Overview

The *European green bond standard* (EUGBS) is the first standard in the world which offers a range of environmentally sustainable bonds that are made available to investors globally. Green bonds are a type of fixed-income instrument, issued by various public, private, or multilateral entities. They are specifically earmarked to finance projects related to a more sustainable economy, and those that generate identifiable climate, environmental or other sustainable benefits.

EUGBS is a voluntary gold standard for *Green, Social, and Sustainability* (GSS) bond issuers, aiming to combat greenwashing and enhance the transparency, investor protection and credibility of green bonds across the EU. The standard will be available to issuers in Dec. 2024, and it will use the EU taxonomy to define green economic activities, and green safeguard requirements for issuers. It also creates an EU-level registration and supervision system for the various companies carrying out pre- and post-issuance reviews of issuers' disclosures. ESMA will be the supervisory authority of all such reviewers. The national competent authorities of the EU member states will be responsible for supervision and enforcement regarding the issuers' compliance with their EUGBS obligations.

Background

The European green bond market previously relied on private market self-regulation through the *ICMA Green Bond Principles* (see #217068). However, the lack of obligatory prescriptive standards for issuers was criticized as a cause of concern for transparency and, thus, for effective investor protection.

The concept of EUGBS was first announced by the European Commission (EC), on Jan. 14, 2020, as part of the *European Green Deal Investment Plan* (see #70257). The first substantiated EC proposal occurred on Jul. 6, 2021, which set out the requirements for the EU to become a leader in sustainable finance, protect investors and fight greenwashing through the *European Green Bond* (EuGB) label. In Apr. 2022, the European Council (EU CNCL) published its initial negotiating position, followed by a report of the European Parliament's (EP) Committee for Economic and Monetary Affairs (ECON Committee) in May 2022. Both texts included changes to the EC's initial proposal. EU CNCL, EP, EC negotiators reached a provisional agreement on sustainable standards for the creation of EUGBs on Feb. 28, 2023, and on May 10, 2023, a draft compromise was agreed by the EU CNCL's permanent representatives' committee.

On Nov. 30, 2023, *Regulation (EU) 2023/2631 of the European Parliament and of the Council on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds* (European Green Bond Regulation) was published on the Official Journal of the European Union.

Effective Date

The *European Green Bond Regulation* came into force 20 days from the date of its official publication, on Dec. 21, 2023, and will begin to apply 12 months later, on Dec. 21, 2024. By the time of its application, the companies in scope will have, already, collected non-financial information to meet the requirements of the *Corporate Sustainability Reporting Directive (CSRD)* 2022/2464 (see #153128), in line with the EU *Taxonomy Regulation* 2020/852 (see #75887) for the year starting Jan. 2024, to be published in 2025, which could provide help with EuGB issuance.

Reg-Track Rule #164644 EU CNCL Green Bond Regulation	**Reg 2023/2631**

Voluntary Designation

The regulation introduces the European Green Bond (EuGB) voluntary designation or label, providing issuers with a distinctive mark for bonds committed to the green use of proceeds. Some degree of flexibility is granted to the respective issuer, allowing for the deduction of specific issuance costs from the proceeds. Since the EuGB is a voluntary standard, issuers in the EU can continue to issue green bonds under other standards, if they wish to, such as the *ICMA Green Bond Principles* and without complying with EuGB requirements. Those standards will co-exist in the green bond market (see #227810).

Allocation of Proceeds

Issuers must allocate at least 85% of the net proceeds, i.e. gross proceeds minus issuance costs, from bonds designated as EuGB directly, by paying for assets or expenditures, or indirectly, through financial assets, e.g. loans, financing of environmentally-sustainable activities within the meaning of the Taxonomy Regulation, prior to maturity of the bond.

The EuGB proceeds must be allocated towards one or more of the following: fixed tangible or intangible assets that are not financial assets; capital expenditure (Capex); operating expenditure incurred no more than three years before the issuance of the EuGB (Opex); financial assets created no later than five years after the issuance of the EuGB); assets and expenditures of households. They would have to relate to economic activities that meet the taxonomy requirements, i.e. the so-called 'gradual approach'. However, the allocation of the proceeds to a portfolio of fixed assets or financial assets is also permissible, i.e. the so-called 'portfolio approach', which is the approach currently taken by the majority of green bond issuers in the market.

