



THE INTERNATIONAL DEBT CAPITAL MARKETS REVIEW
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THE EUROPEAN GREEN BOND STANDARD - A NEW FRAMEWORK FOR EUROPEAN ISSUERS

FOREWORD

Since their introduction by the European Investment Bank (EIB) on 5 July 2007, green bond issues have experienced year-on-year exponential growth that—while momentarily interrupted by the Covid-19 health crisis—is forecasted to set a new record in 2021.

Only recently, Iberdrola, S.A., the Spanish global energy leader, and one of the world's largest electricity utilities in terms of market capitalisation, launched what is currently reported by specialised media to be the historically largest green hybrid bond issue, with €2 billion issued through its subsidiary, Iberdrola International B.V. Following this trend, two Spanish real estate companies have issued green bonds in 2021 (Vía Célere issued €300 million 5.25% Senior Secured Notes due 2026 and Neinor issued a €300 million 4.5% Senior Secured Notes due 2026).

The growth trend demonstrates that green bonds have become a fundamental financing tool in connection with the assets and projects necessary to carry out the low-carbon transition expected by the international community. Nevertheless, and despite their importance, a uniform standard for the criteria and framework under which a bond can be considered “green” has yet to be implemented.

As a result of this vacuum, many issuers have adopted or followed principles inspired by the Green Bond Principles (GBPs) published by the International Capital Markets Association (ICMA), which have become an accepted market standard to determine whether or not a bond can be labelled “green”.

The European Union (EU) has, in turn, been working to develop a uniform green bond standard since it was recommended to do so in the final report of the Commission's High-Level Expert Group on sustainable finance delivered on 31 January 2018, materialising in, among other measures; the European Green Deal of 11 December 2019; the new EU Taxonomy Regulation, which entered into force on 12 July 2020; and the European Commission's commitment to deliver a legislative proposal on the EU Green Bond Standard (EU GBS) in the second quarter of 2021.

THE EU TAXONOMY REGULATION - A UNIFORM GREEN SYSTEM

The EU Taxonomy Regulation and the EU GBS are two key legislative instruments for implementing the European Green Deal. The EU Taxonomy Regulation is a classification system that, among others, will provide appropriate definitions to issuers, investors, regulators and policymakers on what economic activities can be considered environmentally sustainable, enhancing market transparency and increasing investor protection from the practice known as “greenwashing” (labelling a financial product as a green or sustainable bond when the fundamental standards for that classification have not been met).



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Mr Rodríguez-Viña has over 6 years of experience advising domestic and international clients on initial public offerings (IPOs) and stock exchange listings, rights issues and offerings of shares by listed companies, block trades, takeover bids and issues of bonds (including convertible bonds) and hybrid securities.

Mr Rodríguez-Viña also regularly advises clients (issuers and investors) on matters related with capital markets regulations (investments in listed companies, transparency, market abuse, etc.) and the corporate governance of listed companies (general meetings, internal regulations, corporate law, etc.).



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Alfonso Bernar joined Uría Menéndez in Madrid in 2014. From 2019 to 2020, he was seconded to the firm's London office. Mr Bernar's practice focuses on M&A and securities law. He also advises on wide-ranging corporate matters, such as corporate governance and national and international contracting, and regulatory aspects concerning financial activities, such as banking and investment and payment services.



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The EU Taxonomy Regulation establishes six environmental objectives, as well as specific thresholds for economic activities to determine whether they are substantially contributing to the achievement of those six objectives:

- (i) climate change mitigation;
- (ii) climate change adaptation;
- (iii) the sustainable use and protection of water and marine resources;
- (iv) the transition to a circular economy;
- (v) pollution prevention and control; and
- (vi) the protection and restoration of biodiversity and ecosystems.

For any economic activity to be considered in compliance with the EU Taxonomy Regulation it must directly or indirectly contribute substantially to one or more of the six objectives, avoid doing any significant harm to the other five and comply with specific minimum safeguards and Technical Screening Criteria (TSC) pending to be adopted by the Commission.

Under the EU Taxonomy Regulation, the Commission is responsible for establishing, among others, the TSC applicable to each of the foregoing environmental objective through the corresponding delegated acts (the so-called Taxonomy Delegated Acts) regulating the specific technicalities for their implementation (including without limitation metrics, thresholds, performance measures for each objective, etc.). While the Taxonomy Delegated Acts with the TSC for the first two objectives were expected to be published no later than 31 December 2020, the overwhelming response to its consultation has warranted its delay, and now it is expected to be formally adopted at the end of May 2021 with application from 1 January 2022. The Taxonomy Delegated Acts with the TSC for the other four remaining environmental objectives are currently being developed and its application is not expected until 1 January 2023.

