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European Mortgage Federation – European Covered Bond Council (EMF-ECBC)

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Response to Targeted Consultation

ESTABLISHMENT OF AN EU GREEN BOND STANDARD

INTRODUCTION

In March 2018, the European Commission published its Action Plan on Financing Sustainable Growth with the goal of embedding sustainability considerations at the heart of the financial sector. Specifically, it aims to:

(1) reorient capital flows towards sustainable investment to achieve more sustainable and inclusive growth;

(2) manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and

(3) foster greater transparency and long-termism in financial and economic activity.

As part of the Action Plan, the Commission committed to developing standards and labels for green financial products and instruments, including an EU Green Bond Standard (EU GBS).

As a first step, the Commission's Technical Expert Group on sustainable finance (TEG) was tasked with preparing a report on an EU GBS.

The TEG published its first report in June 2019 with 10 recommendations for the establishment of an EU GBS based on current best market practices and feedback received from stakeholders. The TEG also recommended the creation of an official voluntary EU GBS building on the new EU Taxonomy, which provides a classification system for sustainable economic activities. The TEG provided further usability guidance in March 2020, which includes an updated proposed standard (see the annexes).

The Commission is now considering how to take the recommendations of the TEG forward, including in a possible legislative manner. This consultation is designed to gather further input of a technical nature from relevant stakeholders in the green bond market, in particular issuers, investors and related service providers.

The questions assume that the reader has read the reports by the TEG on the EU GBS and is familiar with the proposed content of the EU GBS, including its link to the EU

Taxonomy. If this is not the case, the report on the EU GBS, the TEG usability guide on the EU GBS and the final report on the EU Taxonomy should be read first. A brief summary of the EU GBS as proposed by the TEG is provided at the beginning of the consultation.

The European Green Deal

This consultation builds upon the European Green Deal, which significantly increases the EU's climate action and environmental policy ambitions. To complement the Green Deal, the Commission also presented the European Green Deal Investment Plan, which seeks to mobilise at least €1 trillion in sustainable investments over the next decade. As part of the Green Deal and its investment plan, the Commission reaffirmed its commitment to establish an EU GBS. The Commission also committed to developing a renewed sustainable finance strategy, which is the subject of a separate public consultation currently open for submissions until 15 July 2020. That consultation contains several questions on green bonds and respondents are requested to also participate in it.

COVID19 & Social Bonds

Social bonds have emerged as a key instrument for mobilising private capital for social objectives. Social bonds are similar to green bonds, except that the proceeds are used exclusively for social causes, instead of energy transition and environmental goals.

The ongoing COVID-19 outbreak shows the critical need to strengthen the sustainability and resilience of our societies and the importance of integrating social issues and objectives into the broader functioning of our economies. Financial markets have so far responded to the challenge with increased issuance of social bonds responding to the impact of COVID19.

These social bonds often follow established market-based Social Bond Principles. The Commission is seeking the input of stakeholders on the lessons learned from this new development, including whether the Commission can play an even greater supportive role in building resilience to address future potential crises.

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Consultation questions

Your role on the green bond market

What type of organisation are you, in relation to the green bond market?

a. Issuer
b. Investor
c. Verifier / external reviewer / 3rd party opinion provider
d. Intermediary
e. Market-infrastructure
f. NGO
g. Public Authority
h. Trade or Industry Association
i. Other (if so, please specify) [BOX]

I. Questions on the EU Green Bond Standard

About the TEG proposed EU GBS

The EU GBS aims to address several barriers identified in the current market. Firstly, by reducing uncertainty about what constitutes green investment by linking it to the EU taxonomy. Secondly, by standardising costly and complex verification and reporting processes, and thirdly, by establishing an official standard to which potential incentives could be linked.

The EU GBS as proposed by the TEG is intended to finance both physical and financial assets and includes the use of the latter as security (i.e. as a covered bonds or asset-backed securities).

The key components of such a standard – as recommended by the TEG and building on best market practices such as the Green Bond Principles and the Climate Bonds Initiative labelling scheme – should be:

(1) alignment of the use of the proceeds from the bond with the EU Taxonomy;

(2) the publication of a Green Bond Framework;

(3) mandatory reporting on the use of proceeds (allocation reports) and on environmental impact (impact report); and

(4) verification of compliance with the Green Bond Framework and the final allocation report by an external registered/authorised verifier.