The European Taxonomy framework is used by other European directives and regulations as a means to identify activities that qualify as *environmentally sustainable*. Therefore, under the taxonomy, an economic activity is environmentally sustainable if it contributes substantially towards an enumerated environmental objective, it does not *significantly harm* any of the other environmental objectives, it is carried out in compliance with minimum social safeguards, and complies with certain technical screening criteria (TSC) (see #103501).

Limited Flexibility in Proceeds' Use

The European Green Bond Regulation allows some limited flexibility regarding the use of the proceeds in the following cases: the flexibility pocket, the Capex plan, and the limited grandfathering.

The flexibility pocket allows up to 15% of the net proceeds of an EuGB to be earmarked towards non-taxonomy aligned activities, i.e. economic activities that comply with all requirements of the taxonomy other than the TSC, if no TSC are in place for the relevant environmental objective, or if the proceeds are being allocated towards activities in the context of certain international support in accordance with certain internationally agreed guidelines. In the second case, issuers shall comply with the TSC on a *best effort* basis.

If the proceeds are allocated towards Capex and Opex that meet the taxonomy requirements, issuers must publish a Capex plan according to Annex I to the EC Delegated Regulation 2021/2178 (see #110490). The Capex plan will have to specify a timeline by which all Capex and Opex shall be taxonomy-aligned before the EuGB reaches maturity. Issuers shall obtain an external review regarding the taxonomy-alignment of the Capex plan and include a summary of the Capex plan in the prospectus. If allocated proceeds subject to a Capex plan risk not being aligned with the amended TSC, an *alignment* plan is required which must be reviewed externally and published on the issuer's website.

Regarding limited grandfathering cases, the EuGB proceeds must be allocated in accordance with the relevant TSC applicable on the issue date of the EuGB. However, if the TSC changes during the lifetime of the bond, proceeds allocated pursuant to a Capex plan and any unallocated proceeds must be (re-) allocated in alignment with the respective amended TSC within seven years after their entry into application.

Disclosure and Transparency

Issuers of European green bonds must comply with rigorous transparency standards, both before issuance (see #219123) and after issuance (see #205377). Those standards include the publication of a factsheet before the issuance of an EuGB. Also, they include the submission of allocation reports and environmental impact reports after the proceeds have been allocated.

The European green bond factsheet is subject to pre-issuance review by an external reviewer and must include certain elements. This is how the EuGB is expected to contribute to the broader environmental strategy of the issuer, including the environmental objectives under the taxonomy. If the issuer is subject to art 8 of the taxonomy, a description must be included of how, and to what extent, bond proceeds are expected to contribute to the issuer's taxonomy-aligned assets, turnover, Capex, and Opex. The factsheet must also describe how the proceeds are intended to contribute to the transition plan of the issuer, if such a plan is available at the time of issuance; the intended allocation of bond proceeds to EU taxonomy-aligned economic activities and information on reporting. The European Green Bond Regulation provides an annexed factsheet template.

Post issuance, issuers must publish annual allocation reports until full allocation and must obtain a post-issuance external review after full allocation. After full allocation, and at least once during the lifetime of the bond, issuers must publish an impact report. The European Green Bond Regulation provides annexed templates for both the annual allocation and the impact report.

The European Green Bond Regulation includes an optional disclosure regime, the so-called 'EuGB Lite regime'. It concerns green bonds that do not meet the 85%-taxonomy alignment requirement for use of proceeds, but are marketed as environmentally sustainable bonds (ESBs) and sustainability-linked bonds (SLBs) with pre-defined, by the issuer, environmental-sustainability objectives. This could also include green bonds and SLBs issued pursuant to the ICMA Principles. Their issuers can voluntarily opt in to publish certain pre- and post-issuance information in line with the European Green Bond Regulation. For ESBs, the issuer provides investors with a commitment or any form of pre-contractual claim that the bond proceeds are allocated to economic activities that contribute to an environmental objective. If issuers choose the voluntary disclosure, they will come under the supervision of the national competent authorities but they will not be able to have the EuGB label.

The EC has planned to issue guidelines for the pre-issuance disclosure, within one year after the entry into force of the regulation. A delegated act will be issued for the post-issuance disclosure to clarify its content and methodology. Five years after entry into force, and every three years thereafter, the EC shall submit a report on the application of the regulation, including a legislative proposal on disclosure requirements for other green bonds and SLBs. Within three years of the regulation's entry into force, the EC shall publish a report and a proposal regarding the need to regulate SLBs.

