The Intersection of the EU Green Bond Standard Regulation and Good Corporate Governance

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Abstract:
This article explores the EU Green Bond Standard (EU GBS) Regulation, emphasising its significance in fostering a sustainable financial ecosystem. As climate change intensifies, green bonds emerge as crucial instruments for funding environmentally beneficial projects, aligning financial performance with environmental stewardship. The EU GBS Regulation sets a rigorous framework for transparency and accountability in green investments, reflecting the intrinsic link between sustainable finance and good corporate governance. By adopting the EU GBS, companies can integrate sustainable practices into their financing strategies, promoting long-term sustainability, transparency, and accountability. This article explores how the EU GBS enhances corporate practices, driving the transformation of the green bond market and contributing to a greener, more resilient future.

Keywords:
Sustainable finance; green bonds; EU Green Bond Standard Regulation; corporate governance

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1. Introduction

In a world that is becoming increasingly more vulnerable to the devastating impacts of climate change, the EU Green Bond Standard (EU GBS)[2] Regulation (hereafter, the "EU GBS Regulation" or the "Regulation") emerges as a beacon of hope and a testament to human ingenuity and responsibility. Green bonds, financial instruments dedicated to funding projects with positive environmental outcomes, represent a powerful mechanism for channelling capital toward sustainable development. They stand at the crossroads of finance and environmental stewardship, embodying the transformative potential of the private sector in the fight against climate change.

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[2] Regulation (EU) 2023/2631 of the European Parliament and of the Council of 22 November 2023 on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds, available here.

'We need the private sector everywhere to drive deep and immediate decarbonisation', voiced António Guterres, the Secretary-General of the United Nations (UN), who has repeatedly emphasised the critical role that businesses must play in addressing our planet's most pressing environmental challenges.[3] António Guterres eloquently calls upon companies to embrace their responsibilities and leverage their resources, innovation, and influence to foster a sustainable future. The EU GBS Regulation not only sets a rigorous framework for transparency and accountability in green investments but also stresses the intrinsic link between sustainable finance and good corporate governance. By aligning financial performance with environmental integrity, companies can drive meaningful change and demonstrate that profitability and sustainability are not mutually exclusive but mutually beneficial.

Green bonds have emerged as a pivotal financial instrument in addressing climate change challenges. As the global community intensifies efforts to transition to a low-carbon economy, green bonds offer companies[4] an effective way to integrate sustainable practices into their financing strategies.[5]

The European Union (EU) has been at the forefront of promoting sustainable finance, with the EU GBS Regulation being a significant step in the right, more sustainable direction. The Regulation aims to create a robust framework for green bonds, ensuring that the proceeds are effectively used for environmentally beneficial projects. The Regulation aligns with broader goals of promoting good corporate governance, which encompasses transparency, accountability, and long-term sustainability.

This article explores the interconnections between the EU GBS Regulation and good corporate governance, highlighting how the EU GBS can enhance corporate practices and contribute to a more sustainable financial ecosystem.

2. Green Bonds in Corporate Financing Strategy

Green bonds are a type of debt security issued to fund projects featuring environmental benefits. These bonds allow companies to raise capital for initiatives aimed at improving environmental outcomes, such as installing renewable energy systems, enhancing energy efficiency, and developing sustainable infrastructure. By integrating green bonds into their financing strategies, companies can achieve multiple advantages.

Firstly, issuing green bonds allows companies to demonstrate a strong commitment to sustainability. This commitment can significantly enhance their reputation among both investors and customers, showcasing their dedication to environmental responsibility and corporate social responsibility. This, in turn, can lead to increased brand loyalty and a stronger market position.

[3] UN, Press Release, 21 June 2023, available here.

[4] Even if this financial instrument is suitable both for companies and for states, this article will focus on the corporate space only due to the scope of PLMJ Think Tank's Forum on Sustainable Corporate Governance.

[5] EU High-Level Expert Group on Sustainable Finance, *Final Report 2018*, p. 13, available here.

Secondly, green bonds enable companies to tap into a growing pool of environmentally conscious investors. This investor base is particularly interested in supporting projects that contribute to environmental conservation and sustainability. By appealing to these investors, companies may benefit from potentially lower borrowing costs, as the demand for green bonds often results in favourable interest rates compared to traditional bonds.[6]

Additionally, aligning with green bond frameworks helps companies adhere to current regulatory requirements and anticipate future compliance demands. As environmental regulations become more stringent, companies that have already integrated sustainable financing mechanisms into their operations are better positioned to meet these evolving standards. This proactive approach not only ensures compliance but also minimises the risk of future financial penalties and regulatory challenges.

