

STUDY

Requested by the ECON committee

Green Bonds

An assessment of the proposed EU
Green Bond Standard and its
potential to prevent greenwashing



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Abstract

This study analyses the Commission proposal for a Regulation on European green bonds. It compares the proposal with existing EU legislation on sustainable finance and financial regulation and contextualises it in the EU green bond market. The assessment covers key regulatory aims, advantages of voluntary and mandatory options, different types of sustainable bonds, alignment with the Taxonomy Regulation, corporate and sovereign bonds, transparency requirements, review and supervision, enforcement and sanctions, and international aspects. On each aspect it provides policy recommendations to the co-legislators.

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LIST OF ABBREVIATIONS

AIFM	Alternative Investment Fund Manager
bn	billion
CBI	Climate Bonds Initiative
CJEU	Court of Justice of the European Union
CRD IV	Capital Requirements Directive (Directive 2013/36/EU)
CRR	Capital Requirements Regulation (Regulation (EU) No 575/2013)
CSRD proposal	Commission proposal for a Corporate Sustainability Reporting Directive (COM/2021/189 final)
DNSH	Do No Significant Harm
EP	European Parliament
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
EuGB	European green bond
EuGBR proposal	Commission proposal for a Regulation on European Green Bonds (COM(2021) 391 final)
EuGBS	European green bond standard
EUR	Euro
fn	footnote
H1	first half of the year
GATS	General Agreement on Trade in Services
ICMA	International Capital Market Association
KPI	Key Performance Indicator
MiFID II	Markets in Financial Instruments Directive (Directive 2014/65/EU)

NCA	National Competent Authority
OECD	Organisation for Economic Co-operation and Development
SFDR	Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088)
SME	Small and medium-sized enterprise
SPT	Sustainability Performance Target
TEG	Technical Expert Group on sustainable finance
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UCITS	Undertaking for Collective Investment in Transferable Securities
UK	United Kingdom
UN	United Nations
USD	US Dollar
WTO	World Trade Organisation

EXECUTIVE SUMMARY

Background

The fast growing market of green bonds in the EU is not yet harmonised. Thus far, only private standards exist. In July 2021, the Commission issued a proposal for a Regulation on European Green Bonds (EuGBR proposal).¹ It is part of a broader EU legislative focus on sustainable finance that has resulted in the adoption of the Taxonomy Regulation² and the Sustainable Finance Disclosure Regulation³. This study analyses the fundamental aspects of the EuGBR proposal in the context of the EU green bond market and existing EU legislation in the area of sustainable finance and financial regulation.

Aim

This study assesses to what extent the EuGBR proposal can achieve its key regulatory goals and how it can be modified to better achieve them.

The key regulatory goals of the EuGBR proposal (below 2) are to:

- foster the uptake of green bonds by issuers;
- enhance the transparency, comparability and credibility of the EU green bond market;
- prevent greenwashing;
- help prevent climate change; and
- create a 'gold standard' for green bonds globally.

As with any EU legislation on financial services, the co-legislators have to decide how they want to regulate and influence the currently free market of green bonds in the EU, which has grown significantly in recent years. For the European Green Bond Standard (EuGBS) to succeed, in addition to achieving its goals, it needs to counter three dangers. The first of these is that the EuGBS makes green fundraising more expensive, cumbersome and bureaucratic, especially for small and medium-sized enterprises (SMEs). The second is over-regulation, i.e. a scenario in which the regulatory requirements of the EuGBS suffocate entrepreneurial inventiveness. The third is that the EuGBS reduces the competitiveness of the EU financial markets by setting the wrong incentives, which would result in capital flight and reputational damage. If the EuGBS is well designed, it can counter all these risks and achieve its key regulatory goals. This study puts a particular focus on strengthening the prevention of greenwashing and fostering market growth.

Key Findings

The EuGBR proposal is a good starting point for the co-legislators to adopt an effective and reliable EuGBS. In light of the current EU green bond market (below 1), this study analyses the main regulatory aspects for a successful EuGBS.

¹ European Commission, proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (COM(2021) 391 final). https://eur-lex.europa.eu/resource.html?uri=cellar:e77212e8-df07-11eb-895a-01aa75ed71a1.0001_02/DOC_1&format=PDF.

² Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 [2020] OJ L 198/13. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN>.

³ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector [2019] OJ L 317/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN>.

The co-legislators will mainly have to decide on:

- whether to adopt a voluntary or a mandatory standard (below 3);
- whether to focus on green bonds or to include social and sustainability bonds (below 4);
- alignment with the Taxonomy Regulation (below 5);
- whether and how to create a single standard for corporate and sovereign bonds (below 6);
- transparency requirements (below 7);
- review and supervision (below 8);
- enforcement and sanctions (below 9); and
- international aspects (below 10).

All these regulatory aspects are interrelated. A policy choice on one aspect will impact other regulatory aspects. This study intends to view the EuGBS holistically and to highlight the most important consequences of specific policy choices.

The EuGBR proposal chooses a voluntary standard for issuers to use the label 'European green bond' or 'EuGB' (below 3.1). Such a voluntary standard would add a public standard to the existing market of voluntary private standards. It relies on the quality of the EuGBS, the appeal of the 'European green bond' label and the good reputation of the EU as a standard-setter (below 3.2.1). There are several options on the spectrum of voluntariness, ranging from voluntary to mandatory (below Figure 3). This study considers a mandatory standard for all bonds labelled 'green' or 'environmentally sustainable' most appropriate as it would most effectively prevent greenwashing and create a regulatory level playing field (below 3.3, 3.4 and 3.5). Yet, if the co-legislators prefer a voluntary standard, this study recommends that they consider making the transparency requirements under the EuGBS mandatory for all bonds that are labelled 'green' and issued or marketed in the EU (below 7.5).

The scope of application under the EuGBR proposal is limited to green bonds, i.e. bonds financing environmental objectives. The EuGBS could follow market trends and include social and sustainability bonds, i.e. bonds financing social objectives or a combination of social and environmental objectives (below 4.1). This would create a 'sustainable bond standard'. In theory, this is appealing (below 4.2), but in practice, clear guidance on social criteria is still missing (below 4.3). Therefore, this study recommends that the co-legislators mainly focus on green bonds (below 4.5).

The EuGBR proposal requires issuers to allocate the proceeds from 'European green bonds' to economic activities that comply with the Taxonomy Regulation (below 5.1). This entails that they contribute substantially to an environmental objective, do not significantly harm another environmental objective, fulfil minimum social safeguards and comply with the technical screening criteria (below 5.2). The technical screening criteria are specified by the Commission in delegated acts. Thus far, only the two objectives of climate change mitigation and climate change adaptation have been specified in the Taxonomy Climate Delegated Act⁴ and the recent Taxonomy Complementary

⁴ Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives [2021] OJ L 442/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R2139&qid=1643891065831&from=EN>.

Climate Delegated Act⁵, which conditionally includes nuclear power and natural gas among the economic activities contributing substantially to climate change mitigation (below 5.2.4). The latter is highly controversial and currently under the scrutiny of the co-legislators. Aligning the EuGBS with the Taxonomy Regulation is recommended because the Taxonomy Regulation provides solid and clear technical guidance for issuers and enhances the comparability for investors. To make transitional elements transparent to investors, this study recommends that the co-legislators consider introducing the category of ‘transition bonds’ covering transitional economic activities and economic activities in transition towards taxonomy alignment (below 5.4).

A single standard for corporate and sovereign issuers is the best way to ensure a level playing field for both issuer types that compete on the same market and for the same investors (below 6). The peculiarities of sovereign issuers can be addressed by modifying the use of proceeds (below 6.3) and review requirements (below 8.5).

Transparency duties are a very important tool for the success of the EuGBS (below 7). The EuGBR proposal requires issuers to disclose before the issuance a factsheet on the ‘European green bond’ and a pre-issuance review by an external reviewer. After issuance, issuers have to disclose annual allocation reports, post-issuance reviews and impact reports (below 7.1). The disclosures give information to investors. Together with the substantive requirements under the Taxonomy Regulation, they enhance the transparency, comparability and credibility of the EU green bond market and help prevent greenwashing. The impact reports could be merged into the allocation reports (below 7.1.3). The transparency duties under the EuGBR proposal consistently relate to other transparency duties under EU law (below 7.3). While extending the disclosure obligations under the EuGBR proposal to social and governance matters at entity-level is not recommended (below 7.4.1), this study recommends that the co-legislators consider requiring transparency for ‘social bonds’, ‘sustainability bonds’ and ‘sustainability-linked bonds’ (below 7.4.2).

External review and supervision operate in three layers under the EuGBR proposal (below 8.1). First, private external reviewers assess a bond’s substantive compliance with the Taxonomy Regulation (below 8.1.1). Second, national competent authorities (NCAs) supervise the issuers’ compliance with the disclosure obligations (below 8.1.2). Third, the European Securities and Markets Authority (ESMA) registers and supervises the private external reviewers (below 8.1.3). This three-pronged approach is complicated and runs the risk of supervisory diffusion (below 8.2). It could be simplified by giving the NCAs the powers to supervise issuers regarding their substantive and disclosure compliance with the EuGBS. Also, under a mandatory standard, external reviewers could operate voluntarily if issuers choose to have their second opinion. The heavy organisational and governance requirements for external reviewers could then be reduced (below 8.4.2).

The enforcement and sanctions regime under the EuGBR proposal follows the three layers of review and supervision (below 9.1). It is based on the deterrent effect of negative opinions by private external reviewers (below 9.1.1), the supervisory and sanctioning powers of NCAs regarding disclosure infringements (below 9.1.2), and the supervisory and sanctioning powers of ESMA regarding external reviewers, including withdrawal of registration and imposing fees (below 9.1.3). This mechanism does not enforce issuers’ compliance with the Taxonomy Regulation effectively. It could be strengthened by giving the NCAs supervisory and sanctioning powers regarding issuers’ substantive compliance (below 9.2). Furthermore, this study recommends that the co-legislators consider adding a civil liability

⁵ Commission Delegated Regulation (EU) .../... of 9.3.2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities [C(2022) 631 final]. [https://ec.europa.eu/transparency/documents-register/api/files/C\(2022\)631_0/090166e5e98cca4f?rendition=false](https://ec.europa.eu/transparency/documents-register/api/files/C(2022)631_0/090166e5e98cca4f?rendition=false).

mechanism for issuers and/or external reviewers. Such private law enforcement could follow the models of the Prospectus Regulation⁶ and the Credit Rating Agencies Regulation⁷ and would strengthen the overall enforcement level (below 9.3).

The EuGBR proposal addresses international issuers and external reviewers located outside the EU (below 10). Along the EU's general open market philosophy, it gives third-country corporate and sovereign issuers the possibility to opt for the EuGBS (below 10.1). It also opens the EuGBS market for external review to third-country external reviewers by way of a Commission equivalence decision on a third country (below 10.2.1), an individual recognition by ESMA (below 10.2.2) or the endorsement of their services by EU external reviewers (below 10.2.3). The EuGBS is likely to influence third-country legislators to some extent. This influence will probably be stronger in the case of a mandatory standard applicable to all green bonds marketed in the EU as this would de facto bind third-country issuers seeking investment from within the EU (below 10.3).

⁶ Article 11(2) Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ L 168/12. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1129&from=EN>.

⁷ Article 35a Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009R1060&from=EN>.

1. THE GREEN BOND MARKET AND REGULATORY BACKGROUND

KEY FINDINGS

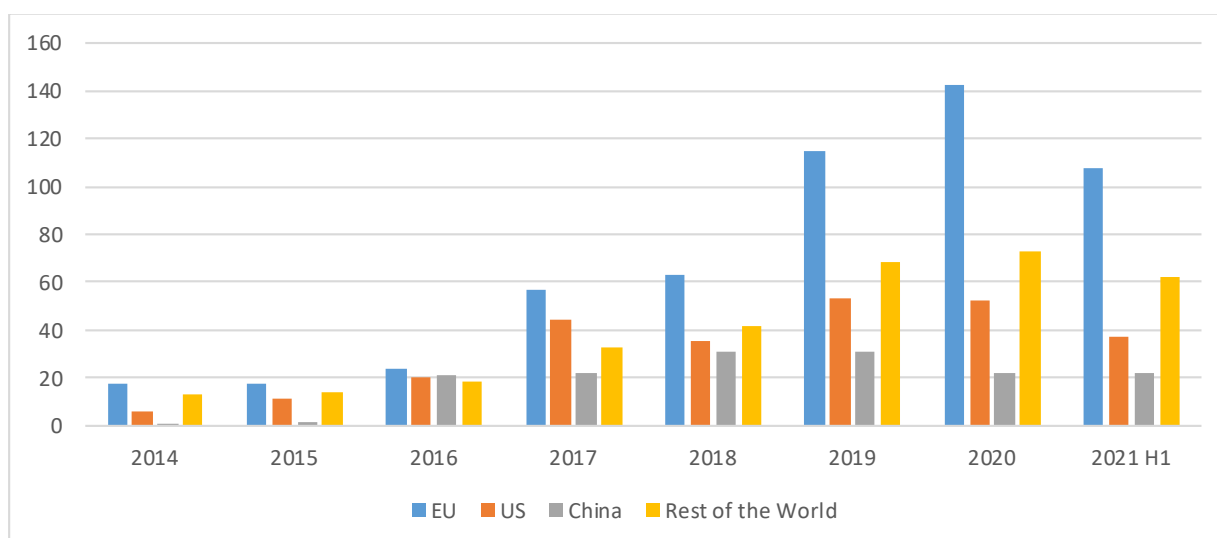
Green bonds have risen strongly in corporate and sovereign issuances. The EU is the world’s leading geographic area in terms of green bond issuance. While initially public issuances prevailed over private issuances, they are now becoming equal. Green bonds in Europe mainly finance activities in the three industry sectors of energy, buildings and transport, combined totalling 85% of the market share. The degree of environmental sustainability of existing bonds depends on the applicable definition.

The EGBR proposal is the most ambitious, comprehensive, detailed and rigorous standard compared with existing private and public standards. The proposal is closely linked to the Taxonomy Regulation and the delegated acts further specifying it. In terms of transparency requirements, it relates to the Sustainable Finance Disclosure Regulation and the recent proposal for a Corporate Sustainability Reporting Directive.

1.1. Current market trends

Green bonds are a relatively new phenomenon and have been on the rise for the past 15 years. Starting from the first green bond issuances by the European Investment Bank in 2007⁸ and the World Bank in 2008⁹, the market has grown ever since. Figure 1 illustrates the global value increase of green bonds issued per year between 2014 and the first half of 2021 measured in USD¹⁰. It shows that the EU has been a driving force behind the global rise of green bonds and that for the past three consecutive years it has accounted for at least half of the global value of green bonds issued. Similarly, the Euro is the top currency for green bond issuances, i.e. most green bonds are nominated in EUR¹¹.

Figure 1: Global green bond issuance 2014 – 2021 H1 (Amount in USD bn)



⁸ European Investment Bank, Annual Report 2007, Volume I – Activity and Corporate Responsibility Report, 3 June 2008, p. 48. <https://www.eib.org/attachments/general/reports/ar2007en.pdf>.

⁹ World Bank, Green Bond Impact Report 2018 – 10 Years of Green Bonds, 16 November 2018, p. 5.

<https://thedocs.worldbank.org/en/doc/916521543500726747-0340022018/original/reportimpactgreenbondlowre2018.pdf>.

¹⁰ Unfortunately, there is no publicly available comprehensive database providing granular data on green bonds in EUR (instead of USD).

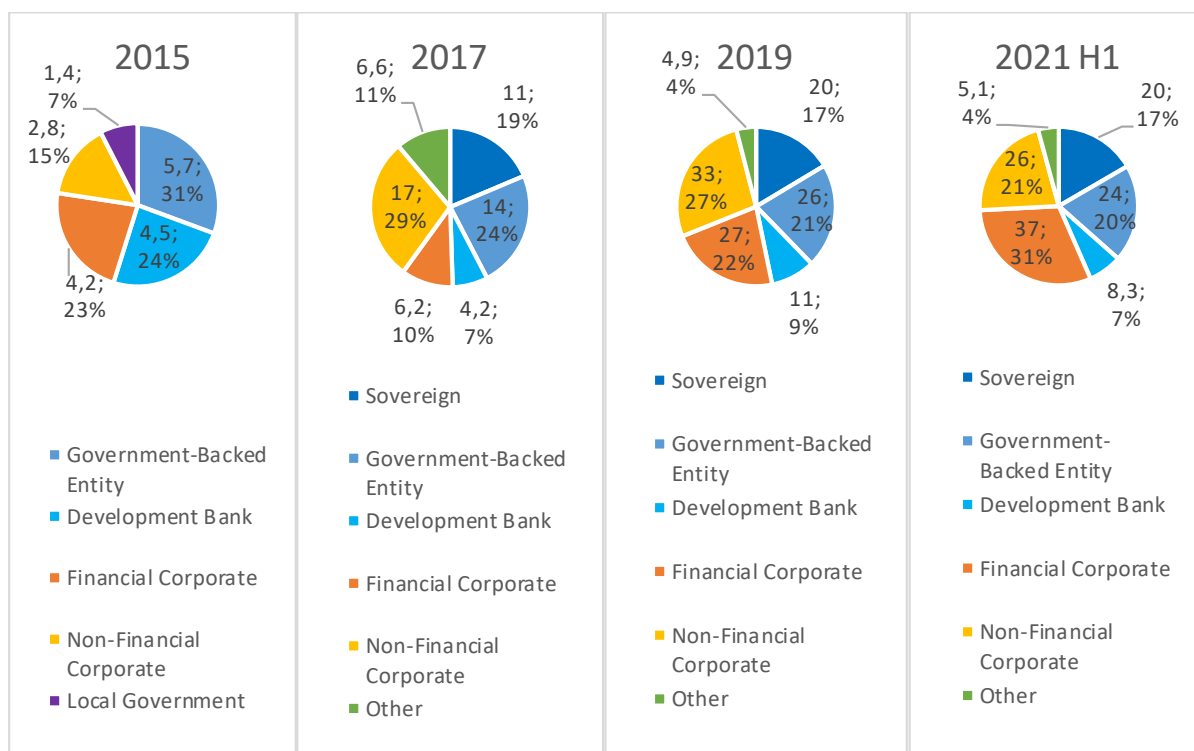
¹¹ While in 2015, 2016 and 2017 the volume of green bonds issued in USD was bigger, the biggest market share of green bonds issued in 2014, 2018, 2019 and 2020 was nominated in EUR; see Harrison, C. and Muething, L., Sustainable Debt Global State of the Market 2020, Climate Bonds Initiative, April 2021, p. 8. https://www.climatebonds.net/files/reports/cbi_sd_sotm_2020_04d.pdf.

Source: Chart made by the author based on own calculations. Data extracted from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

Note: EU includes national and supranational issuances. UK counts as EU until 2019 and to the rest of the world from 2020 onwards.

The rise of green bonds occurred similarly in the public and private sectors as public and private issuances have increased significantly. Figure 2 shows the evolution of green bond issuance in Europe by type of issuer between 2015 and the first half of 2021 (2021 H1). In 2015, government-backed entities were the most important issuers and their issuance's value of 5,7 bn USD made up 31% of the market. Even though their importance decreased relatively to 20% in 2021 H1, their issuance's value amounted to 20 bn USD and nearly quadrupled compared to 2015. Development banks first played a very important role and their issuance's value of 4,5 bn USD accounted for 24% of the total amount in 2015. Although their importance decreased relatively, they accounted for 9% in 2019 and 7% in 2021 H1, they tripled their issuance's value in 2019 (11 bn USD) and nearly doubled it in 2021 H1 (8,3 bn USD) compared to 2015. Sovereign issuers enter the stage in 2017 and have had a steady market share of 17% to 19%, rising from 11 bn USD in 2017 to 20 bn USD in 2021 H1. Financial corporate entities have risen to the first issuers, accounting for nearly a third of issued amounts. Non-financial corporate entities had a relative peak in 2017 and 2019 with respective values of 17 bn and 26 bn USD making up 29% and 27% of the respective total market values. While the ratio between private and public issuers was roughly 40% (private) to 60% (public) in 2015 and 2017, in 2019 and 2021 it steadied at 50% to 50%.

Figure 2: Evolution of issuer type in Europe 2015 – 2021 H1 (Amount in USD bn; Market share)



Source: Chart made by the author. Data extracted from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

Note: The category 'Other' includes Asset Backed Securities, Loan and Local Government.

1.2. Overview of activities financed by existing green bonds

Thus far, green bonds in Europe mainly finance activities in the industry sectors of energy, buildings and transport, all three sectors combined totalling 85% of the market share¹². Initially, more than half of the proceeds of green bonds in Europe were used for the energy sector and since 2018 a third of bond proceeds are still used for energy-related activities¹³. Buildings are the second biggest sector in Europe to be financed by green bonds, doubling its market share between 2015 and 2021 H1¹⁴. Transport has risen to roughly a fifth of the proceeds used since 2018¹⁵. Green bonds finance a variety of activities considered to be 'green', depending on the applicable definition. Technically speaking, the 'greenness' of a bond is determined by the use of its proceeds. If the bond proceeds are used for 'environmentally sustainable purposes', a bond can be issued as green. The definition of 'environmentally sustainable purposes' is up to issuers if the green bonds are not verified or certified and up to external private reviewers if the green bonds are verified or certified under private standards (below 1.3).

1.3. Comparison of the Commission proposal with existing standards

The proposed Regulation on European Green Bonds (EuGBR proposal)¹⁶, including its Annexes¹⁷, is not the first green bond standard, but certainly the most ambitious, comprehensive, detailed and rigorous standard. In comparison with other standards, it is both principles-based and gives clear guidance as to which economic activities are eligible by referring to the Taxonomy Regulation.

The first green bond standards widely used by private and public issuers were voluntary standards set by private organisations. The not-for-profit organisation Climate Bonds Initiative (CBI) issued the first Climate Bond Standard in 2011 introducing the definitory link to the use of proceeds¹⁸. In 2014, the financial industry association International Capital Market Association (ICMA) launched the Green Bond Principles¹⁹ as voluntary process guidelines for issuing green bonds. ICMA's Green Bond Principles (2021)²⁰ are still based on the four components: use of proceeds, process for project evaluation and selection, management of proceeds, and reporting. CBI's current Climate Bonds Standard (2019)²¹

¹² In 2015: energy (10bn USD, 55%), buildings (3,1bn USD, 16%), transport (2,1bn USD, 11%). In 2021 H1: energy (44bn USD, 36%), buildings (41bn USD, 33%), transport (19bn USD, 15%). Data from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

¹³ 2014: 11bn USD, 61%; 2015: 10bn USD, 55%; 2016: 15bn USD, 59%; 2017: 26bn USD, 43%; 2018: 23bn USD, 33%; 2019: 42bn USD, 34%; 2020: 57bn USD, 36%; 2021 H1: 44bn USD, 36%. Data from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

¹⁴ 2015: 3,1bn USD, 16%; 2021 H1: 41bn USD, 33%. Data from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

¹⁵ 2015: 2,1bn USD, 11%; 2018: 14bn USD, 20%; 2019: 25bn USD, 20%; 2020: 37bn USD, 23%; 2021 H1: 19bn USD, 15%. Data from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

¹⁶ European Commission, proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (COM(2021) 391 final). https://eur-lex.europa.eu/resource.html?uri=cellar:e77212e8-df07-11eb-895a-01aa75ed71a1.0001.02/DOC_1&format=PDF.

¹⁷ European Commission, Annexes to the proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (COM(2021) 391 final ANNEXES 1 to 4). https://eur-lex.europa.eu/resource.html?uri=cellar:e77212e8-df07-11eb-895a-01aa75ed71a1.0001.02/DOC_2&format=PDF.

¹⁸ Climate Bonds Initiative, Climate Bond Standard, 2011. <https://www.climatebonds.net/2014/05/climate-bond-standard-launch-backed-investors-and-ngos-goal-assure-integrity-green>.

¹⁹ International Capital Market Association, Green Bond Principles, 13 January 2014. <https://www.climatebonds.net/files/uploads/2014/01/Green-Bond-Principles-FINAL.pdf>.

²⁰ International Capital Market Association, Green Bond Principles – Voluntary Process Guidelines for Issuing Green Bonds, June 2021. <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Green-Bond-Principles-June-2021-100621.pdf>.

²¹ Climate Bonds Initiative, Climate Bonds Standard Version 3.0, 2019. <https://www.climatebonds.net/files/files/climate-bonds-standard-v3-20191210.pdf>.

further specifies these four pre- and post-issuance requirements and adds a Climate Bond Taxonomy²² and specific sectoral eligibility criteria²³.

In terms of public standards, the existing national standards vary significantly. China's Green Bond Endorsed Projects Catalogue (2015 Edition²⁴ and 2021 Edition²⁵) offers a mere list of activities considered to be 'green' for bond issuance purposes. India's Disclosure Requirements for Issuance and Listing of Green Debt Securities of 2017²⁶ defines green debt securities broadly and mandates certain disclosure requirements. Japan's Green Bond Guidelines (2017²⁷ and 2020²⁸) and France's standard for its first sovereign green bond issuance in 2017²⁹ followed ICMA's Green Bond Principles.

1.4. Legal context

The EuGBR proposal is part of the EU's broader strategy to foster sustainable finance as projected by the Commission's Action Plan on Financing Sustainable Growth from 2018³⁰. As to the definition of 'green', it is therefore closely linked to Regulation (EU) 2020/852 (Taxonomy Regulation)³¹, which defines the criteria for investments to be considered environmentally sustainable. The Taxonomy Regulation is further specified by the Commission and contains seven empowerments for the Commission to adopt delegated acts: one on disclosure³² and six on environmental objectives³³. Thus far, the Commission has adopted only the delegated act on disclosure and two delegated acts on environmental objectives. The first delegated act, Commission Delegated Regulation (EU) 2021/2139 (Taxonomy Climate Delegated Act)³⁴, established the technical screening criteria for determining the taxonomy-conformity of economic activities that substantially contribute to climate change mitigation and climate change adaptation. The second delegated act, Commission Delegated Regulation (EU)

²² Climate Bonds Initiative, Climate Bonds Taxonomy, September 2021.

https://www.climatebonds.net/files/files/Taxonomy/CBI_Taxonomy_Tables-08A%20%281%29.pdf.

²³ Climate Bonds Initiative, Sectoral Eligibility Criteria, 2022. <https://www.climatebonds.net/standard/sector-criteria>.

²⁴ Green Finance Committee of China Society of Finance and Banking, Green Bond Endorsed Projects Catalogue (2015 Edition). <http://www.greenfinance.org.cn/displaynews.php?cid=79&id=468>.

²⁵ People's Bank of China, National Development and Reform Commission, and China Securities Regulatory Commission, Green Bond Endorsed Projects Catalogue (2021 Edition). <https://www.climatebonds.net/files/files/the-Green-Bond-Endorsed-Project-Catalogue-2021-Edition-110521.pdf>.

²⁶ Securities and Exchange Board of India, Circular on Disclosure Requirements for Issuance and Listing of Green Debt Securities, 30 May 2017, CIR/IMD/DF/51/2017. https://www.sebi.gov.in/legal/circulars/may-2017/disclosure-requirements-for-issuance-and-listing-of-green-debt-securities_34988.html.

²⁷ Japan's Ministry of the Environment, Green Bond Guidelines, 2017. Available at: http://greenbondplatform.env.go.jp/pdf/greenbond_guideline2017_en.pdf.

²⁸ Japan's Ministry of the Environment, Green Bond Guidelines – Green Loan and Sustainability Linked Loan Guidelines, 2020. https://www.env.go.jp/policy/guidelines_set_version_with%20cover.pdf.

²⁹ République Française, Framework for the Green OAT, 10 January 2017. Available at: <https://www.aft.gouv.fr/files/archives/attachments/25562.pdf>.

³⁰ European Commission, Action Plan: Financing Sustainable Growth, Brussels 8.3.2018, COM(2018) 97 final. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN>.

³¹ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 [2020] OJ L 198/13. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN>.

³² Article 8(4) Taxonomy Regulation.

³³ Articles 10(3), 11(3), 12(2), 13(2), 14(2), 15(2) Taxonomy Regulation.

³⁴ Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives [2021] OJ L 442/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R2139&qid=1643891065831&from=EN>.

2021/2178 (Taxonomy Disclosure Delegated Act)³⁵, specified disclosure obligations regarding environmentally sustainable economic activities. The third delegated act, including natural gas and nuclear energy in the Taxonomy under certain conditions (Taxonomy Complementary Climate Delegated Act)³⁶, is not yet in force, but was formally adopted by the Commission on 9 March 2022 and is currently under scrutiny by the Council and the European Parliament. In the future, the Commission will adopt further delegated acts on the remaining four environmental objectives and amend the existing ones to reflect the evolving technological state-of-the-art and environmental needs.