Securitization Bonds

Securitization bonds designated as EuGB are subject to strict additional disclosure requirements. Due to the limited existing stock of taxonomy-aligned securitized assets, the regulation's proceeds' allocation requirement will be applied to the originator of the securitized assets, in relation to the proceeds obtained by the originator from selling the securitized exposures to the issuer, instead of the issuer directly.

Certain securitizations are out-of-scope, e.g. synthetic securitizations, and securitizations with certain types of underlying exposures, e.g. those financing certain fossil fuel-related activities. The European supervisors in the banking, securities market and insurance sectors will be required to publish a report on the evolution of green securitization five years from when the regulation enters into force. This report will consider if the volume of taxonomy-aligned assets has increased sufficiently in order to allow the proceeds' allocation requirement to be shifted to the securitization issuer.

External Reviewers

The European Green Bond Regulation introduces, for the first time, a mandatory registration and supervision regime for independent external reviewers. Following an initial 18-month transition period, companies that wish to act as external reviewers for EuGB will need to be registered with the European Securities and Markets Authority (ESMA) which is their supervisory authority. EC confirmed draft delegated regulation is in preparation (see #227042) on fees to be paid by external reviewers for their supervision by ESMA under the European Green Bond Regulation, including different fee types, amounts and payment methods. The regulation contains detailed requirements that external reviewers need to comply with before they can be registered. This includes a demonstration from the applicants that they have sufficient experience and skill to act as external reviewers and that they have adequate corporate governance arrangements in place to deal with conflicts of interest.

External reviewers will play an important role in maintaining the integrity of the EUGBS by ensuring that the investors receive reliable information, as they review the compliance of the factsheet and of the annual allocation report with the requirements of the regulation, including alignment with the TSC. The annual allocation reports will be assessed in terms of compliance with the proceeds' allocation requirements. The reviewers also assess the taxonomy-alignment of Capex and Opex as set out in the Capex plan, in terms of taxonomy-alignment of expenditures funded by the proceeds, if applicable.

The impact report on the environmental impact of the proceeds' allocation may be reviewed by external reviewers. They will assess whether the issuance of the EuGB is in line with the broader environmental strategy and rationale of the issuer and of the indicated environmental impact of the proceeds. Although the external review of the impact report is optional, it may serve as a useful tool to mitigate against risks of greenwashing.

Prospectus

Issuers who wish to issue an EuGB must publish a prospectus that complies with the EU Prospectus Regulation 2017/1129 (see #27887), unless they are exempt from the requirement to issue a prospectus, such as EU sovereign or quasi-sovereign issuers. This means, in practice, that an EuGB will need to be listed on a regulated market and issuers that have in the past listed their green bonds on non-regulated markets would need to bring their disclosure back in line with the stricter disclosure regime under the EU Prospectus Regulation. It is worth mentioning that the proposed EU Listing Act (see #176061) is expected to require the inclusion of specific ESG-related information in a prospectus for green, social or sustainability-labeled bonds in the form of a new disclosure annex.

Under the European Green Bond Regulation, the prospectus must state that the bonds are designated as EuGB throughout the prospectus, and that the EuGBs are issued in accordance with the European Green Bond Regulation. If the issuer is required to publish a Capex plan, the prospectus must also include its summary. Under applicable securities law, a prospectus is required if the securities are being offered to the public, i.e. 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.

For reasons of transparency, in addition to the prospectus, issuers need to publish certain information on their websites. For example, the pre-issuance factsheet, the annual allocation report, and the impact report. As previously mentioned, the factsheet, allocation report, and the Capex plan if applicable, will need to be accompanied by a review from an independent external reviewer. The external review of the impact report is encouraged but not imposed. All the required reports as well as the external reviews need to follow standardized templates, which are set out in annexes to the regulation.

Sovereign issuers (see #219295) are not only exempt from having to produce a prospectus, but they are also exempt from having to use external reviewers and can opt to use their own auditors. Sovereign EuGB issuers also have some flexibility on the use of proceeds, such as financing public assets or expenditures that meet or are expected to meet the Taxonomy Regulation requirements, including tax relief, subsidies or international support activities.