Overall, green bonds represent a strategic financial tool that supports environmental initiatives while offering companies tangible benefits in terms of reputation, investor engagement, and regulatory alignment. By issuing green bonds, companies can contribute to global sustainability goals while enhancing their financial and operational resilience.

3. The Bond Market and Climate Change Investment Needs

In 2007, the Intergovernmental Panel for Climate Change (IPCC) published a report that linked global warming and human activity.[7] It urged market participants to consider financing projects that contributed positively to the environment.

Coincidently (or not), also in 2007, the European Investment Bank (EIB) issued the first green bond even, its Climate Awareness Bond (CAB),[8] creating a meaningful financing tool to direct investments into projects with a substantial green contribution.[9] One year after, in 2008, the World Bank issued its first green bond in response to such increasing demand and as an example of the kind of innovation the World Bank was trying to encourage to help stimulate and coordinate public and private sector activity to fight climate change.[10] Both the EIB CAB and the World Bank green bond

[6] Serena Fatica, Roberto Panzica, Michela Rancan, *The pricing of green bonds: Are financial institutions special?*, Journal of Financial Stability, Volume 54, 2021, available here. This study investigates whether green bonds are priced differently compared to conventional bonds. Among other aspects, the authors concluded that, "(…) after controlling for relevant characteristics of the debt instruments, green bonds issued by supranational institutions and non-financial corporates indeed benefit from a premium compared to ordinary bonds.", p. 15.

[7] IPCC, *Climate Change 2007: Synthesis Report*, 2007, p. 2, available here.

[8] EIB, Investor Relations materials, available here.

[9] EIB, *From niche to mainstream*, 19 July 2022, available here.

[10] World Bank, Investor Relations materials, available here.

were listed and admitted to trading on the Luxembourg Stock Exchange and now displayed on the Luxembourg Green Exchange.[11]

The first corporate green bond was issued in 2013 by Vasakronan, a Swedish property company. According to the company, the reason for issuing green bond was to further diversify Vasakronan's borrowings, which, over time, would result in lower borrowing costs. Christer Nerlich, the company's CFO, said at the time that:

> '[w]e've noticed an increased demand for green investments from the capital market and we want to respond to that. Vasakronan's current energy use is already nearly 50% lower than the industry average and since 2008, the company has had climate neutral operations. In addition to that, we are pursuing the very ambitious goal of obtaining environmental certification for our entire property portfolio'.[12]

Since the issuance of the first green bond, the market has grown considerably. According to the Climate Bonds Initiative (CBI), global green bond issuance reached USD 870 billion in 2023,[13] with projections suggesting continued growth as more countries and companies commit to net-zero targets. The International Energy Agency (IEA) estimates that achieving net-zero emissions by 2050 will require annual clean energy investment to triple by 2030 to around USD 4 trillion.[14]

In summary, green bonds provide a mechanism for channelling private capital into projects that contribute to environmental sustainability. They offer a structured way for investors to support the transition to a low-carbon economy while earning returns on their investments.

4. The Role of Labelled Bonds

Labelled bonds, including green bonds, are designated for specific environmental or social purposes. The primary types of labelled bonds are:

- **Green bonds:** Used exclusively for environmental projects.
- **Social bonds:** Finance projects with positive social outcomes.
- **Sustainability bonds:** Fund a combination of environmental and social projects.

These labelled bonds enhance transparency and accountability by ensuring that the proceeds are allocated to pre-defined sustainable projects. This labelling provides investors with confidence that their funds are used to support actual sustainability efforts.

The emergence of labelled (green, social or sustainability) bonds in financial markets is similar to the rise of organic and bio products in supermarkets, both driven by growing consumer awareness and

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[11] Listing details, available here.

[12] Vasakronan, Press Release, available here.

[13] CBI, available here.

[14] IEA, *Net Zero by 2050 – A Roadmap for the Global Energy Sector*, p. 83, available here.

demand for sustainable practices. Just as environmentally conscious shoppers seek out organic produce to reduce their ecological footprint and support sustainable farming, investors are increasingly turning to green bonds to channel funds into projects that address climate change and environmental protection. This shift reflects a broader societal trend where consumers and investors alike are using their purchasing power to foster a greener, more sustainable world.

For companies, this means adapting to meet the evolving preferences of their stakeholders. In the same way that food producers have diversified their offerings to include organic and bio products to attract eco-conscious consumers, companies are issuing green bonds to respond to those investors who prioritise environmental sustainability. These labelled bonds finance projects such as renewable energy, energy efficiency, and pollution prevention, directly contributing to a lower carbon footprint. Thus, whether it is through selecting organic apples at the supermarket or investing in green bonds, the underlying motivation is the same – a commitment to fostering a healthier planet through informed and conscientious choices.