The focus of the EuGBR proposal on transparency requirements connects to Regulation (EU) 2019/2088 (Sustainable Finance Disclosure Regulation)³⁷, which stipulates transparency duties for financial market participants and financial advisers on sustainability-related information. Similarly, it relates to the latest Commission proposal for a Corporate Sustainability Reporting Directive (CSRD proposal)³⁸, which aims to introduce mandatory EU sustainability reporting standards for large and listed companies in the EU. The CSRD proposal is currently undergoing the ordinary legislative procedure³⁹. In addition, the EU introduced climate benchmarks in Regulation (EU) 2019/2089 (Climate Transition Benchmark Regulation)⁴⁰ and its Delegated Regulation (EU) 2020/1818 (Climate Transition Benchmark Delegated Regulation)⁴¹.

³⁵ Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation [2021] OJ L 443/9. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R2178&from=EN>.

³⁶ Commission Delegated Regulation (EU) .../... of 9.3.2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities [C(2022) 631 final]. [https://ec.europa.eu/transparency/documents-register/api/files/C\(2022\)631_0/090166e5e98cca4f?rendition=false](https://ec.europa.eu/transparency/documents-register/api/files/C(2022)631_0/090166e5e98cca4f?rendition=false).

³⁷ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector [2019] OJ L 317/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN>.

³⁸ European Commission, proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, Brussels 21.4.2021 (COM/2021/189 final). <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0189&qid=1643893433551&from=EN>.

³⁹ Information on the current state of the procedure is <https://eur-lex.europa.eu/legal-content/EN/HIS/?uri=CELEX:52021PC0189>.

⁴⁰ Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks [2019] OJ L 317/17. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2089&from=EN>.

⁴¹ Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks [2020] OJ L 406/17. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R1818&from=EN>.

2. THE KEY REGULATORY AIMS OF A EUROPEAN GREEN BOND STANDARD

KEY FINDINGS

The creation of a European Green Bond Standard (EuGBS) has five intertwined regulatory aims. First, it aims at to help the green bond market grow. Like many EU acts of financial regulation, it will strengthen the single market by fostering the uptake by issuers and stimulating the demand of investors.

Second, an EuGBS aims to enhance the comparability, transparency and credibility of the EU's green bond market. A single standard with clear and understandable criteria will create a regulatory level playing field and give solid guidance for both issuers and investors.

Third, it is meant to prevent issuers from 'greenwashing' their activities, i.e. from misleading investors by marketing bonds as 'green' even though they do not finance environmentally sustainable economic activities. 'Greenwashing' is unfair competitive behaviour that harms misled investors and competing issuers. It ultimately torpedoes climate change prevention and harms society and the environment.

Fourth, the EuGBS ultimately intends to help prevent climate change. In line with the Paris Agreement and the EU's Green Deal, the EGBS is meant to direct private funds towards environmentally sustainable activities.

Fifth, the EuGBS can create a 'gold standard' for green bonds globally and therefore have a global impact. The EU is well known around the world as a sound and effective standard setter. It influences legislators, regulators and also market participants outside the EU, described as the 'Brussels effect'. This requires the EuGBS to be well designed and convincing.

2.1. Foster uptake by issuers

The EuGBR proposal aims to stimulate demand for green bonds in the EU by creating a single and trustworthy green bond standard⁴². This goal is based on a threefold assumption relating to the existing strong investor appetite to buy green financial products and green bonds in particular. The first is that more and more issuers will be interested in issuing green bonds to meet the growing investor demand and to have a 'green' reputation. The second is that investors already interested in buying green bonds will buy even more of them once there is a uniform, clear and reliable standard for green bonds. The third is that a uniform clear, and reliable green bond standard will also convince such investors who are currently not yet interested in green bonds. From a regulatory theory perspective, the underlying idea is that regulating the market conditions will create a new market. The strong investor appetite is highlighted by the fact that most green bond issuances are oversubscribed and that investors are willing to pay a 'greenium', i.e. they invest in green bonds even though their yields are lower than those of comparable conventional bonds⁴³.

⁴² EuGBR proposal, p. 1.

⁴³ Löffler, K.U., Petreski, A., and Stephan, A., Drivers of green bond issuance and new evidence on the "greenium" (2021) 11 Eurasian Economic Review 1–24; Agliardi, E., and Agliardi, R., Corporate Green Bonds: Understanding the Greenium in a Two-Factor Structural Model (2021) 80 Environmental and Resource Economics 257–278; Lau, P., et al., The Economics of the Greenium: How Much is the World Willing to Pay to Save the Earth? (2022) 81 Environmental and Resource Economics 379–408.

2.2. Enhance the transparency, comparability and credibility of the green bond market

The EuGBR proposal addresses market fragmentation and uncertain investment conditions. Currently, there is no protected EU label for green bonds. As a result, issuers can label their bonds 'green' without having to abide by clear and verifiable rules. Issuers can either opt for one of the existing private standards, which some stock exchanges even require for green bonds to be listed,⁴⁴ or simply decide on their own which activities they want to finance and label as 'green'. There is no regulatory level playing field. This leads to distorted markets and problems on the supply and demand sides⁴⁵. The criteria of 'greenness' are unclear for both issuers and investors. Issuers have to invest in market research to choose one of the existing green bond standards or use their own criteria. Investors have to conduct research to understand the criteria used by an issuer and to evaluate whether the green bonds of different issuers are comparable. This is cumbersome in light of competing standards and it lacks clarity on definitions. A uniform standard with transparent conditions will make the green bond market more transparent and credible for both issuers and investors. It will be easier for issuers to choose the applicable criteria and for investors to make an informed choice. It will also reduce regulatory divergence and create a regulatory level playing field.

2.3. Prevent greenwashing

The creation of a single and clear EuGBS also aims to tackle a negative phenomenon called 'greenwashing'. The Oxford English Dictionary defines the verb 'to greenwash' in the following way:

- “(a) To mislead (the public) or counter (public or media concerns) by falsely representing a person, company, product, etc., as being environmentally responsible;
- (b) to misrepresent (a company, its operations, etc.) as environmentally responsible.”⁴⁶

Under the current EU legal framework, issuers are free to call their bonds 'green' without having to respect specific conditions. They can pick and choose their 'greenness' criteria and any third party verification or certification is voluntary. As a result, issuers can easily mislead investors by marketing bonds 'green' even though they do not finance environmentally sustainable economic activities, but heavy CO₂-emitting activities relating to coal or oil. 'Greenwashing' is unfair competitive behaviour vis-à-vis the competitors that abide by stricter criteria and have higher compliance costs⁴⁷. In addition, it misleads and harms investors who wrongly believe the financial product follows restrictive criteria⁴⁸. 'Greenwashing' also undermines trust in the green bond market and torpedoes the overarching goal to help prevent climate change.

⁴⁴ For example, Börse Frankfurt requires green bonds to meet ICMA's Green Bond Principles (above fn 20), see Börse Frankfurt, Green Bonds – Sustainable bond investments, 2021. Available at: <https://www.boerse-frankfurt.de/bonds/green-bonds>. Borsa Italiana identifies green or social bonds as such only if they are certified by an independent third party entity, see Borsa Italiana, Green and Social Bonds – How to be Included, 2022. Available at: <https://www.borsaitaliana.it/obbligazioni/greenbondsbridge/accediallista.en.htm>. Euronext requires an independent third party review under any framework, but consistent with ICMA's Guidelines for External Reviewers (below fn 367), see Euronext, Euronext ESG Bonds, 2022. Available at: <https://www.euronext.com/en/list-products/bonds/esg-bonds>. These and other stock exchanges in the EU have joined the UN Sustainable Stock Exchanges Initiative, see UN Sustainable Stock Exchanges Initiative, SSE Partner Exchanges, 2022. Available at: <https://sseinitiative.org/members/>.

⁴⁵ Antonicic, M., Is ESG investing contributing to transitioning to a sustainable economy or to the greatest misallocations of capital and a missed opportunity? (2022) 15(1) Journal of Risk Management in Financial Institutions 6-12.

⁴⁶ "greenwash, v." OED Online, Oxford University Press, December 2021. www.oed.com/view/Entry/251865. Accessed 17 January 2022.

⁴⁷ Czarnezki, J., Homant, A., and Jeans, M., Greenwashing and Self-Declared Seafood Ecolabels (2014) 28(1) Tulane Environmental Law Journal 37-52.

⁴⁸ Gatti, L., Pizzetti, M., and Seele, P., Green lies and their effect on intention to invest (2021) 127 Journal of Business Research 228–240.

2.4. Help climate change prevention

The overarching goal behind the EuGBR proposal is to contribute to the prevention of climate change by creating effective means for private investments to finance the transition towards an environmentally sustainable economy⁴⁹. This is in line with the EU's international obligations under Article 2(1) lit. c of the Paris Agreement⁵⁰, which aims to strengthen the global response to the threat of climate change by making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development. It also implements the EU's Green Deal, which aims to transform the EU into a resource-efficient and competitive economy without net emissions of greenhouse gases by 2050, where economic growth is decoupled from resource use⁵¹, and Regulation (EU) 2021/1119 (European Climate Law)⁵², which makes the EU's transition towards greenhouse emission neutrality by 2050 an EU law obligation. The economic transition requires significant public and private investments in environmentally sustainable economic activities. Bonds are a widely-used financial instrument of corporate and public entities to raise investments. The EuGBR proposal aims to create a robust and effective standard to guarantee that bonds labelled 'European green bonds' merit their name and really help the prevention of climate change by directing financing towards environmentally sustainable economic activities.

2.5. Create a 'gold standard' for green bonds globally

If it is well designed and convincing, the EuGBS can be a regulatory model for green bonds globally. From a global perspective, the EuGBR proposal is the most ambitious, comprehensive, detailed and rigorous standard on green bonds to be legislated. Hence, it is a pioneering work and will certainly influence other legislators, regulators and market participants around the world. The EU is very good at creating regulatory standards in all kinds of areas. Given the economic importance of the EU as a major economic market and the quality of the EU's regulatory standards, they tend to influence other legislators who see the EU as a model and market participants who want to export into the EU. Bradford (2020) has analysed this phenomenon and called it the 'Brussels effect'⁵³.

⁴⁹ EuGBR proposal, p. 1.

⁵⁰ Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change [2016] OJ L 282/4. [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22016A1019\(01\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22016A1019(01)&from=EN).

⁵¹ Commission Communication, The European Green Deal, Brussels 11.12.2019 (COM(2019) 640 final), p.2. https://eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f-01aa75ed71a1.0002.02/DOC_1&format=PDF.

⁵² Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 (European Climate Law) [2021] OJ L 243/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R1119&from=EN>.

⁵³ Bradford, A., The Brussels Effect: How the European Union Rules the World, Oxford University Press 2020.

3. VOLUNTARY OR MANDATORY SCHEMES – HOW TO CREATE INCENTIVES AND ACHIEVE REGULATORY AIMS

KEY FINDINGS

While the EuGBR proposal designs the EuGBS as a voluntary scheme (Option 1), several options of voluntary or mandatory standards exist on the scale of voluntariness. The standard could be mandatory for the voluntary use of the ‘green’ label (Option 2). It could further require a mandatory ‘green’ or ‘non-green’ label for all bonds (Option 3). As an extreme, the standard could impose mandatory ‘green’ requirements for all bonds (Option 4).

The general arguments in favour of a voluntary standard are based on the freedom of contract in line with the general free market economy. The general arguments in favour of a mandatory standard rely mainly on considerations of effectiveness. The EU Ecolabel serves as an example of a voluntary standard. The EU organic label is an example of a voluntary-mandatory standard.

While a voluntary standard helps the market transition, in the long run a mandatory EuGBS under Option 2 will achieve the key regulatory aims most effectively and help create a regulatory level playing field.

3.1. EuGBR proposal: voluntary scheme

The evolution of the green bond market in the EU (above 1.1) shows that issuers and investors are increasingly interested in green bonds as a financial instrument. One of the key regulatory aims of the EuGBR proposal is to foster the uptake by issuers (above 2.1). The EuGBR proposal tries to achieve this goal by offering the label ‘European green bond’ as a voluntary tool for issuers⁵⁴. Issuers who wish to use the designation ‘European green bond’ or ‘EuGB’ have to comply with the bond-related, transparency and external review requirements under the EuGBR proposal until their maturity⁵⁵. Under the EuGBR proposal, issuers would continue to be free to issue their bonds as ‘green bonds’ or ‘environmentally sustainable bonds’ without respecting any of the regulatory criteria.

3.2. Possible degrees of voluntariness for EuGBS

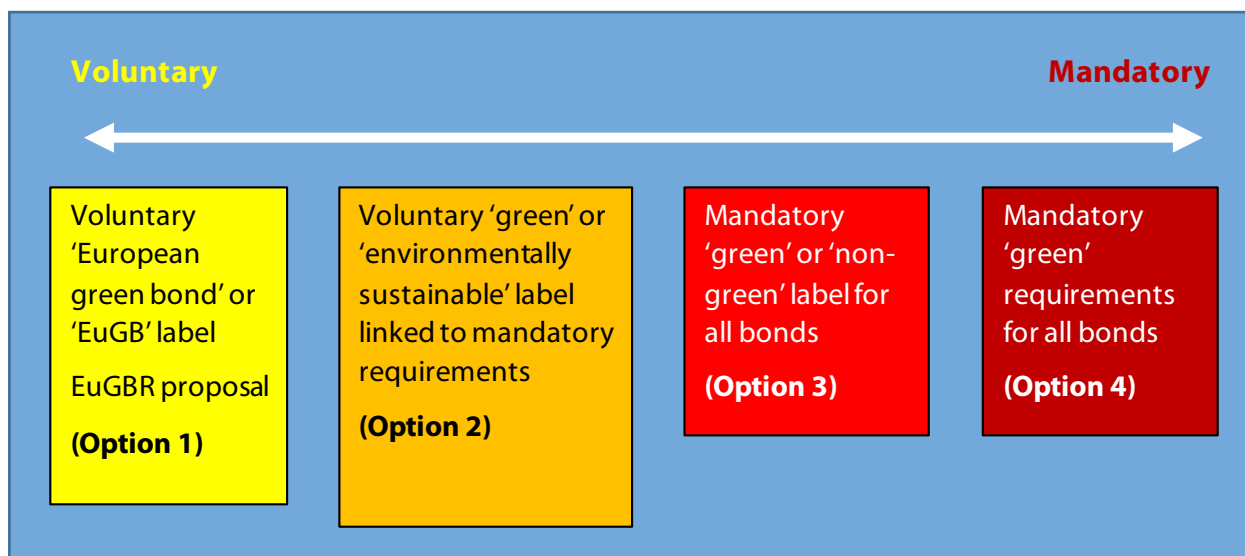
The decision between a voluntary or a mandatory standard is not binary, but gradual. The co-legislators in fact face a multiple choice because the EuGBS can be shaped with different degrees of voluntariness as visualised in Figure 3. On one side of the spectrum, there is the least intrusive option of an entirely voluntary label restricted to the use of the designation ‘European green bond’ or ‘EuGB’ as proposed in the EuGBR proposal (Option 1). On the other side of the spectrum, there are mandatory ‘green’ requirements for all bonds issued or marketed in the EU (Option 4). This most intrusive option would de facto ban bonds as financial instruments for the financing of environmentally unsustainable activities. In between the two extremes, there are two options with voluntary and mandatory elements. Closer to the mandatory end of the spectrum is the option of a mandatory label for all bonds issued or marketed in the EU on their ‘greenness’, i.e. the duty for issuers to declare whether the issued bonds are ‘green’ and comply with the EuGBS or not (Option 3). Closer to the voluntary end of the spectrum, there is the option of mandatory requirements for bonds labelled as ‘green’ or ‘environmentally

⁵⁴ Article 1 EuGBR proposal.

⁵⁵ Article 3 EuGBR proposal.

sustainable' without making the declaration on a bond's 'greenness' compulsory for all bonds (Option 2).

Figure 3: Spectrum of voluntariness options for the EuGBS



Source: Author's own elaboration.

3.2.1. General arguments in favour of a voluntary standard

The general arguments in favour of a voluntary standard (Option 1) are based on the freedom of contract in line with the general free market economy. In the EuGBR proposal, the Commission states that the voluntary approach avoids disruptive impacts on existing green bond markets⁵⁶. The creation of a voluntary standard would add another standard to the market which would compete with the existing standards. Market participants could test the EuGB label and at the same time the co-legislators could test the uptake by issuers and the general market reaction. According to the Commission, this would facilitate a competitive market environment in which investor demand rather than regulatory requirements drives the future issuance of environmentally sustainable bonds⁵⁷. The underlying idea is that the EuGBS will convince the market if it is good enough. Furthermore, given the designation 'European green bond', the voluntary approach builds on the reputation of the EU as a good and effective standard setter and on the assumption that markets will trust the EU label.

3.2.2. General arguments in favour of a mandatory standard

The general arguments in favour of a mandatory standard rely mainly on considerations of effectiveness. A mandatory standard would have much stronger effects on markets and practically ban less restrictive green bond standards. While the voluntary approach could possibly result in the EuGBS being practically insignificant because issuers might not choose it for several reasons, a mandatory standard would certainly be applied as long as issuers want to issue green bonds (Option 2) or bonds more generally (Options 3 and 4) and investors continue to be interested in them. The more mandatory the EuGBS becomes, the more it is likely to end the current state of market fragmentation in the EU. The EuGBS would diminish market fragmentation by imposing specific criteria for bonds to be called 'green' (Option 2), by requiring all issuers to label their bonds 'green' or 'non-green' according to their

⁵⁶ EuGBR proposal, p. 8.

⁵⁷ Ibid.

compliance with the EuGBS (Option 3), or by requiring all bonds to be 'green', i.e. to comply with the EuGBS. A voluntary standard only diminishes market fragmentation if it convinces a significant amount of issuers to use it. But issuers might want to continue calling their bonds green without paying the cost of external verification or review. As a result, it can be argued that a voluntary standard (Option 1) is rather likely to contribute to further fragmentation by adding another standard for issuers to choose. In addition, a voluntary standard (Option 1) might not create sufficient incentives for issuers to adopt the EuGBS because it relies mainly on the reputation and persuasiveness of the EuGB label, which is still to be seen.

3.2.3. The EU Ecolabel as an example of a voluntary standard (Option 1)

The opt-in approach of the EuGBR proposal (Option 1 in Figure 3) parallels other acts of EU legislation that offer private parties a specific instrument without making it mandatory, e.g. the EU Ecolabel under Regulation (EC) No 66/2010 (Ecolabel Regulation)⁵⁸. The EU Ecolabel is a voluntary scheme for producers, manufacturers, importers, service providers, wholesalers or retailers to have their goods or services registered and to sell them using the EU Ecolabel logo⁵⁹. It certifies that the good or service is compliant with the Ecolabel criteria, which are based on environmental performance determined on a scientific basis and considering the whole life cycle of products⁶⁰. The Ecolabel criteria for each product group can be initiated by the Commission, Member States, national competent bodies or other stakeholders, must be in consultation with the EU Ecolabelling Board and are ultimately established by the Commission⁶¹.

The Commission is currently developing an EU green label for retail financial products under the Ecolabel Regulation to provide retail investors with a credible, reliable and widely recognised label for retail financial products⁶². After mandating the Joint Research Centre (JRC) to provide technical support in the development of the criteria in 2018 and several consultation rounds, the Commission intends to adopt the EU Ecolabel for retail financial products in 2022⁶³. The Commission intends to link the eligibility criteria of the EU Ecolabel for retail financial products to the Taxonomy Regulation criteria for environmentally sustainable economic activities⁶⁴.

3.2.4. The EU organic label as an example of a voluntary-mandatory standard (Option 2)

Other acts of EU legislation related to sustainability maintain the voluntary approach, but stipulate mandatory requirements for the use of a specific label (Option 2 in Figure 3). A prominent example is the EU organic product label under Regulation (EU) 2018/848 (Organic Product Regulation)⁶⁵ that repealed its predecessor Council Regulation (EC) No 834/2007⁶⁶. The Organic Product Regulation

⁵⁸ Regulation (EC) No 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel [2010] OJ L 27/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32010R0066&from=EN>.

⁵⁹ Article 9 Ecolabel Regulation.

⁶⁰ Article 6 Ecolabel Regulation.

⁶¹ Articles 7-8 Ecolabel Regulation.

⁶² Commission Staff Working Document, Accompanying the Communication from the Commission Strategy for Financing the Transition to a Sustainable Economy (SWD(2021) 180 final), p. 4. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021SC0180&from=EN>.

⁶³ Ibid, p. 13.

⁶⁴ Ibid, p. 6, 7.

⁶⁵ Regulation (EU) 2018/848 of the European Parliament and of the Council of 30 May 2018 on organic production and labelling of organic products and repealing Council Regulation (EC) No 834/2007 [2018] OJ L 150/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0848&from=EN>.

⁶⁶ Council Regulation (EC) No 834/2007 of 28 June 2007 on organic production and labelling of organic products and repealing Regulation (EEC) No 2092/91 [2007] OJ L 189/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0848&from=EN>.

stipulates very detailed requirements for products labelled, advertised or otherwise described as 'organic' in the EU. It prohibits use of the term 'organic', its derivatives and diminutives, such as 'bio' or 'eco' in the labelling, advertising material or commercial documents of a product that does not comply with the Organic Product Regulation and also prohibits the use of misleading terms that suggest compliance⁶⁷. Before being placed on the market, operators are required to have their production certified 'organic' by the national competent authorities⁶⁸. The national competent authorities verify compliance with the Organic Product Regulation in regular official controls⁶⁹. If they suspect non-compliance, they have to carry out an official investigation immediately and provisionally prohibit the placing on the market of the products concerned and their use in organic production⁷⁰. The sanctions for non-compliance are left to Member States that 'shall take any measures, and provide for any necessary sanctions, to prevent fraudulent use' of the protected labels⁷¹.

3.3. Weighing up the arguments

The EU Technical Expert Group on sustainable finance (TEG) advocated a voluntary standard (Option 1)⁷². Several participants of a targeted survey during the Commission's impact assessment explicitly warned of a mandatory standard, while only a small minority expressed their wish for such a standard⁷³. The main criticisms of a mandatory standard (Options 2, 3 or 4) relate to the uptake by issuers, but they can be addressed by adapting the EuGBS.

The first criticism is that it is not clear whether the Taxonomy Regulation is feasible in all regards because it has not yet been tested and applied by markets⁷⁴. As a result, a mandatory standard (Options 2, 3 or 4) might impede uptake by issuers and the green bond market's growth in the EU. This problem can be addressed by creating a transitional period, e.g. one or two years, during which time the EuGBS is voluntary before it becomes mandatory.

The second concern is that a mandatory standard (Options 2, 3 or 4) would lead to divestment in the EU and trigger capital flight to third countries⁷⁵. This can be countered by rendering the EuGBS mandatory for all green bonds issued in the EU (offer) and all green bonds marketed (demand) in the EU. Thereby, a mandatory EuGBS would cover both the offer and the demand sides of the EU green bond market. If EU or non-EU issuers seek investment from within the EU, they will have to abide by the EuGBS to attract EU capital. This would be supported by the overwhelming demand for green bonds in the EU by retail and institutional investors. Hence, capital flight is unlikely as long as the EuGBS is mandatory for the issuance and marketing of green bonds in the EU.

The third criticism is that SMEs in particular would be deterred by the high costs of the required external review⁷⁶. While this problem would exist under a voluntary standard too, it could be solved by giving

⁶⁷ Article 30(1),(2) Organic Product Regulation.

⁶⁸ Articles 34-35 Organic Product Regulation.

⁶⁹ Article 38 Organic Product Regulation.

⁷⁰ Article 41(1) Organic Product Regulation.

⁷¹ Article 41(3) Organic Product Regulation.

⁷² EU Technical Expert Group on Sustainable Finance, Usability Guide, *TEG proposal for an EU Green Bond Standard*, March 2020. https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf.

⁷³ Commission Staff Working Document, Impact Assessment Report Accompanying the document proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (SWD(2021) 181 final), p. 63. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021SC0181&from=EN>.

⁷⁴ *Ibid*, p. 31.

⁷⁵ *Ibid*, p. 31.

⁷⁶ *Ibid*, p. 63.

SME issuers certain privileges or by making only the disclosure requirements mandatory for bonds labelled 'green' (below 7.5).

3.4. How far different options can achieve key regulatory aims

When deciding on the degree of voluntariness for the EuGBS, the co-legislators should take into account which of the options is likely to achieve the key regulatory aims (above 2) in the best way. It is one very important element for the success of the EuGBS and strongly relates to the design of the other elements of the EuGBS, especially the substantive (below 5 and 6) and transparency criteria (below 7), review and supervision (below 8) and enforcement (below 9).

3.4.1. Foster uptake by issuers

Regarding the aim to foster uptake by issuers (above 2.1), the arguments are similar to the general arguments in favour of a voluntary (above 3.2.1) or mandatory standard (above 3.2.2). It is mainly about predicting market reactions. Survey evidence suggests that issuers favour standardisation and that they consider green bonds to be costlier than conventional bonds, but accept these costs because green bond issuance is beneficial because it heightens demand, strengthens investor engagement, and diversifies the investor base⁷⁷. There is no evidence whether issuers prefer a voluntary standard over mandatory standards because the survey did not ask this question.

The voluntary standard presupposes that issuers will be convinced by the high quality of the EuGBS and even accept potentially higher costs passed on by external reviewers in terms of supervisory fees and compliance, legal and organisational costs⁷⁸. The mandatory standard assumes that a voluntary standard will not be effective because issuers might not choose it voluntarily.

The incentives of a voluntary standard (Option 1 and EuGBR proposal) rely on the quality and good reputation of the designation 'European green bond' or 'EuGB'. The European label is supposed to incentivise issuers. Given that the EuGBS is likely to be a more expensive choice for issuers than existing private standards,⁷⁹ the EuGBR proposal is only worth using if the reputational gain of using the 'European green bond' or 'EuGB' label outweighs the higher costs of issuance. A voluntary standard relies on the idea that market growth will be stimulated, but not suffocated, by over-regulating and making investment costlier. The uptake depends on the persuasiveness of the EuGBS framework as a whole. The incentives of a voluntary standard can be illustrated by the EU Ecolabel under the Ecolabel Regulation (above 3.2.3). Its growing importance is underlined by Ecolabel products in the EU having quadrupled since 2010. As per September 2021, 83,590 goods and services had been awarded the Ecolabel in the EU market in 23 product categories, the majority of which were attributable to tourist accommodation services, hard surface cleaning products and tissue paper and tissue products⁸⁰.

The incentives of a more mandatory standard rely on the force of law. Option 2 builds on the general incentives for issuers to use the label 'green', i.e. the existing strong investor demand for green bonds. Issuers know that their bonds are likely to attract investors if they use the label green. If the EuGBS requirements are compulsory for labelling bonds 'green', issuers face the choice between either complying with the EuGBS or issuing a bond not labelled 'green'. For issuers interested in issuing green

⁷⁷ Sangiorgi, I., and Schopohl, L., Explaining green bond issuance using survey evidence: Beyond the greenium (2021) The British Accounting Review 101071. <https://doi.org/10.1016/j.bar.2021.101071>.

⁷⁸ EuGBR proposal, p. 9.

⁷⁹ Ibid.

⁸⁰ European Commission, EU Ecolabel facts and figures, September 2021. https://ec.europa.eu/environment/ecolabel-facts-and-figures_en.

bonds, the incentives are stronger under Option 2 than under Option 1. The criticism that a mandatory standard would suffocate market growth depends on the overall conditions of the EuGBS and can be addressed by reducing the administrative burden for issuers, e.g. streamlining disclosure requirements (below 7) and reducing the costs of review and supervision (below 8). The success of a mandatory standard is exemplified by the very successful EU 'organic' label under the Organic Product Regulation (above 3.2.4), which has seen a sharp rise in the EU over the past two decades. Organic retail sales in the EU grew by more than 800 percent between 2000 and 2020⁸¹.

The more mandatory Options 3 and 4 set even stronger incentives to use the 'green' label, either by requiring issuers to declare bonds as 'non-green' if non-compliant with the EuGBS (Option 3) or by requiring all bonds to comply with the EuGBS (Option 4). However, the danger of these more mandatory standards is over-regulation and preventing the market from functioning properly. For this reason, Options 3 and 4 are not recommended. Option 4 would force all bonds to be green and render market funding via bonds impossible for environmentally unsustainable economic activities. Issuers would have no choice but to issue green bonds and investors would have no choice either. Option 3 would lead to a deterioration in market conditions for bonds that do not comply with the EuGBS because they would have to be labelled 'non-green'. While this would incentivise issuers to find environmentally sustainable economic activities to finance, it would discourage issuances of and investments in bonds pejoratively designated 'non-green' and could in general reduce bonds issuances in the EU and investments in the EU bond market.

3.4.2. Enhance the transparency, comparability and credibility of the green bond market

The different options can achieve the aim of enhancing the transparency, comparability and credibility of the green bond market (above 2.2) depending on their ability to reduce market fragmentation and to harmonise conditions for green bonds. A voluntary EuGBS (Option 1) will have this ability only if and so far as it is taken up by issuers. The more mandatory the design of the EuGBS is, the more it reduces market fragmentation by imposing a single EuGBS for all bonds labelled 'green' (Option 2), for all bonds as a benchmark to be called 'green' or 'non-green' (Option 3) or for all bonds via mandatory 'green' requirements (Option 4). Increasing what is obligatory also augments the harmonisation of the green bond market. A higher degree of harmonisation automatically enhances the transparency and comparability of green bonds and their conditions. However, 'greening' all bonds under Option 4 would also abolish the comparison between green bonds and non-green bonds.