Questions on the potential need for an official / formalised EU GBS

1) In your view, which of the problems mentioned below is negatively affecting the EU green bond market today? How important are they? Please select and rate the extent of the impact on a scale of 1 to 5 (1 no impact, 5 very strong impact). Multiple answers are possible.

   a. Absence of economic benefits associated with the issuance of green bonds

[1] [2] [3] [4] [5]

b. Lack of available green projects and assets

[1] [2] [3] [4] [5]

c. Uncertainty regarding green definitions

[1] [2] [3] [4] [5]

d. Complexity of the external review procedure(s)

[1] [2] [3] [4] [5]

e. Cost of the external review procedure(s)

[1] [2] [3] [4] [5]

f. Costly and burdensome reporting processes

[1] [2] [3] [4] [5]

g. Uncertainty with regards to the eligibility of certain types of assets (physical and financial) and expenditure (capital and operating expenditure)

[1] [2] [3] [4] [5]

h. Lack of clarity concerning the practice for the tracking of proceeds

[1] [2] [3] [4] [5]

i. Lack of transparency and comparability in the market for green bonds

[1] [2] [3] [4] [5]

j. Doubts about the green quality of green bonds and risk of green washing

[1] [2] [3] [4] [5]

k. Other (if so, please specify)

We believe that other factors that negatively impact the market today are: the complexity and comparability of investors' ESG processes including analyzing the external reviews (of different green bonds issuances and issuers), data availability, the lack of CO2 benchmarks for each country for Real Estate and, finally, the availability and comparability of EPV. Finally, we would like to highlight that we consider the uncertainty regarding the lack of green definitions of utmost importance. There needs to be a common definition of which assets that qualifies for issuing green bonds as this would create less uncertainty for investors and support the green transition. Furthermore, we consider crucial to avoid introducing additional naming to the Green bond industry (v. gr. light, dark, kaki), the green bond needs to be fully standardized but without the introduction of new terms that could lead to misunderstandings.

2) To what extent do you agree that an EU GBS as proposed by the TEG would address the problems and barriers mentioned above in question 1? Please indicate which specific barriers it would address on a scale of 1 to 5 (1 negative impact, 3 no impact, 5 positive impact). Multiple answers are possible.

a. Absence of economic benefits associated with the issuance of green bonds

[1] [2] [3] [4] [5]

b. Lack of available green projects and assets

[1] [2] [3] [4] [5]

c. Uncertainty regarding green definitions

[1] [2] [3] [4] [5]

d. Complexity of the external review procedure(s)

[1] [2] [3] [4] [5]

e. Cost of the external review procedure(s)

[1] [2] [3] [4] [5]

f. Costly and burdensome reporting processes

[1] [2] [3] [4] [5]

g. Uncertainty with regards to the type of assets (physical and financial) and expenditure (capital and operating expenditure)

[1] [2] [3] [4] [5]

h. Lack of clarity concerning the practice for the tracking of proceeds

[1] [2] [3] [4] [5]

i. Lack of transparency and comparability in the market for green bonds

[1] [2] [3] [4] [5]

j. Doubts about the green quality of green bonds and risk of green washing

[1] [2] [3] [4] [5]

k. Other (if so, please specify)

a.It depends on what financial incentives, if any, are implemented to increase the issuance/investments in green bonds as part of the EU sustainable finance strategy, we believe that there is a strong need for financial incentives as right now the benefit for the company issuing a green bond is too low if you compare to the cost associated with it, then this should be managed by governments to increase the issuance;

d. The EU GBS could also address the problems regarding complexity and comparability of investors' ESG processes including the analysis/use of external reviews of green bond issuances and/or issuers;

f. It depends on the extent to which, the issuer has already implemented market principles for green bonds (e.g. ICMA Green Bond Principles); and

j.We believe the Green Bond Standard will be the main market practice over time. However, the current criteria for particularly renovations of buildings but also the DNSH assessments do leave room for other formats of green bonds. This is true because today a renovated building today is considered green – not just the cost of the renovation – in contrast to the Taxonomy.