IMPLICATION FOR ISSUERS - A NEW FRAMEWORK FOR GREEN BOND ISSUANCES

The EU GBS is a voluntary standard that seeks to enhance the transparency, credibility and comparability of the EU green bond market, harmonising the analysis of whether an economic activity qualifies as environmentally sustainable for financing purposes and thus helping issuers to raise funds across borders for their environmentally sustainable activities.

To assist in the development of this standard, the European Commission mandated a Technical Expert Group on sustainable finance (TEG) to come forward with a standard for green bonds. The TEG published the Report on EU Green Bond Standard in June 2019, which included a Draft Model of the EU Green Bond Standard and an EU Green Bond Framework Template (EU GBS Report), and a usability guide for the EU GBS in March 2020.

While the European Commission's commitment is to deliver a legislative proposal on the EU GBS in the second quarter of 2021, the legislative proposal is expected to largely follow the TEG's approach established in the EU GBS Report.

Pursuant to the guidelines set by the TEG, issuers will need to develop a green bond framework (GBF), or thoroughly review their existing framework, that can capture several bond issuances but also other products and detailing the approach and compliance with the EU GBS requirements. In particular, the GBF will include the issuer's environmental objectives and strategy; the process by which the issuer ensures alignment of each of the financed projects with the EU Taxonomy Regulation requirements, including the evaluation and selection process for such projects; guidelines on how proceeds allocated to green projects are managed and on general reporting requirements (e.g., frequency, content, metrics); and information on the external review performed by accredited third-parties at the time of issuance and after full allocation of proceeds to verify alignment with the EU GBS.

The GBF shall be published on the issuer's website before or at the time of the issuance of an EU Green Bond and shall remain available until the maturity of the relevant EU Green Bond.

This article gives a brief overview of the contents and requirements issuers must meet in relation to their respective frameworks in order to be adequately aligned with the EU GBS since, despite its voluntary nature, that alignment will be required in order to use the "EU Green Bond" label in connection with their issues.

ENVIRONMENTAL STRATEGY AND OBJECTIVES

In this section, issuers will be required to describe the environmental objectives to which their green projects contribute as part of the issuer's overall environmental strategy and explain how the green bond issuance contributes to their achievement.

The TEG considers the inclusion of a description of the extent of the environmental impact by business area of the issuer and a description on the manner in which such impacts are handled as a best practice.

Furthermore, issuers subject to the Non-Financial Reporting Directive must include information on their alignment with the EU Taxonomy in their respective GBFs.

The purpose of this section of the GBF is to allow investors to evaluate an issuer's environmental targets and determine whether the framework adheres to any existing international environmental frameworks (including the EU GBS) or sustainability commitment.

USE OF PROCEEDS - EU TAXONOMY REGULATION ALIGNMENT

Net proceeds from the issuances of green bonds must be used to finance projects aligned with the activities covered by the EU Taxonomy Regulation and, once available, the Taxonomy Delegated Acts. In the interim period during which alignment might not be possible—for example, due to the lack of implementing acts in relation to the applicable EU Taxonomy Regulation objectives that the financed project seeks to comply with, issuers normally apply a selection of the most relevant guidelines and criteria available at the time, such as the EU Commission's TEG reports.

As previously explained, before the development of the EU Taxonomy Regulation, no uniform standard existed to determine the criteria and framework under which a bond could be considered “green”. Issuers tended to rely on guidance provided by private institutions such as ICMA and its GBPs.

Consequently, the novelty and heightened scrutiny required by the EU Taxonomy Regulation to determine whether an activity could be considered environmentally sustainable may prove to be the most challenging section to prepare in any issuer’s GBF.

Issuers must corroborate the: a) substantial contribution to environmental objectives, b) the absence of significant harm to the remaining environmental objectives, c) compliance with minimum safeguards, and d) compliance with the TSC established by the relevant Taxonomy Delegated Acts.

This necessary alignment with the EU Taxonomy Regulation is expected to increase market transparency and mitigate the risk of greenwashing. For example, a green bond issued to finance a solar photovoltaic project would comply with ICMA’s GBPs but would not be considered an eligible green project pursuant to the EU GBPs unless it also complies with the TSC applicable to activities covered under the EU Taxonomy Regulation’s climate objectives (change and mitigation).

