German Banking Industry Committee

Die Deutsche Kreditwirtschaft

COMMENTS

Proposal of the European Commission for a regulation on green bonds – COM(2021)391

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent almost all German banks.

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I. Proposal for a regulation on green bonds – key aspects for the Commission's online feedback tool

The GBIC very much welcomes the opportunity to comment on the draft EU Green Bond Standard (EuGBS). Due to the length limitations in the online feedback, we will only highlight some key aspects at this point. Our further comments are outlined below.

As a part of the European Green Deal, it is of utmost importance for the EuGBS to be established in a practical manner.

Several amendments to the EuGBS are necessary to enable issuers to help stimulate the Green Bond markets and make the European Green Deal a reality.

Grandfathering

We are concerned about Art. 7(1) subpara. 2 and Art. 7(2) subpara. 3 as they could imply that grandfathering of an EU Green Bond (EuGB) would be eroded indirectly. The requirement to reallocate bond proceeds following new technical screening criteria (TSC) within five years will have a negative impact on issuers, the price of European green bonds, as well as investors. In other words: projects that were suitable for allocation before the amendment would have to be refinanced, the issuer would have to find new "green" uses of proceeds or, in the worst case, bond proceeds would have to be repaid.

This would cause serious difficulties for long-term financing. For example, in terms of covered bonds: due to the long-term nature of mortgage loans that serve as cover assets for covered bonds, rare green mortgage loans cannot be reallocated or replaced easily.

In order to provide legal certainty to issuers and investors and prevent any negative impact on the price of EuGBs already issued, it should be made clear that issuers may allocate bond proceeds under the elegated act applicable at the point in time the bond is issued, and they do not need to be replaced until their maturity.

Potentially, the complexity described above might cause reluctance to issue EuGBs with a term exceeding five years. As a result, the EuGBs could be perceived as less flexible and less attractive.

Use of Proceeds

Generally, the requirement to allocate the green bond proceeds in line with Regulation (EU) 2020/852 and the delegated acts (yet to be) adopted thereunder appears useful to ensure consistency with the EU sustainable finance taxonomy. However, it seems questionable whether 100% taxonomy conformity is possible right from the start. We are of the view that a transitional period for the use of proceeds, during which there is no requirement to allocate 100% of proceeds to EU taxonomy-aligned assets, would represent a practical and helpful phase-in for issuers. The resulting flexibility would in particular reduce risks in the context of validating compliance for those assets where experience with minimum safeguards or DNSH criteria is still low at best.

A 100% requirement with no transitional period is equivalent to overly careful issuers who will prefer to use other well-known standards when issuing a bond and where the minimum issue size appears more easily achievable. This holds true especially for smaller banks. A threshold of 80% and a five-year transitional period would be reasonable.

Costs of the issuance

It appears unusual that the costs of the issuance of a green bond cannot be settled out of the proceeds of the issuance. The issuance process always generates costs (such as fees for underwriting, prospectus approval, listing, the external reviewer, legal advisors, auditors, or cost for the printing of a prospectus). These costs are normally allocated to the individual bond issuance. However, the ICMA Green Bond Principles only provide for the use of the "net proceeds" of the issuance (after deduction of costs). Such a prohibition would result in unnecessary complexity as other sources of financing will have to be sought and, hence, reduce the attractiveness of EuGBs. Moreover, it would also have accounting implications and could raise further questions, for example whether such costs are an eligible expense for determining the tax liability of the issuer.

II. Detailed comments on the Commission's proposal for a regulation on green bonds

Indicative Comments

The European green bond standard (EuGBS) is a common framework of rules regarding the use of the designation "European green bond" (EuGB). The EUGBS adopts and further develops many elements of other international green bond standards (such as ICMA Green Bond Principles) but goes beyond those in many ways.

We very much welcome the voluntary character of the EuGBS and its availability to all issuers, whether within or outside the EU. The EuGBS does not claim exclusivity, but will exist in parallel with other industry standards, such as the Green Bond Principles of the International Capital Market Association (ICMA) or the Climate Bonds Standard of the Climate Bonds Initiative (CBI). We support its conception as a premium standard. In this way, it should generate additional interest in investing in sustainable financial products. The use of the designation of a bond as "EuGBS", however, makes the framework binding.

The central objective of the EuGBS is to provide investors with a common definition of environmentally sustainable economic activities that a bond may pursue and which is aligned with the definitions of Regulation (EU) 2020/852 (Taxonomy Regulation).