The credibility of the green bond market follows the strength of the EuGBS. If a voluntary EuGBS under Option 1 convinces many issuers, it will enhance the EU green bond market's overall credibility. It is uncertain whether this assumption materialises. Mandatory requirements under Options 2 to 4 are likely to enhance credibility as long as the compulsory requirements do not deter issuers. Given the severity of Option 4, it is likely to have a deterrent effect on overall bond markets and hamper market growth. While Option 3 promotes 'green' bonds, it weakens 'non-green' bonds by defaming them, which does not necessarily enhance the green bond market's credibility and, in addition, undermines the competitiveness of 'non-green' EU capital markets. Therefore, Option 2 is likely to achieve the aim to enhance the transparency, comparability and credibility of the EU green bond market in the best

⁸¹ Trávníček, J., Willer, H., and Schaack, D., Organic Farming and Market Development in Europe and the European Union, in Willer et al. (eds), *The World of Organic Agriculture - Statistics and Emerging Trends 2022*, Research Institute of Organic Agriculture FiBL, Frick, and IFOAM – Organics International, Bonn, 2022) p. 254 (Figure 83). https://www.fibl.org/fileadmin/documents/shop/1344-organic-world-2022_lr.pdf.

way. There is also the possibility of making the transparency requirements alone mandatory for bonds labelled 'green', which would similarly achieve the aim of transparency (below 7.5).

3.4.3. Prevent greenwashing

The ability to prevent greenwashing (above 2.3) differs from option to option. The voluntary EuGBS under Option 1 is not likely to be chosen by issuers who want to greenwash their activities that do not comply with the EuGBS. The compulsory substantial requirements for green bonds under Option 2 will effectively prevent greenwashing as long as the requirements are strict. That is the main advantage of mandatory requirements labelling a bond 'green'. However, the ability to prevent greenwashing does not increase linearly with further increases in what is compulsory, which can create negative counteractions. Options 3 and 4 could motivate issuers of non-green bonds towards the greenwashing of their economic activities as non-green bonds would either be stigmatised or banned. Therefore, Option 2 is likely to assure the most effective prevention of greenwashing.

3.4.4. Help climate change prevention

Whether the EuGBS can achieve the overall goal to help climate change prevention depends on its effectiveness in market uptake. Only a widely used EuGBS with solid criteria will be able to contribute effectively to rendering the EU economy more environmentally sustainable. Therefore, the arguments parallel those with the aim to foster uptake by issuers (above 3.4.1).

3.4.5. Create a 'gold standard' for green bonds globally

The EuGBS can create a 'gold standard' for green bonds globally if it convinces international financial markets in terms of substance. Therefore, its uptake in the EU matters as the market of reference, hence paralleling the arguments on the uptake by issuers (above 3.4.1). More importantly though, it needs to have convincing science-based, substantial criteria for labelling a bond 'green' (below 5.2, 5.3 and 5.4) and effective enforcement mechanisms (below 9).

3.5. Policy recommendations

The co-legislators face the choice between different options on the spectrum of voluntariness (Options 1 to 4 in Figure 3). The following recommendations are based on the ability of the different options to achieve the key regulatory goals of an EuGBS (above 3.4). An entirely voluntary standard linked to the label 'European green bond' or 'EuGB' as proposed by the EuGBR proposal (Option 1) leaves the uncertainty of its effectiveness and market acceptance. The incentives linked to the EU label's good reputation might not outweigh the higher costs compared to private standards. The main difficulty of a voluntary standard under Option 1 is that it does not effectively prevent greenwashing because it would not prevent bonds from being sold as 'green', even though they do not comply with the EuGBS. The more mandatory standards requiring the labelling of bonds 'green' or 'non-green' (Option 3) or requiring all bonds to be 'green' (Option 4) would be more effective in certain regards, but would have the potential to deter investment in the EU bond market and are therefore not recommended either.

This study recommends an EuGBS stipulating mandatory requirements for the issuance of bonds labelled 'green' (Option 2) as the preferred option. It is best placed to create a reliable green bond market and prevent greenwashing by effectively incentivising issuers, and enhancing the transparency, comparability and credibility of the EU green bond market. It is therefore also most suited to help prevent climate change and, possibly, to create a 'gold standard' for green bonds globally. The main criticisms of a mandatory standard could be addressed by adapting the EuGBS. To test the EuGBS' compatibility with market needs, the co-legislators could render the EuGBS mandatory only after a limited transition period, e.g. of one or two years. The danger of capital flight to third countries can be

countered by rendering the EuGBS mandatory for the offer and demand sides, i.e. for all green bonds issued or marketed in the EU. If EU or non-EU issuers seek investment from within the EU, they will have to abide by the EuGBS to attract EU capital (above 3.3). Given the strong ESG investor appetite in the EU, a mandatory standard under Option 2 is unlikely to hamper market growth over time and will instead create a regulatory level playing field giving certainty to issuers and investors and enabling fair competition under the same rule set.

4. GREEN BONDS OR SUSTAINABLE BONDS

KEY FINDINGS

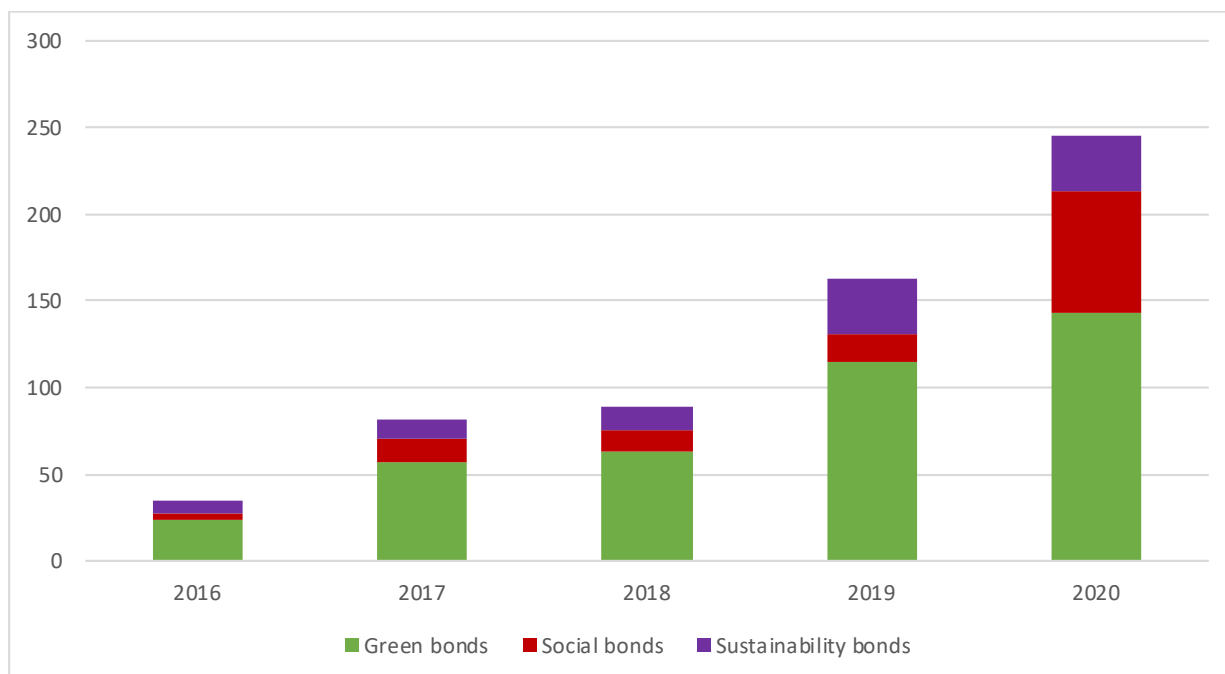
The EGBR proposal only covers green bonds and excludes other types of sustainable bond, e.g. social bonds relating to social objectives or sustainability bonds linking social and environmental objectives.

Including social and sustainability bonds in the EGBS would create a 'sustainable bond standard' covering all aspects of sustainability. While this might appeal in theory, in practice there are no tangible standards for the social and governance aspects of such a standard yet.

4.1. The EuGBR proposal on green bonds only vs. market developments

The co-legislators face a fundamental choice on the scope of application. The scope can either be limited to 'green bonds' as in the EuGBR proposal or extended to 'social bonds' and 'sustainability bonds'. In substance, the question is whether to focus on environmental sustainability (green bonds) or to encompass bonds related to broader social purposes (social bonds) and bonds linking social and environmental sustainability (sustainability bonds). Figure 4 shows the respective evolution in terms of the amount issued over the past five years, which is helpful to understand the importance of social bonds and sustainability bonds compared to green bonds.

Figure 4: Green, social and sustainability bond issuance in the EU 2016 – 2020 (Amount in USD bn)



Source: Chart made by the author based on own calculations. Data extracted from Climate Bonds Initiative, Interactive Data Platform. <https://www.climatebonds.net/market/data/>.

Note: The EU data include issuances in the UK until 2019. In 2020, UK issuances amounted to 5.4 USD bn of green bonds, 1.7 USD bn of social bonds and 2.3 USD bn of sustainability bonds.

4.2. Arguments in favour of the inclusion of social and sustainability bonds

The arguments in favour of a larger scope including social and sustainability bonds are that the term sustainability usually includes not only environmental, but also social and governance matters, and hence is abbreviated 'ESG'. While initially restricted to green bonds, the EU bond market has seen rising market shares in social bonds and sustainability bonds over the past few years. The increased importance of social and sustainability bonds in 2020 is part of a global trend related to the Covid-19 pandemic, which caused increasing bond issuance in the health sector and for other social purposes⁸². This market share of social and sustainability bonds has continued to grow in 2021 and is likely to continue into 2022⁸³. It can be argued that it would make sense to address social and sustainability bonds too if the EU co-legislators already undertake the effort to regulate green bonds. From a market perspective, the three types are comparable as they attract investors interested in financing sustainable projects and are part of a broader phenomenon that can be called a 'sustainable bond market'. This has materialised in private standard-setting. The International Capital Market Association issued its first principles for social bonds (Social Bond Principles) in 2017⁸⁴ and its first guidance on sustainability bonds (Sustainability Bond Guidelines) in 2018⁸⁵. The current versions are the Social Bond Principles of 2021⁸⁶ and the Sustainability Bond Guidelines of 2021⁸⁷.

4.3. Arguments in favour of the exclusion of social and sustainability bonds

The arguments in favour of regulating green bonds distinctly, without encompassing social and sustainability bonds for the moment, are twofold. First, as opposed to green bonds, social and sustainability bonds are a more recent phenomenon where best practices and clear market standards have not yet crystallised sufficiently and, thus, regulators cannot rely on them. ICMA's Social Bond Principles and its Sustainability Bond Guidelines are still very vague and offer only high-level guidance. Second, and more importantly, it is much easier to qualify and quantify criteria for the environmental sustainability of economic activities because the emission of CO₂ and other impacts on the environment are measurable. In contrast, social sustainability is very difficult to define and still a vague concept. This is mirrored by the EU legislation where the Taxonomy Regulation provides a taxonomy on environmental sustainability that already exists, while a taxonomy on social sustainability (Social Taxonomy) is still missing⁸⁸. This lack of specification of eligible bonds and their criteria makes it difficult

⁸² Harrison, C. and Muething, L., Sustainable Debt Global State of the Market 2020, Climate Bonds Initiative, April 2021. https://www.climatebonds.net/files/reports/cbi_sd_sotm_2020_04d.pdf.

⁸³ Climate Bonds Initiative, Sustainable Debt Market Summary H1 2021, September 2021, pp. 1-2. https://www.climatebonds.net/files/reports/cbi_susdebtsum_h12021_02b.pdf.

⁸⁴ International Capital Market Association, Social Bond Principles 2017, 2 June 2017. <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/SocialBondsBrochure-JUNE2017.pdf>.

⁸⁵ International Capital Market Association, Sustainability Bond Guidelines, June 2018. <http://dev.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Sustainability-Bonds-Guidelines-June-2018-270520.pdf>.

⁸⁶ International Capital Market Association, Social Bond Principles – Voluntary Process Guidelines for Issuing Social Bonds, June 2021. <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Social-Bond-Principles-June-2021-140621.pdf>.

⁸⁷ International Capital Market Association, Sustainability Bond Guidelines, June 2021. <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Sustainability-Bond-Guidelines-June-2021-140621.pdf>.

⁸⁸ On the progress of a possibly future Social Taxonomy see EU Platform on Sustainable Finance, Final Report on Social Taxonomy, 28 February 2022. https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/280222-sustainable-finance-platform-finance-report-social-taxonomy.pdf.

to regulate social bonds and sustainability bonds at the same level as green bonds, where measurable determination criteria exist.

4.4. Other sustainable bond types: sustainability-linked bonds and transition bonds

Besides social and sustainability bonds, it can be asked whether it makes sense to include two other recent types of sustainable bonds in the EuGBS. The regulatory scope could be extended to 'sustainability-linked bonds' and 'transition bonds'. While in the medium term sustainability-linked bonds and transition bonds are likely to play a significant role in financing the EU's transition towards greenhouse emission neutrality by 2050 as enshrined in EU law by the European Climate Law⁸⁹, they are still very small market segments. These two categories are less common than social bonds and sustainability bonds and more recent phenomena on the bond market⁹⁰.

'Sustainability-linked bonds' are normal bonds where the issuer does not have to spend the bonds' proceeds for specific sustainable activities, but promises to reach certain quantifiable sustainability goals, often expressed in key performance indicators and sustainability performance targets. In case of failure, the issuer has to pay the investor a certain percentage as a premium, which makes this type attractive to investors. In 2020, the International Capital Market Association issued its first principles on sustainability-linked bonds (Sustainability-Linked Bond Principles)⁹¹. It is difficult to set a threshold for sustainability goals linked to a bond to be sufficiently green to really enhance an issuer's environmental sustainability. Therefore, some sustainability-linked bonds have attracted criticism for their greenwashing⁹². In addition, given that issuers have to pay the additional premium only if they fail to reach the targets, investors have a monetary incentive for the issuer to miss the goal. So the instrument by itself does not necessarily incentivise green investment.

'Transition bonds' are bonds for economic activities that are not environmentally sustainable enough to be classified as a green bond, but for activities that help the issuer transition towards stronger environmental sustainability, e.g. by aligning its business model more with environmental objectives or by reducing CO₂ emissions in high-emitting economic activities. In 2020, the International Capital Market Association published guidance on transition bonds (Climate Transition Finance Handbook)⁹³. Transition bonds can play a crucial role to cover transitional elements under the EuGBR proposal and are further analysed in this study (below 5.4).

4.5. Policy recommendations

This study does not recommend regulating social bonds, sustainability bonds and sustainability-linked bonds in the same detailed way as green bonds. The reason is twofold. First, all three types are relatively new phenomena on the bond market, still developing their features and investor appeal. Second, and more importantly, social bonds cannot technically be regulated in the same way as green bonds at the

⁸⁹ Regulation (EU) 2021/1119 (above fn 52).

⁹⁰ For the global evolution of sustainability-linked bonds and transition bonds compared to green bonds, social bonds and sustainability bonds see Climate Bonds Initiative, Sustainable Debt Market Summary H1 2021, September 2021, p. 1. https://www.climatebonds.net/files/reports/cbi_susdebtsum_h12021_02b.pdf.

⁹¹ International Capital Market Association, Sustainability-Linked Bond Principles – Voluntary Process Guidelines, June 2020. <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/June-2020/Sustainability-Linked-Bond-Principles-June-2020-171120.pdf?showiframe=true>.

⁹² Asgari, N., 'Europe's first sustainable junk bond draws scrutiny over green impact' Financial Times, 12 March 2021. <https://www.ft.com/content/d7fa935a-a2d5-4d8d-bee5-77a92bce5e2c>.

⁹³ International Capital Market Association, Climate Transition Finance Handbook – Guidance for Issuers, December 2020. <https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Climate-Transition-Finance-Handbook-December-2020-091220.pdf>.

moment because there is not yet a clear definition of the criteria attached to the 'social' labelling of a bond. Social sustainability is more difficult to qualify and quantify than environmental sustainability, especially since an EU Social Taxonomy is still missing. Sustainability bonds encounter the same difficulty as they merge green and social bonds. Sustainability-linked bonds function differently as the sustainability elements are not linked to the use of proceeds but to general targets. A potential inclusion in the EuGBS runs the risk of giving them the same reputational prestige that green bonds enjoy. This could result in unnecessary levelling. Hence, it is currently not recommended to include them in the fully-fledged standard. This notwithstanding, the co-legislators could consider stipulating disclosure requirements for 'social bonds', 'sustainability bonds' and 'sustainability-linked bonds' (below 7.4.2). Instead, transition bonds are a tool that is already included in the EuGBR proposal without being clearly named as such (below 5.3.3) and should be further developed (below 5.4).

5. THE USE OF BOND PROCEEDS AND ALIGNMENT WITH THE TAXONOMY REGULATION

KEY FINDINGS

A crucial element for the success of the EuGBS will be a thorough and reliable definition of what exactly makes a bond 'green'. This is necessary to achieve all five key regulatory goals. The EuGBR proposal requires green bonds to align the use of bond proceeds with the Taxonomy Regulation. This includes the technical screening criteria as adopted by the Commission in delegated acts. The EuGBR refers dynamically to them.

The EuGBR proposal requires that bond proceeds be used in a taxonomy-compliant way, but also opens the 'European green bond' label to transition elements. First, it includes transitional economic activities under Article 10(2) Taxonomy Regulation. Second, it grants the 'green' label to activities that do not yet comply with the Taxonomy Regulation and its delegated acts but will foreseeably do so in a period of up to ten years. The dynamic referral to the delegated acts adds a further element of transition. It applies evolving standards to bonds after their issuance by requiring compliance with them five years after their entry into application. To deal with transition in a coherent way and make the transitional elements transparent to investors, this study recommends that the co-legislators consider introducing a category of 'transition bonds' and attaching clear disclosure requirements thereto.

5.1. Use of proceeds under EuGBR proposal

5.1.1. Type of assets

The EuGBR proposal requires a specific allocation of the bond's proceeds. In general, before a bond's maturity, its proceeds have to be exclusively and fully allocated, without deducting costs, to fixed assets, including those of households, which are not financial assets, to capital expenditures, including those of households, to operating expenditures that were incurred more recently than three years prior to the issuance of the European green bond, or to financial assets⁹⁴. Capital expenditures mean either additions to fixed tangible and fixed intangible assets during the financial year considered before depreciation, amortisation and any re-measurements, including the additions resulting from revaluations and impairments for the financial year concerned, and excluding fair value or any additions to fixed tangible and fixed intangible assets resulting from business combinations⁹⁵. Operating expenditures means direct non-capitalised costs which relate to research and development, education and training, building renovation measures, short-term lease, maintenance and repair, and any other direct expenditures relating to the day-to-day servicing of fixed tangible or fixed intangible assets of property, plant and equipment that are necessary to ensure the continued and effective functioning of such assets⁹⁶. Financial assets are debt and equity⁹⁷. The proceeds of the financial assets must be allocated to fixed assets that are not financial assets, to capital expenditures or to operating expenditures⁹⁸. In addition, the proceeds of the financial assets can be allocated to other financial

⁹⁴ Article 4(1) subparagraph 1 EuGBR proposal.

⁹⁵ Article 4(1) subparagraph 2 EuGBR proposal.

⁹⁶ Article 4(1) subparagraph 3 EuGBR proposal.

⁹⁷ Article 5(1) EuGBR proposal.

⁹⁸ Article 5(2) EuGBR proposal.

assets as long as the proceeds from those financial assets are allocated fixed assets that are not financial assets, to capital expenditures or to operating expenditures⁹⁹. To accommodate specific characteristics of sovereign bonds, the EuGBR proposal gives sovereign issuers further possibilities to allocate bond proceeds (below 6.3).

5.1.2. Obligation to use taxonomy criteria

The EuGBR proposal is closely linked to the Taxonomy Regulation. According to the EuGBR proposal, the use of proceeds of a European green bond must relate to activities that meet the requirements of Article 3 Taxonomy Regulation (taxonomy requirements)¹⁰⁰.

The co-legislators bound themselves to using the Taxonomy Regulation criteria to define environmentally sustainable economic activities when legislating on corporate bonds that are made available as environmentally sustainable. On the use of the criteria for environmentally sustainable economic activities in public measures, in standards and in labels, Article 4 Taxonomy Regulation stipulates:

‘Member States and the Union shall apply the criteria set out in Article 3 to determine whether an economic activity qualifies as environmentally sustainable for the purposes of any measure setting out requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable.’

It is noteworthy that the Taxonomy Regulation refers only to corporate bonds, and not to sovereign bonds. The EuGBR proposal instead applies this obligation to both corporate and sovereign bonds (below 6) and, thus, goes beyond the obligation under Article 4 Taxonomy Regulation.

5.2. Environmental sustainability criteria under Taxonomy Regulation

In 2020, the co-legislators achieved one of the central elements of the Commission’s 2018 Action Plan on Sustainable Finance¹⁰¹ by legislating a unified classification system for environmentally sustainable activities, the Taxonomy Regulation¹⁰². Article 3 Taxonomy Regulation stipulates four conditions for economic activities to be qualified as environmentally sustainable: (i) substantial contribution to at least one environmental objective, (ii) no significant harm to an environmental objective, (iii) compliance with minimum safeguards, and (iv) compliance with technical screening criteria¹⁰³. The environmental objectives are: climate change mitigation, climate change adaptation, the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems¹⁰⁴.

5.2.1. Substantial contribution to an environmental objective

According to the first condition of substantial contribution to an environmental objective¹⁰⁵, substantial contribution to climate change mitigation means the avoidance or reduction of greenhouse gas emissions or the increase of greenhouse gas removals, e.g. by generating,

⁹⁹ Article 5(3) EuGBR proposal.

¹⁰⁰ Articles 2(4) and 6 EuGBR proposal.

¹⁰¹ European Commission (above fn 30) p. 4.

¹⁰² Regulation (EU) 2020/852 (above fn 31).

¹⁰³ Article 3 Taxonomy Regulation.

¹⁰⁴ Article 9 Taxonomy Regulation.

¹⁰⁵ Article 3(a) Taxonomy Regulation.

transmitting, storing, distributing or using renewable energy, improving energy efficiency, increasing clean or climate-neutral mobility or switching to the use of sustainably sourced renewable materials¹⁰⁶. Substantial contribution to climate change adaptation means that an activity either substantially reduces the risk of adverse climate impacts on the activity or provides adaptation solutions that substantially contribute to preventing or reducing adverse climate impacts on people, nature or assets¹⁰⁷. The Taxonomy Regulation further specifies substantial contributions to the other four environmental objectives¹⁰⁸ and, in addition, enabling activities¹⁰⁹.

5.2.2. Do no significant harm

Under the second condition¹¹⁰, an economic activity may not significantly harm other environmental objectives (Do No Significant Harm – DNSH). The Taxonomy Regulation requires the examination of the environmental impact of the activity itself and the provided products and services throughout their life cycle and stipulates criteria for determining the significant harm¹¹¹. In the case of climate change mitigation, the significant harm is related to the activity leading to significant greenhouse gas emissions¹¹². For climate change adaptation, it is linked to increasing adverse climate impact on the activity itself or on people, nature or assets¹¹³. An activity significantly harms the sustainable use and protection of water and marine resources where it is detrimental to the good status or ecological potential of bodies of water, including surface water and groundwater, or to the good environmental status of marine waters¹¹⁴. Regarding the circular economy, including waste prevention and recycling, significant harm means that the activity leads to significant inefficiencies in the use of materials or natural resources, to a significant increase in the generation, incineration or disposal of waste, or that the long-term disposal of waste may cause significant and long-term harm to the environment¹¹⁵. Pollution prevention and control is significantly harmed where the activity leads to a significant increase in the emissions of pollutants into air, water or land, compared with the situation before the activity started¹¹⁶. For the protection and restoration of biodiversity and ecosystems, significant harm means that the activity is significantly detrimental to the good condition and resilience of ecosystems or detrimental to the conservation status of habitats and species, including those of EU interest¹¹⁷.

5.2.3. Minimum social safeguards

The third condition of environmental sustainability is compliance with certain minimum social safeguards¹¹⁸. Compliance means implementing procedures to ensure alignment with the OECD Guidelines for Multinational Enterprises¹¹⁹ and the UN Guiding Principles on Business and Human

¹⁰⁶ Article 10(1) Taxonomy Regulation.

¹⁰⁷ Article 11(1) Taxonomy Regulation.

¹⁰⁸ Articles 12–15 Taxonomy Regulation.

¹⁰⁹ Article 16 Taxonomy Regulation.

¹¹⁰ Article 3(b) Taxonomy Regulation.

¹¹¹ Article 17(1),(2) Taxonomy Regulation.

¹¹² Article 17(1)(a) Taxonomy Regulation.

¹¹³ Article 17(1)(b) Taxonomy Regulation.

¹¹⁴ Article 17(1)(c) Taxonomy Regulation.

¹¹⁵ Article 17(1)(d) Taxonomy Regulation.

¹¹⁶ Article 17(1)(e) Taxonomy Regulation.

¹¹⁷ Article 17(1)(f) Taxonomy Regulation.

¹¹⁸ Article 3(c) Taxonomy Regulation.

¹¹⁹ Organisation for Economic Cooperation and Development, OECD Guidelines for Multinational Enterprises, 2011. <https://www.oecd-ilibrary.org/docserver/9789264115415-en.pdf?expires=1644936826&id=id&accname=quest&checksum=11EB00C6D65A4619C3D8E5B58D3BE244>.

Rights¹²⁰, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights¹²¹. Furthermore, by referral to the Sustainable Finance Disclosure Regulation (SFDR)¹²², the implementation of such procedures will adhere to the principle of 'do no significant harm' (DNSH)¹²³. This means that the undertaking follows good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance, and that it does not significantly harm social objectives, in particular the tackling of inequality or fostering of social cohesion, social integration and labour relations, or human capital or economically or socially disadvantaged communities¹²⁴.

The minimum social safeguards could be difficult for companies to operationalise. Even though the principles are enumerated, they are so vague that it is very difficult for issuers to verify their own compliance and for reviewers or supervisors to check their compliance. Some stakeholders voiced this as a major concern when interviewed as part of the Commission's impact assessment for the EuGBR proposal¹²⁵. The Taxonomy Regulation tries to solve this problem by referring to the regulatory technical criteria developed under the SFDR to further specify the principle of 'do no significant harm'¹²⁶. The application of these standards would help companies to operationalise the vague principles, but so far the standards do not exist. While the European Supervisory Authorities have developed these regulatory technical standards and published their final report on them in February 2021¹²⁷, the Commission has not yet adopted them as delegated acts.

It is highly questionable whether the guidance developed for and applicable to financial institutions under the SFDR should be applied to corporate and sovereign green bond issuers under the EuGBS. The EuGBS applies to all kinds of bond issuers that are not financial institutions. These bond issuers have different corporate structures and are not subject to the same disclosure requirements as financial market participants and financial advisers under the SFDR. The regulatory technical standards developed for the SFDR specify the sustainability disclosure duties of financial market participants and financial advisers on sustainability risks, sustainability impacts of their processes and sustainability-related information on their financial products (below 7.3.2). As proposed by the European Supervisory Authorities, they address the DNSH criterion for social and governance factors in specifying these disclosure duties, but not separately¹²⁸. This makes them operable only for issuers that are financial market participants or financial advisers under the SFDR, e.g. investment firms, credit institutions and insurance undertakings (below 7.3.2). Hence, these standards cannot be applied *mutatis mutandis* under the EuGBS. Instead, to make the minimum social safeguards operable for all other issuers under the EuGBS, a distinct catalogue of minimum social requirements pertaining strictly to the Taxonomy

¹²⁰ United Nations, Guiding Principles on Business and Human Rights, 2011. https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf.

¹²¹ Article 18(1) Taxonomy Regulation.

¹²² Regulation (EU) 2019/2088 (above fn 37).

¹²³ Article 18(2) Taxonomy Regulation.

¹²⁴ Article 18(2) Taxonomy Regulation referring to Article 2(17) SFDR.

¹²⁵ Commission Staff Working Document, Impact Assessment Report Accompanying the document proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (SWD(2021) 181 final), pp. 67–68. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021SC0181&from=EN>.

¹²⁶ Recital 35 Taxonomy Regulation.

¹²⁷ Joint Committee of the European Supervisory Authorities, Final Report on draft Regulatory Technical Standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a(3), Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088, 2 February 2021 (JC 2021 03). https://www.esa.europa.eu/sites/default/documents/files/document_library/Publications/Draft%20Technical%20Standards/2021/962778/JC%202021%2003%20-%20Joint%20ESAs%20Final%20Report%20on%20RTS%20under%20SFDR.pdf.

¹²⁸ Ibid.

Regulation or the EuGBS would be necessary. The co-legislators could set the principles of such a distinct catalogue in the EuGBS and empower the Commission to further define the specificities in a delegated act.

