European Commission

INCEPTION IMPACT ASSESSMENT	
TITLE OF THE INITIATIVE	*Establishment of an EU Green Bond Standard*
LEAD DG (RESPONSIBLE UNIT)	Directorate-General for Financial Stability, Financial Services and Capital Markets Union (DG FISMA). Responsible Unit: FISMA.C.4 (Asset Management)
LIKELY TYPE OF INITIATIVE	*Legislative initiative*
INDICATIVE PLANNING	*Q1 2021*
ADDITIONAL INFORMATION	*https://ec.europa.eu/info/business-economy-euro/banking-and-finance/green-finance_en*

This Inception Impact Assessment aims to inform stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to make available any relevant information that they may have, including on possible impacts of the different options. This Inception Impact Assessment is provided for information purposes only and its content may change. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content.

A. Context, Problem definition and Subsidiarity Check

Context

The European Green Deal of 11 December 2019 underlined that long-term signals are needed to direct financial and capital flows to green investments and avoid stranded assets. It announced that the Commission will present a renewed sustainable finance strategy in 2020, focusing on a number of actions, including making it easier for investors to identify sustainable investments and ensuring that they are credible. The European Green Deal Investment Plan of 14 January 2020 announced that the Commission will establish an EU Green Bond Standard.

Green bonds play an increasingly important role in financing assets needed for the low-carbon transition. However, there is no uniform green bond standard within the EU. Establishing such a standard was a recommendation in the final report of the Commission's High-Level Expert Group on Sustainable Finance. It was then included as an action in the 2018 Commission Action Plan on Financing Sustainable Growth. And finally it was assessed by the Commission's Technical Expert Group on Sustainable Finance, which provided detailed input on this subject in its final proposal for an EU GBS in June 2019.

This work should be seen in the broader context of transitioning to a sustainable economy and triggering the significant additional investment efforts needed across all sectors to reach the EU's current 2030 climate and energy targets (approximately EUR 260 billion a year in the core polluting sectors alone, and well beyond the capacity of the public sector) and the EU's environmental policy objectives. It links with other initiatives on sustainable finance, such as the Regulation on a classification system (so-called 'EU Taxonomy') of sustainable economic activities and the Regulation on sustainability disclosures in the financial services sector. As the euro is already the main currency of denomination for the issuance of green bonds world-wide, an official EU green bond standard could also bolster the international role of the euro, and help to consolidate the EU as a global hub for green finance.

Problem the initiative aims to tackle

Bonds are one of the main instruments used for financing fixed assets in sectors related to energy and resource efficiency. For this reason, bond markets will continue to play an important role in reaching the EU's environmental sustainability objectives, including enabling the transition to a climate neutral economy. While the green bond market is growing – annual issuances reached around EUR 225 billion in 2019 – green bonds remain a fraction of the overall bond market (less than 4% of the EU market as of 2019). There seem to be three main barriers for further growth of the current market:

- **Lack of agreement on definition of green.** For investors, this lack of certainty about the green credentials of a product can cause reticence to invest. For issuers, there is a risk of reputational damage from issuing a bond whose greenness is subsequently questioned. In the past, this has prevented some issuers from tapping the market, particularly in economic sectors that are very important for the low-carbon transition, but where the identification of green assets and projects is not straightforward, such as steel or cement industries.

- **Often complex review procedures for green bonds.** A wide array of market practices, actors with very diverse levels of expertise on environmental matters, and potential conflicts and quality control issues create uncertainty for issuers and investors on the actual value, quality and impact of external reviews.

- **A lack of investable projects and assets**. Despite the many financial institutions eager to 'go green', investor demand for green bonds outstrips the capacity of issuers to identify eligible green projects and assets for financing. So far, most assets financed with green bonds have been in renewable energy, real estate, green transport, or sustainable water management.

In addition, issuing a green bond is typically more costly and work-intensive than issuing a standard bond, with the average cost for external review estimated at about EUR 40.000. These costs are rarely offset by any pricing difference with regular bond issuance.

Without EU action in this field, the most likely outcome is the continued development of market-based or less comprehensive public standards for green bonds. This could lead to cross-sector divergences, thereby hindering economies of scale, and making green bond issuance more costly and less lucrative. It could also cause confusion among end-investors and other users of green bond standards. And it could lead to increased "green-washing", since market-based standards might be insufficiently rigorous and verifiable, which could potentially create reputational problems for the whole sustainable investment market.

Basis for EU intervention (legal basis and subsidiarity check)

The type of initiative should be identified based on the impact assessment.

In the case of a legislative initiative, the legal basis could be Article 114 TFEU, which confers to the European institutions the competence to lay down appropriate provisions that have as their objective the establishment and functioning of the internal market, should it emerge that there are concrete genuine obstacles or significant distortions to competition in the internal market hindering or likely to hinder the development of the green bond market.

The impact assessment will assess whether the objectives of the initiative can be better achieved at EU level than by Member States acting alone, given the international nature of the green bond market, and given the risk that national level action could lead to a proliferation of diverging green bond standards, incentive schemes, and verification regimes, which could fragment the EU green bond market and potentially hamper cross-border investment flows.

