Brussels, 5th October 2020

EACB answer to the EC targeted consultation on the EU Green Bond Standard

2nd October 2020

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%.

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

Question 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)

a. Absence of economic benefits associated with the issuance of green bonds: **2**

b. Lack of available green projects and assets: **4**

c. Uncertainty regarding green definitions: **3**

d. Complexity of the external review procedure(s): **2**

e. Cost of the external review procedure(s): **2**

f. Costly and burdensome reporting processes: **3**

g. Uncertainty with regards to the eligibility of certain types of assets (physical and financial) and expenditure (capital and operating expenditure): **3**

h. Lack of clarity concerning the practice for the tracking of proceeds: **3**

i. Lack of transparency and comparability in the market for green bond: **2**

j. Doubts about the green quality of green bonds and risk of green washing: **3**

k. Other

A standardized definition of a bond being green and a standardized management process can provide greater transparency that will help the green bond market to grow and increase investors' confidence about the environmental benefits of their investments. Currently the variety of principles and standards already existing in the market lead to a lack of comparability and make the development of a secondary green bond market harder.

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Question 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).

a. Absence of economic benefits associated with the issuance of green bonds: **3**

b. Lack of available green projects and assets: **3**

c. Uncertainty regarding green definitions: **4**

d. Complexity of the external review procedure(s): **3**

e. Cost of the external review procedure(s): **3**

f. Costly and burdensome reporting processes: **3**

g. Uncertainty with regards to the type of assets (physical and financial) and expenditure (capital and operating expenditure): **5**

h. Lack of clarity concerning the practice for the tracking of proceeds: **5**

i. Lack of transparency and comparability in the market for green bond: **5**

j. Doubts about the green quality of green bonds and risk of green washing: **5**

k. Other [ ]

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Additional comments regarding;

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

- i. We would expect an EU GBS to become the benchmark market standard over time. However, the usability of the EU Taxonomy, that in some cases only leave room for very stringent approach to classification of green activities, will leave room for other formats of green bonds. An example is financing of buildings where owners in some markets typically will re-mortgage the whole loan when granted extra proceeds to finance a green renovation of the building. Such a loan only partially financing green activities is not considered Taxonomy eligible although it contributes to the renovation of existing buildings making them more energy efficient.

Questions on the proposed content of the standard

Question 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).

a. Alignment of eligible green projects with the EU Taxonomy: **5**

b. Requirement to publish a Green Bond Framework before issuance: **5**

c. Requirement to publish an annual allocation report: **5**

d. Requirement to publish an environmental impact report at least once before final allocation: **5**

e. Requirement to have the (final) allocation report and the Green Bond framework verified: **5**

The idea of a verification regime with certification of taxonomy-compliant activities to be provided by companies has been raised by the EACB in several occasions. Indeed, the EACB is in favour of the creation of a "mandatory verification regime". Pre- and post-impact & allocation reporting and pre-verification are already market practice today, even if not with reference to EU Taxonomy/GBS, but to ICMA. An accreditation process of external verifiers will be necessary to increase the credibility of the standard and simplify the current situation of a market where it can be difficult to determine what sets different players apart. However, it is our impression that although the market is new,

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there are some consolidations currently going on that will affect the market in the future and divert those players who do not live up to a credible verification process.

Question 4. Do you agree with the proposed content of the following documents as recommended by the TEG?
Please note that these reporting requirements refer only to the requirements in relation to the issued green bond (it is common in the green bond market to have reporting on the bond). These reporting requirements are not related to disclosure requirements for companies or funds, which arise from the EU Taxonomy Regulation or the Sustainability –related Disclosures Regulation.

a) The Green Bond Framework: **YES**

b) The Green Bond Allocation Report: **YES**

c) The Green Bond Impact Report: **YES**

Question 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?

- **DO NOT KNOW**

The introduction of a requirement to have the final allocation report verified would create a market barrier for current second and third party opinion providers as there is currently no requirements, which second-party opinion providers need to meet when they review green bond issuances and/or issuers. However, a new requirement to have the final allocation report verified is welcomed, as it would move in the direction of removing 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[1] specifies that the Union shall apply the EU Taxonomy when setting out the requirements for the marketing of corporate bonds that are

[1] See agreed compromise text: https://data.consilium.europa.eu/doc/document/ST-5639-2020INIT/en/pdf

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.

Question 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?

- **YES, but with some flexibility**

The EACB answers option b to this specific question according to the views of the majority, but not all, of its members. Our members acknowledge and agree that the objective should be to align 100% of the use of proceeds of green bonds with the taxonomy to ensure the integrity of the EU GBS. However, as rightfully explained by the TEG in its usability guide, there are some challenges as of today that would prevent the EU GBS to be widely used by the market (as for example the technical screening criteria of the taxonomy are not yet completed, some might be too stringent hence excluding entire economic activities from the EU GBS or some questions still remain regarding the application of the taxonomy, cf. Q8).

To address that issue, we would recommend the Commission to introduce some flexibility for a limited period, using a threshold that is yet to be defined but should not question the "green" quality of the bonds issued. If not applicable to the EU GBS, such flexibility should be ensured at least for those activities that have still to be defined as sustainable according to the provisions of the taxonomy regulation.

Question 7. 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. Do you agree with this approach?

- **YES, both (1) and (2)**

Nevertheless, these should be enough room for other business activities to be included in the scope compared to EU Taxonomy. Some green activities are not mentioned in Taxonomy. It is good that verifier confirms that project contribute to environmental objectives.

Question 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?**

- **YES**

Alignment to the Taxonomy introduces a new significant conduct risk for issuers in terms of validating whether the underlying assets are eligible at all times – both in terms of minimum safeguards, DNSH-criteria but also the technical criteria on different actives that all requires a very high level of expertise and controlling systems at the issuers. The underlying borrowers 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 work force and IT support.

