FESE Position Paper on Green Bond Prospectus

Brussels, 29th April 2019

The Action Plan on Sustainable Finance from March 2018 outlines that the Commission will specify the content of the prospectus for green bond issuances to provide potential investors with additional information.

At this point in time, FESE would not favour the creation of a green bond prospectus. The green bond market is rapidly growing but remains very modest, accounting for less than 1% of total bonds outstanding worldwide as noted by the Commission in the Action Plan published in 2018.[1] While the Prospectus Regulation only applies to bonds listed on regulated markets, a large share of bond issuances in the EU are currently conducted through private placements. The latter are already subject to lower legally binding requirements compared to listed instruments and introducing further prospectus requirements for listed bonds would risk creating an even more unlevel playing field. While the intention would be to have additional transparency, such a measure could thus cause less transparency in the market.

In addition, many green bond issuances are issued by states or their local authorities, which are exempt from the Prospectus Regulation.

It should also be noted that the product type is constantly evolving. Therefore, to set out requirements within the Prospectus Regulation runs the risk of excluding future developments within the green bond sphere.

FESE fully supports the Commission’s Sustainable Finance proposals aimed at reorienting capital flows to sustainable investments and managing financial risk related to climate change, as well as fostering transparency and long-termism in financial and economic activity. FESE considers it important to ensure that all capital market raising activities adhere to sustainable financing so all companies can be part of the necessary transition towards a sustainable future for our planet. To this end, FESE supports the creation of a taxonomy as this will favour both comparability and transparency by providing clarity on the activities that can be considered sustainable and, based on this, facilitate the determination of the degree to which assets are sustainable. However, in the absence of such a defined taxonomy, a regime for a Green Bond Prospectus would be open to interpretation and potentially lead to inequitable application of the regime and also the potential for litigation in the event of a default under the bond.

Issues to consider in relation to green bond issuers

It is important to understand that for issuers, adding a firm green commitment into the prospectus would introduce another risk factor, which to the issuer limits the attractiveness of issuing green bonds since this means a) additional costs in legal fees b) if the ‘greenness’

[1] Commission Action Plan, 8th March 2018, ‘Financing Sustainable Growth’, available here.

of the bond would change this could trigger a default in the bond which would trigger the generally included cross-default provision. An event such as the latter could potentially risk the financing of the whole corporation. In a rapidly changing field where activities considered green today may be considered much less green five years from now, due to scientific and political developments, this represent a considerable risk for any issuer. In order to minimise such default risk, the issuer would therefore most likely value the impact of the green bond at a lower level. However, issuers setting less ambitious goals could mean a slower, less effective transition towards a sustainable economy.

Moreover, while a lot of attention is dedicated to greenwashing, it is important to also consider the reputational risk any issuer overstating the greenness of their bonds would face.

Issues to consider in relation to green bond investors

With regard to investors, while there is growing demand for green bonds, investors are today investing in green bonds without receiving a significant 'greenium'. Although this might be a simplistic view, many market participants consider that the investor's mandate is to invest to get the highest return. However, if green bonds provide a significantly lower yield and perhaps also have less ambitious objectives (in order not to trigger the early re-payment), green investments will be less attractive for investors. A potential remedy could be to make green bonds rank senior to other liabilities of the relevant issuer. This would change the credit risk of the bond as the investor would buy a bond with a higher probability to get re-payed in case of default.

Should the Prospectus Regulation be modified to impose additional requirements on green bond issuers, FESE considers that consideration should be given to ways of incentivising green bond issuance, for instance by making the prudential regulation for green bonds more attractive.

Overall, the Prospectus Regulation should be broad enough to cater to the ever-evolving green bond sphere.

Green bond standards

In addition to the workstream on green bond prospectus, the Commission is also in parallel assessing developments on green bond standards. As stated above, FESE considers that a clearly defined taxonomy is a necessary starting point for other actions, including standards and labels.

Standards, labels and classifications for green financial products, including for green bonds, are critical. These new frameworks are likely to:

1) Encourage legal certainty regarding disclosures/reporting obligations;
2) Enhance transparency and accountability among practices, improving readability and comparability of performance;
3) Reward stakeholders and incentivise change.

Issuers compliant with the green bond standards could be identified based on second party opinions and impact reports in accordance with the currently proposed EU Green Bond Standard.

Market standards have in recent years developed and the green bond space can be seen as a sector that could now benefit from further strengthening by recommendations or some level of regulation. In considering standards for green bonds, it should be noted that tracking and reporting of use of proceeds is very important. This should be compulsory but has to be flexible to allow for projects in new industries where no green bonds have yet been issued. In some sectors there has already been more activity, such as real estate and local councils.

The Federation of European Securities Exchanges (FESE) represents 36 exchanges in equities, bonds, derivatives and commodities through 19 Full Members from 30 countries, as well as 1 Affiliate Member and 1 Observer Member.

At the end of March 2019, FESE members had 8,617companies listed on their markets, of which 13% are foreign companies contributing towards the European integration and providing broad and liquid access to Europe's capital markets. Many of our members also organise specialised markets that allow small and medium sized companies across Europe to access the capital markets; 1,322 companies were listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission's objective of creating a Capital Markets Union.