Overall, we consider that several aspects could have strong impact such as the lack of available data; the missing national benchmarks; or the missing harmonisation within taxonomy e.g. NZEB definition within member states (very ambitious to non-ambitious - leading to competitive distortion within members states).

Questions on the proposed content of the standard

3. To what extent do you agree with the proposed core components of the EU GBS as recommended by the TEG?

   Please express your views using the scale from 1-5 (1 strongly disagree, 3 neutral, 5 strongly agree). Multiple answers are possible.

a. Alignment of eligible green projects with the EU Taxonomy

[1] [2] [3] [4] [5]

b. Requirement to publish a Green Bond Framework before issuance

[1] [2] [3] [4] [5]

c. Requirement to publish an annual allocation report

[1] [2] [3] [4] [5]

d. Requirement to publish an environmental impact report at least once before final allocation

[1] [2] [3] [4] [5]

e. Requirement to have the (final) allocation report and the Green Bond framework verified

[1] [2] [3] [4] [5]

Please specify the reasons for your answer [BOX]

Criteria should be feasible (incl. DNSH). Final allocation can be completed on day of issuance. Then first impact report should be made one year thereafter. The requirement to publish an impact report before final allocation does not fit to a dynamic cover pool – clear SSA approach.

4. Do you agree with the proposed content of the (a) Green Bond Framework, (b) Green Bond allocation report, and (c) Green Bond impact report as recommended by the TEG?[1] Select which elements you agree with. Multiple answers are possible.

   a. I agree with the proposed content of the Green Bond Framework.
   b. I agree with the proposed content of the Green Bond Allocation Report.
   c. I agree with the proposed content of the Green Bond Impact Report.
   d. None
   e. Do not know

If you disagree with the proposed content for some or all of these documents by the TEG, please specify the reasons for your answer

Despite mostly being aligned with the proposed content of the Green Bond Allocation Report we would like to signal that some concerns still remain as the Green Bond Standard Reporting would be bond-based whilst the current market practice is portfolio-based. This could mean that some investors would prefer different green bonds issued by the same issuer based on the different use of proceeds.

5. Do you expect that the requirement to have the Green Bond Framework and the Final Allocation report verified (instead of alternatives such as a second-party opinion) will create a disproportionate market barrier for third party opinion providers that currently assess the alignment of EU green bonds with current market standards or other evaluation criteria?

   a. Yes

b. No
c. Do not know

If yes, please specify the reasons for your answer

As there is currently no requirements for second-party opinion providers when they review green bond issuances and/or issuers, then the introduction of requirements to have the final allocation report verified would create a market barrier for current second and third party opinion providers. However, a new requirement to have the final allocation report verified is welcomed, as it would ameliorate other important barriers for increased growth in the green bond market.

Questions on the use of proceeds and the link to the EU Taxonomy

The EU Taxonomy Regulation[2] specifies that the Union shall apply the EU Taxonomy when setting out the requirements for the marketing of corporate bonds that are categorised as environmentally sustainable. Given that the EU Green Bonds initiative will pursue, as its core objective, the aim of delineating the boundaries of what shall constitute an 'environmentally sustainable' bond, the Taxonomy will need to be applied to determine the eligibility of the proceeds of the bond issuance. However, there may be reasons to provide a degree of flexibility with regard to its application, or its application in specific cases.

Building on market practice, the proposed EU GBS by the TEG recommends a use-of-proceeds approach, where 100% of the proceeds of an EU Green Bond should be aligned with the EU Taxonomy (with some limited flexibility).

The below questions aim to gather stakeholder input on the application of the taxonomy in the context of EU Green Bonds.

6. Do you agree that 100% of the use of proceeds of green bonds should be used to finance or refinance physical or financial assets or green expenditures that are green as defined by the Taxonomy?

   a. Yes, with no flexibility
   b. Yes, but with some flexibility (i.e. <100% alignment)
   c. No
   d. Do not know

   Please specify the reasons for your answer. If you selected b., please indicate what thresholds you would suggest, and why.