Technical criteria should be defined to facilitate the verification that the DNSH condition is met.

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Question 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.

- **NO, the proposed EU GBS by the TEG is sufficiently clear on this point.**

R&D is a wide universe, from research sponsored by investors to academic research sponsored by sovereigns. There are no technical criteria yet. We think the market should first develop before considering providing further guidance under the GBS.

Questions on grandfathering and new investments

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

- **DO NOT KNOW**

Question 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?

- **YES, green at issuance should be green for the entire term to maturity of the bond**.

The 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 be eligible for green financing until maturity. It would create uncertainty for borrowers, issuers and investors if the status of the existing loan could change as the Taxonomy changes. Other solutions would be problematic in secondary markets. Bonds that used to be green would suffer and some investors would have to sell those older assets because on the status change out of green.

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Furthermore, it has to be considered that according to Art 19 Para 5 Taxonomy Regulation the Commission shall regularly review the technical screening criteria and amend the delegated acts to reflect scientific and technological developments. Against this background it is pivotal that green at issuance is considered green for the entire term to maturity of the bond in order to ensure legal certainty for investors, issuers and verifiers.

Question on incentives

Question 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?:

a. Verification: **3**

b. Reporting: **3**

c. More internal planning and preparation: **3**

d. Other

It is important that the accreditation process doesn't "take over" and builds on standards already developed in the market - so the issuers don't end up being charged with higher costs. The EACB believes that a simple, centralised process that would be accessible to any kind of players, including smaller issuers, should be the right way to follow. Moreover, the costs for large companies are minor and for smaller issuers and SMEs the costs are relatively high in each element mentioned above.

In addition, with the current state of the green bond market, there is no clear evidence for investors' willingness to provide funds for green bonds for a lower rate. One of the reasons lies in the credit risk that the investors are exposed to. Green bonds and regular bonds issued by the same issuer have the same credit rating. Given that fact, complicated verification and reporting requirements that are associated with higher additional costs for issuers might make the overall issuing process difficult for companies.

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Question 13. 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.

- **3**

This depends on potential increase of verification costs (as required by ESMA in the future) and internal processes and resources for larger internal analyses. The verification process in terms of aligning with the Taxonomy is the main driver of costs together with project screening.

The EU GBS implies a little bit more verification work but the framework is clearer and more standardised so it should attract more players, which then will create more competition which will then drive down costs to the same level as other market standards.

Question 14. 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):

a. Public guarantee schemes provided at EU level, as e.g. InvestEU: **3**

b. Alleviations from prudential requirements: **4**

c. Other financial incentives or alternative incentives for investors: **2**

d. Other Incentives or alternative incentives for issuers: **3**

The EACB welcomes the proposal already formulated by the TEG for financial incentives such as subsidies to cover/reduce verification costs.

The EACB supports the proposal to examine the possibility to grant preferential treatment to certain EU-GBS green bonds, as provided in Art. 501c CRR2.

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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.

Question 15. Do you foresee any issues for public sector issuers in following the Standard as proposed by the TEG?

- **NO**

Currently, in the use of proceeds of sovereign issuers there are several uses and types of activities that have not been studied by the TEG.

Question 16. Do you consider that green bonds considerably increase the overall funding available to or improve the cost of financing for green projects or assets?

- **NO**

So far, the GB market has financed projects that could have been funded by other sources. However, if the GB market keeps growing, it will be able to constitute an autonomous source of funding.

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.

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Question 17. **To what extent do you agree with the following statements?** Please use the scale from 1 (strongly disagreeing) to 5 (strongly agreeing):

a. Social bonds are an important instrument for financial markets to achieve social objectives: **4**

b. Social bonds targeting COVID19 are an important instrument for financial markets in particular to help fund public and private response to the socioeconomic impacts of the pandemic: **3**

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: **3**

d. Social bonds in general are mostly a marketing tool with limited impact on social objectives: **2**

e. Social bonds in general require greater transparency and market integrity if the market is to grow: **4**

Question 18. **The Commission is keen on supporting financial markets in meeting social investment needs.**

- **Other Commission action is needed.**

The EACB believes that a gradual approach should be guaranteed in taking new initiatives in this field. The creation of an EU Green Bond Standard could be a first step in developing useful and simple standards that work at European level, providing more transparency and clarity in the market. At the same time, the gradual implementation of the taxonomy regulation's provisions (to better identify the activities that could be eligible for the purposes of the green and social bond standard) should be tested and eventually extended in the scope over the upcoming years.

Moreover, we believe that - from a retail, regional banking perspective- the activities of cooperative banks have a clear positive social impact. For this reason, we would in principle be inclined to favour an EU Social bond standard, following the process of the EU Green bond standard. However, developing a Sustainable bond standard is not a priority, due to the fact that once Green and Social bonds have been defined, Sustainable bonds will follow (as a mix of both) without the need of new definitions. In this sense, the ICMA procedures should be taken into account as they are currently market practices. (https://www.icmagroup.org/green-social-and-sustainability-bonds/sustainability-bond-guidelines-sbg/)

A European initiative for COVID bonds seems not quite relevant since there is a real urgency for the relaunch of the Economy; national initiatives will probably be quicker to set-up and more efficient.

At the same time, we believe that the Commission should start considering to take additional initiatives in the field of transition bonds that could help increasing the amount of investments in the transition of industries and sectors with high greenhouse gas emissions. This will allow to raise more capitals needed to take on board on the transition those sectors that would be excluded from the EU Green Bond Standard.

Question 19. **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).

- **3**

We should first let the market grow

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