5. "Use-of-proceeds" Bonds *versus* Sustainability-linked Bonds

For the sake of completeness, it is worth highlighting a distinction between "use-of-proceeds" bonds and non "use-of-proceeds" bonds. Green (as well as social and sustainability) bonds typically fall into the "use-of-proceeds" category, meaning the funds raised must be used exclusively for eligible green projects.[15] This approach ensures a direct link between the bond issuance and environmental benefits. In contrast, sustainability-linked bonds (SLBs) are not restricted by the use of proceeds. Instead, SLBs are linked to the issuer's overall sustainability performance, with financial and/or structural characteristics of the bonds varying depending on whether predefined sustainability targets are met.[16]

In a nutshell, both types of bonds play important roles in financing the transition to a more sustainable economy:

- **"Use-of-proceeds" bonds:** Provide clear and measurable environmental benefits, appealing to investors focused on specific project outcomes.
- **Sustainability-linked bonds:** Offer flexibility and can drive broader corporate sustainability improvements by embedding sustainability targets into the financial structure.

6. Regulatory Developments

6.1. Context

The lack of clarity in green finance led to a significant challenge for market participants aiming to identify and engage in green investing opportunities. In 2016, the G20 highlighted that 'the ambiguity

[15] International Capital Markets Association (ICMA), *Green Bonds Principles*, p. 3, available here.

[16] ICMA, *Sustainability-Linked Bonds Principles*, p. 2, available here.

surrounding what constitutes green finance activities and products, such as (…) green bonds, acts as an obstacle for market participants'.[17] This uncertainty hampered stakeholders' ability to accurately identify and assess green investment opportunities. Therefore, a more precise and accepted definition of green finance, including green bonds, was necessary to facilitate cross-border and cross-market investments, evaluate the green performance of financial firms, and analyse the macroeconomic implications of green finance activities.

One of the key responses to this challenge has been the development of the Green Bond Principles (GBP) by the International Capital Market Association (ICMA) in 2014. ICMA is a leading industry association representing capital market participants and advocating for the development and efficient functioning of international capital markets.[18] The ICMA GBP were developed to promote transparency, disclosure, and reporting in the green bond market, providing clear guidelines for the issuance of green bonds. Despite the absence of a binding legal framework, the ICMA GBP have gained widespread acceptance and have significantly contributed to the growth and credibility of the green bond market.

To address the demand for more clarity in green finance, the EU established its High-Level Expert Group (HLEG) on Sustainable Finance in 2016. The HLEG played a crucial role in shaping the recommendations on how to create a coherent EU strategy on sustainable finance.[19] One of its key contributions was the recommendation to develop an EU Green Bond Standard, reflecting the need for a more structured and consistent approach to green bond issuance within the EU and beyond. Following the HLEG's recommendations, the EU Technical Expert Group (TEG) on Sustainable Finance was formed to refine and operationalise these suggestions.[20]

The TEG made significant strides in detailing what could be widely accepted standards for green bonds, notably through the so-called Usability Guide, which offered comprehensive guidance on the practical application of the standard.[21] This document outlined the criteria for projects to be considered green, the verification process for green bonds, and the reporting requirements for issuers. This dynamic approach aimed to harmonise market practices, increase transparency, and provide investors with greater confidence in the green credentials of financial products. The combined efforts of the HLEG and TEG illustrate the EU's commitment to creating a robust framework for sustainable finance, leveraging existing market practices like the ICMA GBP while addressing the need for greater clarity, predictability, trust and consistency in green finance.

Inspired by the recommendations of the HLEG, the European Commission's Action Plan on Financing Sustainable Growth (commonly known as Action Plan on Sustainable Finance), unveiled in March 2018,

[17] G20, *Green Finance Synthesis Report*, September 2016, p. 3, available here.

[18] Details about ICMA, available here.

[19] Details about the HLEG, available here.

[20] Details about the TEG, available here.

[21] TEG, *Proposal for a EU Green Bond Standard – Usability Guide*, March 2020, available here.

set the stage for officially developing a green bond standard.[22] This plan emphasised reorienting capital flows towards sustainable investments to achieve a climate-neutral economy by 2050.

