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Breaking down the EuGB Regulation: What it means for Green Bonds in Sweden

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FREDRIK ARVEBRATT

Introduction

The market for green bonds has long been functioning without a precise definition of what qualifies as a "green bond". Since 2014, market participants have relied on the Green Bond Principles (GBP), a voluntary framework that outlines best practices for issuing bonds with social and/or environmental purposes. These global guidelines and recommendations promote transparency and disclosure, ensuring the market's integrity. However, the GBP and other existing self-regulatory measures present various challenges, particularly concerning greenwashing, which undermines investor confidence.

On 6 July 2021, the European Commission introduced a proposal for a regulation that establishes a standard for European Green Bonds. On 28 February 2023, following a negotiation process, the Council and the European Parliament reached a provisional agreement on the proposal. Recently, the consolidated legal text (EuGB Regulation), including the relevant annexes, has become available.

The primary objective of the EuGB Regulation is to ensure that uniform requirements apply to the use of the designation "European Green Bond" and to establish a simple registration system and supervisory framework for external reviewers. In the words of Elisabeth Svantesson, Minister for Finance of Sweden:

> *The new standard which we are setting will be useful for both issuers and investors of green bonds. Issuers will be able to demonstrate that they are funding legitimate green projects aligned with the EU taxonomy. And investors buying the bonds will be able to more easily assess, compare and trust that their investments are sustainable, thereby reducing the risks posed by greenwashing.*

It is important to note that the EuGB Regulation is subject to the ordinary legislative procedure within the European Union. While a provisional agreement has been reached, the regulation still requires confirmation and adoption by both the Council and the European Parliament before it becomes final. Even though the EuGB Regulation is expected to start applying 12 months after its entry into force, market participants can already familiarise themselves with its anticipated requirements. This article provides an overview of the EuGB Regulation and its differences from the existing market standard GBP.

EuGB Regulation and GBP

General principles
The GBP serve as a voluntary framework, outlining best practices for issuing bonds that serve social and/or environmental purposes. These global guidelines and recommendations promote transparency and disclosure, thus upholding the market's integrity. In contrast, the EuGB Regulation establishes uniform requirements for issuers seeking to designate their bonds as "European Green Bonds" or "EuGB". While the GBP is a voluntary framework applicable to all issuers of green bonds, the designation "European Green Bond" or "EuGB" will only be available to issuers publishing a prospectus compliant with Regulation (EU) 2017/1129, known as the EU Prospectus Regulation. Consequently, the regulation will not directly impact all green bond issuers.

Use of proceeds
To be classified as a "green bond" under the GBP, the proceeds of the bond must be allocated towards financing or refinancing "green projects". The GBP recognises various broad categories of eligibility for green projects, encompassing areas such as:

- climate change mitigation;
- climate change adaptation;
- natural resource conservation;

- biodiversity conservation; and
- pollution prevention and control.

Further, the GBP recommend the use of qualitative performance indicators and quantitative performance measures. However, the GBP does not take a definitive stance on the optimal green technologies, standards, claims and declarations for achieving environmentally sustainable benefits.

In contrast, the EuGB Regulation will go a step further by specifying the green technologies and standards that must be employed to qualify as a European Green Bond as the proceeds of the bond must adhere to the EU taxonomy requirements, ensuring alignment with predefined environmental criteria and technical standards. Additionally, the proceeds from a European Green Bond must be exclusively and fully allocated to specific categories, either individually or in combination, such as:

- fixed assets;
- capital expenditures;
- operating expenditures;
- financial assets (provided they were created within five years of bond issuance); and
- households' assets and expenditures.

While the EuGB Regulation emphasises adherence to taxonomy requirements, it also allows for some flexibility. Issuers may allocate up to 15% of the proceeds to economic activities that align with the EU taxonomy requirements, but where no technical screening criteria has been established at the time of bond issuance. Moreover, in specific circumstances, deviations from strict alignment with the EU taxonomy are permitted when the proceeds finance capital and operating expenditures that will eventually meet the EU taxonomy requirements. In such cases, the issuer must provide a Capital Expenditure (CapEx) plan, outlining a deadline for aligning all funded capital and operating expenditures with the EU taxonomy.

By imposing these conditions, the EuGB Regulation align green bonds with the EU taxonomy. Investors purchasing these bonds will have greater confidence in assessing, comparing and trusting that their investments are truly sustainable, thereby reducing the risks associated with relying solely on the GBP, which lacks technical standards.

Transparency and disclosure

The GBP states that issuers of green bonds must communicate key information to the investors, such as outlining the environmental sustainability objectives of the eligible green projects and how the process used to determine how the projects align with the eligible green projects categories. In addition, issuers are encouraged to provide supplementary information on how they identify and manage social and environmental risks associated with the relevant project. This may involve disclosing the issuer's overarching objectives, strategy, policy and processes related to environmental sustainability. Further, issuers are expected to have a process in place to identify and mitigate known material risks of negative social and environmental impacts stemming from the project. It is also recommended that issuers should make, and keep, readily available up to date information on the use of proceeds to be renewed annually until full allocation, and on a timely basis in case of material developments. The annual report should include a list of the projects to which green bond proceeds have been allocated, as well as a brief description of the projects, the amounts allocated and their expected impact.