5.2.4. Technical screening criteria and Commission delegated acts

The fourth condition of environmental sustainability is compliance with the technical screening criteria established by the Commission¹²⁹. The Taxonomy Regulation empowers the Commission to further specify the criteria of substantial contribution to the six environmental objectives and the criteria of 'do no significant harm' to the same environmental objectives by means of delegated acts¹³⁰. Delegated law-making under Article 290 to the Treaty on the Functioning of the European Union (TFEU) is an EU law tool widely used in the area of financial regulation because it allows for regulatory flexibility to change technical standards in a swifter way than by engaging the co-legislators via ordinary legislative procedure. As regards the Taxonomy Regulation, thus far the Commission has issued three delegated acts, two of which provide technical screening criteria for two of the six environmental objectives.

First, the Commission adopted the Taxonomy Climate Delegated Act¹³¹ establishing the technical screening criteria for determining the substantial contribution to the two environmental goals of climate change mitigation and climate change adaptation of most economic activities, excluding the politically difficult areas of nuclear power and natural gas¹³². The Taxonomy Climate Delegated Act gives clear guidance on a vast range of economic activities and under which conditions they contribute substantially to climate change mitigation¹³³ and climate change adaptation¹³⁴. In a very detailed way, it prescribes the conditions necessary to fulfil the substantial contribution criterion for specific economic activities, including forestry, manufacturing, energy, transport, construction, and many subcategories. This high degree of specificity makes it user-friendly both for businesses and supervisors. The final Taxonomy Climate Delegated Act met limited environmentalist criticism,¹³⁵ received broad support from most stakeholders¹³⁶ and entered into force.

Second, on 9 March 2022, the Commission formally adopted the Taxonomy Complementary Climate Delegated Act¹³⁷, which includes nuclear power and natural gas as environmentally sustainable economic activities under certain conditions according to the Taxonomy Regulation. The Commission conditionally classified the energy sources of nuclear power and natural gas as contributing substantially to the environmental goals of climate change mitigation (Annex I Taxonomy

¹²⁹ Article 3(d) Taxonomy Regulation.

¹³⁰ Articles 10(3), 11(3), 12(2), 13(2), 14(2), 15(2), and 23 Taxonomy Regulation.

¹³¹ Commission Delegated Regulation (EU) 2021/2139 (above fn 34).

¹³² A decision on these hotly debated issues was deliberately postponed, see Commission Communication, EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal, Brussels, 21.4.2021 (COM(2021) 188 final), pp. 6–7. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021DC0188&from=EN>.

¹³³ Annex I Taxonomy Climate Delegated Act.

¹³⁴ Annex II Taxonomy Climate Delegated Act.

¹³⁵ BEUC, Better Finance, Greenpeace EU et al., Joint Letter to MEPs on EU Taxonomy Delegated Act, 9 June 2021. https://www.beuc.eu/publications/beuc-x-2021-057_joint_letter_to_meps_on_eu_taxonomy_delegated_act.pdf.

¹³⁶ For media coverage Khan, M., 'Lost in green translation' Europe Express edited by Pop, V. Financial Times, 9 June 2021. <https://www.ft.com/content/59daa4d4-1a90-461b-99f4-9d5daf4f6e3b>.

¹³⁷ Commission Delegated Regulation (EU) .../... of 9.3.2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities [C(2022) 631 final]. [https://ec.europa.eu/transparency/documents-register/api/files/C\(2022\)631_0/090166e5e98cca4f?rendition=false](https://ec.europa.eu/transparency/documents-register/api/files/C(2022)631_0/090166e5e98cca4f?rendition=false).

Complementary Climate Delegated Act)¹³⁸ and climate change adaptation (Annex II Taxonomy Complementary Climate Delegated Act)¹³⁹ and as not significantly harming other environmental objectives¹⁴⁰. This created fierce controversy¹⁴¹, including stark criticism by the EU Platform on Sustainable Finance¹⁴². The Taxonomy Complementary Climate Delegated Act is currently under the scrutiny of the co-legislators and is not yet in force. If neither the Council nor the European Parliament objects to it within the scrutiny period of four to six months, the Taxonomy Complementary Climate Delegated Act will come into force¹⁴³.

In the future, the Commission will adopt delegated acts providing technical screening criteria for the remaining four environmental objectives: sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems.

5.3. Taxonomy compliant use of bond proceeds under the EuGBR proposal

5.3.1. Taxonomy compliance at the moment of issuance

According to the EuGBR proposal, the use of proceeds of a European green bond must relate to activities that meet the requirements of Article 3 Taxonomy Regulation (taxonomy requirements)¹⁴⁴. The base scenario is that the economic activity already meets the taxonomy requirements at the moment of issuance¹⁴⁵ and fulfils all the technical screening criteria as set out in the relevant delegated acts¹⁴⁶. Where the economic activities to be financed already fulfil these taxonomy requirements, in general no problem arises at this point in time because the planned allocation of bond proceeds will comply with the substantial requirements applicable at the moment of issuance.

In this scenario, difficulties arise in only two cases that are linked to the dynamic referral under Article 7 EuGBR proposal (below 5.3.4). First, if bond issuers want to allocate the bond proceeds to economic activities that are not yet covered by a delegated act, they face uncertain standards at the moment of

¹³⁸ Annex I to the Commission Delegated Regulation (EU) .../... amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities [C(2022) 631 final ANNEX 1].
[https://ec.europa.eu/transparency/documents-register/api/files/C\(2022\)631_1/090166e5e98cbcaf?rendition=false](https://ec.europa.eu/transparency/documents-register/api/files/C(2022)631_1/090166e5e98cbcaf?rendition=false).

¹³⁹ Annex II to the Commission Delegated Regulation (EU) .../... amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities [C(2022) 631 final ANNEX 2].
[https://ec.europa.eu/transparency/documents-register/api/files/C\(2022\)631_2/090166e5e98ccea3?rendition=false](https://ec.europa.eu/transparency/documents-register/api/files/C(2022)631_2/090166e5e98ccea3?rendition=false).

¹⁴⁰ Nuclear energy generation affects the environmental objectives under the Taxonomy Regulation of the circular economy, including waste prevention and recycling, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems. So far, no Member State or any other state in the world has yet succeeded in safely storing the highly radioactive waste, see Gross, A., and White, S., 2022, 'The nuclear power dilemma: where to put the lethal waste', The Big Read, Financial Times, 6 February 2022. Available at: <https://www.ft.com/content/246dad82-c107-4886-9be2-e3b3c4c4f315>.

¹⁴¹ For media coverage Pop, V., 'EU green investment labels pose problems for German coalition', Europe Express, Financial Times, 12 January 2022. <https://www.ft.com/content/0fe39a5b-af01-4757-8398-95c72a27a38c>. Khan, M., 'EU lawmakers plan last-ditch effort to reject Brussels' green investment rules', Financial Times, 7 February 2022. <https://www.ft.com/content/9d287d09-20d4-4dc6-bc93-79ce143f9f26>. Schreiber, P., 'Letter: Stick to the science-based spirit of the EU taxonomy', Financial Times, 9 February 2022. <https://www.ft.com/content/131c26e6-7ae4-4422-9ce3-a74f5339ea10>.

¹⁴² EU Platform on Sustainable Finance, 2022, Response to the Complementary Delegated Act, 21 January 2022.

https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220121-sustainable-finance-platform-response-taxonomy-complementary-delegated-act_en.pdf.

¹⁴³ Article 23(6) Taxonomy Regulation.

¹⁴⁴ Articles 2(4) and 6 EuGBR proposal.

¹⁴⁵ Article 6(1) subparagraph 1 EuGBR proposal.

¹⁴⁶ Article 7(1) subparagraph 1 EuGBR proposal.

issuance because they cannot apply technical screening criteria that are not yet developed. Either the economic activity is not yet covered by an existing delegated act on a specific environmental objective or there is no delegated act for an environmental objective at all, such as the current objectives of sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. This is a blind spot of the EuGBR proposal, which relies on the assumption that the Commission will have adopted delegated acts for all environmental objectives by the time the EuGBS enters into force. Second, issuers can face difficulties post-issuance if the technical screening criteria change due to amendments to the relevant delegated acts. Once the relevant technical screening has been amended, issuers will have to abide by this up to five years from their application into force¹⁴⁷.

5.3.2. Taxonomy compliance of ‘transitional activities’

As per the EuGBR proposal, bonds can carry the label ‘European green bond’ if their proceeds are allocated to economic activities that comply with the taxonomy requirements. This also embraces ‘transitional activities’ under Article 10(2) Taxonomy Regulation as long as they are included in and fulfil the conditions of the relevant delegated acts.

A ‘transitional economic activity’ under Article 10(2) Taxonomy Regulation has five conditions. First, it is an activity for which there is no technologically and economically feasible low-carbon alternative¹⁴⁸. Second, it supports the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1.5 °C above pre-industrial levels, including by phasing out greenhouse gas emissions, in particular emissions from solid fossil fuels¹⁴⁹. Third, it has greenhouse gas emission levels that correspond to the best performance in the sector or industry¹⁵⁰. Fourth, it does not hamper the development and deployment of low-carbon alternatives¹⁵¹. Fifth, it does not lead to a lock-in of carbon-intensive assets, considering the economic life time of those assets¹⁵².

The Taxonomy Climate Delegated Act identifies several transitional activities and stipulates conditions for them in different sectors. Manufacturing activities are among them, e.g. the manufacture of cement¹⁵³, aluminium¹⁵⁴, carbon black¹⁵⁵, soda ash¹⁵⁶, chlorine¹⁵⁷, organic basic chemicals¹⁵⁸, and plastics in primary form¹⁵⁹. The renovation of existing buildings is also a transitional activity under certain conditions.¹⁶⁰ The same applies to data processing, hosting and related activities.¹⁶¹ In addition, certain transportation activities with low CO₂ emissions are classified as transitional activities, e.g. freight railway transport¹⁶², certain means of urban, suburban and road passenger transport¹⁶³,

¹⁴⁷ Article 7(1) subparagraph 2 EuGBR proposal.

¹⁴⁸ Article 10(2) sentence 1 EuGBR proposal.

¹⁴⁹ Article 10(2) sentence 1 EuGBR proposal.

¹⁵⁰ Article 10(2) sentence 1 point (a) EuGBR proposal.

¹⁵¹ Article 10(2) sentence 1 point (b) EuGBR proposal.

¹⁵² Article 10(2) sentence 1 point (c) EuGBR proposal.

¹⁵³ Point 3.7 Annex I Taxonomy Climate Delegated Act.

¹⁵⁴ Point 3.8 Annex I Taxonomy Climate Delegated Act.

¹⁵⁵ Point 3.11 Annex I Taxonomy Climate Delegated Act.

¹⁵⁶ Point 3.12 Annex I Taxonomy Climate Delegated Act.

¹⁵⁷ Point 3.13 Annex I Taxonomy Climate Delegated Act.

¹⁵⁸ Point 3.16 Annex I Taxonomy Climate Delegated Act.

¹⁵⁹ Point 3.17 Annex I Taxonomy Climate Delegated Act.

¹⁶⁰ Point 7.2 Annex I Taxonomy Climate Delegated Act.

¹⁶¹ Point 8.1 Annex I Taxonomy Climate Delegated Act.

¹⁶² Point 6.2 Annex I Taxonomy Climate Delegated Act.

¹⁶³ Point 6.3 Annex I Taxonomy Climate Delegated Act.

transport by motorbikes, passenger cars and light commercial vehicles¹⁶⁴, and inland passenger water transport¹⁶⁵.

The Taxonomy Complementary Climate Delegated Act adds the generation of electricity or heat based on nuclear power and natural gas among the transitional activities under Article 10(2) Taxonomy Regulation under certain conditions. This includes the construction and safe operation of new nuclear power plants, for the generation of electricity or heat, including for hydrogen production, using best-available technologies¹⁶⁶, as well as electricity generation from nuclear energy in existing installations¹⁶⁷. In addition, the Taxonomy Complementary Climate Delegated Act conditionally classifies the electricity generation from fossil gaseous fuels as a transitional activity¹⁶⁸. It also includes the high-efficiency co-generation of heat/cool and power from fossil gaseous fuels¹⁶⁹, and the production of heat/cool from fossil gaseous fuels in an efficient district heating and cooling system¹⁷⁰. By comparison, the private CBI Climate Bonds Taxonomy deems the generation of nuclear power to be automatically compliant with a 1.5°C degree decarbonisation trajectory and requires more work to be done to assess the compliance of natural gas¹⁷¹. It is noteworthy that the CBI Taxonomy focuses merely on decarbonisation and, besides climate change mitigation, does not take into account potential harms to other environmental objectives, i.e. it has no DNSH requirement, unlike the Taxonomy Regulation. ICMA's Green Bond Principles do not rely on a taxonomy and, hence, neither include nor exclude nuclear power and natural gas. However, ICMA recommends transparency on the issuer's exposure to or use of these controversial technologies¹⁷².

Under the EuGBR proposal, all these transitional activities under Article 10(2) Taxonomy Regulation can be financed by 'European green bonds'. This means that the green label can be put on bonds financing the manufacturing of cement, aluminium or carbon black under the Taxonomy Climate Delegated Act, as well as the generation of electricity by use of nuclear power or natural gas if the Taxonomy Complementary Climate Delegated Act enters into force. These transitional activities enjoy the same green label as activities that substantially contribute to climate change mitigation under Article 10(1) Taxonomy Regulation. This is questionable because there is a substantial difference between the two categories regarding their level of contribution to environmental objectives. The introduction of an additional category of 'transition bond' can be useful (below 5.4).

5.3.3. Taxonomy compliance in the foreseeable future – taxonomy-alignment plan and 'transition bonds'

At the moment of issuance, difficulties arise where issuers seek financing for economic activities that do not yet meet the taxonomy requirements. The EuGBR proposal tries to incentivise such issuers to meet the taxonomy requirements by giving them the opportunity to issue an EuGB for activities if it is foreseeable that they will fulfil the taxonomy criteria in the future¹⁷³. The necessary condition is that,

¹⁶⁴ Point 6.5 Annex I Taxonomy Climate Delegated Act.

¹⁶⁵ Point 6.7 Annex I Taxonomy Climate Delegated Act.

¹⁶⁶ Point 4.27 Annex I Taxonomy Complementary Climate Delegated Act.

¹⁶⁷ Point 4.28 Annex I Taxonomy Complementary Climate Delegated Act.

¹⁶⁸ Point 4.29 Annex I Taxonomy Complementary Climate Delegated Act.

¹⁶⁹ Point 4.30 Annex I Taxonomy Complementary Climate Delegated Act.

¹⁷⁰ Point 4.31 Annex I Taxonomy Complementary Climate Delegated Act.

¹⁷¹ Climate Bonds Initiative, Climate Bonds Taxonomy, September 2021, p. 5.

¹⁷² https://www.climatebonds.net/files/files/Taxonomy/CBI_Taxonomy_Tables-08A%20%281%29.pdf.

¹⁷³ International Capital Market Association, Guidance Handbook, June 2021, p.11. <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/The-GBP-Guidance-Handbook-June-2021-140621.pdf>.

¹⁷³ Article 6(1) subparagraphs 1 and 2 EuGBR proposal.

before the issuance, issuers set up and publish a taxonomy-alignment plan describing the actions and expenditures necessary to meet the taxonomy requirements in a specified period of time¹⁷⁴. This period will in principle not exceed five years, exceptionally ten years if justified by the specific features of the activity documented in the plan¹⁷⁵.

Such activities under the EuGBR proposal that do not yet meet the taxonomy requirements, but that are likely to do so in the future can be referred to as 'activities in transition towards taxonomy alignment'. They refer to activities that could already comply with the Taxonomy if they were adjusted, but do not yet do so, e.g. because they do not yet reach the required thresholds. These activities have to be distinguished from 'transitional activities' (above 5.3.2) under Article 10(2) Taxonomy Regulation that are deemed to be taxonomy compliant because, from a sector perspective, there is no technologically and economically feasible low-carbon alternative.

The fact that the EuGBR proposal includes activities in transition towards taxonomy-alignment means that it includes 'transition bonds' (above 4.4) in the EuGBS. This is controversial because it significantly broadens the scope of application and brings vagueness into a standard that tries to be precise. By comparison, the private CBI Climate Bond Standard does not include such activities¹⁷⁶. ICMA's Climate Transition Finance Handbook recommends the use of a 'transition' label for such bonds and suggests issuers develop an encompassing and science-based climate transition strategy and governance, general environmental materiality of their business model, and implementation transparency¹⁷⁷. The incentive for issuers to green their activities by lowering the emissions of certain activities to comply with the Taxonomy in the foreseeable future pursues the regulatory goal to help prevent climate change (above 2.4). The taxonomy-alignment plan is a feature enabling understanding of how realistic it is that currently non-eligible activities will become eligible under the Taxonomy Regulation in the future, i.e. by lowering their climate impact.

The co-legislators have to be careful that this does not become a regulatory loophole for greenwashing future activities if issuers promise unrealistic scenarios to investors only to receive the green label. It is striking that the EuGBR proposal is unclear on the content of a taxonomy-alignment plan. It neither specifies the exact content, nor does it contain a model for a taxonomy-alignment plan or empower the Commission to adopt a delegated act further specifying it. In addition, the variable time frame to meet the taxonomy requirements creates further uncertainty. It can be up to five years or even up to ten years in specific cases, but the EuGBR proposal does not specify the relevant circumstances. It is particularly unclear when the ten year time frame applies because the definition of the 'specific features' is left to the issuer. In this context, it should be noted that many bonds are issued for ten years. This means that if the transition towards taxonomy alignment is planned to take ten years, none of the proceeds will be allocated to activities that comply with the taxonomy requirements.

Given the high potential of greenwashing future activities at a pre-issuance stage, it is recommended that the co-legislators treat activities in transition towards taxonomy-alignment in a more specific way. They could require issuers to label bonds financing such activities as 'transition bonds'. It is recommended to attach specific disclosure requirements to the issuance of 'transition bonds'. It would be helpful for issuers and investors if the co-legislators specified the content of a taxonomy-alignment

¹⁷⁴ Article 6(1) subparagraphs 1 and 2 EuGBR proposal.

¹⁷⁵ Article 6(1) subparagraph 3 EuGBR proposal.

¹⁷⁶ Climate Bonds Initiative, Climate Bonds Standard Version 3.0, 2019 (above fn 21).

¹⁷⁷ International Capital Market Association, Climate Transition Finance Handbook – Guidance for Issuers, December 2020 (above fn 93).

plan, included a model for it in the Annexes, or empowered the Commission to adopt a delegated act further specifying the requirements for taxonomy-alignment plans.

5.3.4. Dynamic Referral to Taxonomy Delegated Acts and ‘Grandfathering’

The EuGBR proposal dynamically refers to the delegated acts supplementing the Taxonomy Regulation and renders those delegated acts binding for the allocation of the bond proceeds that were applicable at the moment of issuance¹⁷⁸. If these delegated acts are amended throughout the lifetime of a bond, the issuers have to apply them at the latest five years after they entered into application¹⁷⁹. For example, if a bond is issued for ten years in 2023 and the then applicable Taxonomy Climate Delegated Act is amended in 2024, the issuer will have to apply the amended version at the latest from 2029 onwards. If the bond proceeds are to be allocated to debt, then those delegated acts apply that were applicable when the debt was created¹⁸⁰. If at that point in time no such delegated act existed, then the first delegated acts adopted will apply retrospectively¹⁸¹. In case of amendments, the same five year rule applies as for the other bonds¹⁸².

The EuGBR proposal follows a dynamic referral approach by referring to the evolving legal framework of the delegated acts under the Taxonomy Regulation. Currently, there are only delegated acts on the two environmental objectives of climate change mitigation and climate change adaptation. Over time, the dynamic referral approach will lead to an increasing link between the EuGBS and the Taxonomy framework when there will also be delegated acts stipulating technical screening criteria for the other four environmental objectives: sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. The dynamic referral under the EuGBR proposal aims to strike a balance between the legal certainty necessary for issuers and investors that rely on the legal framework applicable at the moment of issuance and the foreseeable change of technical screening criteria over time¹⁸³.

While other acts of EU legislation contain a principle called ‘grandfathering’¹⁸⁴, i.e. that persons can rely on and derive rights from rule sets of a specific moment also for the future, this is only partly the case for the EuGBR proposal within the time limit of five years. The dynamic referral to the Taxonomy Delegated Acts and their amendments over time, to be applied at the latest five years after their entry into application, means that issuers cannot be sure that the rules applicable at the moment of issuance will also apply at the moment of maturity. Instead, these criteria are likely to become stricter over time. Therefore, the EuGBR proposal contains grandfathering only for a period of five years, similar to a grace period. This approach is sensible in light of changing technical evolutions and environmental needs.

However, the EuGBR proposal has a blind spot as regards the applicable delegated acts (above 5.3.1). It relies on the assumption that by the entry into force of the EuGBS the Commission will have adopted delegated acts for all six environmental objectives and that these will have entered into application. This assumption is ambitious given that, thus far, the Commission has only covered two environmental objectives. If it is foreseeable that there will not be technical screening criteria for all six environmental objectives by the time the EuGBS enters into force, the co-legislators are recommended to include a

¹⁷⁸ Article 7(1) subparagraph 1 EuGBR proposal.

¹⁷⁹ Article 7(1) subparagraph 2 EuGBR proposal.

¹⁸⁰ Article 7(2) subparagraph 1 EuGBR proposal.

¹⁸¹ Article 7(2) subparagraph 2 EuGBR proposal.

¹⁸² Article 7(2) subparagraph 3 EuGBR proposal.

¹⁸³ Recital 11 EuGBR proposal.

¹⁸⁴ On the notion Schuessler, R., A Luck-Based Moral Defense of Grandfathering, in Meyer and Sanklecha (eds) *Climate Justice and Historical Emissions*, 2017 Cambridge University Press, pp. 141-164, 142-144.

provision that if no relevant delegated act is applicable at the moment of issuance, then the first delegated act shall become applicable at the latest five years after entry into application.

5.4. Introducing ‘transition bonds’ and attaching clear transparency requirements

The EuGBR proposal deals explicitly with transition only regarding economic activities that are in transition towards taxonomy-alignment (above 5.3.3). In addition, the referral to the technical screening criteria in the applicable delegated acts implicitly incorporates transitional activities under Article 10(1) Taxonomy Regulation in the EuGBR proposal (above 5.3.2). The dynamic referral to the amendments of these delegated acts adds another layer of transition over time because the technical screening criteria are likely to become more restrictive over time to prevent the ongoing climate change more effectively (above 5.3.4). These transitional elements can all be considered necessary to foster the development of a more environmentally sustainable economy in the EU.

However, the EuGBR proposal treats these transitional elements in the same way as it treats non-transitional elements and offers the label ‘European green bond’ irrespective of the transition. Bonds relating to transitional elements do not have to make this transition transparent in the bond’s name. It is questionable whether this is in line with the key regulatory goals to enhance the transparency, comparability and credibility of the EU green bond market (above 2.2) and to prevent greenwashing effectively (above 2.3). When buying an EuGB, investors see the label ‘European green bond’ and expect the financed activities to be environmentally sustainable at all times. This expectation can be in conflict with the transitional elements under the EuGBR proposal.

If an EuGB finances economic activities in transition towards taxonomy-alignment, i.e. that do not yet comply with the taxonomy requirements but will foreseeably do so in the future, it can still be labelled a ‘European green bond’. Article 6(1) EuGBR proposal merely prescribes a taxonomy-alignment plan that describes the necessary actions and expenditures for an economic activity to meet the taxonomy requirements within the specified period of time of up to ten years. It could well be that the economic activities will comply with the technical screening criteria that were applicable at the time of issuance only shortly before the maturity, e.g. after ten years, at a moment when these technical screening criteria are outdated and have already been amended. It is highly questionable whether this reflects the objective market expectation of a ‘green bond’.

In addition, an EuGB can use the ‘European green bond’ label to finance transitional activities under Article 10(2) Taxonomy Regulation if they are included in the Taxonomy Climate Delegated Act, e.g. the manufacturing of cement and aluminium, and fulfil the technical screening criteria. The same applies to the generation of electricity or heat/cool by use of nuclear power and natural gas under the Taxonomy Complementary Climate Delegated Act if it enters into force.

The EuGBR proposal does not require issuers to make the transitional elements transparent as ‘transitional’, neither in the bond’s label nor in the EuGB factsheet (below 7.1.1), nor in the allocation reports (below 7.1.2) nor in the impact reports (below 7.1.3). Investors have to read in depth to detect the specific economic activity and evaluate whether it is transitional or not. This is burdensome and hampers the achievement of transparency. Introducing a category of ‘transition bonds’ that are not allowed to carry the green bond label, but have to be called ‘transition bonds’ because the financed activities are not eligible for the higher ‘green bond’ standard (above 4.4) would solve the lack of transparency for investors.

Given the paramount importance of transparency for the comparability and credibility of the EU green bond market, the co-legislators are recommended to require the transitional elements to be clearly

labelled as such. They could require bonds financing transitional activities under Article 10(2) Taxonomy Regulation to be labelled 'transition bonds'. They could also require bonds that finance activities in transition towards taxonomy-alignment to be labelled 'transition bonds' or 'green bonds in transition'. Even though the two different transition elements are different, they share the transitional element. If investors were able to identify them clearly as such, this would strongly foster the transparency, comparability and credibility of green bonds in the EU. Furthermore, if a bond financing the generation of electricity or heat/cool by use of nuclear power or natural gas were not allowed to be labelled a 'green bond', but only a 'transition bond', this could partially address the criticism of greenwashing because the label would clearly point to the transitional nature of the financed activities.

5.5. Policy Recommendations

This study recommends a general referral to the Taxonomy Regulation and its definition of 'green' economic activities for use of bond proceeds in the EuGBS. The Taxonomy Regulation provides an unparalleled detailed and very sophisticated framework that gives issuers and investors important legal certainty. For this reason and for legal cohesion, the EuGBS should adhere to the technical screening criteria developed by the Commission. The Taxonomy Climate Delegated Act gives important details for issuers, investors and supervisors to assess the environmental sustainability of an economic activity to be financed via a green bond. The Taxonomy framework can, as such, emerge as a 'single rulebook'¹⁸⁵ for EU sustainable finance. However, it is necessary to clarify and specify the minimum social safeguards to render them operable for companies. In the current form, they are too vague and, hence, an ineffective means of regulation. While the Taxonomy Regulation refers to regulatory technical standards under the SFDR, these are operable only for issuers that are also subject to the SFDR, e.g. investment firms, credit institutions or insurance undertakings. To make the minimum social safeguards operable for all other issuers under the EuGBS, a distinct catalogue of minimum social requirements pertaining strictly to the Taxonomy Regulation or the EuGBS would be necessary. The co-legislators could set the principles of such a distinct catalogue in the EuGBS and empower the Commission to further define the specificities in a delegated act (above 5.2.3).

In addition, the co-legislators are recommended to create a specific category of 'transition bonds' that covers the allocation of proceeds both to transitional activities under Article 10(2) Taxonomy Regulation and to activities that are in transition towards future taxonomy compliance. The 'transition' label would distinguish them from non-transitional activities that enjoy the plain 'European green bond' label. This would help investors categorise the degree of 'greenness' immediately and prevent the criticism of greenwashing transitional activities. In addition, for activities in transition towards future taxonomy compliance, the co-legislators are advised to stipulate clear requirements for the taxonomy-alignment plan and specify the applicable time limit. Depending on the degree of specification, they could create a template for a taxonomy-alignment plan and empower the Commission to further specify these conditions.

¹⁸⁵ Term borrowed from the European Banking Union, see European Banking Authority, 2022, The Single Rulebook. <https://www.eba.europa.eu/regulation-and-policy/single-rulebook>.

6. A SINGLE STANDARD FOR CORPORATE AND SOVEREIGN BONDS

KEY FINDINGS

The co-legislators have to decide whether to create a single standard for corporate bonds and sovereign bonds, whether to regulate them separately or whether to create a standard for either corporate or sovereign bonds.

As corporate and sovereign bonds compete on the same market and attract the same types of investors, it is sensible to regulate them together. While sovereign bonds are peculiar to some extent, these peculiarities can be addressed by adapting the EuGBS to them.

6.1. Advantages of a single standard

The recent developments of the EU green bond market (above 1.1) show that both the corporate and sovereign bond markets have been growing significantly over the past few years. Corporate entities and EU Member States are increasingly inclined to issue green debt, especially green bonds, and there is strong investor demand for them. They compete on the green bond market and attract similar investors. Market evidence shows that there is a common market for corporate and sovereign bonds attracting especially institutional investors investing in both types¹⁸⁶. The creation of a single EuGBS for both corporate and sovereign green bonds would therefore reduce market fragmentation between the two types and make the applicable substantive criteria more transparent. It would increase the comparability of corporate and sovereign green bonds. Even though institutional investors seem to have a preference for corporate green bonds, the more recent phenomenon of sovereign green bonds comes close to the more established green bonds issued by development banks¹⁸⁷.