We would caution against using the reference to 'high quality green bonds'. The standard provides for best in class identification of environmentally sustainable objectives but has no credit quality requirements. The credit quality of an issuer, even if issuing a "green" bond, remains its overall credit quality without the segregation of green assets for the benefit of any EuGB; among other things, such an overall credit quality is decisive for its pricing as well as for the assessment of its target market, suitability and appropriateness for certain investors (notably retail investors).

Art. 4(1) Use of the proceeds of European green bonds

It seems questionable whether 100% taxonomy conformity is possible right from the start. We are of the view that a transitional period for the use of proceeds, during which 100% of proceeds do not have to be allocated to EU taxonomy-aligned assets, would represent a practical and helpful phase-in for issuers. The resulting flexibility would especially reduce risks in the context of validating compliance for those assets where experience with minimum safeguards or DNSH criteria still is low at best.

A 100% requirement with no transitional period is equivalent to overly careful issuers who will prefer to use other well-known standards when issuing a bond and where the minimum issue size appears more easily achievable. This holds true especially for smaller banks. A threshold of 80% and a five-year transitional period would be reasonable.

In addition, it appears unusual that the cost of the issuance of a green bond (such as fees for underwriting, prospectus approval, listing, the external reviewer, legal advisors, auditors or cost for the printing of a prospectus) cannot be settled out of the proceeds of the issuance as usual. The ICMA Green Bond Principles only provide for the use of the "net proceeds" of the issuance, i.e. after deduction of costs. The prohibition on deducting costs would result in unnecessary complexity, as other sources of financing will have to be sought.

Issuers will normally allocate such costs to the individual bond issuance, either applying them pro rata temporis over the term or up-front. Not being able to assign such costs to the individual bond issuance would have accounting implications and could raise further questions, for example whether such costs are an eligible expense for determining the tax liability of the issuer. Hence, the extent to which costs may not be reflected in an EuGB needs further clarification.

Art. 5 (3) Financial assets

We very much welcome the ability to use an EuGB to refinance an investment in green assets, as it offers issuers flexibility in structuring the financing of green projects. Also, it supports interim or temporary funding, e.g. via bank loans. It allows using the green nature of the initial investment as an incentive to provide funding if it can be refinanced via green bonds. That said, if we read the draft correctly, it may allow for a multi-dimensional use of an initial investment into a green asset to make refinancings "green". In other words, it appears that issuers could use a green bond, re-financing a loan that was provided to finance a green asset (e.g. a wind park), as an underlying for another EuGB issuance and so on. By doing so the same green asset could be used as an underlying for a potentially unlimited number of green bonds, unless there is a contractually agreed specific refinancing relationship between the different layers of financial assets as is, for example, customary in the context of the lending activities of national promotional banks. However, it remains to be seen whether such a multiple derivative use of a green purpose would be accepted by investors.

In light of the foregoing flexibility, there is also a need to revisit the question of whether the proceeds of an EuGB issuance can be allowed to be used to cover costs directly related to the issuance of that EuGB, which is customary for primary market issuances in general.

Art. 6(1) subpara. 3 Taxonomy-alignment of use of proceeds

We generally welcome the 5 (or in specific cases 10) year period for the taxonomy-alignment plan. However, it remains to be seen to what extent the market (i.e. investors) would accept this. However, the alignment should be tied to the taxonomy as it exists at the time of issuance; see our comment relating to Art. 7 below.

Art. 7(1) subpara. 2, Art. 7(2) subpara. 3 Application of the taxonomy requirements

The requirement to allocate the green bond proceeds to uses contributing to the environmental objectives as defined in Regulation (EU) 2020/852 and the delegated acts (yet to be) adopted thereunder appears useful to ensure consistency of the application of the EU sustainable finance taxonomy.

Recital 11 of the EUGB Regulation points out that in view of the expected technological progress in the field of environmental sustainability, the delegated acts adopted pursuant to Regulation (EU) 2020/852 are likely to be reviewed and amended over time. However, regardless of such changes, in order to provide legal certainty to issuers and investors and prevent amendments to the technical screening criteria from having a negative impact on the price of EuGBs that will already have been issued at the time of a possible future amendment, issuers of an EuGB, when allocating the proceeds to eligible fixed assets or expenditures, should be able to apply the technical screening criteria that were applicable at the time of the issuance until maturity of the EuGB. Likewise, where proceeds are allocated to financial assets, the underlying economic activities funded by those financial assets should comply with the technical screening criteria applicable when the financial assets were created. Surprisingly, however, Recital 11 states in its last sentence that in the case of an amendment of the relevant delegated acts, the issuer should allocate proceeds by applying the amended delegated acts within five years.