Eventually, in July 2021, the European Commission proposed the EU GBS Regulation, underscoring its commitment to environmental sustainability and the Paris Agreement targets. The Regulation was designed to build on the success of the ICMA GBP, providing a robust legal framework to ensure the integrity of green bonds issued within the EU and beyond.

6.2. The EU Green Bond Standard Regulation

6.2.1 Overview

The EU GBS, a "clear gold standard", as coined by the European Commission,[23] is a voluntary standard for issuers of green bonds. It was introduced to address the growing demand for transparency and credibility in the green bond market. The standard defines criteria for projects eligible for green bond financing and mandates stringent reporting and verification requirements.

By establishing a framework for green bonds, aiming to enhance transparency, accountability, and investor confidence in green finance, the Regulation marks a significant step forward in the EU's efforts to foster a sustainable financial ecosystem.

6.2.2 Scope of the Regulation

On 20 December 2023, the EU GBS Regulation came into force, following its publication in the EU's Official Journal on 30 November 2023. The Regulation will start applying on 21 December 2024, establishing a new framework for issuers who wish to label their bonds as "European Green Bonds" or "EuGB" (Article 1 and Article 3 of the Regulation). This label will generally be available only for bonds that have a prospectus published in accordance with the Prospectus Regulation, with some limited exceptions (Article 14 of the Regulation).

The Regulation's primary aim is to foster sustainable finance within the EU and the global financial markets, contributing to sustainable growth and the transition towards a climate-neutral and resource-efficient economy in the EU. By setting a rigorous standard, the Regulation seeks to enhance consistency and comparability in the green bond markets. Issuers adhering to these standards will demonstrate that the projects funded through EU green bonds are aligned with the EU Taxonomy, thereby reducing the risks of greenwashing and bolstering investor confidence in green investments.

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[22] European Commission (EC), *Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions – Action Plan: Financing Sustainable Growth*, March 2018, pp. 4-5, available here.

[23] EC, Press Release, available here.

The Regulation establishes stringent criteria for companies using green bonds to raise funds for large-scale investments. These investments must meet rigorous sustainability requirements, providing a protective measure for investors. The EU GBS is also intended to serve as a benchmark for similar standards outside the EU.

Under the Regulation, funds raised through EuGB-labelled green bonds must be allocated to projects aligned with the EU Taxonomy Regulation, provided the sectors involved are covered by it (Article 4 of the Regulation). For sectors not yet covered by the EU Taxonomy Regulation and for specific activities, there is a flexibility pocket of 15% (Article 5 of the Regulation). This alignment requirement ensures that the funded projects adhere to the detailed and specific criteria of the EU Taxonomy Regulation, which may limit the eligibility of some green projects and potentially slow the growth of the green bond market.

Transparency is a cornerstone of the Regulation, requiring comprehensive reporting on how bond proceeds are allocated. This includes detailed disclosures in the prospectus, a pre-issuance European Green Bond factsheet, and post-issuance allocation and impact reports (Articles 10, 11 and 12 of the Regulation). The Regulation also includes voluntary disclosure requirements for other environmentally sustainable bonds and sustainability-linked bonds issued in the EU (Articles 20 and 21 of the Regulation).

External review is mandated for all EuGB-labelled green bonds both before and after issuance to ensure compliance with the Regulation and alignment with the EU Taxonomy. Unlike the ICMA GBP, which recommends external review, the Regulation requires it (Articles 10, 11 and 12 of the Regulation). Additionally, the European Securities Markets Authority (ESMA) will supervise and register external reviewers to ensure the quality and reliability of their services, thus protecting investors and ensuring market integrity (Article 22 of the Regulation).

Finally, the Regulation includes a set of four annexes, which provides templates for reports and external reviews. Using these prescribed forms is considered important to achieving the EU's broader sustainable finance disclosure goal, ensuring that investors and market participants in general have access to consistent, comparable, and decision-useful information. This approach is likely to aid in the efficient flow of sustainable capital, transparency, predictability and ultimately trust in the green bond market.

In summary, this new Regulation sets a new standard in the green bond market, emphasising transparency, EU Taxonomy alignment, and external review. This new framework aims to ensure that green bonds genuinely contribute to sustainable economic activities, so that both investors and the market are protected.

7. Linking the EU Green Bond Standard Regulation with Good Corporate Governance

7.1. Context

Corporate governance refers to the comprehensive system of rules, practices, and processes by which a company is directed and controlled. A robust framework of good corporate governance is essential to ensure transparency, accountability, responsibility and fairness, along with the company's interactions with its stakeholders.

Transparency is fundamental to good corporate governance. It involves providing stakeholders with accurate and timely information regarding the company's performance, financial status, and decision-making practices. By doing so, the company fosters trust and confidence among its stakeholders, which is crucial for long-term success and sustainability.