In a survey of European asset managers, satisfactory green credentials emerged as the most important factor for a green bond investment, even more important than the price¹⁸⁸. This shows that there is equal need for solid criteria to determine a bond's greenness, independent of the issuer being a corporate entity or a sovereign state. In addition, requiring private sector entities and Member States to abide by the same rules would give the EuGBS stronger credibility and enhance the EU green bond market's credibility. Applying the same standard to corporate and sovereign green bonds would therefore significantly foster one of the key regulatory aims (above 2.2). In order to create a level playing field between corporate and sovereign green bonds, a single EuGBS covering both is needed.

6.2. Disadvantages of a single standard

The disadvantages of a single standard relate mainly to the fact that the two types of issuer are very different, which makes regulating them to the same standard difficult. The first difficulty relates to the activities financed by the bond's proceeds. While a corporate entity usually finances its own activities with the bond proceeds, a sovereign state either invests the proceeds in tangible assets, e.g. related to infrastructure, or in less direct expenditures, e.g. subsidies or operational expenditures. The second difficulty is that states have a less close overview of the financed activities, e.g. by means of grants, so that ensuring compliance with the Taxonomy Regulation can be difficult for them. Third, states are not

¹⁸⁶ Sangiorgi, I., and Schopohl, L., Why do institutional investors buy green bonds - Evidence from a survey of European asset managers (2021) 75 International Review of Financial Analysis 101738, p. 2. <https://doi.org/10.1016/j.irfa.2021.101738>.

¹⁸⁷ Ibid, p. 9.

¹⁸⁸ Ibid, pp. 10-11.

used to being audited by private reviewers, but have their own public authorities to supervise government accounts. Fourth, there might be legal constraints for a sovereign to commit to a specific allocation of future proceeds. Some constitutions stipulate the principle of parliamentary sovereignty over the budget, while the government raises funds by issuing bonds¹⁸⁹.

However, most of these difficulties can be resolved by adjusting the EuGBS criteria for sovereign bonds, especially requirements for the use of bond proceeds (below 6.3) and specific rules for review and supervision (below 8.5). While the environmental sustainability criteria for using bond proceeds can remain equal in substance, the lack of oversight can translate into conditionality of subsidies and operational expenditures, to be monitored by reviewers. Reviewers do not have to be private entities, but can be state auditors or public authorities. From an EU law perspective, constitutional or other legal constraints can create conflicts of law that can be resolved by the principle that EU law takes precedence over national law, including constitutional law¹⁹⁰. Besides, no sovereign is obliged to issue green bonds, and if a state does so, the commitment problem remains the same, independent of the green standard's provenience.

6.3. Specific requirements for the use of sovereign bond proceeds

The EuGBR proposal deals with the specificity of sovereign states and public authorities as issuers and widens the instruments for allocation of proceeds to their benefit. In addition to the general allocation of proceeds to fixed assets, capital expenditures, operating expenditures and financial assets (above 5.1.1), sovereign issuers have five further possibilities to allocate the bond's proceeds¹⁹¹. To define these possibilities, the EuGBR proposal refers to Regulation (EU) No 549/2013 of the European system of national and regional accounts¹⁹². The **first** possibility is fixed assets, here meaning produced non-financial assets as outputs of the production processes¹⁹³. The **second** possibility is non-produced non-financial assets, i.e. economic assets that come into existence other than through processes of production and consist of natural assets, contracts, leases, licences, permits, and goodwill and marketing assets¹⁹⁴. The **third** possibility is tax relief that was granted more recently than three years prior to the issuance of the EuGB¹⁹⁵. Tax relief can take the form of a tax allowance, exemption, or deduction subtracted from the tax base, or of a tax credit subtracted directly from the tax liability otherwise due by the beneficiary household or corporation¹⁹⁶. The **fourth** possibility is subsidies that were transferred more recently than three years prior to the issuance of the EuGB¹⁹⁷. Subsidies are defined as current unrequited payments, which general government or the institutions of the EU make to resident producers¹⁹⁸. The **fifth** possibility is capital expenditures¹⁹⁹. Capital expenditure comprises

¹⁸⁹ Commission Staff Working Document, Impact Assessment Report Accompanying the document proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (SWD(2021) 181 final), p. 40. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021SC0181&from=EN>.

¹⁹⁰ CJEU Case 106/77 Amministrazione delle Finanze dello Stato v Simmenthal SpA [1978] ECR 629. <https://curia.europa.eu/juris/showPdf.jsf?sessionid=C7DA676DA7E92827402B4F27541D166A?text=&docid=89693&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=761915>.

¹⁹¹ Article 4(2) EuGBR proposal.

¹⁹² Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union [2013] OJ L 174/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0549&aid=1646070162517&from=EN>.

¹⁹³ Article 4(2)(a) EuGBR proposal referring to point 7.22 of Annex A to Regulation (EU) No 549/2013.

¹⁹⁴ Article 4(2)(b) EuGBR proposal referring to point 7.24 of Annex A to Regulation (EU) No 549/2013.

¹⁹⁵ Article 4(2)(c) EuGBR proposal referring to point 20.167 of Annex A to Regulation (EU) No 549/2013.

¹⁹⁶ Point 20.167 of Annex A to Regulation (EU) No 549/2013.

¹⁹⁷ Article 4(2)(d) EuGBR proposal referring to point 4.30 of Annex A to Regulation (EU) No 549/2013.

¹⁹⁸ Point 4.30 of Annex A to Regulation (EU) No 549/2013.

¹⁹⁹ Article 4(2)(e) EuGBR proposal referring to point 20.104 of Annex A to Regulation (EU) No 549/2013.

capital transfers, in the form of investment grants and other capital transfers, as well as investment expenditure²⁰⁰.

The EuGBR proposal motivates these exceptions for sovereign issuers with their capacity to indirectly finance taxonomy aligned economic activities through the use of programmes of tax expenditures or programmes of transfers, including subsidies²⁰¹. In addition, given that sovereign issuers ensure that economic activities funded by such programmes comply with the terms and conditions of those programmes, the EuGBR proposal privileges sovereign issuers in such a way that external reviewers will not be required to assess the taxonomy-alignment of each economic activity funded by such programmes²⁰². According to the EuGBR proposal, in these cases it is sufficient for external reviewers to assess the alignment of the terms and conditions of the funding programmes concerned with the taxonomy requirements²⁰³.

6.4. The legal basis caveat for sovereign bonds under mandatory EuGBS

A mandatory standard for green sovereign bonds might be in conflict with the legal basis of Article 114 TFEU. The Commission explicitly excluded the policy option of a mandatory standard for sovereign issuers at an early stage because ‘the chosen legal basis – Article 114 TFEU – does not warrant such type of legislative action’²⁰⁴. Neither does the Commission cite, nor can this study find, specific reasons in the text of Article 114 TFEU, or in the case law of the Court of Justice of the European Union (CJEU), prohibiting mandatory requirements for the use of a specific sovereign bond designation, such as ‘green’. However, should such a restriction exist, the requirements of the EuGBS could be made mandatory only for corporate bonds and voluntary for sovereign bonds.

6.5. Bindingness towards the EU and the relationship with Next Generation EU green bonds

The EuGBR proposal includes Euratom and the EU and any of their agencies in the term sovereign issuer²⁰⁵. This means that the EU itself will have to respect the EuGBS as long as it voluntarily opts for the label ‘European green bond’. Of course, the EU will not issue green bonds without respecting its own standard because this would damage significantly the reputation of the EuGBS and the EU’s own reputation.

In 2021, the Commission adopted a funding strategy for the recovery instrument ‘Next Generation EU’ as a response to the COVID-19 pandemic, aiming to raise EUR 806 billion between 2021 and 2026²⁰⁶. In September 2021, the Commission adopted a green bond framework for Next Generation EU bonds, following the private Green Bond Principles set by ICMA²⁰⁷. This notwithstanding, the Commission pledged to align ‘as much as feasible’ with the upcoming EuGBS²⁰⁸. The Commission obtained a

²⁰⁰ Point 20.104 of Annex A to Regulation (EU) No 549/2013.

²⁰¹ Recital 16 sentence 1 EuGBR proposal.

²⁰² Recital 16 sentences 2 and 3 EuGBR proposal.

²⁰³ Recital 16 sentence 4 EuGBR proposal.

²⁰⁴ Commission Staff Working Document, Impact Assessment Report Accompanying the document proposal for a Regulation of the European Parliament and of the Council on European green bonds, Strasbourg, 6.7.2021 (SWD(2021) 181 final), pp. 40, 167. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021SC0181&from=EN>.

²⁰⁵ Article 2(3)(a) EuGBR proposal.

²⁰⁶ Commission Communication, A new funding strategy to finance NextGenerationEU, Brussels, 14.4.2021 (COM(2021) 250 final), p. 2. https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/com2021_250_en_act_part1_v3.pdf.

²⁰⁷ Commission Staff Working Document, Next Generation EU - Green Bond Framework, Brussels, 7.9.2021 (SWD(2021) 242 final), p. 9. https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/nextgenerationeu_green_bond_framework.pdf.

²⁰⁸ Ibid.

positive second party opinion on the green bond framework from a private reviewer²⁰⁹. In October 2021, the EU issued its first green bond under the Next Generation EU framework; it raised EUR 12 billion, was strongly oversubscribed and the world's largest green bond issuance so far²¹⁰.

Once the EuGBS comes into force, the EU can be expected to apply the EuGBS for the green bond issuances under the Next Generation EU programme. The EU could also opt into the EuGBS and comply with the EuGBS for the future allocation of proceeds from Next Generation EU bonds that were issued before the EuGBS' entry into force. But the EU would not be legally obliged to do so.

6.6. Policy Recommendations

This study recommends that the co-legislators create a single standard mandating in principle the same substantive requirements for corporate and sovereign green bonds. Only an encompassing EuGBS can effectively reduce market fragmentation and enhance the transparency, comparability and credibility of the EU green bond market. The peculiarities of sovereign issuers can be addressed by modifying certain requirements of them, especially on the use of proceeds and review. The EuGBR proposal effectively widens the possibilities to allocate bond proceeds for sovereign issuers (above 6.3). It also establishes specific external review privileges for sovereign issuers (below 8.5) that should be modified for sovereign issuers below government level (below 8.6).

²⁰⁹ V.E, Second Party Opinion on the sustainability of the European Commission's NextGenerationEU (NGEU) Green Bond Framework, 7 September 2021. https://ec.europa.eu/info/sites/default/files/about_the_european_commission/eu_budget/v.e._second_party_opinion_on_the_framework.pdf.

²¹⁰ European Commission, Press Release – NextGenerationEU: European Commission successfully issues first green bond to finance the sustainable recovery, Brussels, 12 October 2021. https://ec.europa.eu/commission/presscorner/detail/en/IP_21_5207.

7. TRANSPARENCY REQUIREMENTS

KEY FINDINGS

The EuGBR proposal requires issuers to disclose and publish on their website an EuGB factsheet, the pre-issuance review, annual allocation reports, post-issuance reviews and impact reports. While the EuGB factsheet and annual allocation reports will add valuable information for investors, the impact reports could be merged with the allocation reports.

Some corporate issuers will face very limited disclosure overlaps with the Prospectus Regulation, the Sustainable Finance Disclosure Regulation, and the proposal for a Corporate Sustainability Reporting Directive when it is adopted.

While an extension of the transparency requirements under the EuGBR proposal to social criteria and environmental sustainability at entity-level is not recommended, the co-legislators should seriously consider rendering the transparency requirements mandatory for all bonds that are labelled 'green' and issued or marketed in the EU.

7.1. EuGBR proposal

The EuGBR proposal requires issuers to disclose five types of document in a distinct section called 'European green bonds' on their website free of charge, at least until the bond matures: an EuGB factsheet, the pre-issuance review, annual allocation reports, the post-issuance review and an impact report²¹¹.

7.1.1. EuGB factsheet and pre-issuance review

The EuGBR proposal mandates issuers to complete and publish an EuGB factsheet before the issuance, which may relate to one or several EuGB issuances²¹². The EuGB factsheet has to provide: (i) general information on the issuer, the bond and the external reviewer, (ii) a statement that the issuer voluntarily adheres to the EuGBS, (iii) an environmental strategy and rationale stating the environmental objectives pursued and explaining how the bond aligns with the issuer's environmental strategy, (iv) the intended allocation of the proceeds, and (v) information on reporting with a link to the website where the allocation and impact reports will be published and indicating whether the allocation reports will include project-by-project information on amounts disbursed and their expected environmental impact²¹³. Issuers have to disclose detailed information on the intended allocation of proceeds and state the estimated time until the proceeds will be fully allocated²¹⁴. They must describe the processes for selecting green projects according to the taxonomy requirements, the applicable technical screening criteria and Taxonomy Delegated Acts, and, where available, information on the methodology and assumptions to be used for the calculation of key impact metrics and the estimation of positive and negative environmental impacts²¹⁵. Where available, the issuers are to publish detailed project-level information on the intended qualifying green projects, including their environmental objectives, the types and sectors of projects, their countries and the respective amount to be allocated

²¹¹ Article 13(1) EuGBR proposal.

²¹² Articles 8(1)(a),(2) 13(1)(a) EuGBR proposal.

²¹³ Points 1 to 5 Annex I EuGBR proposal.

²¹⁴ Point 4.1 Annex I EuGBR proposal.

²¹⁵ Point 4.2 Annex I EuGBR proposal.

from bond proceeds²¹⁶. Issuers also have to disclose how the temporary use of unallocated proceeds will not affect the delivery of the environmental objectives²¹⁷.

In addition, prior to issuing the EuGB, issuers have to publish the pre-issuance review obtained by an external reviewer with a positive opinion on the compliance of the EuGB factsheet with the EuGBS and taxonomy requirements (below 8.1.1)²¹⁸.

7.1.2. Annual allocation report and post-issuance review

Every year, and until the full allocation of the EuGB proceeds, issuers have to publish allocation reports demonstrating that the proceeds have been allocated in full respect of the bond-specific and taxonomy requirements²¹⁹. The yearly allocation reports may relate to one or more issuances²²⁰. Similarly to the EuGB factsheet, they have to contain: (i) general information, (ii) a statement that the issuer voluntarily adheres to the EuGBS, and (iii) detailed information on the allocation of the proceeds²²¹. The allocation of proceeds is to be described at best at project level, specifying the environmental objectives, types and sectors of projects, the countries of allocation, and the respective amount allocated from bond proceeds; providing confirmation of compliance with the minimum social safeguards; and giving an indication of the Taxonomy Delegated Acts used²²². Financial undertaking issuers allocating proceeds from a portfolio of several EuGBs to a portfolio of financial assets have to respect stricter disclosure requirements for their allocation report. They must give an overview of all outstanding EuGBs, indicating their individual and combined value, and of the eligible financial assets on the issuer's balance sheet, indicating, inter alia, their total amortised value, environmental objectives, types, sectors and countries, and a comparison of the total value of outstanding EuGBs and the total amortised value of eligible financial assets²²³.

After full allocation of the EuGB proceeds, and under other specific circumstances even earlier, issuers have to obtain a post-issuance review by external reviewers showing that the allocation has met the EuGBS requirements and publish it on their website (below 8.1.1)²²⁴.

7.1.3. Impact report

At least once during the lifetime of an EuGB and after the proceeds have been fully allocated, issuers must issue and publish on their website an impact report on the environmental impact of the use of the bond proceeds²²⁵. Such a report can cover one or more EuGB issuances²²⁶. The EuGB impact report combines elements of the EuGB factsheet and the yearly allocation reports and requires: (i) general information, (ii) an environmental strategy and rationale stating the environmental objectives pursued, explaining how the bond aligns with the issuer's environmental strategy and explaining any changes of the environmental strategy since the EuGB factsheet, (iii) the allocation of the proceeds specifying the environmental objectives, types and sectors of projects, the countries of allocation, the respective

²¹⁶ Point 4.3 Annex I EuGBR proposal.

²¹⁷ Point 4.4 Annex I EuGBR proposal.

²¹⁸ Articles 8(1)(b), 13(1)(b) EuGBR proposal.

²¹⁹ Articles 9(1), 13(1)(c) EuGBR proposal.

²²⁰ Article 9(2) EuGBR proposal.

²²¹ Points 1 to 3 Annex II EuGBR proposal.

²²² Point 3.A Annex II EuGBR proposal.

²²³ Point 3.B Annex II EuGBR proposal.

²²⁴ Articles 9(3)–(8), 13(1)(d) EuGBR proposal.

²²⁵ Articles 10(1), 13(1)(e) EuGBR proposal.

²²⁶ Article 10(2) EuGBR proposal.

amount allocated from bond proceeds, confirmation of compliance with the minimum social safeguards, and indication of the Taxonomy Delegated Acts used, and (iv) environmental impact of bond proceeds estimating the positive and negative environmental impacts both in aggregated form and at project level and, if not already contained in the EuGB factsheet, information on the methodologies and assumptions²²⁷.

7.2. Assessment of the EuGBR proposal

In principle, the transparency requirements under the EuGBR proposal make sense, add valuable transparency to the current poorly transparent EU green bond market and foster one of the key regulatory aims (above 2.2). By obliging issuers to explain why the allocation of bond proceeds to a certain project contributes substantially to an environmental objective, they also make greenwashing more difficult and foster another key regulatory aim (above 2.3). Disclosure rules are very important to the fostering of transparency and comparability for investors, and ultimately stimulate investment in the EU green bond market. According to surveys, investors see the current lack of reporting standards as the major impediment to ESG investment²²⁸.

The initial EuGB factsheet will be especially helpful for investors to assess the promise of the environmental sustainability impact of investing in a certain EuGB and that its proceeds will contribute to an environmental objective. It is an effective means to clarify a bond's greenness and constitutes a sort of 'green prospectus' for investors, similar to a prospectus under the Prospectus Regulation (below 7.3.1). Annex I to the EuGBR proposal gives clear and practical guidance for issuers on how to draft an EuGB factsheet and enhances the comparability of different EuGBs along their factsheets.

Also the annual allocation reports help guarantee transparency on how the funds raised translate into a material environmental impact. After the issuance, this makes environmental performance of EuGBs visible for investors who have invested in an EuGB or will do so in the future. Annex II to the EuGBR proposal gives clear and practical guidance both for issuers on how to draft annual allocation reports and for investors on what to expect from them and to compare different EuGBs.

In light of the EuGB factsheet and annual allocation reports, the additional impact report seems an unnecessary regulatory burden for issuers. It duplicates elements of the EuGB factsheet and the annual allocation reports. The relevant aspects showing the environmental impact of an EuGB could easily be included in the annual allocation report or in the final allocation report. In fact, Annex II includes a section on the environmental impact of the bond proceeds, but states that no such information is required under this heading for annual allocation reports. To avoid unnecessary disclosure, duplication of efforts for issuers and information overload for investors, the impact reports should be merged into the allocation reports.

7.3. Relation to other disclosure requirements

The EuGBR proposal's disclosure requirements relate to other disclosure requirements under EU financial regulatory legislation. There is a close link to the Prospectus Regulation, the Sustainable Finance Disclosure Regulation and the latest CSRD proposal.

²²⁷ Points 1 to 4 Annex IV EuGBR proposal.

²²⁸ Amel-Zadeh, A., and Serafeim, G., Why and How Investors Use ESG Information: Evidence from a Global Survey (2018) 74(3) Financial Analysts Journal 87-103. <https://doi.org/10.2469/faj.v74.n3.2>.

7.3.1. Prospectus Regulation

The EuGBR proposal covers many bonds that also have to comply with the disclosure requirements under Regulation (EU) 2017/1129 (Prospectus Regulation)²²⁹. As a fundamental pillar of the EU's Capital Markets Union, the Prospectus Regulation stipulates rules that are mandatory for the issuance of securities prospectuses when securities are offered to the public or admitted to trading on a regulated market in the EU²³⁰. It applies to securities in the meaning of transferable securities under Directive 2014/65/EU (MiFID II)²³¹, i.e. classes of securities that are negotiable on the capital market, with the exception of instruments of payment, including bonds or other forms of securitised debt, including depositary receipts in respect of such securities²³². In the present context, it is important to note that the Prospectus Regulation does not apply to sovereign bonds, bonds issued by regional or local authorities or central banks because they are exempt from the scope of application²³³. As to corporate bonds, the Prospectus Regulation has few general exemptions that are unlikely to apply to most green bonds as the exemptions concern issuances quantitatively or qualitatively limited to certain investors²³⁴.

Before corporate issuers offer green bonds to the public, they have to publish a prospectus according to the Prospectus Regulation²³⁵. While Member States are allowed to exempt such securities offered whose total amount does not exceed EUR 8 million over 12 months²³⁶, all corporate green bond offers exceeding this sum have to be accompanied by a prospectus. The prospectus has to contain the necessary information for investors to make an informed assessment of the assets and liabilities, profits and losses, financial position, and prospects of the issuer and of any guarantor, the rights attaching to the securities, and the reasons for the issuance and its impact on the issuer²³⁷. The information must be written and presented in an easily analysable, concise and comprehensible form²³⁸. In general, prospectuses consist of a registration document, a securities note and a summary²³⁹. The summary must be accurate, fair, clear, not misleading and must provide warnings, including on the potential loss of the invested capital²⁴⁰. For bond prospectuses as non-equity prospectuses, the registration document mandatorily includes detailed information on the persons responsible for the prospectus (which is also relevant for the civil liability mechanism, below 9.3.1), experts' reports, approval by the NCA, statutory auditors, information on the issuer and its business, organisational structure, trend

²²⁹ Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ L 168/12. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R1129&from=EN>.

²³⁰ Article 1(1) Prospectus Regulation.

²³¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance [2014] OJ L 173/349. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN>.

²³² Article 2(a) Prospectus Regulation refers to Article 4(1) point 44 MiFID II.

²³³ Article 1(2)(b) Prospectus Regulation: 'This Regulation shall not apply to the following types of securities: (...) (b) non-equity securities issued by a Member State or by one of a Member State's regional or local authorities, by public international bodies of which one or more Member States are members, by the European Central Bank or by the central banks of the Member States'.

²³⁴ Securities offered only to qualified investors, to fewer than 150 investors per Member State, to investors that acquire securities for at least EUR 100,000, or securities offers of a denomination of at least EUR 100,000 per unit; see Article 1(4)(a)–(d) Prospectus Regulation.

²³⁵ Article 3(1) Prospectus Regulation.

²³⁶ Article 3(2) Prospectus Regulation.

²³⁷ Article 6(1) Prospectus Regulation.

²³⁸ Article 6(2) Prospectus Regulation.

²³⁹ Article 6(3) subparagraph 2 Prospectus Regulation. The conditions are further specified by Commission Delegated Regulation (EU) 2019/980 of 14 March 2019 supplementing Regulation (EU) 2017/1129 of the European Parliament and of the Council as regards the format, content, scrutiny and approval of the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Commission Regulation (EC) No 809/2004 [2019] OJ L 166/26. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0980&from=EN>.

²⁴⁰ Article 7 Prospectus Regulation.

information, profit forecasts or estimates, administrative, management or supervisory bodies, major shareholders, financial information on the issuer's assets and liabilities, financial position and profits and losses²⁴¹. The securities note of a bond will inform investors especially of the risk factors, reasons for the offer and use of proceeds, the bond's amount, currency and seniority, the rights and interest attached to it, maturity date and yields, and the terms and conditions²⁴². Bonds offered to retail investors have stricter requirements than bonds offered on the wholesale market. Sustainability risks are not part of the prospectus requirements.

7.3.2. Sustainable Finance Disclosure Regulation (SFDR)

As a landmark piece of legislation in the area of EU sustainable finance, mostly applicable since March 2021, the SFDR²⁴³ stipulates a vast array of transparency requirements for financial market participants and financial advisers regarding sustainability risks, sustainability impacts of their processes and sustainability-related information on their financial products²⁴⁴. It applies to insurance undertakings, investment firms, credit institutions, other providers of financial products (financial market participants) and providers of investment or insurance advice (financial advisers)²⁴⁵; they have to establish and publish on their websites policies on the integration of sustainability risks in their investment decision-making process and financial advice²⁴⁶. Sustainability risk means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment²⁴⁷. The integration of these policy risks has to be made transparent in pre-contractual disclosures²⁴⁸. By 30 December 2022, this will include a disclosure obligation of adverse sustainability impacts at financial product level²⁴⁹. Financial market participants and financial advisers have to disclose and motivate on their websites whether and why they consider their investment decisions or advice to have or not to have negative impacts on sustainability factors²⁵⁰. Sustainability factors are environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters²⁵¹. In addition, they have to disclose on their websites how their remuneration policies are consistent with the integration of sustainability risks²⁵². Where a financial product promotes environmental and/or social characteristics, a pre-contractual disclosure has to be published on how these characteristics are met and if an index has been designated as a reference benchmark²⁵³. The Taxonomy Regulation extended this disclosure obligation in such a way that the disclosure has to name the environmental objectives to which the investment contributes and how and to what extent the investments underlying the financial product are environmentally sustainable under the Taxonomy Regulation²⁵⁴. Where a financial product has sustainable investment as its objective and an index has been designated as a reference benchmark, the disclosure has to include information on how the designated index is aligned with that objective

²⁴¹ Articles 7 and 8, Annexes 6 and 7 Prospectus Delegated Regulation.

²⁴² Articles 15 and 16, Annexes 14 and 15 Prospectus Delegated Regulation.

²⁴³ Regulation (EU) 2019/2088 (above fn 37).

²⁴⁴ Article 1 SFDR.

²⁴⁵ Article 2(1),(11) SFDR.

²⁴⁶ Article 3 SFDR.

²⁴⁷ Article 2(22) SFDR.

²⁴⁸ Article 6 SFDR.

²⁴⁹ Article 7 SFDR.

²⁵⁰ Article 4 SFDR.

²⁵¹ Article 2(24) SFDR.

²⁵² Article 5 SFDR.

²⁵³ Article 8(1) SFDR.

²⁵⁴ Article 8(2a) SFDR, Articles 5, 6 and 25(2)(a) Taxonomy Regulation.

and explain why and how that index aligned with that objective differs from a broad market index²⁵⁵. If no index has been designated as a reference benchmark, the disclosure has to explain how the environmental objective is to be attained²⁵⁶. Where financial market participants offer products with environmental and/or social characteristics, they have to publish a description of these characteristics, the methodologies used and periodic reports on how the characteristics have been met²⁵⁷.

While the SFDR does not apply to sovereign issuers and non-financial corporate issuers of green bonds, it applies to certain financial undertaking issuers that allocate proceeds from a portfolio of several EuGBs to a portfolio of financial assets, i.e. debt or equity. Such financial undertakings can be investment firms, credit institutions, insurance or reinsurance undertakings, alternative investment fund managers (AIFMs) or management companies of undertakings for collective investment in transferable securities (UCITS)²⁵⁸. The disclosure obligations under the SFDR especially apply to all of these undertakings if they provide financial advice²⁵⁹. In addition, they apply to AIFMs and UCITS management companies unconditionally, to credit institutions and investment firms that provide portfolio management and to insurance undertakings that offer insurance-based investment products²⁶⁰. Where these financial undertakings issue green bonds that allocate proceeds to a portfolio of financial assets, the disclosure requirements under the SFDR and the EuGBR proposal overlap. Given the complexity of such assets, the co-legislators can decide to apply both sets of disclosure requirements to them. Otherwise, the disclosure requirements could be simplified, e.g. by merging them via incorporation by reference.

7.3.3. Proposal for a Corporate Sustainability Reporting Directive (CSRD proposal)

In April 2021, the Commission issued the CSRD proposal²⁶¹, which intends to amend Directive 2013/34/EU (Accounting Directive)²⁶² as amended by Directive 2014/95/EU (Non-Financial Reporting Directive)²⁶³ and to make reporting on sustainability-related information mandatory for companies in the EU. As per the CSRD proposal, the current non-financial statement, also referred to as 'corporate social responsibility report', in the management report is to be replaced by sustainability reporting. This would be applicable to large undertakings and, from January 2026 onwards, also small and medium-sized undertakings listed in the EU.

Sustainability reporting aims to inform on the undertaking's impacts on sustainability matters and the impact of sustainability matters on the undertaking's development, performance and position²⁶⁴. Sustainability matters mean sustainability factors, i.e. environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters, and governance factors²⁶⁵.

²⁵⁵ Article 9(1) SFDR.

²⁵⁶ Article 9(2) SFDR.

²⁵⁷ Articles 10 and 11 SFDR.

²⁵⁸ Article 2(2) EuGBR proposal.

²⁵⁹ Article 2(11) SFDR.

²⁶⁰ Article 2(1) SFDR.

²⁶¹ COM/2021/189 final (above fn 38).

²⁶² Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC [2013] OJ L 182/19. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0034&from=EN>.

²⁶³ Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L 330/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN>.

²⁶⁴ Article 1(3) CSRD proposal inserting a new Article 19a(1) into Directive 2013/34/EU.

²⁶⁵ Article 1(2) CSRD proposal adding a point (17) to Article 2 Directive 2013/34/EU, Article 2(24) SFDR.

Sustainability reporting is to include a brief description of the undertaking's business model and strategy, including its resilience to sustainability risks, opportunities related to sustainability matters, plans to be compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement, taking account of the stakeholders' interests and impacts on sustainability matters, and the implementation of the sustainability strategy²⁶⁶.