The impact assessment will further assess whether EU action in the green bonds market adds value, given the risk that inaction could lead to market fragmentation and consumer confusion, and given the potential for EU action to promote economies of scale, thereby helping the market to grow.

B. Objectives and Policy options

The objective of this initiative would be to establish a recognizable and high-quality standard for green bonds – an EU Green Bond Standard - anchored to the EU Taxonomy. This should serve to address barriers to growth in the current market for green bonds, in order to fuel an increase in public and private funding for investments in green projects and activities, in line with the goals of the European Green Deal.

The form of the initiative will follow the policy choices made. The use of a non-legislative measure, such as a Commission guideline would allow for a more adaptive approach, including an assessment of market uptake. Alternatively, a legislative proposal, such as a regulation, would improve legal certainty and could facilitate authorisation and supervision.

The establishment of an EU GBS should contribute to growing the market for green bonds in two main ways:

First, on the demand side, by reducing search costs for investors looking to invest in bonds that contribute to environmental goals, by providing a trusted and recognized alternative to current market-based standards. This would help institutional investors and providers of investment products for retail investors (such as bond- or mixed funds, pension funds, insurance products, etc) to more easily locate assets that can be used to construct green portfolios. An EU GBS with EU-level verification would allow issuing companies to more easily demonstrate alignment of their bonds with the EU Taxonomy, in turn helping product manufacturers using such bonds as underlying investments to demonstrate the greenness of their products,

Second, on the supply side, by making it more attractive to issue green bonds, by standardising, providing clarity on definitions, and ensuring that verifiers have the necessary expertise and objectivity. The proposed EU GBS would incorporate existing best market practice, while addressing current uncertainties. In this way, it would aim to establish itself as the dominant standard for green bonds, catering to a large segment of the market, including corporate, sovereign, sub-sovereign and agency sovereign issuers. The EU GBS would also aim to serve as reference for other sustainable financial products such as social and sustainable bonds, as well as green, social and sustainable loans. A legal definition for an EU green bond would also enable linkages with other EU legislation, for instance to promote their use.

The link with the EU Taxonomy and the technical screening criteria for the objectives of the taxonomy is one of the key issues that will need to be calibrated when establishing an EU GBS. It will also be important that any verification is robust enough to avoid mis-selling and abuses of the brand “EU Green Bond”. The EU GBS could also aim to offset the costs of issuance by implementing some form of incentive scheme to increase the benefits for companies of issuing green bonds, if need be.

C. Preliminary Assessment of Expected Impacts

Likely economic impacts

The economic impact of the standard will depend on the degree to which it is used. In case of a voluntary standard, only those issuers wishing to be recognised as complying with the EU Green Bond Standard would need to use it.

Overall, the adoption of a European standard is expected to have a positive economic impact in terms of the costs of issuance and third-party validation. While there will be initial one-off costs (e.g. authorisation of validators) the increased level of standardisation should lower issuance costs in the medium to long run for EU Taxonomy aligned green bonds. Moreover, there is a potential for significant economies of scale in the validation process. Again, these will depend crucially on the market uptake. If other initiatives (e.g. a green loan standard) would equally build on the envisaged Green Bond third-party validation system, there would be economies of scope providing further economic advantages.

In addition, a clear legal definition of what constitutes an EU green bond would enable regulators to provide regulatory incentives in respective follow-up actions. This could further enhance the expected positive economic effect.

Likely social impacts

This initiative will promote compliance with minimum social safeguards among issuers of green bonds, as the EU GBS is likely to require respect of the eight fundamental conventions identified in the International Labour Organisation’s Declaration on Fundamental Rights and Principles at Work.

Likely environmental impacts

This initiative is expected to have indirect but significant positive impacts on the environment, including climate, air, water, land, biodiversity, and resource use. These impacts will arise to the extent that the market takes up the voluntary EU Green Bond Standard and uses it to issue new green bonds. This initiative should not lead to any significant negative environmental impacts.

Likely impacts on fundamental rights

There is no relevant impact on fundamental rights from this initiative.

Likely impacts on simplification and/or administrative burden

The EU GBS has the potential to simplify the landscape of green bond standards. Assuming that it becomes the most widely used green bond standard in Europe, there will be benefits as regards economies of scale and scope that will lower the administrative burden in the issuance process and especially third party validation.

D. Evidence Base, Data collection and Better Regulation Instruments

Impact assessment

An impact assessment is being prepared to support the preparation of this initiative and to inform the Commission's decision.

Evidence base and data collection

Work will be based on the final report of the Commission’s Technical Expert Group on Sustainable Finance on the EU Green Bond Standard.

Consultation of citizens and stakeholders

The interim version of the report of the Commission’s Technical Expert Group on Sustainable Finance was subject to a public consultation. It received 104 replies from a balanced group of stakeholders, with a strong majority of respondents supporting the creation of a voluntary EU GBS standard. In addition, a technical consultation on the creation of an EU GBS will be carried out in Q2-Q3 2020, in relation to the open public consultation for a renewed EU Sustainable Finance Strategy (available here). This consultation will run for 16 weeks. The Commission may hold additional workshops.

Will an Implementation plan be established?

If a legislative approach is taken to enact this initiative, an implementation plan will be established accordingly.