Supervision

EuGB issuers will be supervised by the national competent authority (NCA) that approves the prospectus under the EU Prospectus Regulation and that will be responsible for overseeing the issuers' compliance with the European Green Bond Regulation in the relevant member state. However, NCAs will not be responsible for checking whether the information published by issuers in the factsheets and reports is truthful. Nor whether an EuGB actually adheres to the criteria of the Taxonomy Regulation or whether the bond proceeds are used properly. Issuers of relevant government bonds are not subject to supervision by NCAs.

Under the EU Regulation, NCAs have a range of powers to ensure compliance, including the power to suspend approval of a prospectus, withdraw the EuGB label or prohibit an issuer from issuing EuGBs for up to a year. They 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 or even prohibit an offer or admission to trading if there are reasonable grounds to believe that the issuer continues to fail to comply. They can also issue financial penalties of up to 0.5% of an issuer's turnover and EU member states have the legal discretion to choose to impose criminal penalties for non-compliance. NCAs can publicly disclose an issuer's non-compliance and request that the issuer publishes the same on its website. Also, disclosure of a decision imposing an administrative penalty or other measure shall be published by NCAs on their official websites immediately after the subject entity is informed of that decision.

Main Challenges for Issuers

One of the challenges issuers may face is the usability of the data collected under the taxonomy requirements. Most issuers have gaps between their existing internal data collection and the data requirements under the Taxonomy Regulation and the European Green Bond Regulation. Therefore, companies might struggle to obtain reliable data to prove alignment with the taxonomy, especially those looking to fund projects outside the EU. Sustainability-related reporting and a general lack of data causes difficulties in the assessment of technical screening criteria. Also, there are companies that operate in sectors that are not yet covered by the taxonomy and making use of the flexibility pocket of 15% might not be sufficient for some of them.

Costs and timing in the short term will also need to be factored in as the new external reviewer regime beds down. Obtaining external reviews for pre- and post-issuance reports will most probably be considerably more expensive than getting a second-party opinion under the ICMA Principles. This is because the registration regime for external reviewers is stringent and it is, at the time, unclear how many registered service providers will be available in the market. The reviewers' involvement especially over proceeds' allocation and compliance with the TSC and the *do no significant harm* requirements, include significant technical analysis, which will make the EuGB preparation to become a lengthier process than issuing green bonds under other standards.

Due to the legal and regulatory framework, EuGBs are now regulated products. This allows investors to lodge complaints against issuers who may be exposed to relevant litigation risks. Also, because of the wide-ranging powers of NCAs to impose administrative measures and penalties and publish those decisions, issuers may face reputational risks.

The EuGB aspires to set a global standard, which leads to the question of whether EU issuers can utilize that standard for issuing green bonds outside the EU for non-EU investors. Furthermore, while all non-EU issuers offering green bonds in the EU may take advantage of the European Green Bond Regulation opportunities, the oversight of such non-EU issuers remains unclear. Non-EU issuers will be subject to oversight by their respective non-EU national authorities. This could, potentially, create discrepancies in regulatory frameworks and supervisory mechanisms between EU and non-EU regions.

EU Member States

Many EU member states have already taken measures to adapt their current legal and regulatory framework to the requirements of the European Green Bond Regulation.

- Germany has submitted to the parliamentary process a draft law to adapt its legislation and appoint GE BaFin as the competent authority on EuGBs (see #214766).
- Sweden submitted a proposal to Parliament to align its laws with the EuGB and appoint SWE FI as the supervisory authority (see #196077). The later, is in the process of amending its regulations on marketplace activities to align them with EuGB requirements (see #224882).
- Denmark issued a draft proposal for a law amending various financial laws and appointed DEN FSA as the competent authority for EuGBs (see #215419).
- Finland, also issued a bill to align its laws with the EuGB requirements and appointed FINFSA as the supervisory authority (see #223623).
- Hungary has already published a law to harmonize various laws with EU developments, including the EuGB requirements (see #209200).
- Lithuania follows the parliamentary procedure with a bill amending its Securities Law to consolidate the EuGB (see #218324).
- Luxembourg is also following the parliamentary procedure with a bill to implement EU rules on crypto-assets and green bonds (see #212912).
- Romania is amending ROM ASF regulation regarding issuers of financial instruments and market operations to incorporate its competence and requirements for EuGBs (see #224927).
- The Netherlands has issued a bill to implement EuGB requirements and appoint NLD AFM as the supervisory authority (see #226887).