

## Policy Brief

# Building EU green bonds that deserve their name

19 October 2020

**Lucas Guttenberg**, Deputy Director  
**Sebastian Mack**, Policy Fellow

[#Recovery](#)  
[#SustainableFinance](#)  
[#FiscalPolicy](#)

The EU should seize the day: It should issue parts of the Recovery Instrument debt as green bonds and thereby boost that burgeoning market. But it is important to manage expectations: Issuing green bonds alone will not 'green' recovery spending. This will depend on the criteria for climate-friendly spending in the legal texts governing the Recovery Instrument – and these so far lack teeth. So, there is a substantial risk that EU green bonds will set the wrong precedent now if backed by weak criteria. This would pre-empt future legislative work on the final EU green bond standard. If the criteria for climate-friendly spending are not strengthened, the Commission should scale back its ambition and should only issue green bonds for measures that fully match the criteria set out in the EU Taxonomy Regulation.

The European Union is on the verge of formally adopting its Recovery Instrument: It will allow the Union to borrow up to 750 billion euros in the markets on its own account. Of these, €390bn will go to extra EU expenditure to fight the economic fallout from the pandemic; in addition, €360bn can be given to member states in the form of loans. In her State of the European Union speech, President Ursula von der Leyen announced that the Commission intends to raise 30% of Recovery Instrument funds – up to €225bn<sup>1</sup> – through “green bonds”. This policy brief explains what these are, how they would work in the context of the Recovery Instrument – and why they cannot be a substitute for robust rules on how the funds should be spent.

### What are green bonds and how are they regulated in the EU?

Green bonds are commonly understood as debt instruments to finance projects with an environmental benefit, such as renewable energy, low carbon transport or protection of water resources. Unlike conventional bonds, green bonds provide investors with a higher degree of transparency on the use of proceeds. However, unlike project bonds which are often used to finance investment in infrastructure, green bonds are backed by the entire balance sheet of the issuer so that investors get their capital back even if a specific project fails.

There is as yet no EU legislation in place specifying the requirements for debt instruments to qualify as green bonds. Green bond issuers therefore have full liberty to follow one of the many privately developed international guidelines

<sup>1</sup> These numbers are expressed in 2018 prices – actual amounts will be slightly higher.

such as the [Green Bond Principles](#) (GBP) from the International Capital Market Association. While application is always voluntary, the various standards differ as regards purpose, criteria and level of detail.

The European Commission's Technical Expert Group on Sustainable Finance (TEG), an advisory group bringing together regulators, industry and civil society representatives, has proposed an [EU Green Bond Standard](#) (EUGBS). The Commission is expected to put forward a legislative proposal for the EUGBS based on the TEG draft in 2021.

The draft EUGBS uses the [EU Taxonomy Regulation](#) that entered into force in summer 2020: A bond can be classified as 'green' if it clears the bar set out there for an activity to be sustainable. These criteria are that an activity 1) contributes substantially to at least one of the six specified environmental objectives; 2) does not significantly harm any of the other five ('do-no-significant-harm-principle'); 3) complies with minimum social safeguards, mainly in terms of fundamental labour rights; and 4) meets the technical screening criteria adopted by the Commission for each objective.

The technical screening criteria should allow for a more precise and granular set of definitions to determine which activities in a given economic sector qualify as sustainable. The two delegated acts that will determine the screening criteria for climate change mitigation and adaptation are ready and are set to be adopted by the Commission by year-end; the specification of the four other environmental objectives will follow only next year.

So, the regulation of what 'green bond' means is very much in flux. Issuing green bonds to finance the Recovery Instrument will strongly influence this debate.

### **How can green bonds contribute to the green transition?**

Many projects mitigating climate change and stopping depletion of clean air, water, land and biodiversity rely on fixed assets by and large financed by debt. To achieve climate neutrality by 2050 and genuinely protect natural resources, it is crucial to shift capital flows towards such sustainable investments.

Green bonds can support this shift by providing transparency on which projects are green. This lowers search and transaction costs for investors that actively want or are mandated to invest in sustainable assets. Greater transparency can translate into a pricing advantage over conventional bonds as seen [in recent bond issuances](#). Conversely, this transparency allows civil society groups to scrutinise issuers on their environmental impact.

