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EU Council Adopts New European Green Bond Standard

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By Sukhvir Basran
Partner | Financial Services

On October 25, 2023, the European Council adopted the **European Green Bond Standard (EU GBS)**, a new voluntary regime for green bonds that aims to solidify the EU's position as a leader in sustainable finance, reduce greenwashing, and enhance investor protections. The EU GBS is intended to be the "gold standard" for green bonds and requires that all bond proceeds be allocated in alignment with the EU Taxonomy for sustainable activities. Issuers from both within and outside the EU can issue and market their bonds as “European green bonds” (EuGBs) if they adhere to the requirements of the EU GBS.

The EU GBS was first proposed by the European Commission on July 6, 2021, setting out requirements for environmentally sustainable bonds marketed in the European Union as EuGBs, and has been the subject of extensive negotiations between the European Commission, the European Parliament, and the European Council. In February 2023, the legislators reached a **“provisional agreement on European green bonds”** and on May 10, 2023, a draft overall compromise was agreed to by the Council’s permanent representatives’ committee.

The Regulation

The key aspects of the regulation are as follows:

- **Use of proceeds:** At least 85% of the net proceeds raised by an EuGB must be invested in environmentally sustainable activities aligned with the EU Taxonomy Framework. The EU GBS allows for a “flexibility pocket,” permitting up to 15% of the net proceeds to be allocated to activities for which there are no technical screening criteria in force at the date of issuance, provided the activities comply with the generic criteria for ‘Do No Significant Harm,’ as set out in Delegated Regulation (EU) 2021/2139, and/or activities in the context of international support, provided those activities comply with the appropriate technical screening criteria on a best effort basis.

- **Transparency:** Issuers of EuGBs will be subject to specific and standardized disclosure requirements to ensure full transparency on the allocation of proceeds and the environmental impact of the EuGB. This will enable potential investors to evaluate and compare EuGBs.
- **External Reviewers:** EuGBs must be reviewed by external reviewers (registered with and supervised by the European Securities Market Authority) for compliance with the EuGB standard.
- **Required Documentation:** Issuers of EuGBs must publish a prospectus that complies with the EU Prospectus Regulation (the "EU PR"), unless they are exempt from the requirement to issue a prospectus, such as EU sovereign or quasi-sovereign issuers. Essentially, this means that EuGBs will need to be listed on a regulated market. The prospectus must explicitly state that the bonds are designated as "European Green bonds" or "EuGB" and that they are issued in accordance with the EU GBS. Where the use of proceeds relates to capital expenditure and operating expenditures that meet the EU Taxonomy requirements, the issuer is required to publish a "CapEx plan" in accordance with Commission Delegated Regulation (EU) 2021/2178, and a summary of the issuer's CapEx Plan must also be included in the prospectus.
- **Factsheet:** Issuers of EU GBS bonds must prepare a "green bond factsheet," which must be reviewed pre-issuance by an external reviewer. The EU GBS sets out a prescribed template for the factsheet and content requirements, which will be considered "regulated information" for the purposes of the EU PR and may be incorporated by reference in the bond prospectus.
- **Sanctions:** Issuers of EU GBS bonds will need to have their prospectus approved by a national competent authority (NCA) in the relevant Member State and the NCAs will be responsible for supervising an issuer's compliance with the EuGB standard. Pursuant to the regulation, the relevant NCA has an array 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. In addition, the regulation includes the power to issue monetary fines of up to 0.5% of an issuer's turnover, and EU member states may choose to impose criminal sanctions for non-compliance.

Next Steps

The regulation will enter into force 20 days from the date of publication in the Official Journal of the European Union and will start applying 12 months after its entry into force.

Taking the Temperature: The EU GBS is an ambitious standard, surpassing existing guidelines and labels in the green bond market. It is expected to be initially utilized by EU institutions and "pure play" issuers, but broader adoption hinges on the usability of the EU Taxonomy. Challenges related to assessing criteria like Do No Significant Harm and Minimum Safeguards, data availability, and reliance on EU legislation raise concerns about the flexibility provided for issuers.

The EuGB label's relevance may primarily extend to EU issuers reporting in line with the Corporate Sustainability Reporting Directive, while non-EU issuers might be more inclined towards voluntary disclosures aligned with wider sustainable finance market

standards. It is becoming increasingly common for such standards to be designed to be cohesive with one another, and this latest development will help towards closing any gaps. The success of the EU GBS depends on factors such as investor demand, pricing advantages, and incentives for issuers to shift from existing market practices.

The stricter penalties associated with the EU GBS will undoubtedly influence issuers, which are becoming increasingly aware of the reputational and legal risks involved in issuing EuGBs, including based on disclosures in the ESG bond prospectuses. While the EU GBS is the first formal effort to regulate the green bond market, the growing emphasis on accountability and transparency likely will lead other regulators to follow suit. The UK's Financial Conduct Authority has stated that it will examine various approaches to ESG disclosure in prospectuses as part of UK prospectus reforms. It remains to be seen how this evolving regulatory landscape, along with shifting investor expectations, will impact the global sustainable bond market, and whether the EU GBS will eventually encourage issuers to adopt more ambitious strategies when seeking funding for their green projects.