   The Taxonomy introduces a new significant risk for issuers in terms of validating whether the requirements have been meet at all times by customers – both in terms of minimum safeguards, DNSH-criteria but also the technical criteria that all requires a very high level of expertise and control systems at the issuers. Also, for the renovation of building the taxonomy deviates from current market practices. That goes for renovations of buildings. Hence, some flexibility would make a great difference. This is also the case for commercial mortgages, which constitutes a major part of the mortgages funded by covered bonds in Europe. Most often, loans are not separated into specific business activities, but are granted to businesses as a whole. To exemplify this challenge, the agricultural sector can serve as a case. The sector is important, in terms of contributing to greenhouse gas reductions. The loans granted to farms are typically granted on "farm level" rather than on "activity level". As many farms produce a combination of perennial crops, non-perennial crops, livestock and contain dwellings, it could be challenging to obtain 100% alignment with the taxonomy as the taxonomy criteria suggested by the TEG are separated into specific activities. Hence, it would make sense to operate with a significance criterion to make sure the production on a farm as a whole could become eligible for EUs Green Bond Standard, if the major part of the activities fulfils the taxonomy criteria. If for example around 80% percent of a farm's turnover for example stems from animal production (the rest from crops) and the farmer applies all the management practices suggested by the TEG in EU Green Taxonomy for animal production, the productions on the farm as a whole should be considered eligible for EUs Green Bond Standard.

Thus, a threshold around 70 percent could be a solution. Also, the market develops quickly making it vital that the GBS leaves room for innovations by allowing some flexibility.

For covered bonds, The EU Green Bond Framework should be possible to apply on a cover pool level. Under The Green Bond Framework it should be possible to label the proportion of assets in the cover pool that are aligned with the EU Taxonomy. All covered bonds from this cover pool should get the same percentage of Taxonomy aligned assets. These covered bonds should still live up to the same requirements as 100% Taxonomy aligned covered bonds – i.e. verification, 2nd party opinion, allocation reporting, impact reporting, et cetera.

The TEG proposes that in cases where (1) the technical screening criteria have not yet been developed for a specific sector or a specific environmental objective or (2) where the developed technical screening criteria are considered not directly applicable due to the innovative nature, complexity, and/or the location of the green projects, the issuer should be allowed to rely on the fundamentals of the Taxonomy to verify the alignment of their green projects with the Taxonomy. This would mean that the verifier confirms that the green projects would nevertheless (i) substantially contribute to one of the six environmental objectives as set out in the Taxonomy Regulation, (ii) do no significant harm to any of these objectives, and (iii) meet the minimum safeguards of the Taxonomy Regulation.

7. Do you agree with this approach?

   a. Yes, both (1) and (2)
   b. Yes, but only for (1)
   c. Yes, but only for (2)
   d. No
   e. Do not know

Please specify the reasons for your answer. Do you see any other reasons to deviate from the technical screening criteria when devising the conditions that Green Bond eligible projects or assets need to meet? If so, please clearly specify the reason for your answer and, where applicable, the respective area or (taxonomy-defined) activity.

It should be possible to apply taxonomy to activities that are currently not covered by the EU taxonomy. Some green activities are currently not mentioned in the Taxonomy. We support the practice of the verifier confirming that projects contribute to environmental objectives.

8. As part of the alignment with the EU Taxonomy, issuers of EU Green Bonds would need to demonstrate that the investments funded by the bond meet the requirements on do-no-significant-harm (DNSH) and minimum safeguards. The TEG has provided guidance in both its Taxonomy Final Report and the EU GBS user guide on how issuers could show this alignment.
   Do you foresee any problems in the practical application of the DNSH and minimum safeguards for the purpose of issuing EU green bonds?

   a. Yes
   b. No
   c. Do not know

   Please specify the reasons for your answer

   Both minimum safeguards, DNSH-criteria but also the technical criteria for each asset class require a very high level of expertise and control systems at the issuers. Furthermore, the customers will need to document their practices on a much more sophisticated level and issuers will potentially have to make ex ante controls of the different projects. This will cause a need for very significant investments in manpower and IT and still the issuers will take on a new conduct risk. On top of that there are the enormous challenges that banks face to receive DNSH data for buildings/constructions. Some criteria are not realistic and doable for banks (e.g. water standards), as they can't be monitored by banks. These would have to be covered in building/construction regulations.