However, the contribution of these bonds to the green transition crucially hinges on the definition of what qualifies as sustainable: Only if the criteria are restrictive enough and subject to reliable external review, do green bond standards strengthen transparency. Furthermore, financing projects through green bonds does not necessarily increase the number of green projects. The Bank for International Settlements [in a recent study](#) found little evidence that previous green-bond issuances led to any decarbonisation of companies. Therefore, green bonds can complement, but not substitute for, other public policies that increase real economy investments in the green transition.

### **How would the issuance of green bonds to finance the Recovery Instrument affect the green bond market?**

If the European Commission were to raise up to €225bn to finance 30% of the Recovery Instrument's expenditure and loans through green bonds, [it would give the associated market a massive push](#). Since the European Investment Bank (EIB) issued the first "Climate Awareness Bond" in 2007, the market for green bonds has grown at accelerating pace. The rising importance of green bonds is also acknowledged by the European Central Bank which decided on 22 September [to accept sustainability-linked bonds](#) in its monetary policy operations. Yet, in 2019, global yearly issuance of green bonds still stood at roughly 214 billion euros, just 3.5% of total global bond issuance.

The additional liquidity provided by the EU issuance can be expected to stimulate private sector issuance. Furthermore, it could attract additional investors that so far have been reluctant to invest in this asset class; it could also lead, however, at least in the short term, to a crowding out of other sovereign green bond issuers.

In addition, as total EU issuance for the financing of the Recovery Instrument exceeds the volume of global green bond issuance in 2019, the EU green bonds will go a long way towards setting the

new benchmark of what ‘green bond’ means even in the absence of a definition in EU law. So, the projects that will be financed under the Recovery Instrument will significantly contribute to defining which measures qualify for green bond financing in the EU. This will not only foreshadow future EU legislation on the matter; it will also likely set a global standard.

Therefore, understanding the interaction between bond issuance and the choice of projects in the Recovery Instrument is critical.

### **Will green bonds make Recovery Instrument spending greener?**

It is very unlikely that issuing EU bonds as green bonds will make the expenditure under the Recovery Instrument any greener. Most of the spending – €312.5bn in grants and €360bn in loans – will come through the Recovery and Resilience Facility (RRF). Measures to be financed will be proposed by each member state for their pre-agreed allocation in their recovery and resilience plans. These plans will be negotiated between the Commission and the member state in question. In the end, the Commission will formally assess the plans and will propose to the Council whether to allocate the full amount to each member state based on the plan. The plan will also include a set of milestones for each measure; once a milestone is completed, the member state can apply for a pay-out from the EU. This is when funds start to flow and when the EU will have to issue bonds, green or not, in the market.

In this setup, the key moment for deciding on the measures to be financed is the approval of national plans. The Commission will conduct its assessment based on the criteria still to be fixed in the RRF Regulation by European Parliament and Council. These criteria will be decisive for how “green” RRF expenditure will be. The Commission can only apply what is legally given to it as leverage over member states, which remain in the driving seat as it’s their prerogative to propose measures to be financed within their plans. In addition, the final governance arrangements will be important to ensure that the Commission can enforce the criteria when it assesses member state plans. Therefore, [a strong involvement of the EP in adopting the plans](#) beyond what the summit in July has agreed is crucial. But once plans are adopted, there will be very little leeway to change measures within them. The Commission will still be able to block payments if countries do not stick to their plans – but it will not be able to enforce any “green” standards above and beyond what will be in the approved plans.

As a result, when bonds are issued, the set of measures to be financed will already have been finalised. Whether bonds are then issued as green or ordinary bonds will have no bearing on them.

This is also true for the other instruments that will receive funding from the Recovery Instrument such as REACT-EU, Horizon Europe, or the Just Transition Fund. Each of these programmes has its own set of rules agreed between the co-legislators and only these rules will determine how green spending will be.

Thus, it will not be the nature of the bond – green or brown – but the robustness of the criteria in the RRF Regulation and their subsequent enforcement by the Commission that will define how green Recovery Instrument spending will be.