Undertakings have to describe sustainability targets and the progress made to achieve them, the sustainability role of administrative, management and supervisory bodies, sustainability policies, a sustainability due diligence process, the major negative sustainability impacts of the value and supply chain, actions taken to prevent them, the principal sustainability risks, and indicators relevant to any of the aforementioned disclosures²⁶⁷. The reporting needs to be encompassing and contain forward-looking and retrospective, qualitative and quantitative information, and include the entire value chain²⁶⁸.

Under the CSRD proposal, the information that undertakings are to disclose would be further specified in sustainability reporting standards, adopted as delegated acts by the Commission²⁶⁹. In particular, these are supposed to include understandable, relevant, representative and verifiable information about the environmental factors related to the six environmental objectives named in the Taxonomy Regulation in addition to social and governance factors²⁷⁰. Social factors include equal opportunities for all, working conditions, respect for human rights, fundamental freedoms and democratic principles²⁷¹. Governance factors comprise the sustainability role of the undertaking's bodies, business ethics and corporate culture, including anti-corruption and anti-bribery, political engagements of the undertaking, including its lobbying activities, the management and quality of relationships with business partners, including payment practices, and internal control and risk management systems²⁷². For SMEs, the delegated acts need to proportionately reflect the capacities and characteristics of SMEs²⁷³. All sustainability reporting has to use a single electronic reporting format²⁷⁴.

Issuers of green bonds will have to perform sustainability reporting under the CSRD proposal provided that they fall within the scope of application. This does not apply to sovereign issuers and certain corporate issuers. The CSRD proposal is meant to apply to large undertakings, i.e. undertakings that on their balance sheet dates exceed two of the three criteria: (i) balance sheet total of EUR 20 million, (ii) net turnover of EUR 40 million, (iii) on average 250 employees during the financial year²⁷⁵. From January 2026 it will also apply to listed SMEs in the EU, i.e. SMEs that are governed by the laws of a Member State and whose transferable securities are admitted to trading on the regulated market of a Member State²⁷⁶.

If any such undertaking issues a green bond, the disclosure requirements under both the CSRD proposal and the EuGBR proposal will apply in parallel. The CSRD proposal requires very detailed sustainability disclosures on the entity level, while the EuGBR proposal focuses on the allocation of the

²⁶⁶ Article 1(3) CSRD proposal inserting a new Article 19a(2) subparagraph 1 (a) into Directive 2013/34/EU.

²⁶⁷ Article 1(3) CSRD proposal inserting a new Article 19a(2) subparagraph 1 (b)–(g) into Directive 2013/34/EU.

²⁶⁸ Article 1(3) CSRD proposal inserting a new Article 19a(3) subparagraphs 1 and 2 into Directive 2013/34/EU.

²⁶⁹ Article 1(4) CSRD proposal inserting a new Article 19b into Directive 2013/34/EU.

²⁷⁰ Article 1(4) CSRD proposal inserting a new Article 19b(2) subparagraphs 1 and 2 into Directive 2013/34/EU.

²⁷¹ Article 1(4) CSRD proposal inserting a new Article 19b(2) subparagraph 2 into Directive 2013/34/EU.

²⁷² Article 1(4) CSRD proposal inserting a new Article 19b(2) subparagraph 2 into Directive 2013/34/EU.

²⁷³ Article 1(4) CSRD proposal inserting a new Article 19c into Directive 2013/34/EU.

²⁷⁴ Article 1(7) CSRD proposal inserting a new Article 29a into Directive 2013/34/EU.

²⁷⁵ Article 1(3) CSRD proposal inserting a new Article 19a(1) into Directive 2013/34/EU, Article 3(4) Directive 2013/34/EU.

²⁷⁶ Article 1(3) CSRD proposal inserting a new Article 19a(1) into Directive 2013/34/EU, Article 2(1)(a) Directive 2013/34/EU.

bond's proceeds in general and, where possible, on the allocation of proceeds at project level. The only entity-level disclosures under the EuGBR proposal relate to the general environmental strategy in the EuGB factsheet (above 7.1.1) and the impact reports (above 7.1.3), but the overlap with the CSRD proposal is very small. Even though the CSRD proposal requires disclosure of environmental sustainability aspects, they largely focus on the operational level and impact of an undertaking, and less so on the financial side. The only reference to the financial statements is that sustainability reporting will include references to and additional explanations of other information included in the management report and amounts reported in the annual financial statements²⁷⁷. If an undertaking issues a green bond and reports this in the management report and/or financial statements, there can be an overlap. However, sustainability reporting does not require the same level of detail at project level as the EuGBR proposal. Only the general environmental strategy of the issuer will be a point to disclose in parallel, but omitting it would not change the regulatory burden. As a result, the overlap of disclosure requirements should be very limited. While, theoretically, the annual allocation reports could be merged into the sustainability reporting, this would make it difficult for investors to extract their content if they are interested only in the allocation reports. Given the small overlap of disclosure requirements, this should not be a pressing concern for the co-legislators.

7.4. The extension of transparency requirements on sustainability matters to social criteria

As sustainability also includes social and governance aspects, the co-legislators could possibly decide to broaden transparency under the EuGBS and strengthen social aspects in two ways. First, they could require issuers of a 'European green bond' to disclose a social sustainability strategy at entity-level or disclose how their use of proceeds fosters social sustainability. Second, they could introduce the distinct categories of 'social bonds' and 'sustainability bonds' (above 4) and attach disclosure requirements to their use.

7.4.1. Introducing transparency requirements for EuGBs on social criteria regarding entity-level and use of proceeds

While the EuGBR proposal clearly concentrates on environmental objectives, the EuGBS could follow the examples of the SFDR and the CSRD proposal and require all issuers to disclose on sustainability matters more holistically. For example, the co-legislators could extend the transparency requirements on the use of a bond's proceeds to social and governance criteria and, in addition, include disclosure on environmental, social and governance aspects at the entity level. Such disclosure could be included in the EuGB factsheet, in the allocation reports and the impact report.

The **arguments in favour** of such broader disclosure are the close link of all three ESG criteria and that a green bond cannot be sustainable if it does not align with broader sustainability criteria, including social and governance aspects. It would also align with other reporting standards, such as the SFDR and the CSRD proposal. The latest Commission proposal for a Directive on corporate sustainability due diligence (CSDDD proposal)²⁷⁸ also follows a holistic approach and prescribes due diligence on actual

²⁷⁷ Article 1(3) CSRD proposal inserting a new Article 19a(3) subparagraph 3 into Directive 2013/34/EU.

²⁷⁸ European Commission, proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, Brussels, 23.2.2022 (COM(2022) 71 final). https://ec.europa.eu/info/sites/default/files/1_1_183885_prop_dir_susta_en.pdf. European Commission, Annex to the proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, Brussels, 23.2.2022 (COM(2022) 71 final ANNEX). https://ec.europa.eu/info/sites/default/files/1_2_183888_annex_dir_susta_en.pdf.

and potential adverse human rights and environmental impacts and their prevention²⁷⁹. The EuGBS could follow the approach pursued by the SFDR and mandate reporting requirements for green bonds on a broad range of sustainability factors, i.e. social and employee matters, respect for human rights, anti-corruption and anti-bribery matters²⁸⁰. It can be argued that a bond's greenness is impaired by the potential human right infringements of the issuer. The same goes for other social aspects, such as inequality, inhumane working conditions etc., and governance aspects, such as lobbying activities, management control, corruption and bribery. The underlying idea is that labelling a bond as 'green' will not be allowed to greenwash, 'socialwash' or 'sustainability-wash' the financed activities.

The arguments against extending the transparency requirements under the EuGBS are related to the nature of a bond, the focus on environmental sustainability and the existing minimum social safeguards under the EuGBR proposal. First, a bond is a debt instrument for companies or countries to finance economic activities. It represents specific financing needs and, unlike equity, not the company as a whole. Second, if a bond is labelled 'green', investors expect it to finance activities by allocating proceeds to environmentally sustainable projects that contribute to environmental objectives. Regulating green bonds is already challenging enough and should be focused on its primary goal to prevent greenwashing and help prevent climate change. Requiring further disclosure on social or governance matters would add an administrative burden that does not strictly relate to a bond's greenness and could hence be regarded as unnecessary. This could hamper the competitiveness of the EU's green bond market and be criticised as over-regulation. Third, the existing social safeguards can be deemed sufficient. The EuGBR proposal requires bonds to comply with the taxonomy requirements, including the minimum social safeguards (above 5.2.3). The compliance with minimum social safeguards is controlled by external reviewers or, possibly, by public authorities (below 8). As long as the minimum social safeguards are further specified and operable for all issuers alike as suggested by this study (above 5.2.3 and 5.5), this can be deemed sufficient to prevent 'socialwashing' or 'sustainability-washing'.

This study does not recommend an extension of the transparency requirements to further social or governance aspects. Requiring disclosure on social and governance aspects of the proceed allocation at the project level would raise the regulatory burden for issuers significantly and transform the green bond into a sustainability bond (above 4). This would be even more the case if transparency requirements on environmental, social and governance matters were added at the entity level. It could result in extending the disclosure obligations under the SFDR and the CSRD proposal to all issuers that are currently outside their scope of application and in duplicating these disclosure duties for issuers covered by the SFDR or the CSRD proposal. Both consequences would add significant burdens and risk over-regulation.

7.4.2. Introducing transparency requirements for bonds labelled 'social bonds', 'sustainability bonds' or 'sustainability-linked bonds'

The second possibility would be to add the categories of 'social bonds', 'sustainability bonds' and 'sustainability-linked bonds' to the EuGBS and attach disclosure duties. 'Social bonds' would relate to bonds financing economic activities that are deemed to foster social or governance objectives; 'sustainability bonds' would relate to bonds combining social and environmental purposes (above 4.1). 'Sustainability-linked bonds' are conventional bonds with specific sustainability targets that do not

²⁷⁹ Articles 5 to 8 CSRD proposal.

²⁸⁰ Article 2(24) SFDR.

necessarily relate to the activities financed, but to any part of the issuer's business, granting investors a specific premium in case the issuer fails to reach its target (above 4.4).

Thus far, only private standards exist for these three types of sustainable bonds. While the CBI has not yet issued a standard for bonds other than climate-related, ICMA has issued voluntary process guidelines for issuing social bonds (Social Bond Principles)²⁸¹, sustainability bonds (Sustainability Bond Guidelines)²⁸² and sustainability-linked bonds (Sustainability-Linked Bond Principles)²⁸³. The Social Bond Principles mirror the structure of the Green Bond Principles²⁸⁴ as they require alignment with the four criteria: (i) use of proceeds, (ii) process for project evaluation and selection, (iii) management of proceeds, and (iv) reporting²⁸⁵. The use of proceeds has to relate to eligible social projects that provide clear social benefits, as assessed and, where feasible, quantified by the issuer²⁸⁶. Social project categories include affordable basic infrastructure, access to essential services, affordable housing, employment generation, food security and sustainable food systems, and socioeconomic advancement and empowerment²⁸⁷. ICMA also recommends social bond frameworks in which issuers explain the alignment of their social bond with the four core components and external reviews that assess the alignment²⁸⁸. The Sustainability Bond Guidelines merely state that sustainability bonds relate to bonds financing a combination of green and social projects under the Green Bond Principles and the Social Bond Principles²⁸⁹. The Sustainability-Linked Bond Principles consist of five core elements: (i) selection of key performance indicators (KPIs), (ii) calibration of sustainability performance targets (SPTs), (iii) bond characteristics, (iv) reporting, and (v) verification²⁹⁰. The KPIs must be relevant to the issuer's overall business, of high strategic significance to the issuer's operations, measurable or quantifiable on a consistent methodological basis, externally verifiable, and able to be benchmarked²⁹¹. The SPTs should represent a material improvement in the respective KPIs and be beyond a 'business as usual' trajectory, possibly be compared to a benchmark or an external reference, be consistent with the issuer's overall sustainability strategy, and be determined on a predefined timeline²⁹².

The arguments in favour of creating transparency duties for issuers of these three types of bonds are similar to the general arguments in favour of creating transparency duties for green bonds (above 2) and of including social and sustainability bonds in the EuGBS (above 4.2). There is a fast growing market in social bonds and sustainability bonds (above 4.1, especially Figure 4); the market is fragmented and could be harmonised. Despite the current absence of an EU Social Taxonomy (above 4.3), the co-legislators might still want to regulate these types of sustainable bonds at the same time as they regulate green bonds. If they decide to make transparency duties mandatory for all bonds labelled 'green' (below 7.5), they could in parallel make transparency requirements for social bonds,

²⁸¹ International Capital Market Association, Social Bond Principles – Voluntary Process Guidelines for Issuing Social Bonds, June 2021. <https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Social-Bond-Principles-June-2021-140621.pdf>.

²⁸² International Capital Market Association, Sustainability Bond Guidelines, June 2021 (above fn 87).

²⁸³ International Capital Market Association, Sustainability-Linked Bond Principles – Voluntary Process Guidelines, June 2020 (above fn 91).

²⁸⁴ International Capital Market Association, Green Bond Principles, 2021 (above fn 20).

²⁸⁵ International Capital Market Association, Social Bond Principles – Voluntary Process Guidelines for Issuing Social Bonds, June 2021 (above fn 281), pp. 3-5.

²⁸⁶ Ibid, p. 3.

²⁸⁷ Ibid, p. 4.

²⁸⁸ Ibid, pp. 3, 6.

²⁸⁹ International Capital Market Association, Sustainability Bond Guidelines, June 2021 (above fn 87), p. 3.

²⁹⁰ International Capital Market Association, Sustainability-Linked Bond Principles – Voluntary Process Guidelines, June 2020 (above fn 91), pp. 2-5.

²⁹¹ Ibid, p. 3.

²⁹² Ibid, pp. 3-4.

sustainability bonds and sustainability-linked bonds mandatory. This would also create a regulatory level playing field for these types of bonds.

The arguments against creating transparency duties for social bonds, sustainability bonds and sustainability-linked bonds are similar to the arguments against including them in the EuGBS (above 4.3). They are a relatively recent phenomena that might require further market observation before regulating them. It could also be argued that it makes sense to regulate social bonds and sustainability bonds only once there is a Social Taxonomy. From a different angle, it could be argued that it is not necessary to regulate social and sustainability bonds in a voluntary EU standard that merely prescribes transparency obligations because a voluntary standard with transparency recommendations already exists in ICMA's Social Bond Principles and Sustainability Bond Guidelines.

This study recommends stipulating disclosure requirements for 'social bonds', 'sustainability bonds' and 'sustainability-linked bonds' if the co-legislators decide to make the EuGBS mandatory (Option 2 in Figure 3) or if they decide to make the transparency requirements under the EuGBS mandatory (below 7.5). These three bond types are growing parts of the EU bond market and encounter the same risk of greenwashing as green bonds or a similar risk of 'socialwashing' or 'sustainability-washing'. For social bonds and sustainability bonds to become more transparent, it is recommended to require issuers to disclose how far the bonds are linked to social and green purposes and how this translates in the use of the bonds' proceeds. In order to enhance the transparency of sustainability-linked bonds, it is recommended to require the issuer to disclose and clearly identify the environmental sustainability target and how this qualitatively and/or quantitatively enhances the environmental sustainability of the issuer's economic activities overall.

7.5. Mandatory disclosure requirements for all bonds labelled 'green'

If the co-legislators decide to implement a voluntary EuGBS for bonds called 'European green bonds', as in the EuGBR proposal (Option 1), and not a mandatory standard under Option 2 (Figure 3), they could still decide to attach mandatory disclosure requirements to the labelling of a bond as 'green'. This would be a combination of Options 1 and 2 in Figure 3 (above 3.2) and supported by the general arguments for a mandatory EuGBS (above 3.2.2). Making the disclosure requirements mandatory for all bonds labelled 'green' would create a more effective regulatory tool to achieve the regulatory aims than a mere voluntary standard. Though less than a fully mandatory EuGBS, it would still probably foster uptake by issuers (above 3.4.1), enhance the transparency and comparability of the EU green bond market (above 3.4.2), prevent greenwashing (above 3.4.3) and help prevent climate change (above 3.4.4) in a better way than an entirely voluntary EuGBS. Taking into account the general arguments of a voluntary standard (above 3.2.1), it would leave space for issuers to voluntarily decide to strengthen the quality of their green bonds and achieve the level of a 'European green bond' by fully adhering to the rest of the EuGBS, especially to the private review mechanism.

However, there are practical obstacles; it is not evident how such an EuGBS could be drafted by dividing the EuGBS into voluntary and mandatory standards. The EuGBS, as drafted in the EuGBR proposal, consists only of: (i) substantial, (ii) transparency and (iii) review requirements for issuers that are supposed to (a) comply with the taxonomy requirements, (b) make that compliance transparent and (c) guarantee external control of their compliance. The requirements of transparency and external review are two layers assuring substantial taxonomy compliance and cannot be easily separated. Making the transparency requirements mandatory automatically means making the substantial requirements of taxonomy compliance mandatory. Otherwise the disclosures are meaningless. The transparency duties to publish the external pre-issuance and post-issuance reviews inherently rely on the substantial requirement to obtain external review in the first place. If all disclosure requirements,

including those related to external review, were mandatory for bonds labelled 'green', then there would not be much room for additional voluntary aspects for a bond to qualify as a 'European green bond'.

Hence, the only sensible possibility would be to make mandatory only those transparency requirements to disclose the EuGB factsheet, the annual allocation reports and, if not merged into the latter, the impact report (above 7.2). As a result, the remaining elements for a voluntary 'European green bond' would be the external pre-issuance and post-issuance reviews, including their publication. The quality difference between a mere 'green bond' and a 'European green bond' would lie in the external review as an additional quality control. This solution is perfectly possible, but would create further difficulties. The first difficulty lies in the external control of mere 'green bonds' whose taxonomy compliance is not verified by an external reviewer. This difficulty can be addressed in two ways. Either the NCAs would step in and supervise such bonds or external control would be missing altogether. In this latter case, it would be up to investors to make an assessment of taxonomy compliance of mere 'green bonds', while the label 'European green bond' would be awarded only after the positive assessment of an external reviewer.

The second difficulty is that the label 'European green bond' might significantly lose its appeal if there is an official 'green' alternative without a significant reputational difference. The extra costs involved in complying with the voluntary standard, especially the external review, might not be offset by the reputational advantage. These problems can be solved, at least partially, if external private review is not made mandatory and instead replaced by public supervision of all bonds labelled 'green'. Then public authorities, e.g. the NCAs, verify the bonds' taxonomy compliance and exercise external control over all green bonds (see the general advantages below 8.4.2).

7.6. Policy recommendations

In general, the transparency requirements under the EuGBR proposal are well drafted, add valuable transparency to the current poorly transparent EU green bond market and foster the key regulatory aims. The EuGB factsheet, a sort of 'green prospectus', will help investors evaluate and compare green bonds before issuance. The annual allocation reports will fulfil this function after issuance and help monitor the allocation of proceeds regularly. Only the additional impact reports seem to add little value as stand-alone reports; their elements could be included in the allocation reports (above 7.2).

The comparison with other disclosure requirements under the **Prospectus Regulation**, the **SFDR** and the **CSRD proposal** shows that there are no significant overlaps or inconsistencies that ought to be prevented to ensure market integrity. For many corporate issuers of green bonds, the EuGBS will apply in parallel to the **Prospectus Regulation**, but the respective disclosure requirements do not conflict (above 7.3.1). The **SFDR's** disclosure requirements on sustainability risks, sustainability impacts, and sustainability-linked information apply to financial undertaking EuGB issuers that allocate proceeds from a portfolio of several EuGBs to a portfolio of financial assets. There will be a certain overlap, which could be reduced by cross-referencing the disclosure requirements. However, as the financial products concerned are rather complex, the co-legislators might prefer to apply the disclosure requirements under the EuGBS and the SFDR in parallel (above 7.3.2). Many corporate EuGB issuers will have to perform sustainability reporting under the **CSRD proposal** that focuses on entity-level reporting. As the EuGBR proposal does not require disclosure on sustainability at entity-level besides the general environmental strategy in the EuGB factsheet (above 7.1.1) and the impact report (above 7.1.3), disclosure overlaps between the EuGBR proposal and the CSRD proposal will be minor (above 7.3.3).

The EuGBS disclosure requirements could be extended to broader social and governance matters in two ways (above 7.4). First, the co-legislators could introduce disclosure duties on social and

governance matters at the project level and/or at the entity level. While the term 'sustainability' includes these aspects and the credibility of sustainable green investment might benefit from such an extension, this study does not recommend it. The EuGBR proposal contains minimum social safeguards as part of the taxonomy requirements and ensures external control of them. Adding social and governance disclosure would raise the regulatory burden and transform green bonds into sustainability bonds (above 7.4.1). Second, the co-legislators could introduce the categories of 'social bonds', 'sustainability bonds' and 'sustainability-linked bonds' in the EuGBS and attach transparency requirements to their issuance. As long as these bond types cannot be regulated like green bonds in a fully-fledged standard, especially as there is no Social Taxonomy yet, the co-legislators should consider stipulating transparency requirements relating to them if they adopt a mandatory standard under Option 2 (above 3.5) or if they make the transparency requirements under the EuGBS mandatory for bonds labelled 'green' (above 7.5). This would create a level playing field for these bond types and reduce greenwashing, 'socialwashing' and 'sustainability-washing'.

If the co-legislators opt for a voluntary EuGBS as proposed by the EuGBR proposal, they could still make the EuGBS transparency requirements mandatory for all bonds labelled 'green' (above 7.5). This would mean that the substantial taxonomy requirements become mandatory and issuers disclose information on their compliance in the EuGB factsheet, annual allocation reports and, if not merged into the latter, impact report. The only element remaining for the voluntary additional standard of a 'European green bond' would be pre-issuance and post-issuance reviews by external reviewers and their disclosure. Supervision of the mandatory disclosure requirements and taxonomy compliance of 'green' bonds could be performed by the NCAs (as in general recommended below 8.6). This study recommends (at least) mandatory disclosure requirements for all bonds labelled 'green' if the difficulties attached thereto are addressed. Mandatory disclosure requirements would create a regulatory level playing field, enhance the transparency and comparability of the EU green bond market, prevent greenwashing and ultimately help prevent climate change (above 7.5).

8. EXTERNAL REVIEW AND SUPERVISION: PUBLIC OR PRIVATE

KEY FINDINGS

External review is necessary to ensure compliance with the EuGBS. It can be exercised by private reviewers or public authorities. The EuGBR proposal follows the common market practice in the current EU green bond market by prescribing private review of the bonds' greenness. This practice can be explained by the fact that in the EU, thus far, there are only private standards and no national legislated or other encompassing public standards for green bonds. As a result, no public authorities currently have the task to supervise the environmental sustainability of financial products. In addition to the private review, the EuGBR proposal orders public supervision of the issuer's disclosure requirements and of external reviewers.

However, external control of EuGBS compliance could be simplified and designed completely differently, e.g. by giving supervisory authorities the competence to supervise all aspects of EuGBS compliance. Therefore, when legislating the EuGBS, the co-legislators should reflect on whether to follow the existing market practice, like the EuGBR proposal by adding limited public supervision, or whether to attribute substantial review or bond supervision competences to national or EU authorities. Private reviewers are likely to be companies that already furnish second party opinions, verification and external reviews, plus accounting firms, business consultants, or possibly also rating agencies, banks or other financial intermediaries. Public reviewers could be either national, e.g. the NCAs for financial sector supervision, or European, e.g. ESMA.

8.1. EuGBR proposal: private review and public supervision

The EuGBR proposal creates **three layers of external control**. First, it attributes the control of the issuer's **substantive compliance with the EuGBS**, especially the taxonomy requirements, to **private reviewers**. Second, it prescribes **public supervision** of the issuers' compliance with review and **disclosure requirements** under the EuGBS. Third, it establishes a **registration** procedure for, and public supervision of, the **external reviewers**.

8.1.1. Private review of taxonomy compliance

The **first layer of external control** is exercised by **private reviewers**. These external reviewers assess the bond's compliance with the substantive EuGBS criteria in pre-issuance and post-issuance reviews. After completion of the EuGB factsheet, issuers have to obtain a **pre-issuance review with a positive opinion** by an external reviewer²⁹³. The pre-issuance review of the EuGB factsheet will assess the bond's compliance with the bond-specific requirements²⁹⁴, the taxonomy requirements²⁹⁵ and the factsheet requirements²⁹⁶. The pre-issuance review has to contain especially the following elements: (i) statements on the compliance with the EuGBR, (ii) sources, assessment methodologies, and key assumptions, (iii) assessment and opinion²⁹⁷. Every year, and until the full allocation of the EuGB proceeds, issuers have to issue allocation reports demonstrating that the proceeds have been allocated

²⁹³ Article 8(1) and Annex I EuGBR proposal.

²⁹⁴ Articles 4–5, 8(3)(a) EuGBR proposal.

²⁹⁵ Articles 6–7, 8(3)(a) EuGBR proposal.

²⁹⁶ Article 8(3)(a) and Annex I EuGBR proposal.

²⁹⁷ Article 8(3)(b) and Annex IV EuGBR proposal.

in full respect of the bond-specific and taxonomy requirements²⁹⁸. **After full allocation of the proceeds**, issuers have to obtain a **post-issuance review** by external reviewers attesting that the allocation of proceeds has complied with the requirements²⁹⁹. Under specific circumstances, issuers also have to obtain post-issuance reviews for their yearly allocation reports, e.g. in case of correction after publication or if the issuer is a financial undertaking that allocates proceeds from a portfolio of several EuGBs to a portfolio of financial assets³⁰⁰. Post-issuance reviews must assess whether the allocation of proceeds complies with the bond-specific and taxonomy requirements and whether the issuer has complied with the intended use of proceeds according to the EuGB factsheet and they must be structured like pre-issuance reviews³⁰¹.

8.1.2. Public supervision of review and disclosure requirements by NCAs

The **second layer of external control** is exercised by **public supervisors at national level**. NCAs supervise that issuers **comply with the review and disclosure requirements**. As to their review and disclosure obligations under the EuGBR proposal³⁰², issuers are subject to national supervision by those **NCAs that are competent under the Prospectus Regulation**³⁰³ for the supervision of prospectuses³⁰⁴. This supervision covers the issuer's obligations to complete and publish on its website the EuGB factsheet and its pre-issuance review, the allocation reports and their post-issuance review, an EuGB impact report on the environmental impact of the use of bond proceeds, and, in the case of a prospectus under the Prospectus Regulation, the clear statement that the EuGB is issued in accordance with the EuGBR³⁰⁵. Thus, under the EuGBR proposal the NCAs would have a wide range of supervisory powers, including to request information and documents from the issuer's auditors and senior management, to suspend an EuGB offer for up to ten working days in case of reasonable doubts of infringement, to prohibit or suspend advertisements, to make public that an issuer fails to comply with the disclosure obligations, and to carry out on-site inspections³⁰⁶. As regards issuers infringing the review and disclosure obligations and the duty to cooperate with the NCA, Member States will have to give NCAs the power to impose administrative sanctions and take other appropriate administrative measures (below 9.1.2).

8.1.3. Registration, governance and public supervision of private reviewers by ESMA

The **third layer of external control** is exercised by **public supervisors at EU level**. The EuGBR proposal gives ESMA the competence to **register and supervise external reviewers**. Before taking up their activities, external reviewers have to register with ESMA³⁰⁷. The registration procedure comes close to a formal authorisation procedure. External reviewers have to apply for registration by providing comprehensive information, including on their ownership structure, the identity of the senior management members and their level of qualification, experience and training³⁰⁸. They also have to declare the number of analysts, employees and other persons directly involved in assessment

²⁹⁸ Article 9(1) and Annex II EuGBR proposal.

²⁹⁹ Article 9(3) EuGBR proposal.

³⁰⁰ Article 9(4),(5) EuGBR proposal.

³⁰¹ Article 9(7) EuGBR proposal.

³⁰² Articles 8–13 EuGBR proposal.

³⁰³ Regulation (EU) 2017/1129 (above fn 229).

³⁰⁴ Article 36 EuGBR proposal refers to Article 31 Prospectus Regulation.

³⁰⁵ Articles 8–13, 36 EuGBR proposal.

³⁰⁶ Article 37 EuGBR proposal.

³⁰⁷ Article 14(1) EuGBR proposal.

³⁰⁸ Article 15(1) EuGBR proposal.

activities, and their level of experience and training, describe the procedures and methodologies implemented by the applicant to issue pre-issuance and post-issuance reviews, the policies or procedures implemented by the applicant to identify, manage and disclose any conflicts of interest, and, if applicable, add information on other activities and outsourced activities³⁰⁹.

Registration requires that external reviewers meet **three conditions** at all times³¹⁰. **First**, the senior management of the applicant has to be of sufficiently good reputation, be sufficiently skilled to ensure that the applicant can perform the tasks required of external reviewers, have sufficient professional qualifications, and be experienced in quality assurance, quality control, the performance of pre- and post-issuance reviews and financial services³¹¹. **Second**, the number of analysts, employees and other persons directly involved in assessment activities, and their level of experience and training, have to be sufficient to perform the tasks required by external reviewers³¹². **Third**, the internal arrangements implemented to ensure compliance with the organisational and governance requirements under the EuGBR proposal have to be appropriate and effective³¹³.