As a consequence, Art. 7(1) subpara. 2, (2) subpara. 3 provides, in our understanding, that within five years of an amendment of the delegated acts entered into force, the allocation of the bond proceeds would have to be in line with the amended requirements. This seems to imply that – after five years of the amendment becoming applicable – a reallocation of the proceeds would become necessary. In other words: projects that were suitable for an allocation before the amendment would have to be refinanced, the issuer would have to find new “green” uses of proceeds or, in the worst case, bond proceeds would have to be repaid. Such a refinancing, reallocation or repayment process would be cumbersome, inefficient and not at all practicable. Alternatively, a more moderate interpretation could result in only those proceeds being affected by a requirement to make an adjustment to an amended taxonomy that are not yet allocated five years after the point in time where an amended delegated act came into force. However, such a seemingly more flexible interpretation would be a challenge for issuers who raise financing via an EuGB for a long-term project that is to be financed in different stages of construction but cannot be redesigned during the construction process in order to follow changes in the taxonomy.

As most covered bonds are backed by real estate mortgages, they can be considered an important element in this key initiative to make Europe climate-neutral by 2050. This is because buildings are among the largest sources of energy consumption in Europe, responsible for over a third of EU emissions. Covered bond issuers are obliged to always hold more cover assets than outstanding covered bonds. There is a substantial risk of issuers not having the required assets following any potential amendments of TSCs. In that case, the green (covered) bond would lose its status and could only be covered with assets that do not comply with the taxonomy, which is not in line with the desired long-term nature.

Therefore, this rule would likely result in the term of an EU Green Bond not exceeding five years. Such a de-facto limitation would jeopardise the main objective of the proposed regulation, which is to establish a uniform standard. Rather, such a limitation would render the EuGBS less attractive, in particular in comparison with the current, widely accepted ICMA Green Bond Principles.

Therefore, we firmly oppose this limited grandfathering for a variety of reasons. In particular:

Apart from the required organisational efforts at least if the issuer is an operating company in real economy, any reallocation of the funds may be difficult, especially if the issuer has a limited business focus and may therefore struggle to find meaningful alternative "green" uses within its own business. Also, it would probably be fortuitous if the financing requirements of that alternative use were to correspond to the proceeds of the bond that are to be (re)allocated. Moreover, the issuer would need additional financial resources – possibly through external funding – to refinance the initial uses at uncertain conditions (and availability!) at the time of the issuance of the bond.

Potentially, this complexity might make at least some issuers reluctant to issue EuGBs with a term exceeding five years. As a result, the EuGBS could be perceived as less flexible and, hence, less attractive. Discouraging longer term green bond issuance would pave the way towards using other market standards (such as the ICMA Green Bond Principles). Such a flight away from the EuGBS in the case of longer term issuances is presumably not the intention of the legislators. Rather, the Technical Screening Criteria (TSC) valid at the time of issuance should apply for the entire term of an EuGB; i.e. the initial TSC should be fully "grandfathered".

In a nutshell, we strongly urge the European Commission to consider a "full grandfathering" rule which ensures that EuGB status is granted until the maturity of the bond, regardless of any potential post-issuance adjustments in the TSC.

Art. 8 Green bond factsheet

Article 8 stipulates that, prior to issuing an EuGB, issuers must complete the European green bond factsheet and ensure that the completed European green bond factsheet has been subject to a pre-issuance review with a positive opinion by an external reviewer.

Where a portfolio approach is chosen, there is already a third-party opinion for existing assets. The required review of the factsheet will incur extra costs that are considered to be unnecessary.

Art. 9(5) Post-issuance review by an external reviewer

By imposing a requirement to obtain an additional post-issuance review of the annually submitted allocation report, Art. 9(5) of the proposed regulation puts an extra burden on financial undertakings employing the portfolio approach.

If that requirement were to be retained, we suggest that it should be applied to all issuers following the dynamic portfolio approach, and not only to financial undertakings, in order to ensure a level playing field for all issues that use that form of green bonds. Irrespective of the type of issuer, the requirement as such is quite far-reaching. In our view, an additional post-issuance review should only be requested in cases where significant changes have been made to the portfolio of EuGBs.

Art. 9 (6) Allocation reports and post-issuance review of allocation reports, Art. 13(1) Publication on the issuer's website and notification to ESMA and national competent authorities

Taken together, Art. 9(6) and Art. 13(1) appear to require the preparation of an allocation report within 30 days after the end of the financial year as well as the preparation and subsequent publication of the post-issuance review report within 90 days after receipt of the allocation report. That results in a requirement to publish both documents (if the relevant periods are added up) within 120 days from year-end.