Accountability is another cornerstone of effective good corporate governance. It entails holding management accountable to shareholders and other stakeholders, ensuring that their actions align with the best interests of the company. This principle helps prevent abuses of power and promotes responsible decision-making within the organisation.

Responsibility in good corporate governance ensures that the company adheres to laws and ethical standards, and that its actions are sustainable and socially responsible. This involves considering the impact of the company's operations on the environment, society, and the economy, thereby contributing to the overall well-being of the community.

Fairness is the principle whereby all stakeholders, including shareholders, employees, customers, and the community, should be treated equitably. This means that the company should strive to balance the interests of various groups and avoid favouring one group over another unjustly.

These principles are essential for building a corporate culture that values integrity and ethical behaviour, and they are widely recognised as critical components of good corporate governance practices. By adhering to these principles, companies can enhance their reputation, attract investment, and ultimately achieve long-term success.[24]

7.2. The link with the EU Green Bond Standard Regulation

Enhancing transparency

The EU GBS Regulation promotes high levels of transparency by requiring detailed reporting on the bond's use of proceeds and environmental impact. This transparency aligns with the principles of good corporate governance, ensuring that investors and other stakeholders have access to comprehensive information about how their funds are being used and the environmental benefits achieved.

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[24] OECD, *G20/OECD Principles of Corporate Governance*, 2023, available here.

Strengthening accountability

By mandating independent verification of green bond compliance, the EU GBS Regulation enhances accountability. Issuers are held accountable for their claims regarding the environmental impact of funded projects. This accountability aims at ensuring that companies are genuinely contributing to sustainability goals and not engaging in greenwashing.

Promoting long-term sustainability

The focus on financing projects that meet stringent environmental criteria under the EU GBS Regulation encourages companies to adopt long-term sustainability strategies. This is in line with good corporate governance practices, which emphasise the importance of sustainable development and ethical business conduct.

Encouraging responsible investment

Finally, the EU GBS Regulation provides a legally binding, predictable and comprehensive framework for the issuance of green bonds, making it easier for investors to identify genuine sustainable investment opportunities. This supports the growing trend of responsible investment, where investors consider environmental, social, and governance factors in their decision-making processes. Responsible investment aligns with the principles of good corporate governance by promoting sustainable and ethical business practices.

8. Challenges and Future Directions

Complying with the requirements foreseen by the recently adopted EU GBS Regulation can be complex and costly, particularly for smaller issuers. The rigorous reporting and verification requirements may pose a barrier to entry. As the EU GBS is currently voluntary – in the sense that it co-exists with current principles, such as the ICMA GBP – its adoption may vary across the market. Encouraging widespread adoption is crucial to achieve a significant impact on sustainability.

Providing regulatory incentives and support for issuers adopting the EU GBS can enhance market uptake and ensure broader compliance.[25]

Finally, integrating the principles of the EU GBS with broader corporate governance frameworks could promote a holistic approach to sustainability and ethical business practices.

[25] TEG, *Report on a Proposal for a EU Green Bond Standard*, June 2019, for details on incentives, pp. 43-44, available here.

9. Final Remarks

As we confront the formidable challenges posed by climate change, the EU GBS stands as a symbol of our collective commitment to a greener, more resilient future. Green bonds are more than financial instruments; they are vehicles of change, fostering a symbiotic relationship between economic growth and environmental preservation.

By adhering to the EU GBS, companies not only contribute to environmental sustainability but also embody the principles of good corporate governance. The EU GBS Regulation provides a robust framework for ensuring that green investments are genuine and impactful, fostering investor confidence and encouraging greater participation in the green bond market. As stewards of the planet, businesses have the power to catalyse positive change, demonstrating that financial success and environmental stewardship are two sides of the same coin. In doing so, they answer the urgent call of our time – to build a world where prosperity and sustainability walk hand in hand.

The evolution of the regulatory framework, notably with the adoption of the EU GBS Regulation, provides a robust foundation for the continued growth and credibility of the green bond market and represents a significant advancement in promoting sustainable finance and good corporate governance. By enhancing transparency, accountability, and long-term sustainability, the EU GBS aligns closely with the principles of good corporate governance. As companies adopt the EU GBS, it has the potential to transform the green bond market, driving significant progress towards environmental sustainability and responsible corporate practices. Ensuring that the EU GBS is accessible and widely adopted will be key to realising its full potential and achieving a more sustainable financial ecosystem.

Luxembourg, 20 July 2024