PROJECT EVALUATION AND SELECTION PROCESS

EU GBS bond issuers will need to define the eligible green projects to be financed or refinanced, totally or partially, by its green bond issuances, providing information on the financed project’s alignment with the EU Taxonomy Regulation or, if unavailable, the alternative standards that will be applied.

In the relatively uncommon case in which the issuers have yet to determine the specific project to be financed through a particular green bond issuance, issuers are required to define the class and sectors of potential projects and the environmental objectives to be addressed by those projects. Additionally, once a project has been financed, issuers are expected to publish, when possible, detailed information on the specific project as part of the post-issuance reporting required under the EU GBS framework (see section 3.5 below).

The TEG has also issued a recommendation to include a reference in the EU GBS framework to the corresponding activities, criteria and, where applicable, thresholds of the EU Taxonomy Regulation to enable a more streamlined analysis by investors and other interested parties.

MANAGEMENT OF PROCEEDS

Issuers must confirm and describe the management process to ensure that the net proceeds for the issuance of green bonds are effectively allocated to eligible green projects. Issuers should put in place processes that adequately avoid any double-counting issues and distinguish the stage of development and disbursement of the projects (for example, establishing procedures for the management of proceeds for refinanced projects).

In this section of the GBF, it is critical to assure investors and other market participants that the issuer has implemented a dedicated tracking process that ensures the traceability of the proceeds. It should also indicate, if possible, the use of such proceeds prior to their disbursement and the expected timeframe for the disbursement of the proceeds to the corresponding eligible green projects.

REPORTING

Issuers will need to guarantee their compliance with the reporting requirements under the EU GBS, indicating in their GBF both the scope and frequency of the reporting. In this regard, the EU GBS establishes two distinct reporting categories: allocation reporting and impact reporting.

In relation to allocation reporting, issuers are required to report—at least annually until full allocation of the green bond proceeds—information on total proceeds, amounts allocated as at the end of period and information on a project or activity-by-activity basis, as well as in relation to the environmental objectives covered, and information on the geographical distribution of the projects offering, when possible, the corresponding information on a country-by-country basis.

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With regard to impact reporting, issuers must disclose, at least once prior to the green bond's final maturity date, following full allocation of proceeds, and following any material change, information on the methodology, assumptions, metrics and thresholds it has applied to measure the environmental impact of each project. Once available, thresholds and metrics must be aligned with those developed under the applicable Taxonomy Delegated Acts with TSC for each environmental objective established in the EU Taxonomy Regulation, although additional accepted market metrics may also be applied.

Transparency in connection with the definition, scope and frequency of reporting under the EU GBS when developing the applicable GBF is key to ensure investors and other market participants have a clear understanding of the information provided by the issuer, particularly in relation to the methodologies applied and potential estimates on future environmental impact of the applicable project.

Allocation and impact reportings shall be published on the issuer's website and, when appropriate, through any other accessible communication channel.

THIRD-PARTY VERIFICATION

The GBF should also describe the verification procedures that an EU accredited external reviewer duly appointed by the issuer will undertake to confirm: before or at the time of issuance, the alignment of their GBF with the EU GBS, and, after full allocation of proceeds, the allocation of the proceeds to green eligible projects. In relation to debt programmes, the TEG has clarified that all bonds issued under the same programme and GBF may benefit from a single initial verification. Similarly, any bond issuance by virtue of which the proceeds are fully allocated at the time of issuance may include the verification of the allocation within the initial verification procedure.

Finally, all verifications must be made available on the corresponding issuer's corporate website and, when appropriate, through any other accessible communication channel.

CONCLUSION

The EU Taxonomy Regulation and the EU GBS are highly anticipated landmarks that will further consolidate and boost the green bonds' already positive trend, increasing their transparency and acting as a benchmark standard for the market. While implementation may require an effort from all parties involved, we believe that the benefits clearly outweigh the costs and that the alignment and review of an issuers' GBF is a critical step for issuers to understand the extensive scope and complexity of these modifications.

We trust that the EU Taxonomy Regulation and the EU GBS will contribute to the development of a more standardised and professional green bond market by, among other results, helping investors understand the environmental impact of investing in these assets, which will lead to better and more-informed investment decisions, assisting companies when developing activities allegedly green and may ultimately be the tools necessary for the EU to achieve their ambitious objective of becoming the first climate-neutral continent by 2050 as established in the European Green Deal.

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