### **What are the risks for the EU sustainable finance agenda?**

The green bonds issued by the EU to finance the Recovery Instrument will de facto set a green bond standard. The main risk is that this standard may fall considerably short of what would be desirable from a climate and environmental policy point of view. As described above, the key determinant of the greenness of Recovery Instrument spending will not be the bond covenant or any form of external verification mechanism, but the rules and the governance of the RRF and of the other spending programmes. Yet the methodology currently proposed in the various legal texts is too weak to provide a good green bond standard.

The RRF Regulation will likely contain a 37% target for climate-friendly spending and will also require that all measures to be financed will be in line with the ‘do no significant harm’ principle within the Green Taxonomy Regulation. But the method to calculate the climate-friendly share in a national plan is not grounded in the Taxonomy Regulation but rather relies on the method that is used for [calculating the climate-friendliness of the EU structural funds](#): Measures are grouped in three very broad buckets based on a list in the annex of the so-called Common Provisions Regulation: 0%, 40%, or 100% climate contribution, based on the type of project. 40% of the costs

to renovate a seaport are counted as climate-friendly; a cycling path gets 100%; a new waste-water plant gets 0%, and so on.

This is materially different from what the Technical Expert Group had proposed as green standard: Here, making substantial contribution to one of the six sustainability objectives defined in the Taxonomy Regulation and specified for each economic activity through the technical screening criteria is the main hurdle to clear. This would also ensure that not only the fight against climate change, but also other sustainability objectives such as biodiversity are included. But no link is yet foreseen between the RRF Regulation and the Taxonomy Regulation beyond the ‘no significant harm’ principle. Thus, the methodology for Recovery Facility spending as now foreseen would merely guarantee that measures do no significant harm; it does not ensure that they contribute substantially to any of the sustainability objectives.

Therefore, if the EU were to issue green bonds now to finance the Recovery Instrument and use the methodology currently foreseen to score the greenness of measures, it would set a standard for green bonds that would fall short of the expert advice. Rather than setting a high standard that would provide legal certainty, it would lower the bar substantially. That cannot be the objective and would in fact harm the Commission’s own sustainable finance agenda.


### **What can be done to make green bond issuance by the EU a success?**

The EU should only issue green bonds that can be backed up by truly climate-friendly measures. The best way to ensure this is by linking the calculation of the climate share in Recovery Instrument spending programmes directly to the Taxonomy Regulation: Only if a project is taxonomy-compliant, should it be counted as climate-friendly. In this case, green bonds could be issued against the share of the Recovery Instrument spending that is taxonomy-compliant. This could in due course become the legal standard for green bonds for all issuers.

If a direct link to the Taxonomy Regulation proves unfeasible politically or because it will not be possible to adopt the necessary technical specifications in time for the approval of national spending plans, the Commission should not issue green bonds right away. Instead, it should carry out a separate screening of the measures to determine which ones are taxonomy-compliant. It should then restrict its green bond issuance to the volume these measures alone represent. This could well be lower than the €225bn now floated – but the green bonds issued under these rules will truly deserve their name and set the right standard.

In addition, the Commission should submit itself to the same standards to which it will likely subject others: Its assessment should be subject to independent verification by experts. This could be done by a new independent public body or by private entities that would then need to be certified by e.g. the European Securities Market Authority (ESMA) as suggested by the technical expert group.

This publication is part of the research project “Repair and Prepare”, a joint project of the Bertelsmann Stiftung and the Jacques Delors Centre.

For more information, please visit [www.strengtheningeurope.eu](https://www.strengtheningeurope.eu) **Repair and Prepare**  


Hertie School gGmbH • Chairman of the Supervisory Board: Bernd Knobloch • Chairman of the Board of Trustees: Frank Mattern • Academic Director: Prof. Dr. Henrik Enderlein • Managing Director: Dr. Axel Baisch  
• Registered Office: Berlin • Trade Register: Local Court, Berlin-Charlottenburg HRB 97018 B •  
Hertie School – founded and supported by the non-profit Hertie Foundation

Friedrichstraße 194  
D – 10117 Berlin  
Tel.: +49 (0)30/259 219 107

Online: [delorscentre.eu](https://delorscentre.eu)  
E-Mail: [info@delorscentre.eu](mailto:info@delorscentre.eu)  
Twitter: [@delorsberlin](https://twitter.com/delorsberlin)