability bonds. The recommendations are:

- 1) Allow flexibility on alignment with the DNSH and Minimum Safeguards in all cases.
- 2) Enable TSC adaptation to non-EU jurisdictions to facilitate international usability.
- 3) Allow estimates and third-party data based on a common methodology to assess Taxonomy-alignment.
- 4) Simplify NACE classification for complex green and sustainability projects.
- 5) Grandfather the Taxonomy alignment of the legacy green bond market for Green Asset Ratio/ Green Investment Ratio and the SFDR disclosures.

Unintended barriers to financing Taxonomy aligned CapEx plans under the EU GBS

The EP text contains several unintended barriers to EU GBS financing of CapEx plans that use the Taxonomy as a forward-looking target. The mechanism of CapEx plans can be especially relevant for issuers wishing to fund their climate transition expenditures in a forward-looking manner. However, rules on CapEx plans are being made more onerous compared with the provisions of the [Article 8 Delegated Regulation](#). These additional proposed requirements of the EuGB Regulation are:

- A CapEx plan should be capped to 2-years in case of a transitional activity (Art. 6(1)), a restriction that does not exist under the Article 8 Delegated Regulation. Arguably, there should be more rather than less time available for the CapEx plan of a carbon-intensive issuer. The rationale of the CapEx plan mechanism was to incentivise the use of the EU GBS to finance transition, which we welcomed in our July 2021 note.

- Mandatory disclosure of annual intermediate steps is prescribed under the EuGB Regulation (Annex I - 4.3)) while such a requirement does not exist under Art.8 Delegated Regulation beyond expected costs for the relevant reporting period².
- CapEx plans financed under the EU GBS are made subject to an annual external review in allocation reports which is not generally required for its other use of proceeds (including when financing CapEx) (Art. 6-2a). We note that the same CapEx plan may already be subject to annual external assurance as per the upcoming CSRD.

Duplicative extension of disclosure requirements to all issuers of sustainable bonds raising real implementation challenges

The EP’s final position imposes a variety of obligations to all issuers of green bonds as well as Sustainability-Linked Bonds (“SLBs”) with environmental focus. As a result, the EuGB Regulation ceases to only be a “product-focused” legislation and overlaps with existing or planned “entity level” sustainable legislation, such as the [Taxonomy Regulation](#) and the future [Corporate Sustainability Reporting Directive](#) (“CSRD”).

This should be avoided as it risks significant duplication and potential confusion between product and entity level requirements. It will also disincentivise the issuance of sustainable bonds in the EU as issuers will probably not wish to expose their organisations to such duplication and complexity, especially when their funding requirements can be met by traditional financing instruments or by sustainable bonds offered outside the EU.

These issuer level requirements are mainly located under Art. 7b and Art.7c of the EP text and through cross-references made to the annexes of the EuGB Regulation. They include:

- For issuers of green bonds and SLBs, a website statement on due diligence policies with respect to principal adverse impacts (PAIs) the details of which will be determined by European Supervisory Agencies (ESAs).
- SLB and EuGB issuers in the EU will need to receive a positive audit opinion that confirms the alignment of their transition plans with the 2050 carbon neutrality target, before they can issue any SLB or EuGB.
- Also, for all the issuers above entity-level Taxonomy alignment information, as well as how a green bond or SLB is intended to contribute to the issuer’s Taxonomy aligned turnover, CapEx and OpEx.

In this respect, we note that:

- Detailed transition plans and PAI disclosures as well as related assurance requirements will very likely be required by CSRD and related standards.
- Detailed entity-level Taxonomy alignment disclosures are already required from NFRD/future CSRD entities under Art.8 of the Taxonomy Regulation and the related Delegated Regulation.

² In this respect, we also note that discrepancy may arise as a result of reporting periods under Article 8 and the EuGB issuance not matching.

From an implementation perspective, the requirements under the extended scope described above create several challenges and conundrums, notably:

- Sovereigns, supranationals and agencies cannot disclose their entity-level Taxonomy alignment due to the current lack of a methodology while for financial institutions, [Article 8 Delegated Regulation](#) foresees a different metric.
- Similarly, non-EU issuers are not subject to Article 8 disclosures, but they would be required to make such disclosures when their green bonds are “*marketed in the Union*” to investors. It is not feasible for non-EU issuers to disclose their entity-level Taxonomy alignment (or even of their bond) in many cases as the TSC of the Taxonomy (especially the DNSH) has an international usability problem due to its heavy reliance on EU legislation and criteria (see our paper “[Ensuring the usability of the EU Taxonomy](#)”).
- As mentioned above, a transition plan and a positive “audit” opinion confirming its alignment with the 2050 carbon neutrality target become a pre-condition to SLB and EuGB issuance (Art.7b). The nature of an “audit” process may however not fulfil the substantive analysis required to determine the alignment of a transition plan with 2050 climate neutrality. This kind of analysis could rather be provided by specialised consultancies with relevant qualifications, although further clarity on transition plan content and requirements is also very likely needed by these parties to perform such a role.
- The practical and liability aspects of requiring all green bonds to disclose at pre-issuance “*a clear and reasoned explanation of how the bond takes into account of principal adverse impacts on sustainability factors*”, will need to be assessed and may create considerable difficulties.
- The external review requirement on the proposed “pre-contractual disclosures” (Articles 7b and 7c of the EP text) will pose practical and timing challenges for green UoP bonds and SLBs issued under programmes, which happen very quickly (typically 5 days or less).
- It may not be possible for green UoPs bond issuers to disclose the expected percentage of Taxonomy alignment of proceeds where they will finance future projects that remain unidentified at the time of the issuance (as opposed to refinancing of existing projects for example).