9. Research and Development (R&D) plays a crucial role in the transition to a more sustainable economy, and the proposed EU GBS by the TEG explicitly includes such expenditure as eligible use of proceeds. Do you think the EU GBS should provide further guidance on these types of activities, to either solve specific issues with green R&D or further boost investment in green R&D? If so, please identity the relevant issues or incentives.

   a. Yes, as there are specific issues related to R&D that should be clarified.
   b. Yes, the proposed EU GBS by the TEG should be changed to boost R&D.
   c. No, the proposed EU GBS by the TEG is sufficiently clear on this point.
   d. Do not know

   Please specify the reasons for your answer

Questions on grandfathering and new investments

10. Should specific changes be made to the TEG's proposed standard to ensure that green bonds lead to more new green investments?

    a. Yes
    b. No
    c. Do not know

    Please specify the reasons for your answer. If you are in favour of changes, please explain what changes should be made

    Changes are needed in several areas. First of all, there is a need for more flexibility than the current taxonomy allows on particularly renovations of buildings as described under 2i. Furthermore, changes are needed to solve the enormous challenges imposed by the requirements on DNSH data for buildings and constructions. Moreover, some criteria are not realistic and doable for banks (e.g. water standards), as they can't be monitored by banks. These should be covered in building/construction regulations. Finally, there is a lack of a transition period for existing bonds and underlying assets. Techn. Annex (pg. 373) set too ambitious goals as they will represent less than 15% of a market and reduce eligible assets. Constructions costs for RE are constantly rising due to higher requirements in taxonomy and increase cost of ownership and contradict the goal of affordable housing.

11. The EU Taxonomy technical screening criteria will be periodically reviewed. This may cause a change in the status of issued green bonds if the projects or assets that they finance are no longer eligible under the recalibrated taxonomy. In your opinion, should an EU Green Bond maintain its status for the entire term to maturity regardless of newly adapted taxonomy criteria?

    a. Yes, green at issuance should be green for the entire term to maturity of the bond.
    b. No, but there should be some grandfathering.
    c. No, there should be no grandfathering at all. If you no longer meet the updated criteria, the bond can no longer be considered green.
    d. Do not know

    Please specify the reasons for your answer

    The grandfathering is urgently needed for current green assets to reach the goal of long-termism in the banking industry. This grandfathering should be based on the loan granted to the borrower. As long as the asset at the time of origination of the loan was compliant with the EU Taxonomy, this loan should until maturity be possible to finance with green bonds. It would create uncertainty for borrowers, issuers and investors if the status of the existing loan could change as the Taxonomy changes. If grandfathering would not exist this could be problematic for the secondary markets, as bonds that used to be green would suffer and investors would have to sell those older assets due to the change on the classification, if they are no longer considered green.

    If you select b, what should the maximum amount of years for grandfathering?

    a. 3 years
    b. 5 years
    c. 10 years
    d. 20 years
    e. Different approach all together, please specify reasons for your answer [BOX]

Question on incentives

12. Stakeholders have noted that the issuance process for a green bond is often more costly than for a corresponding plain vanilla bond. Which elements of issuing green bonds do you believe lead to extra costs, if any? Please use the scale from 1 (no additional costs) to 5 (very high extra cost) – multiple answers possible:

    a. Verification

[1] [2] [3] [4] [5]

b. Reporting

[1] [2] [3] [4] [5]

c. More internal planning and preparation

[1] [2] [3] [4] [5]

d. Other

Please explain and specify the reasons for your answer. [BOX]

On top of the verification, reporting and internal planning and preparation elements, the changing required within the IT systems to implement all the above will lead to extra costs.

If possible, please provide the estimated percentage and monetary increase in costs from issuing using the EU GBS, or – ideally – the costs (or cost ranges) for issuing green bonds under the current market regimes and the estimated costs (or cost range) for issuing under the EU GBS. [BOX

In your view, how would the costs of an official standard as proposed by the TEG compare to existing market standards? Please rate on a scale of 1 to 5 (1 substantially smaller, 3 approximately the same, 5 substantially higher).