These organisational and governance requirements for external reviewers are rather intense. In general, external reviewers have to employ appropriate systems, resources and procedures to comply with their obligations, and monitor and evaluate their adequacy and effectiveness at least annually and take appropriate measures to address any deficiencies³¹⁴. The senior management has to ensure the sound and prudent management of the external reviewer, the independence of assessment activities, proper identification, management and disclosure of conflicts of interest, and the external reviewer's compliance with the EuGBR's requirements at all times³¹⁵. External reviewers have to ensure that the analysts, employees and other natural persons directly involved in assessment activities have the necessary knowledge and experience for their duties³¹⁶. These persons are not allowed to initiate or participate in negotiations regarding fees or payments with the assessed entity or third parties related to the assessed entity³¹⁷.

External reviewers are required to have an internal compliance function that assesses them permanently, effectively and independently, has enough resources to perform its duties and is remunerated independently of their employer's business performance³¹⁸. Furthermore, external reviewers have to adopt and implement internal due diligence policies and procedures that ensure their business interests do not impair the independence or accuracy of the assessment activities³¹⁹. In addition, they need to adopt and implement sound administrative and accounting procedures, internal control mechanisms, and effective control and safeguard arrangements for information processing systems³²⁰.

³⁰⁹ Article 15(1) EuGBR proposal.

³¹⁰ Articles 14(2), 15(2) EuGBR proposal.

³¹¹ Article 15(2)(a) EuGBR proposal.

³¹² Article 15(2)(b) EuGBR proposal.

³¹³ Article 15(2)(c) EuGBR proposal.

³¹⁴ Article 18(1),(2) EuGBR proposal.

³¹⁵ Article 19(1) EuGBR proposal.

³¹⁶ Article 20(1) EuGBR proposal.

³¹⁷ Article 20(2) EuGBR proposal.

³¹⁸ Article 21(1),(2) EuGBR proposal.

³¹⁹ Article 22(1) EuGBR proposal.

³²⁰ Article 22(2) EuGBR proposal.

The EuGBR proposal further tries to ensure high quality assessment methodologies and requires external reviewers to use information of sufficient quality and from reliable sources³²¹. If they find errors in their assessment methodologies, they have to notify ESMA and the assessed issuers immediately and publish the errors on their website³²². The EuGBR proposal allows external reviewers to outsource their activities to third party service providers, including the assessment activities, but not the compliance function³²³. External reviewers have to keep records of the persons involved in all reviews, their documentation and internal documents, records of the procedures and copies of internal and external communications³²⁴. Besides, external reviewers have to identify, eliminate, manage and disclose in a transparent manner any actual or potential conflicts of interest; their fees for assessment services cannot depend on the result of the pre-issuance or post-issuance review³²⁵. They also have to ensure that their analysts, employees or other third parties treating the information are bound by the obligation of professional secrecy³²⁶. Where external reviewers provide other services than assessment services, they have to prevent conflicts of interest and disclose in their pre-issuance and post-issuance reviews any other services provided for the assessed entity or any related third party³²⁷.

8.2. The assessment of external review and supervision under EuGBR proposal

The EuGBR proposal **designs a mixed system of private review and public supervision with three layers of external control**. While, at first sight, several layers of control increase the density of control, they risk fragmenting and diffusing supervisory powers, which can result in weakening control altogether. One of the lessons of the Wirecard scandal is that the unclear division of supervisory powers between the German Federal Supervisory Authority (BaFin) and the private reviewer Financial Reporting Enforcement Panel (Prüfstelle für Rechnungslegung e.V.) significantly hindered discovery of the malpractices³²⁸.

Attributing the control of issuers' compliance with the substantive taxonomy requirements to private reviewers and giving NCAs mere supervision of the transparency requirements **carries several risks**. **First**, substantive review is effectively outsourced to private entities. Under the EuGBR proposal, NCAs do not have the power to take over substantive control, and hence, cannot properly supervise in case of malpractice. As a result, NCAs are rather weak and ESMA has only limited supervisory powers. **Second**, the external reviewers have an inherent conflict of interest because they are paid by the issuer for their review. The EuGBR proposal addresses only internal conflict of interest of the external reviewer by preventing the persons assessing a bond's EuGBS compliance from negotiating fees with the issuer. It does not address the general conflict of interest that external reviewers have an intrinsic motivation to issue positive reviews and not negative reviews because they depend financially on the issuers' benevolence, at least for future issuances.

³²¹ Article 23(1),(2) EuGBR proposal.

³²² Article 24 EuGBR proposal.

³²³ Article 25 EuGBR proposal.

³²⁴ Article 26(1) EuGBR proposal.

³²⁵ Article 27(1),(2) EuGBR proposal.

³²⁶ Article 27(3) EuGBR proposal; more generally on professional secrecy obligations in cross-sectoral EU financial regulatory legislation Smits, R., and Badenhoop, N., Towards a Single Standard of Professional Secrecy for Financial Sector Supervisory Authorities: A Reform proposal (2019) 44(3) European Law Review 295-318. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3346946.

³²⁷ Article 28 EuGBR proposal.

³²⁸ Mock, S., Wirecard and European Company and Financial Law (2021) 18(4) European Company and Financial Law Review pp. 519-554, 529-534.

In addition, the internal governance and compliance regime under the EuGBR proposal is similar to the regime applicable to credit rating agencies under Regulation (EC) No 1060/2009 (Credit Rating Agencies Regulation)³²⁹ that focuses mainly on independence and avoidance of conflicts of interest³³⁰, and on appropriate methodologies³³¹. The EuGBR proposal requires appropriate systems, resources and procedures³³², sound and prudent senior management³³³, a fully-fledged compliance function³³⁴, internal due diligence policies and procedures, sound administrative and accounting procedures, internal control mechanisms, and effective control and safeguard arrangements for information processing systems³³⁵ (above 8.1.3). All these requirements are to be specified by regulatory technical standards developed by ESMA and adopted by the Commission in delegated acts³³⁶. While the Credit Rating Agencies Regulation has similar duties³³⁷, these are not specified in regulatory technical standards³³⁸. The foreseeable degree of internal governance and compliance regulation under the EuGBR proposal, once specified in delegated acts, might evolve in the direction of the regimes that apply to regulated financial service providers, such as investment firms under MiFID II³³⁹, credit institutions under Directive 2013/36/EU (Capital Requirements Directive – CRD IV)³⁴⁰ and insurance companies under Directive 2009/138/EC (Solvency II)³⁴¹.

This carries two risks. First, there is a general danger of over-regulation and unnecessary complexity. Second, the requirements for external reviewers are likely to translate into high costs for issuers. The higher costs will make green bond issuance more expensive and difficult, especially for SMEs. Large companies will be better able to deal with these cost increases by scaling them and, hence, be privileged compared to SMEs. Third, the organisational requirements that the EuGBR proposal puts on external reviewers are so heavy that they will allow only very big private entities to perform external review. This means that small and less established entities are likely to be squeezed out of the market of external review. Therefore, the EuGBR proposal carries the risk of creating regulatory monopolies for large and established accounting or other reviewing companies.

Most of these concerns can be addressed by attributing the external control to public supervisory authorities.

³²⁹ Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009R1060&from=EN>. The civil liability mechanism was introduced in the Credit Rating Agencies Regulation by Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies [2013] OJ L 146/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0462&from=EN>.

³³⁰ Articles 6, 6a, 6b and Annex I Credit Rating Agencies Regulation.

³³¹ Articles 8 and 8a Credit Rating Agencies Regulation.

³³² Article 18(1) EuGBR proposal.

³³³ Article 19(1)(a) EuGBR proposal.

³³⁴ Article 21 EuGBR proposal.

³³⁵ Article 22 EuGBR proposal.

³³⁶ Articles 18(3), 19(2), 21(4), 22(3) EuGBR proposal.

³³⁷ Annex I Section A Credit Rating Agencies Regulation.

³³⁸ Article 21 Credit Rating Agencies Regulation does not foresee regulatory technical standards to specify the organisational duties under Annex I. Article 37 Credit Rating Agencies Regulation empowers the Commission to amend the Annexes to the Credit Rating Agencies Regulation, but so far the Commission has not changed Annex I.

³³⁹ Article 9 Directive 2014/65/EU (above fn 231) referring to Articles 88 and 91 Directive 2013/36/EU (below fn 340).

³⁴⁰ Articles 74, 88 and 91 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 176/338. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0036&from=EN>.

³⁴¹ Articles 41-50 Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) [2009] OJ L 335/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0138&from=en>.

8.3. Oversight in EU disclosure and sustainable finance legislation

When designing the oversight mechanism for the EuGBS, the co-legislators will take into account existing EU legislation on similar matters of disclosure and sustainable finance regulation. The sectoral overview shows that most product oversight is attributed to public authorities, while only few legislative acts outsource substantive oversight to private reviewers.

8.3.1. Models of public supervision: Prospectus Regulation and SFDR

The EU financial regulatory legislation that comes closest to the EuGBS is the Prospectus Regulation that provides for public supervision. Before being published, prospectuses under the Prospectus Regulation have to be scrutinised and approved by the NCAs³⁴². In principle, the NCA has to decide within 10 days whether to approve or reject a prospectus. If the prospectus does not meet the requirements, the NCA has to inform the issuer and clearly indicate the changes or the supplementary information needed³⁴³.

The SFDR provides an example for sustainability-related disclosure requirements that are supervised by NCAs. It places financial market participants and financial advisers and their disclosure of, inter alia, sustainability risk policies, adverse sustainability impacts and environmental or social product characteristics under public supervision at national level. The SFDR attributes supervision to the NCAs, designated in accordance with sectoral legislation on the specific type of financial market participants or financial advisers³⁴⁴, i.e. the respective NCAs supervising credit institutions under CRD IV³⁴⁵, investment firms under MiFID II³⁴⁶, insurance undertakings under Solvency II³⁴⁷, AIFMs under Directive 2011/61/EU (AIFM Directive)³⁴⁸ and UCITS management companies under Directive 2009/65/EC (UCITS Directive)³⁴⁹.

8.3.2. Models of private review: Accounting Directive and CSRD proposal

A prominent example of EU disclosure legislation that prescribes private review is the Accounting Directive³⁵⁰. It stipulates an obligation for Member States to require an audit by one or more statutory auditors or audit firms approved by Member States to carry out statutory audits on the basis of Directive 2006/43/EC (Statutory Audit Directive)³⁵¹ for the financial statements of public-interest entities, medium-sized and large undertakings³⁵². This does not apply to non-financial statements or consolidated non-financial statements, i.e. the so-called corporate social responsibility reports³⁵³. Thus

³⁴² Article 20(1) Prospectus Regulation.

³⁴³ Article 20(4) Prospectus Regulation.

³⁴⁴ Article 14(1) SFDR referring to Article 6(3) SFDR.

³⁴⁵ Directive 2013/36/EU (above fn 340).

³⁴⁶ Directive 2014/65/EU (above fn 231).

³⁴⁷ Directive 2009/138/EC (above fn 341).

³⁴⁸ Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L 174/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0061&from=EN>.

³⁴⁹ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] OJ L 302/32. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0065&from=EN>.

³⁵⁰ Directive 2013/34/EU (above fn 262).

³⁵¹ Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC [2006] OJ L 157/87. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32006L0043&from=EN>.

³⁵² Article 34(1) Accounting Directive.

³⁵³ Article 34(3) Accounting Directive.

far, private review of substantive disclosure rules in the area of accounting only applies to financial statements, not to non-financial statements.

The CSRD proposal intends to change this principle, at least in part. The CSRD proposal explicitly excludes sustainability reporting from the mandatory remit of the auditors' opinion on legal compliance³⁵⁴. However, it adds a duty for the auditor to express an opinion on the compliance of the sustainability reporting; this includes the compliance of the sustainability reporting with the reporting standards, the process carried out by the undertaking to identify the information reported pursuant to those reporting standards, compliance with the requirement to mark-up sustainability reporting, and compliance with the reporting requirements of Article 8 Taxonomy Regulation³⁵⁵. While this effectively includes all sustainability reporting in audits, the requirement is softened because the opinion must be based on only a limited assurance engagement, i.e. auditors do not have the responsibility to assure full legal compliance with the sustainability reporting requirements³⁵⁶.

8.4. Weighing up the arguments between private review and public supervision

The co-legislators have to decide whether they adopt the EuGBR proposal's mixed approach between private substantive review, public supervision of disclosure requirements by the NCAs and public registration and supervision of private reviewers by ESMA. They should consider the following arguments in favour of private review and of public supervision.

8.4.1. Advantages of private review

The strongest argument in favour of private substantive review is that a market for such private review already exists; the two dominating private standards include private review. ICMA's Green Bond Principles recommend the use of external reviewers for pre-issuance and post-issuance reviews to enhance transparency³⁵⁷. CBI's Climate Bonds Standard even makes pre-issuance and post-issuance mandatory for issuers to obtain certification³⁵⁸. As a result, many green bond issuers already use private reviewers specialising in review services. These reviewers have built up knowledge and capacities over recent years. Implementing a private review mechanism would use these existing capacities. In addition, it would create useful competition between private reviewers that might keep the costs for issuers lower than expected. The private reviewers' inherent conflicts of interest vis-à-vis the reviewed issuer and the commercial dependence on them could be diminished if the co-legislators introduced an obligation for issuers to change the private reviewer after a certain amount of issuances. The idea of containing inherent conflicts of interest is addressed by the Credit Rating Agencies Regulation in a similar vein as it stipulates that the contractual relationship with a credit rating agency for the rating of re-securitisations may not exceed four years³⁵⁹.

8.4.2. Advantages of public supervision

The strongest argument in favour of public supervision is its effectiveness. It would create supervisory synergies to give the NCAs the substantive supervision of compliance with the taxonomy requirements in addition to the supervisory powers relating to disclosure requirements. All green bond supervision

³⁵⁴ Article 1(10)(a)(i) CSRD proposal replacing Article 34(1) subparagraph 2 point (a)(ii) Accounting Directive.

³⁵⁵ Article 1(10)(a)(ii) CSRD proposal adding Article 34(1) subparagraph 2 point (aa) Accounting Directive.

³⁵⁶ Article 1(10)(a)(ii) CSRD proposal adding Article 34(1) subparagraph 2 point (aa) Accounting Directive.

³⁵⁷ International Capital Market Association, Green Bond Principles, 2021 (above fn 20) pp. 4, 7.

³⁵⁸ Climate Bonds Initiative, Climate Bonds Standard Version 3.0, 2019 (above fn 21) pp. 23-27.

³⁵⁹ Article 6b(1) Credit Rating Agencies Regulation.

would be in one hand. Furthermore, there would be supervisory synergies with other disclosure requirements. As the Prospectus Regulation applies to many corporate issuers of green bonds, NCAs could combine pre-issuance supervision under the EuGBS with prospectus supervision under the Prospectus Regulation. As regards financial undertaking issuers, there would be further supervisory synergy because the NCAs could bundle EuGBS supervision and supervision of the sustainability disclosure requirements under the SFDR. Besides, public supervision would likely be less costly for issuers than private review. Public supervisors would not incur the same organisational and governance costs that private reviewers would incur under the EuGBR proposal. While they would need additional staff and resources to cover new tasks, there could be significant synergy effects with the supervisory tasks of NCAs, both under the Prospectus Regulation and under the SFDR (above 8.3.1). The supervisory teams executing tasks under the Prospectus Regulation and the SFDR could be augmented and could also perform supervisory tasks under the EuGBS. In addition, if the supervisors have to supervise transparency requirements under the EuGBR proposal, giving them additional supervisory powers on substantive taxonomy compliance could be an efficient bundling of tasks in one hand. Supervisory fees would likely be lower than the price of external reviews, also because of the supervisory synergies. This would partially address the problem that the EuGBR proposal risks factually discriminating SMEs compared to large issuers (above 8.2). Furthermore, and unlike the three layers of control under the EuGBR proposal (above 8.1 and 8.2), there would be no diffusion of supervisory responsibilities and no risk of unclear responsibility divisions. The NCAs would serve as a one-stop supervisor for substantive and disclosure requirements. Last but not least, public supervisors have the important benefit of structural neutrality and objectivity. While private reviewers have a general conflict of interest attributable to their own commercial interest in a positive review, public supervisors do not have such a conflict of interest. Public supervisors are also democratically legitimised and can be held publicly accountable for their actions. NCAs are not the best placed supervisors only in the case of governmental issuers, because they are usually subordinated to them, so independent national Courts of Auditors are more suited in this regard (below 8.5.2).

8.5. Specific review and supervision of sovereign bonds

The EuGBR proposal treats the review of bonds issued by sovereigns in a privileged way because of their specific nature as states or public entities. While these privileges are justified in principle for most governmental issuers in the EU, they might not be sensible where public reviewers are not sufficiently independent (below 8.5.1). Alternative ways of assuring compliance exist (below 8.5.2).

8.5.1. EuGBR proposal

The EuGBR proposal contains a privilege for sovereign issuers regarding external review. As opposed to corporate issuers, sovereign issuers may obtain pre-issuance and post-issuance reviews either from an external reviewer or from a state auditor or any other public entity that is mandated by the sovereign to assess EuGBS compliance³⁶⁰. According to the EuGBR proposal, these state auditors are statutory entities with responsibility for, and expertise in, the oversight of public spending, and typically have legally guaranteed independence³⁶¹. Hence, their reviews are deemed equivalent to private external reviewers. State auditors and other public entities mandated by sovereign issuers to assess EuGBS

³⁶⁰ Article 11 EuGBR proposal.

³⁶¹ Recital 19 EuGBR proposal.

compliance are therefore exempted from the registration requirement and not subject to supervision by ESMA under the EuGBR proposal³⁶².

This privilege is in principle justified where it relates to a sovereign EU Member State or the EU itself that have independent state auditors whose function it is to perform independent review of the government's spending, e.g. the European Court of Auditors³⁶³ or national equivalents³⁶⁴. However, the EuGBR proposal uses a broader term of 'sovereign' that does not relate only to the EU or its Member States. Sovereign issuers under the EuGBR proposal are Euratom, the Union and any of their agencies, any state, including a government department, an agency or special purpose vehicle of a state, federal, regional or municipal entities, a collective undertaking of several states in the form of an organisation or a special purpose vehicle, and a company of private law fully owned by one or more of the aforementioned entities³⁶⁵. This includes states that are not members of the EU. While some third countries have independent state auditors, this is not necessarily the case for all third countries. The term 'sovereign issuer' under the EuGBR proposal also includes a vast array of sub-governmental entities, regional and municipal entities as well as private law companies fully owned by a state or any public entity – both in the EU or in any third country. It would be dangerous to render all these sub-entities equal to the EU Court of Auditors or national equivalents in EU Member States because it cannot be assumed that all of these entities have an independent state auditor or a public entity mandated to audit them. For example, a local community might issue a green bond and have a unit of the local council perform the audit on the issue even though that unit has conflicting interests. Another example is a state-owned company with accounting privileges where internal bodies of the company act as auditors and are not necessarily as independent as external reviewers. As a result, the review of public entities issuing EuGBs under the EuGBR proposal does not guarantee the same structural independence that is required for external reviewers of corporate issuers (above 8.1.3), despite the inherent conflicts of interest of private external reviewers because of their commercial dependence (above 8.2).

8.5.2. Alternatives

The co-legislators could either restrict the privileges of review to specific sovereign issuers, e.g. only governmental issuers in the EU, or differentiate state auditors according to their level of independence and competence. This would augment the level of independence for the review of third country governmental issuers and EU or third country sub-governmental public issuers. It would guarantee that all sovereign issuers are reviewed by structurally independent reviewers and therefore ensure a level playing field among sovereign and corporate issuers regarding the quality of external review.

If the co-legislators decide to replace the private external review of a bond's substantive taxonomy compliance by public supervision (above 8.4.2), they could place all those sovereign issuers that are not subject to independent national or EU courts of auditors under the substantive supervision of the NCAs. The NCAs could act as structurally independent supervisors and assess the compliance with substantive taxonomy and transparency requirements alike. In this case, governmental issuers should be subject to review by independent national courts of auditors and not by NCAs because NCAs are

³⁶² Article 14(3) EuGBR proposal.

³⁶³ Articles 285-287 TFEU.

³⁶⁴ Regarding doubts on the independence of certain national auditors, the rejection of a Polish nominee to the EU Court of Auditors by MEPs in December 2020 is exemplary. On the procedure see the European Parliament, Press Release – MEPs reject the Polish nominee to the Court of Auditors, 15 December 2020. <https://www.europarl.europa.eu/news/en/press-room/20201211IPR93632/meps-reject-the-polish-nominee-to-the-court-of-auditors>.

³⁶⁵ Article 2(3) EuGBR proposal.

usually subordinate to the national finance ministries and, hence, are structurally dependent on governmental issuers.

8.6. Policy recommendations

The oversight mechanism under the EuGBR proposal combines elements of private review and public supervision. Private external reviewers assess whether issuers comply with the substantive EuGBS requirements, especially the taxonomy requirements. NCAs supervise issuers regarding their disclosure duties. ESMA registers and supervises the private external reviewers that have to comply with heavy governance and compliance requirements. While it tries to combine the positive aspects of private review and public supervision, this approach raises several concerns. It is likely to create unnecessary costs, especially for SME issuers, and to squeeze out smaller reviewers from the market. It would also create regulatory diffusion and an unclear division of competences between several private and public layers of oversight (above 8.2).

This study recommends the substitution of private external review by public supervision. As regards corporate issuers, it seems sensible to attribute all supervisory powers to the NCAs and to benefit from the resulting supervisory synergies. Most of these NCAs are competent for the supervision of prospectuses under the Prospectus Regulation and for the sustainability reporting of financial undertakings under the SFDR (above 8.3). While private reviewers have an inherent conflict of interest with the assessed issuers given their commercial dependence, public supervisors are independent and objective vis-à-vis corporate issuers (above 8.4.2).

In the case of sovereign bonds, the reviewer privilege should be modified. While it makes sense for the EU and Member States to charge their independent courts of auditors with review, all other sovereign issuers below that level do not generally have such independent oversight bodies. Also, not all third country governmental issuers can be assumed to have independent oversight bodies. This study recommends differentiating either between the different types of sovereign issuer or between the different types of state auditor. It makes sense to place sovereign issuers that are subject to national or EU court of auditors under their supervision regarding substantive taxonomy compliance, especially if private review is replaced by public supervision. All other sovereign issuers should be either subject to review by private external reviewers or to supervision by NCAs (above 8.5.2).

9. ENFORCEMENT AND SANCTIONS

KEY FINDINGS

Enforcement and sanctions under the EuGBR proposal mirror the three layers of external oversight. The first layer of private enforcement seeks to enforce the issuers' taxonomy alignment via the negative opinions of external reviewers. In the second layer, NCAs exercise limited supervisory and sanctioning powers regarding the disclosure requirements. ESMA constitutes the third layer and can impose sanctions on external reviewers, including withdrawal of their registration and administrative fines. This three-pronged approach lacks clear attribution of powers and is weak on the substantive enforcement of taxonomy alignment.

The co-legislators could design enforcement and sanctions differently, attributing encompassing supervisory and sanctioning powers to NCAs regarding both taxonomy and disclosure requirements. In addition, they could add civil liability of issuers and/or external reviewers following the models of the Prospectus Regulation and the Credit Rating Agencies Regulation. This would add a compensatory element and foster overall enforcement.

9.1. The EuGBR proposal

Similarly to review and supervision, the EuGBR follows a **three-pronged approach** regarding enforcement and sanctions. First, it builds on the **deterrent effect of negative opinions** expressed by external reviewers. Second, it gives **NCAs the powers to impose administrative sanctions for non-compliance with the disclosure requirements**. Third, it empowers **ESMA to impose administrative sanctions on the external reviewers**.

9.1.1. Negative opinions by external reviewers

Under the EuGBR, the first layer of enforcement is exercised by private reviewers. A pre-issuance review with a positive opinion by an external reviewer and its publication by the issuer are necessary conditions for a bond to be issued as a 'European green bond'³⁶⁶. This means that only the negative opinion of an external reviewer hinders the issuance of an EuGB. The EuGBR proposal **does not give NCAs the power to intervene** if an EuGB receives the positive opinion of an external reviewer even though it **does not comply with the taxonomy requirements**. The same applies to the post-issuance reviews. If an external reviewer wrongly issues a positive opinion on an allocation report, the EuGBR proposal does not empower the NCAs or ESMA to take over supervision or to sanction the issuer.

In comparison, ICMA's Guidelines for External Reviews distinguishes between different types of external review, i.e. second party opinion, verification, certification and green bond scoring/rating³⁶⁷. Second party opinions assess the bond's issuance alignment with the relevant principles, including the environmental features and benefits of the projects financed. Verification operates similarly³⁶⁸. Green bond scoring or rating may include a focus on environmental performance data or process relative to the principles, or another benchmark, such as a 2° Celsius climate change scenario³⁶⁹. CBI's Climate

³⁶⁶ Articles 8(1)(b), 13(1)(b) EuGBR proposal.

³⁶⁷ International Capital Market Association, Guidelines for Green, Social, Sustainability and Sustainability-Linked Bonds External Reviews, February 2021, p. 3. <https://www.icmagroup.org/assets/documents/Sustainable-finance/Guidelines-for-Green-Social-Sustainability-and-Sustainability-Linked-Bonds-External-Reviews-February-2021-170221.pdf>.

³⁶⁸ Ibid, p. 5.

³⁶⁹ Ibid, p. 6.

Bonds Standard is stricter and requires certification by an approved verifier³⁷⁰. In cases of claimed breach of the standard, the Climate Bonds Standard Board may request a new verifier's report by a different verifier and even revoke the certification if the breach continues³⁷¹.

9.1.2. Administrative sanctions by NCAs

NCAs fulfil the **second layer of enforcement** by ensuring that **issuers correctly disclose** their EuGB factsheet, pre-issuance review, annual allocation reports, post-issuance review and impact reports³⁷². For cases in which issuers do not comply with these disclosure requirements, the EuGBR proposal mandates Member States to give NCAs the power to impose administrative sanctions and take other appropriate administrative measures that are effective, proportionate and dissuasive³⁷³. These administrative measures and sanctions have to cover issuers that infringe their disclosure and review duties, i.e. that do not properly disclose the necessary documents or do not obtain the necessary reviews, and issuers that do not cooperate in an investigation or do not comply with an inspection or request by the NCAs³⁷⁴. The national administrative measures and sanctions have to cover at least a public statement on an issuer's failure to comply (naming and shaming), an order for infringers to cease their conduct, and pecuniary sanctions with a maximum amount of at least EUR 500,000 for legal persons and EUR 50,000 for natural persons³⁷⁵. The EuGBR proposal allows Member States to provide for additional measures and sanctions, and for higher pecuniary sanctions³⁷⁶. When determining the administrative measures or sanctions, NCAs have to take into account all relevant circumstances, including the gravity and duration of the infringement, the degree of responsibility and financial strength of the infringer, the infringement's impact on retail investors' interests, the profits gained and losses avoided, the level of cooperation with the NCA, previous infringements, and measures taken to prevent repeated infringement³⁷⁷.

9.1.3. Administrative sanctions by ESMA

ESMA holds the **third layer of enforcement** that concerns external reviewers. Besides its general supervisory powers to request information, conduct general investigations and on-site inspections³⁷⁸, ESMA can impose administrative sanctions if an external reviewer breaches any of its registration, organisational, governance or compliance duties. ESMA can withdraw the registration of external reviewers and the recognition of third country external reviewers³⁷⁹. It can temporarily prohibit them from conducting external review and order them to cease the infringement³⁸⁰. In addition, ESMA can impose fines and periodic penalty payments³⁸¹; fines require a negligent or intentional infringement³⁸². Non-compliance with the registration, organisational, governance or compliance duties can result in

³⁷⁰ Climate Bonds Initiative, Climate Bonds Standard Version 3.0, 2019, pp. 23–29. <https://www.climatebonds.net/files/files/climate-bonds-standard-v3-20191210.pdf>.

³⁷¹ Ibid, p. 29.

³⁷² Articles 8–13, 36 EuGBR proposal.

³⁷³ Article 41(1) subparagraph 1 sentence 1 EuGBR proposal.

³⁷⁴ Article 41(1) subparagraph 1 sentence 2 EuGBR proposal.

³⁷⁵ Article 41(2) EuGBR proposal.

³⁷⁶ Article 41(3) EuGBR proposal.

³⁷⁷ Article 42(1)(a)–(h) EuGBR proposal.

³⁷⁸ Articles 47–49 EuGBR proposal.

³⁷⁹ Article 51(1)(a),(b) EuGBR proposal.

³⁸⁰ Article 51(1)(c),(d) EuGBR proposal.

³⁸¹ Article 51(1)(e),(f) EuGBR proposal.

³⁸² Article 52(1) EuGBR proposal.

finances ranging from EUR 20,000 to EUR 200,000³⁸³. The same fines can be applied to the submission of false statements in the registration process, failure to provide information to or cooperate with ESMA in an investigation, as well as taking up the activity of, or pretending to be, an external without registration³⁸⁴. In addition, ESMA can impose periodic penalty payments in order to compel a person to stop infringements, to supply complete information, to submit to an investigation by producing all requested material and to submit to an on-site inspection³⁸⁵. ESMA has to disclose to the public every fine and periodic penalty payment imposed, unless this would seriously jeopardise the financial markets or cause disproportionate damage to the parties involved³⁸⁶.