As other regulations under European Union's green deal, the EuGB Regulation includes detailed provisions on transparency. Issuers opting to use the designation European Green Bond will not only be obligated to disclose detailed information about the utilisation of the bond proceeds but also to demonstrate how those investments contribute to the overall transition plans of the company.

This requirement takes the form of the following reporting requirements for issuers:

- a pre-issuance review – the EuGB regulation outline that investors should benefit from cost-effective access to reliable information about European Green Bonds. To ensure such cost-effective access, issuers of European Green Bonds will provide a so called "European Green Bond factsheet", which must undergo a pre-issuance review conducted by an external reviewer, resulting in a positive opinion;
- a post-issuance review – issuers are required to prepare allocation reports for each 12-month period until the full

allocation of the European green bond proceeds and, if applicable, until the completion of the CapEx plan, which must undergo a review conducted by an external reviewer. This review should occur once the proceeds have been fully allocated and, in cases where the allocation is done on a portfolio basis, on an annual basis. The allocation reports and reviews must be published within 270 days after the end of the annual period;

- an impact report – to ensure that investors have comprehensive information to evaluate the environmental impact of a European Green Bond, issuers have a duty to compile and publicly disclose a European Green Bond impact report. This report must specify the metrics, methodologies and assumptions used in assessing the environmental impact. It is required to be made public at least once during the bond's lifetime and following the full allocation of the proceeds. The impact report must undergo an external review; and
- publication on the issuer's website – the disclosure documents referred to in EuGB Regulation must be publicly and freely available on the issuer's website. These include:
  - the European green bond factsheet;
  - the allocation report;
  - the impact report;
  - where applicable, the CapEx plan; and
  - the reviews carried out by external reviewers.

External reviewers

The GBP recommends external verification for the management of Green Bond proceeds. Issuers should appoint external review providers to assess their green bond alignment with the four core components of the GBP, namely:

- use of proceeds;
- process for project evaluation and selection;
- management of proceeds; and
- reporting.

External auditors or third parties should verify the tracking and allocation of funds to eligible green projects. There are different types of external reviews available, and issuers should consult the International Capital Market Association's (ICMA) Guidelines for External Reviews for recommendations. External review providers should disclose their credentials and clearly communicate the scope of their reviews. Issuers should make external reviews publicly available and use the template provided by the ICMA's website.

Issuers of European Green Bond will be obligated to use external reviewers as labelled in the EuGB Regulation. Issuers of European green bonds should only make use of external reviewers, including from third countries, that have been registered and are subject to ongoing supervision by the European Securities and Markets Authority. This is to:

- improve transparency on how these external reviewers reach their conclusions;
- ensure that external reviewers have adequate qualifications, professional experience and independence;
- reduce the risk of potential conflicts of interests; and
- ensure adequate investor protection.

Supervision
Supervision for issuers of green bonds is key. Without supervision, there is a risk that issuers' frameworks may not meet the requirements, preferences or specific investment mandates of all investors. The absence of standardised practices and regulations can create uncertainty and inconsistency in the market. Additionally, issuers retain the right to change the terms of their green commitments, and market practices may evolve after the bond issuance. This means that a green bond issued today may not align with future regulations, principles or standards. Without proper supervision, there is a lack of assurance that green bonds will maintain their environmental integrity over time.

To fulfil their responsibilities, the EuGB Regulation stipulates that competent authorities must be granted expanded supervisory and investigatory powers. For example, in Sweden, the Swedish Financial Supervisory Authority will serve as the competent authority. Further, EU member states must, in accordance with national law, ensure that competent authorities have the power to impose administrative sanctions and other administrative measures in relation to the infringements of the EuGB Regulation. The inclusion of robust supervision by competent authorities and collaboration among them strengthens the regulatory framework for European Green Bonds. It ensures that the issuance and marketing of these bonds comply with legal requirements, promoting transparency and protecting the integrity of the market.

Comment

The EuGB Regulation aims to introduce clarity and transparency, offering investors coherent sustainability information. However, there remain uncertainties regarding its appeal to issuers and practical implementation. Challenges arise in interpreting and applying the technical screening criteria of the EU taxonomy. While some existing market definitions for green bonds ambitiously surpass the EU taxonomy criteria, there is a need for further clarification on the benefits of adopting the European Green Bond standard. Early adopters in well-defined sectors may embrace the standard, but others await greater certainty. Issuers may opt to continue following existing principles while separately demonstrating alignment with the EU taxonomy.

Nonetheless, the introduction of the EuGB regulation (including the templates to be used by issuers) and the establishment of a framework for external reviewers play a crucial role in promoting transparency, streamlining reporting processes and building trust in the market. These measures contribute to the advancement and effectiveness of green finance, supporting sustainable investments and facilitating the transition to a greener economy. As the European Green Bond standard progresses, it will be essential to address the remaining uncertainties and hopefully provide clear incentives for issuers to fully embrace the standard.

For further information on this topic please contact Fredrik Arvebratt at Wigge & Partners by telephone (+46(0)72 062 60 86) or email (fredrik.arvebratt@wiggepartners.se). The Wigge & Partners website can be accessed at www.wiggepartners.se.