[1] [2] [3] [4] [5]

Please specify the reasons for your answer

The verification process in terms of aligning with the Taxonomy is the main driver of cost. This is a time-consuming and hence cost-intensive process that also requires changes in internal processes and new resource for larger internal analysis. On top of that if any additional verification requirement (as required by ESMA in the future) would be introduced push costs even further.

13. Do you believe that specific financial or alternative incentives are necessary to support the uptake of EU green bonds (green bonds following the EU GBS), and at which level should such incentives be applied (issuer and/or investor)? Please express your view on the potential impact by using the scale from 1 (not strong at all) to 5 (extremely strong) – multiple answers possible:

a. Public guarantee schemes provided at EU level, as e.g. InvestEU

[1] [2] [3] [4] [5]

b. Alleviations from prudential requirements

[1] [2] [3] [4] [5]

c. Other financial incentives or alternative incentives for investors

[1] [2] [3] [4] [5]

d. Other Incentives or alternative incentives for issuers?

[1] [2] [3] [4] [5]

e. None

Please specify the reasons for your answer, in particular if you have chosen "other incentives or alternative incentives"

Regarding 14c and 14d, the answer depends on, what financial or other incentives for investors or issuers are created, whether the effect will be extremely strong or nothing at all.

Other questions related to the EU GBS

The EU GBS as recommended by the TEG is intended to apply to any type of issuer: listed or non-listed, public or private, European or international.

14. Do you foresee any issues for public sector issuers in following the Standard as proposed by the TEG?

    a. Yes

    b. No

    c. Do not know

    Please specify the reasons for your answer. [BOX]

15. Do you consider that green bonds considerably increase the overall funding available to or improve the cost of financing for green projects or assets?

    a. Yes

    b. No

    c. Do not know

    Please specify the reasons for your answer. If possible, please provide estimates as to additional funds raised or current preferential funding conditions. [BOX]

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II. Questions on Social Bonds and COVID19

During the ongoing COVID-19, financial markets have so far responded with significantly increased issuance of social bonds responding to the impact of COVID19. These social bonds often follow established market-based Social Bond Principles. The Commission is seeking the input of stakeholders on the lessons learned from this new development, including whether the Commission can play an even greater supportive role in building resilience to address future potential crises.

16. To what extent do you agree with the following statements? Please use the scale from 1 (strongly disagreeing) to 5 (strongly agreeing) – multiple answers possible:
    a. Social bonds are an important instrument for financial markets to achieve social objectives.

       [1] [2] [3] [4] [5]
    b. Social bonds targeting COVID19 are an important instrument for financial markets in particular to help fund public and private response to the socio-economic impacts of the pandemic.

       [1] [2] [3] [4] [5]
    c. Social bonds targeting COVID19 are mostly a marketing tool with limited impact on funding public and private responses to the socio-economic impact of the pandemic.

       [1] [2] [3] [4] [5]
    d. Social bonds in general are mostly a marketing tool with limited impact on social objectives.

       [1] [2] [3] [4] [5]
    e. Social bonds in general require greater transparency and market integrity if the market is to grow.

       [1] [2] [3] [4] [5]

17. The Commission is keen on supporting financial markets in meeting social investment needs. Please select one option below and explain your choice:
    a. The Commission should develop separate non-binding social bond guidance, drawing on the lessons from the ongoing COVID19, to ensure adequate transparency and integrity.
    b. The Commission should develop an official EU Social Bond Standard, targeting social objectives.
    c. The Commission should develop an official "Sustainability Bond Standard", covering both environmental and social objectives.
    d. Other Commission action is needed.
    e. No Commission action is needed in terms of social bonds and COVID19.

    Please specify the reasons for your answer. [BOX]

18. In your view, to what extent would financial incentives for issuing a social bond help increase the issuance of such bonds? Please use the scale from 1 (very strong increase) to 5 (no increase at all).

    [1] [2] [3] [4] [5]

Please explain what kind of financial incentives would be needed, if any.

It will depend on the type of financial incentives that are implemented. It would be beneficial the implementation of RWA incentives (in particular here to the regulated sector such as BIS for Banks or Solvency of the insurers) when they invest in these type of Bonds so we are sure that there will be an improvement in the price for the issuer and that this price can be forwarded to the customer. There should also be an incentive in the regulated liquidity buffers or ratios for the investors who holds a green bond.