9.2. Assessment of the EuGBR proposal

The enforcement and sanction regime under the EuGBR proposal encounters the same problems as the review and supervision regime. The various layers of enforcement involve multiple actors, i.e. private reviewers and public supervisors. There is a **risk of enforcement diffusion and unclear responsibilities**.

Strikingly, **substantive compliance with the taxonomy requirements** is left **entirely to private reviewers** and **not subject to additional public enforcement** (above 9.1.1). If an issuer obtains a positive pre-issuance or post-issuance review for an EuGB that does not comply with the taxonomy requirements, the EuGBR does not empower the NCAs or ESMA to either impose sanctions on the issuer or to require a new review by a different external reviewer. The EuGBR proposal operates under the assumption that only external reviewers can properly assess taxonomy compliance and that their assessments will always be correct. It does not even allow NCAs to double-check and supervise substantive taxonomy compliance in case of malpractice. Rather, NCAs can only impose sanctions on issuers for infringements of the disclosure requirements and the general requirements to obtain pre-issuance and post-issuance reviews (above 9.1.2). This supervisory weakness necessarily **weakens the enforcement mechanism** because NCAs are neither required nor allowed to sanction issuers that do not comply with the taxonomy requirements. Under the EuGBR proposal, substantive non-compliance by an issuer can only result in a negative opinion of an external reviewer.

The EuGBR proposal does not even give ESMA the power to sanction external reviewers for specific wrong reviews or single instances of misbehaviour, e.g. if they wrongly assess an issuer's substantive non-compliance (above 9.1.3). Instead, ESMA can impose sanctions on external reviewers only if they infringe upon their general duties, including appropriate systems, resources and procedures, necessary knowledge and experience of their analysts and employees, permanent and effective compliance function, internal due diligence policies and procedures³⁸⁷. ESMA can also impose sanctions on the management body if it does not ensure sound and prudent management, independence of assessment activities, proper identification of conflicts of interest and the external reviewer's general compliance with its duties at all times³⁸⁸. It is not clear whether this entails powers to impose sanctions against the management body and its members for individual misconduct on a case-by-case basis.

In addition, there is a risk of **difficult enforcement** applying to **sovereign issuers**, given that the EuGBR proposal leaves the supervision and enforcement of their compliance with the taxonomy requirements entirely to their reviewers, and these can be state auditors of any kind by choice of the

³⁸³ Article 52(2)(a),(3) EuGBR proposal.

³⁸⁴ Article 52(2)(b)-(f),(3) EuGBR proposal.

³⁸⁵ Article 53(1) EuGBR proposal.

³⁸⁶ Article 54(1) EuGBR proposal.

³⁸⁷ Articles 18(1), 20(1), 21(1), 51(1), 52(1),(2)(a) EuGBR proposal.

³⁸⁸ Articles 19(1), 51(1), 52(1),(2)(a) EuGBR proposal.

sovereign issuer (above 8.5.1). Especially in the case of sovereign issuers below government-level, i.e. regional or local entities as well as state-owned private companies, the uncertain existence of independent and effective state auditors does not only create a lack of substantive supervision (above 8.5.1), but also a lack of substantive enforcement. The EuGBR proposal does not attribute to either state auditors or the NCAs or ESMA the power to impose sanctions on sovereign issuers to force them to comply with the substantive taxonomy requirements. Furthermore, the EuGBR proposal exempts state auditors from ESMA registration and supervision. As a result, it does not provide any mechanism to enforce the state auditors' EuGBS compliance and impose sanctions on them.

9.3. Proposal for additional civil liability

The co-legislators can foster enforcement by adding a decentralised external layer of enforcement: civil liability. While civil liability is generally a matter of national law and has not been fully harmonised at EU level because of the resistance of Member States³⁸⁹, there are prominent examples of EU legislation on disclosure rules or financial regulation that establish civil liability mechanisms. Civil liability supplements public enforcement and strengthens overall law enforcement.

9.3.1. Models of civil liability: Prospectus Regulation and Credit Rating Agencies Regulation

The Prospectus Regulation obliges Member States to ensure that their laws, regulations and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus, i.e. the issuer or its administrative, management or supervisory bodies, the offeror, the person asking for the admission to trading on a regulated market or the guarantor, as identified in the prospectus³⁹⁰. This civil liability is further circumscribed. It may not rely only on the basis of the prospectus summary unless, when read together with the other parts of the prospectus, it is misleading, inaccurate or inconsistent, or it does not provide key information in order to aid investors when considering whether to invest in the securities³⁹¹.

Regulation (EC) No 1060/2009 (Credit Rating Agencies Regulation)³⁹² applies a strong civil liability mechanism to credit rating agencies and entitles investors and issuers to damages claims. Where a credit rating agency has committed intentionally or with gross negligence a specific infringement that has an impact on a credit rating, an investor or issuer may claim damages from that credit rating agency for damage caused to it because of that infringement³⁹³. Among the specific infringements are those related to conflicts of interest, organisational or operational requirements, to obstacles to the supervisory activities, and to disclosure provisions³⁹⁴. An investor may claim damages when it establishes that it has relied reasonably and with due care on a credit rating for a decision to invest into, hold onto or divest from a financial instrument covered by that credit rating³⁹⁵. An issuer may claim damages when it establishes that it or its financial instruments are covered by that credit rating and

³⁸⁹ For an overview and contextualisation of the EU's harmonisation efforts regarding private law see Hesselink, M., *Justifying Contract in Europe - Political Philosophies of European Contract Law*, Oxford University Press 2021, pp. 19-21.

³⁹⁰ Article 11(1),(2) subparagraph 1 Prospectus Regulation.

³⁹¹ Article 11(2) subparagraph 2 Prospectus Regulation.

³⁹² Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies [2009] OJ L 302/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009R1060&from=EN>. The civil liability mechanism was introduced in the Credit Rating Agencies Regulation by Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies [2013] OJ L 146/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0462&from=EN>.

³⁹³ Article 35a(1) subparagraph 1 Credit Rating Agencies Regulation.

³⁹⁴ Article 35a(1) subparagraph 1, Annex III Credit Rating Agencies Regulation.

³⁹⁵ Article 35a(1) subparagraph 2 Credit Rating Agencies Regulation.

the infringement was not caused by misleading and inaccurate information provided by the issuer to the credit rating agency, directly or through information publicly available³⁹⁶. The investor or issuer bringing the claim has the burden of proof and has to present accurate and detailed information indicating the credit rating agency's infringement and its impact on the credit rating³⁹⁷. Yet, when assessing such information, the competent national court must consider whether the investor or issuer did or did not have access to information that is purely within the sphere of the credit rating agency³⁹⁸. The civil liability of credit rating agencies may be limited contractually in advance only by reasonable and proportionate limitations and where allowed by the applicable national law, but may neither restrict the principal conditions nor be excluded altogether³⁹⁹. National law may grant further civil liability claims⁴⁰⁰. The Credit Rating Agencies Regulation applies the civil liability mechanism in parallel to the public enforcement mechanism that gives ESMA the power to impose administrative fines⁴⁰¹.

9.3.2. Private law enforcement as an effective supplement to public enforcement

More generally, civil liability can be a strong tool of EU law to help regulatory duties gain practical effect and is referred to as 'private law enforcement'⁴⁰². Private law enforcement is particularly strong in EU competition law where it was first developed by the CJEU in its *Courage* judgment⁴⁰³ and later legislated in Directive 2014/104/EU (Cartel Damages Directive)⁴⁰⁴. It is also an increasingly important tool of EU capital markets regulation, as the explicit civil liability mechanisms under the Prospectus Regulation and the Credit Rating Agencies Regulation show. Furthermore, there is a broad debate on the duty to provide investment advice in the best interests of the customer under MiFID II⁴⁰⁵ and the duty to disclose inside information under Regulation (EU) No 596/2014 (Market Abuse Regulation)⁴⁰⁶, and whether civil liability claims arise from these two duties⁴⁰⁷. As opposed to public enforcement, the advantage of private law enforcement, and of civil liability in particular, is that it operates in a decentralised way and empowers investors to bring their own action when they are harmed. It also adds an element of distributive justice, compensating investors that incur losses⁴⁰⁸. The proceeds of civil damages claims reach the harmed person directly, while the amounts of administrative fines are allocated to public budgets as the EuGBR proposal shows⁴⁰⁹. Private law enforcement is also less prone

³⁹⁶ Article 35a(1) subparagraph 3 Credit Rating Agencies Regulation.

³⁹⁷ Article 35a(2) subparagraph 1 Credit Rating Agencies Regulation.

³⁹⁸ Article 35a(2) subparagraph 2 Credit Rating Agencies Regulation.

³⁹⁹ Article 35a(3) Credit Rating Agencies Regulation.

⁴⁰⁰ Article 35a(5) Credit Rating Agencies Regulation.

⁴⁰¹ Articles 35a(6), 36a Credit Rating Agencies Regulation.

⁴⁰² Wilman, F., *Private Enforcement of EU Law before National Courts - The EU Legislative Framework*, Edward Elgar Publishing 2015.

⁴⁰³ Case C-453/99, *Courage Ltd and Bernard Crehan* [2001] ECR I 6314.

<https://curia.europa.eu/juris/showPdf.jsf?sessionid=6A2DA81B04C4CE633DD676D96A4C4EAD?text=&docid=46604&pageIndex=0&clang=EN&mode=lst&dir=&occ=first&part=1&cid=697028>.

⁴⁰⁴ Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union [2014] OJ L 349/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0104&from=EN>.

⁴⁰⁵ Article 24(1) MiFID II.

⁴⁰⁶ Article 17 Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC [2014] OJ L 173/1.

<https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0596&from=EN>.

⁴⁰⁷ Badenhop, N., *Private Law Duties Deriving From EU Banking Regulation and its Individual Protection Goals* (2020) 16(2) *European Review of Contract Law* 233–266, 245–248. <https://doi.org/10.1515/ercl-2020-0013>.

⁴⁰⁸ Badenhop, N., *The Individual Protection Goal in EU Banking Regulation – A Process Towards Private Law Enforcement*, in Grundmann and Sirena (eds), *European Contract Law in the Banking and Financial Union*, Intersentia 2022 (forthcoming). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3411430.

⁴⁰⁹ Article 54(5) EuGBR proposal.

to ‘regulatory capture’, with its unfortunate phenomenon of the underlying specific biases or blind spots of public supervisors, thanks to centralised functioning and organisational structure⁴¹⁰. If juxtaposed with public enforcement, private law enforcement strengthens the overall enforcement level and significantly contributes to its effectiveness⁴¹¹. As to the enforcement of the EuGBS, civil liability can play an important role in strengthening the rather weak enforcement mechanism under the EuGBR proposal. It can add a particularly valuable layer of enforcement vis-à-vis sovereign issuers that are not subject to effective oversight, especially where they are reviewed by other entities than independent courts of auditors.

9.4. Policy recommendations

In a similar way to the review and supervision mechanism (above 8.2), the **enforcement and sanctions mechanism** under the EuGBR proposal **displays inconsistency, incompleteness and supervisory diffusion**. The enforcement powers are not clearly attributed and there is no strong enforcement mechanism to ensure that issuers comply with the substantive EuGBS criteria, i.e. the taxonomy requirements (above 9.2).

The co-legislators can fill the enforcement lacunae under the EuGBR proposal in two ways that complement each other. First, they could foster public enforcement by **attributing substantive supervisory powers** to the NCAs, including the supervision of issuers’ taxonomy compliance (above 8.6). This should not be limited to mere supervisory powers, but should include sanctioning powers. Second, they should consider introducing a **civil liability mechanism to supplement public supervision**. This could be similar to the civil liability regimes that apply to persons responsible for the prospectus under the Prospectus Regulation and to credit rating agencies under the Credit Rating Agencies Regulation (above 9.3.1). Adding this layer of private law enforcement would have the benefit of compensating the persons suffering harm from an issuer’s non-compliance. It would also strengthen the overall level of compliance and effectively deter issuers from infringing their duties under the EuGBS.

⁴¹⁰ Posner, R., The Concept of Regulatory Capture – A Short, Inglorious History, in Carpenter, D., and Moss, D., (eds), Preventing Regulatory Capture – Special Interest Influence and How to Limit it, Cambridge University Press 2014, pp. 49-56.

⁴¹¹ Badenhoop, N. (above fn 407 and fn 408); Badenhoop, N., Europäische Bankenregulierung und private Haftung – Die Durchsetzung von System- und Individualschutz mit Mitteln des Privatrechts, Mohr Siebeck 2020. Open Access ebook available at: https://mohrsiebeck.com/buch/europaeische-bankenregulierung-und-private-haftung-9783161592065?no_cache=1.

10. INTERNATIONAL ASPECTS

KEY FINDINGS

The EuGBR proposal addresses issuers and external reviewers outside the EU. In the case of non-EU issuers, it allows for corporate and sovereign third-country issuers to use the EuGB label. It also establishes a third-country regime for external reviewers based outside the EU. In the case of regulatory equivalence, they can register with ESMA and perform assessment services under the EuGBR proposal under ESMA's supervision. Otherwise, they can seek individual recognition by ESMA. Under specific circumstances, EU external reviewers can endorse the assessment services of third-country external reviewers.

10.1. The extraterritorial effect on third-country corporate and sovereign issuers

The EuGBR proposal is open to issuers from third countries. This applies to both corporate and sovereign issuers. Corporate entities established in a third-country can issue a 'European green bond' as the EuGBR proposal applies to any 'issuer' in the meaning of 'any legal entity that issues bonds'⁴¹², irrespective of their origin or place of establishment. The EuGBR proposal has no requirement of territorial provenance from or establishment in the EU. This is in line with the general open market approach of EU financial regulatory legislation and even has its roots in primary EU law. The free movement of capital also applies to third-country nationals and their capital⁴¹³ and, in this regard, significantly differs from the other fundamental freedoms relating to the free movement of goods, workers, services and freedom of establishment that apply only to EU nationals⁴¹⁴.

Sovereign issuers from third-countries can also choose to apply the label 'European green bond'. The EuGBR proposal defines the term 'sovereign' to include 'any State, including a government department, an agency, or a special purpose vehicle of such State'⁴¹⁵. It is explicitly not restricted to sovereign issuers from Member States, but openly addresses all states. Therefore, it is not only governments of third countries that can use the EuGBS, but any sub-governmental public entity, including regional or municipal entities as well as companies fully owned by third countries⁴¹⁶.

The only necessary condition is that third-country issuers make their EuGBs available to investors in the EU⁴¹⁷. This applies to both corporate and sovereign issuers.

10.2. The extraterritorial effect on third-country external reviewers

The EuGBR proposal opens the market for external review to third-country entities in **three distinct ways**⁴¹⁸. First, they can provide their assessment services under the EuGBR proposal **if the Commission has adopted an equivalence decision** for their country and the third-country external reviewers

⁴¹² Article 2(1) EuGBR proposal.

⁴¹³ Article 63(1) TFEU.

⁴¹⁴ Articles 28(1), 34, 45(1),(2), 49, 54 TFEU.

⁴¹⁵ Article 2(3)(b) EuGBR proposal.

⁴¹⁶ Article 2(3)(b)-(f) EuGBR proposal.

⁴¹⁷ Article 1 EuGBR proposal.

⁴¹⁸ These are modelled after the treatment of third country benchmarks under the Benchmarks Regulation, i.e. Articles 30–33 Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 [2016] OJL 171/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1011&from=EN>.

comply with specific requirements. Second, for third countries without such an equivalence decision, their external reviewers can apply for **individual recognition** by ESMA. Third, EU external reviewers can **endorse** the services of third-country external reviewers under specific conditions.

10.2.1. Market access via equivalence decision by Commission

Third-country reviewers are allowed to provide assessment activities under the EuGBR proposal to issuers throughout the EU as long as they are registered by ESMA in the register of third-country reviewers⁴¹⁹. Such registration is subject to **three cumulative conditions**.

First, it requires that the Commission has issued **an equivalence decision** that deems the applicable third-country's legal and supervision requirements to be equivalent to those under the EuGBR proposal⁴²⁰. The EuGBR proposal empowers the Commission to adopt an equivalence decision for a specific third country if its legal and supervisory arrangements ensure legally binding organisational and business conduct requirements for external reviewers registered or authorised in that third country, with an equivalent effect to the requirements under the EuGBR proposal⁴²¹. Equivalent effect means that external reviewers have to be subject to registration or authorisation in the third country, to adequate organisational requirements in the area of internal control functions and to the appropriate conduct of business rules⁴²².

The first condition of an equivalence decision depends on the Commission. Equivalence decisions for third-country entities that wish to provide their services on the EU market are a particularly common feature of EU financial regulatory legislation⁴²³. They have been adopted, inter alia, for MiFID II, Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR)⁴²⁴, the Accounting Directive, the Statutory Audit Directive and the Prospectus Directive⁴²⁵. Equivalence has also become the main regulatory tool for post-Brexit mutual market access for financial services providers⁴²⁶. The Trade and Cooperation Agreement between the EU and the UK does not grant general market access to financial services⁴²⁷. It mirrors general WTO terms under the General Agreement on Trade in Services⁴²⁸ and stops short of an encompassing free trade agreement that includes financial services⁴²⁹. External

⁴¹⁹ Articles 31(1), 32(4), 59 EuGBR proposal.

⁴²⁰ Articles 31(2)(a), 32(1) EuGBR proposal.

⁴²¹ Article 32(1) EuGBR proposal.

⁴²² Article 32(2) EuGBR proposal.

⁴²³ For an overview of the purpose and mechanism of equivalence decisions Commission Staff Working Document, EU Equivalence Decisions in Financial Services Policy: An Assessment, Brussels, 27.2.2017 (SWD(2017) 102 final). https://ec.europa.eu/info/sites/default/files/eu-equivalence-decisions-assessment-27022017_en.pdf.

⁴²⁴ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 176/1. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=EN>.

⁴²⁵ European Commission, Overview table of Equivalence/Adequacy Decisions taken by the European Commission, 10 February 2021. https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/overview-table-equivalence-decisions_en.pdf.

⁴²⁶ Moloney, N., Reflections on the EU Third Country Regime for Capital Markets in the Shadow of Brexit (2020) 1 European Company and Financial Law Review 35-71; Giusti, G., and Batbayar, K., UK post-Brexit financial regulation: the status quo on equivalence (2020) 21 ERA Forum 199-207.

⁴²⁷ Articles 182-189 Trade and Cooperation Agreement between the European Union and the European Atomic Energy Community, of the one part, and the United Kingdom of Great Britain and Northern Ireland, of the other part [2021] OJ L 149/10. [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22021A0430\(01\)&qid=1646044051347&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:22021A0430(01)&qid=1646044051347&from=EN).

⁴²⁸ Implemented in the EU via Council Decision 94/800/EC of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994) [1994] OJ L 336/190. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31994D0800&qid=1646045301139>.

⁴²⁹ On legal requirements and potential models for such a free trade agreement Berger, H., and Badenhop, N., Financial Services and Brexit - Navigating Towards Future Market Access (2018) European Business and Organization Law Review 679-714. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3577498.

reviewers established in the UK would need a Commission equivalence decision to provide their services under the EuGBR proposal.

Second, the third-country external reviewer has to be **registered or authorised** to provide the external review services and be **subject to effective supervision and enforcement** ensuring full compliance with the requirements applicable **in that third country**⁴³⁰.

Third, **cooperation arrangements** must have been established between **ESMA and the third-country NCAs**⁴³¹. Once ESMA has registered a third-country external reviewer, no further requirements can be imposed on it⁴³². The cooperation agreement between ESMA and the third-country NCAs must specify the mechanism for the exchange of information, including access to all information regarding the third-country external reviewers, the mechanism for prompt notification to ESMA in case of infringements, and the procedures concerning the coordination of supervisory activities including, where appropriate, on-site inspections⁴³³.

In the case of misconduct, ESMA will withdraw the registration of a third-country external reviewer⁴³⁴. This is the case where ESMA has well-founded reasons to believe that the third-country external reviewer is acting in a manner that is clearly prejudicial to the interests of investors or the orderly functioning of markets⁴³⁵. It is further the case where the third-country external reviewer has seriously infringed the provisions applicable to it in the third country, which formed the basis for the Commission's equivalence decision⁴³⁶. ESMA will also withdraw the registration where the third-country NCA has not taken the appropriate measures needed to protect investors and the proper functioning of the markets in the EU or has failed to demonstrate that the third-country external reviewer concerned complies with its national requirements⁴³⁷.

While the EuGBR proposal requires third-country external reviewers to be under effective supervision in their home country based on equivalence, it does not subject it to the supervision of ESMA in case ESMA deems this necessary. Furthermore, it is not clear if, in case of malpractice, ESMA has the power to impose sanctions on third-country external reviewers besides withdrawing their registration. To ensure effective oversight, the co-legislators should clarify this and consider extending ESMA's supervisory powers (above 8.1.3) and sanctioning powers (above 9.1.3) to third-country external reviewers.

10.2.2. Market access via individual recognition by ESMA

As long as the Commission has not adopted an equivalence decision for their country, third-country external reviewers may provide their services under the EuGBR proposal if they acquire **prior recognition from ESMA**⁴³⁸. In order to gain such individual market access, third-country external reviewers have to comply with the **specific requirements** for external reviewers under the EuGBR proposal and subject themselves to **ESMA's supervision**, including requests for information, general

⁴³⁰ Article 31(2)(b) EuGBR proposal.

⁴³¹ Articles 31(2)(a), 32(3) EuGBR proposal.

⁴³² Article 31(3) EuGBR proposal.

⁴³³ Article 32(3) EuGBR proposal.

⁴³⁴ Article 33 EuGBR proposal.

⁴³⁵ Article 33(1)(a) EuGBR proposal.

⁴³⁶ Article 33(1)(b) EuGBR proposal.

⁴³⁷ Article 33(1)(c) EuGBR proposal.

⁴³⁸ Article 34(1) EuGBR proposal.

investigations and on-site inspections⁴³⁹. In addition, they must have a legal representative in the EU that is co-responsible for the external reviewer's compliance and accountable to ESMA, which acts as main point of contact and has sufficient knowledge, expertise and resources to fulfil its obligations⁴⁴⁰. ESMA will suspend or even withdraw the recognition where, based on documented evidence, it has well-founded reasons to consider that the third country external reviewer is acting in a manner clearly prejudicial to the interests of users of its services or the orderly functioning of markets, or has seriously infringed its obligations, or made false statements or used any other irregular means to obtain the recognition⁴⁴¹.

While recognition subjects third-country reviewers to ESMA's supervision, it is not clear if, in the case of malpractice, the EuGBR proposal gives ESMA the powers to impose sanctions on them besides suspending or withdrawing the recognition. The co-legislators should clarify this question and consider extending ESMA's sanctioning powers to recognised third-country external reviewers.

10.2.3. Market access via endorsement by an EU external reviewer

Under specific circumstances, the EuGBR proposal offers third-country external reviewers a third possibility to access the EU market for external review: the **endorsement of its services by an external reviewer located in the EU**⁴⁴². EU external reviewers may apply to ESMA to endorse the services provided by a third country external reviewer on an ongoing basis in the EU under three conditions. First, the endorsing external reviewer has verified and is able to demonstrate on an on-going basis to ESMA that the provision of services voluntarily or mandatorily meets requirements which are at least as stringent as the EuGBR⁴⁴³. Second, the endorsing external reviewer has the necessary expertise to monitor effectively the activity of the provision of services by that third country external reviewer and to manage the associated risks⁴⁴⁴. Third, the third country external reviewer is relied upon because of the objective specificities of the underlying markets or investments, proximity of the endorsed reviewer to third country markets, issuers or investors, or the third-country reviewer's expertise in providing the services of external review or in specific markets or investments.⁴⁴⁵ The applicant has to provide all information necessary to satisfy ESMA that all the conditions referred to in that paragraph are fulfilled at the time of application⁴⁴⁶. The endorsed services of the third-country external reviewer are considered to be endorsing the external reviewer's services and may not be used with the intention of avoiding the requirements under the EuGBR⁴⁴⁷. The endorsing external reviewer remains fully responsible⁴⁴⁸. Where ESMA has well-founded reasons to consider that the conditions are no longer fulfilled, it has the power to require the endorsing external reviewer to cease the endorsement⁴⁴⁹.

Here too, it is not clear if, in case of malpractice, the EuGBR proposal gives ESMA the powers to impose sanctions on third-country external reviewers whose reviews are endorsed besides requiring the endorsing reviewer to cease the endorsement. The co-legislators should clarify this question and

⁴³⁹ Articles 15–30, 34(2), 47–49 EuGBR proposal.

⁴⁴⁰ Article 34(3) EuGBR proposal.

⁴⁴¹ Article 34(6) EuGBR proposal.

⁴⁴² Article 35 EuGBR proposal.

⁴⁴³ Article 35(1)(a) EuGBR proposal.

⁴⁴⁴ Article 35(1)(b) EuGBR proposal.

⁴⁴⁵ Article 35(1)(c) EuGBR proposal.

⁴⁴⁶ Article 35(2) EuGBR proposal.

⁴⁴⁷ Article 35(4) EuGBR proposal.

⁴⁴⁸ Article 35(5) EuGBR proposal.

⁴⁴⁹ Article 35(6) EuGBR proposal.

consider extending ESMA's sanctioning powers to third-country external reviewers whose reviews are endorsed.

10.3. Potential to influence third-country legislation

The EuGBR proposal has the potential to influence legislation and regulatory standards on green bonds in third countries. This influence regards both the substantive standards that apply to green bond issuers and the standards that apply to external reviewers.

As regards **green bond issuers**, the EuGBR proposal explicitly includes corporate and sovereign issuers from third countries. To appeal to investors in the EU, third-country issuers can opt for the voluntary 'European green bond' label under the EuGBR proposal. The incentive lies in the strong ESG appetite of EU investors. If EuGBS works well and stimulates even stronger investment in green bonds in the EU, this might be a model for third-country legislators. Under a voluntary standard, the EuGBS may have an influence on third-country legislators thanks to the 'Brussels effect', i.e. the general phenomenon that EU legislation influences market participants, regulators and legislators globally⁴⁵⁰.

The incentives would become even stronger if the co-legislators adopted a mandatory EuGBS applicable to all bonds labelled 'green' that are issued or marketed in the EU. Under such a mandatory standard, third-country issuers would have to comply with the EuGBS if they seek any investment from within the EU. A mandatory EuGBS for green bonds marketed in the EU would effectively oblige corporate and sovereign third-country issuers to comply with the EuGBS if they address EU investors.

As regards **external reviewers**, the third-country regime under the EuGBR proposal is likely to foster influence on third-country legislation. Market access requires that third-country external reviewers have been registered or authorised and that the applicable rules and supervision have an equivalent effect. The latter is measured against the adequacy of organisational and internal control requirements and appropriateness of conduct of business rules. This creates incentives for third-country legislators to open EU markets by regulating external reviewers in a similar way to EuGBR. If they want to open the EU assessment market, third-country legislators are likely to create rules similar to the EuGBS regarding external review. However, given the additional possibilities of individual recognition by ESMA and endorsement by EU external reviewers, the approximation of third-country legislation is not a necessary condition for market access.

10.4. Policy recommendations

The EuGBR proposal continues the EU's general open market approach vis-à-vis third countries. The fact that it gives third-country issuers, both corporate and sovereign, the opportunity to opt for the 'European green bond' label fosters the aim to create a global green bond standard (above 2.5). If the co-legislators decide to adopt a mandatory EuGBS for all green bonds marketed in the EU (above 3.5), or at least mandatory disclosure requirements for such bonds (above 7.5 and 7.6), the EuGBS is likely to influence third-country issuers even more, in so far as they seek investment from within the EU. As a result, it is also likely to influence third-country legislators.

The regime for third-country external reviewers under the EuGBR proposal follows the equivalence approach that is ubiquitous in EU financial regulatory legislation. Granting third-country external reviewers access to the EU market of assessment services subject to registration or authorisation and equivalence of regulatory and supervisory standards is to be recommended. However, the EuGBR proposal does not extend ESMA's supervisory and sanctioning powers to such entities and, apart from

⁴⁵⁰ Bradford, A., (above fn 53).

the withdrawal of registration, does not offer clear enforcement tools. The co-legislators are advised to clarify this and to ascertain that ESMA has sufficient supervisory and sanctioning powers over third-country external reviewers operating on the EU market. This applies to all three types of market access, i.e. equivalence, recognition and endorsement.

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This study analyses the Commission proposal for a Regulation on European green bonds. It compares the proposal with existing EU legislation on sustainable finance and financial regulation and contextualises it in the EU green bond market. The assessment covers key regulatory aims, advantages of voluntary and mandatory options, different types of sustainable bonds, alignment with the Taxonomy Regulation, corporate and sovereign bonds, transparency requirements, review and supervision, enforcement and sanctions, and international aspects. On each aspect it provides policy recommendations to the co-legislators.

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