In this context, the initial 30 day period for the preparation of the allocation report not only appears quite ambitious in comparison to the financial reporting according to Art. 4(1) of Directive 2004/109, which allows four months (i.e. 120 days) for the preparation of an annual financial report (including the management report with non-financial information pursuant to Art. 19a, 29a of Directive 2013/34/EU). From a merely practical perspective, the preparation of the allocation report would also interfere with the preparation of the annual financial report.

Moreover, the period for the preparation of the allocation report appears disproportionately short in comparison to the 90 days the external reviewer may take for their review. Firstly, the split of the 120 days period in total, calculated from the end of a business year, appears counterintuitive. We would assume that the compilation of the allocation report will take longer than its review. Also, we believe it is absolutely sufficient to set a maximum period for the publication of the package (allocation report and post-issuance review report) without allocating fractions of that period to each of the two related documents – just as it is today for the publication of annual financial statements and the auditor's opinion.

Art. 10 European green bond impact report

Requiring a single impact report during the lifetime of an EUGB appears appropriate from an issuer's perspective.

Art. 12 Prospectus for European green bonds

It appears appropriate to allow, on a discretionary basis, the incorporation of the factsheet into a prospectus by reference.

Art. 13 (4) Publication on the issuer's website and notification to ESMA and national competent authorities

In our view it makes sense to also equip the NCA, which is responsible for prospectus approvals under the Prospectus Regulation, with responsibility for notifications according to Art. 13, i.e. the NCA of an issuer's home member state. In the case of non-equity securities (i.e. bonds) with a denomination per unit of at least EUR 1,000, the issuer has the choice between the state of its registered office, of the offeror of securities or of the listing venue. However, it is unclear what happens if the issuance of an EUGB involves neither an offer to the public nor the admission of the bonds to trading on a regulated market. In this case, the issuer does not have to choose a home member state for the issuance and the options. Rather, the NCA in the member state where the issuer has its registered office seems to be the only available "option" according to Art. 2(m)(ii) of Regulation 2017/1129. This seems to be a fair outcome, but a clarification to that effect could be considered (at least in the form of a guidance by ESMA, such as Q&A).

Art. 20(2) Analysts and employees of external reviewers, and other persons directly involved in the assessment activities of external reviewers

The fact that the negotiation of the external reviewer's fees is to be carried out by persons other than those involved in the review itself appears to be quite restrictive and is not currently handled in this way in other areas. It would make more sense to conclude a fee agreement before the review begins and to make it explicitly independent of the outcome of the investigation.

Art. 30(2) Publication of pre-issuance reviews and post-issuance reviews

The provision, which requires the pre-issuance review to be made publicly available "within a reasonable period of time prior to the beginning of the offer" and "without delay following the assessment" appears vague, ambiguous and impracticable.

In particular, it is unclear what "within a reasonable period" exactly means. It would appear preferable to align the requirement with Art. 21(1) of the Prospectus Regulation (Regulation (EU) 2017/1129). The latter stipulates: "Once approved, the prospectus shall be made available to the public […] at a reasonable time in advance of, and at the latest at the beginning of, the offer to the public or the admission to trading of the securities involved."

This should be sufficient and add both clarity and consistency to the documentation requirements for green bonds.

Art. 35(7) Endorsement of services under this Regulation provided in a third country

Art. 35(7) of the EUGBS Regulation requires an external reviewer endorsing services by a third country external reviewer to publish the information referred to in Art. 13 of the EuGB Regulation on its website. Art. 13 of the EuGB Regulation defines publications to be made by the issuer. Therefore, it appears that the correct reference should be to the publications to be made by the external reviewer according to Art. 30 (instead of Art. 13).

Art. 40(3) (d), Art. 42(1) (c) Precautionary measures

The level of sanctions is to be determined in proportion to the financial strength of the person responsible for the infringement. However, the total turnover, annual income and net assets of the person do not appear suitable indicators. It seems more appropriate to refer to the most recent annual profit or other performance indicators.

Annex I

We expect that the factsheet could be derived from an existing Green Bond Framework as provided for in the ICMA Green Bond Principles. As stated above, we believe that the option to incorporate the factsheet by reference into a prospectus is useful.

In particular:

4. Intended allocation of bond proceeds

Based on the structure of existing green bonds, we consider that providing the information set out in item 4.3 on a project level is onerous and overly detailed.